DIARY

Book 231

December 20 - December 21, 1939

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TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE,
Wednesday, December 20, 1939.

Press Service
No. 19-73

Secretary of the Treasury Morgenthau announced today that reports from the Federal Reserve banks indicate that $1,301,182,100 of Treasury Notes of Series A-1940, maturing March 15, 1940, have been exchanged, $1,018,176,100 for the 2-1/4 percent Treasury Bonds of 1951-53 and $283,006,000 for the 1 percent Treasury Notes of Series C-1944. In addition to the exchanges, $73,006,000 of the bonds have been allotted to Government investment accounts, within the $100,000,000 reservation.

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

Federal Reserve District	For 2-1/4 percent Bonds of 1951-53	For 1 percent Notes, Series C-1944
Boston	$ 39,972,050	$ 9,724,700
New York	683,842,700	212,876,700
Philadelphia	20,159,600	4,507,900
Cleveland	22,594,400	11,034,400
Richmond	32,306,200	786,900
Atlanta	9,347,450	860,200
Chicago	127,246,700	31,324,400
St. Louis	12,025,200	4,563,300
Minneapolis	10,433,900	1,267,700
Kansas City	20,631,400	1,585,700
Dallas	6,632,150	597,500
San Francisco	28,822,750	3,540,600
Treasury	4,161,600	336,000
Government Investment Accounts	73,006,000	
TOTAL	$1,091,182,100	$283,006,000

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December 20, 1939.
12:15 p.m.

H.M.Jr: Hello.

Captain Collins: Good morning, sir. This is Collins.

H.M.Jr: Good morning.

C: I just wanted to say Mr. Secretary. I was talking with Speer this morning and concerning the committee.

H.M.Jr: Yes.

C: He said that he had not seen - he understood a letter had been signed late yesterday afternoon by Edison, prepared by Johnson, in which they are again taking to the President, their objections to the Board, putting it this time on a basis of legality.

H.M.Jr: Well -

C: I thought it might be just a matter of -

H.M.Jr: On the basis of legality.

C: Legality. They're writing to the President to do it.

H.M.Jr: They're questioning the President's right to do this.

C: Apparently so. He said it's on - that's as much as Speer knew. He said he'd only gotten this second handed from Edison's aide. He said he'd told them he didn't think the Secretary should have been allowed to sign it, but they are questioning the legality of the President's action. That was the information he conveyed to me sir.

H.M.Jr: Now, Speer is Quartermaster General.

C: No, Speer is Paymaster General.

H.M.Jr: Paymaster General of the Navy.

C: Yes, sir.

H.M.Jr: Well, I'd say they were putting their neck way way way out.

C: Well I think it's out too far this time. Never get it back again.

H.M.Jr: Well, Watson is bringing over General Arnold and I'm just going to listen.

C: Yes, sir.

H.M.Jr: But, you say this letter was prepared by Johnson.

C: Presumably it was sent over for signature to the Navy by Edison yesterday afternoon.

H.M.Jr: And Edison signed it.

C: He signed it.

H.M.Jr: Well -

C: Just before he left on his holidays.

H.M.Jr: Thanks for the tip.

C: Entirely welcome, indeed, sir.

H.M.Jr: I think -

C: Sir.

H.M.Jr: Who does Johnson and Edison think they are?

C: Well I can't figure that sir.

H.M.Jr: No.

C: I think they ought to move over to sixteen hundred.

H.M.Jr: What's that?

C: The White House.

H.M.Jr: Oh! Yes. Well thank you.

C: You're welcome, sir.

H.M.Jr: Goodbye.

C: Goodbye.

RE BUDGET MESSAGE

December 20, 1939.
4:00 p.m.

4

Present: Mr. Hanes Mrs. Klotz
Mr. Gaston
Mr. Young
Mr. White
Mr. Bell
Mr. Blough

Hanes: I don't think there is any difference between us except verbiage.

H.M.Jr: Is there still a philosophic difference?

White: No, I think in fifteen minutes we can make a clean copy. There will be one or two minor changes in the copy you have. There will be one or two minor changes later on.

Hanes: I have got the first page and there are a lot of corrections. I will have to read very slowly.

"In the fall of 1937 when the new agricultural program was under consideration in Congress, I strongly urged that if its cost should exceed the five hundred million dollars already in the budget to finance the soil conservation and domestic allotment plan, additional revenues should be provided to finance the excess. The Agricultural Adjustment Act of 1938, approved by me on February 16, 1938, authorized parity payments, the cost of which was in addition to the soil conservation and domestic allotment program, but no provision was made for financing these payments. When I signed this Bill I said publicly that no parity payments ought to be made until Congress has provided the necessary revenues. While Congress has taken no steps to provide this additional revenue, it did appropriate in 1938 and again in 1939 a total of four hundred thirty-seven million dollars for making parity payments. It seems to me that Congress should provide the revenues necessary to reimburse the Treasury for these expenditures. If further appropriations are made for additional parity payments, the revenue should also be made for financing them."

I think "The revenues should also be raised for financing them" would be better.

H.M.Jr: This isn't the introductory thing, is it?

Hanes: This is the introduction.

H.M.Jr: Oh, no. The President might be talking about - he has got to have something. He can't start like that. That is a perfectly good page.

Blough: Mr. Gaston has —

Hanes: We have got two or three approaches.

H.M.Jr: The President has also asked for a snap at the end. I don't know what the snap is that comes in the middle.

Gaston: That is technically called a lead.

H.M.Jr: Right. What you need is a lead, but it is just like shoving a fellow off in the Potomac and saying, "Swim, damn you."

What comes next, John?

Hanes: Harry, will you - Roy, have you got a corrected page?

Blough: I have part of it and Herbert has part of it and Harry has part of it.

White: Roy's is next.

Blough: I copied this from Herbert.

"This year diligent efforts have been made to reduce expenditures in all branches of the Government except national defense items."

Gaston: I had it organized a little different.

Blough: "Notwithstanding substantial reductions which have been made in these Departments, additional steps to reduce the deficit by increasing tax revenues would seem advisable. The budget for 1941 has accordingly been drawn to show the amount of five hundred million dollars to be raised by additional taxes. I feel confident that this sum will

prove adequate to cover such additional armament as will be required to cover additional armament during the next year.'

H.M.Jr: That is your lead.

Blough: That brings us back to the main document, then, Mr. Hanes.

H.M.Jr: That is your lead.

White: Well, I will tell you why we suggested that. Our thought was as follows: If you put that in the lead, it appears as though your request for four hundred thirty-seven million dollars for back parity payments is to support this additional armament expenditure, when as a matter of fact it is separate.

H.M.Jr: Excuse me. What he just read, he didn't say anything about parity payments.

White: Then if you put parity payments right after, as we did in the first part, right after that sentence --

H.M.Jr: You could give that as your lead, what Hanes read. Is that parity payments?

White: Yes.

H.M.Jr: What comes next?

White: We could put the parity payments last. Then you could go on with that and say since it is the function of Congress to determine how revenue should be raised and so on, speaking of this five hundred million alone, and after you get through with that you can go back to this first page he read which relates exclusively to parity payments.

H.M.Jr: Which would come last?

White: Then it would be last.

H.M.Jr: Couldn't you try it that way and see how it looks?

Blough: That was our original organization.

Hanes: That is the way we had it originally.

H.M.Jr: Who upset it?

Hanes: You did.

H.M.Jr: Good.

Bell: Historically it comes first.

Blough: It has this significance, that it seems to put the agricultural taxes outside the objectives of putting the burden where it belongs, on those who can afford to pay.

H.M.Jr: I thought this little stump speech I made here was to put the —

White: That comes after. That is the next paragraph.

H.M.Jr: If you don't mind my saying it, I think all these pieces of paper should be given to Gaston and let him put them together so it makes a good newspaper story. He knows how his story ought to flow.

Hanes: I would like to go back just for a minute and stick to your suggestion of putting that parity payments business entirely separate from your national defense. I think the big part of this thing - story, is national defense. The Congress may or may not do anything on this parity business. Therefore, the President, it would seem to me, would carry out, continue to make the continuity of his story since 1937 identical. We should proceed to call attention again just as he has in the past to these facts we have recited, then the big part of the story is, "I want some more revenue and the need for this revenue is brought about because we need a certain amount for national defense." Then end up like the way you suggested, end up the paragraph by saying that these taxes should be earmarked and when the need is no longer there —

White: I think that is the logical approach.

H.M.Jr: I agree.

Hanes: Let me read the whole statement, with everybody's mind open for a minute. Let me read the whole statement to you in that order and see how it sounds.

H.M.Jr: May I say one thing. The reason I like that is, the emphasis that you put and what I want to put is on the armament and the new taxes. We mean that. Then when we talk about the parity payment we kind of do it like that (indicating quietly).

Hanes: Because you probably aren't going to get it. That makes it consistent.

H.M.Jr: That is right.

Hanes: This is the question of verbiage here. Don't let's stop on words for a minute, because I don't care.

H.M.Jr: O.K.

Hanes: "During the 1937 and 1938 Congressional sessions, I specifically called to the attention of Congressional leaders that if Congress appropriated funds for parity payments by agriculture it should finance them by providing new revenues. At that time an appropriation of two hundred twelve million dollars was made for parity payments for fiscal '39. No revenues were provided, but Congressional leaders promised to raise them at the 1939 session. In my message of January 3, 1939, accompanying the 1940 budget, I again called attention to the fact that such appropriations should be matched by additional revenue. The amount of two hundred twenty-five million dollars was appropriated for fiscal 1940 but no additional revenues were provided for either of these two appropriations. Congress has thus added to the aggregate deficit four hundred thirty-seven million dollars for parity payments, for which it is duty bound to reimburse the Treasury from some source. Revenues should be raised for financing not only this, but

also any future parity payments."

That is true. You are finished with that.

H.M.Jr: You are sticking to the thought that this should come first?

Hanes: I don't care where it comes. It is just the idea of keeping it separate from national defense.

H.M.Jr: We are together.

White: Then you need a better lead for what follows.

Hanes: I am not thinking about the lead nor the details nor the words, but merely the thoughts we want to get out and you can rearrange them any way you like.

"In view of the special expenditures needed to put our national defense in the condition required to safeguard us in a world at war, it is desirable to consider further the position of the Federal revenues. We - "

That is in case that comes first.

"We need additional revenues in order to reduce the deficit. I have made an extraordinary effort to reduce expenses in every Department of the Government excepting the Army and Navy. While drastic measures would be unwise, we can and should increase our tax revenues moderately and the budget for 1941 has accordingly been drawn to show the amount of five hundred million dollars to be raised by additional taxes. I feel confident that this sum will prove adequate to cover such additional armaments as will be required in the next fiscal year.

"Since it is the function of Congress to determine how revenues should be raised, I leave the choice of particular tax measures to its judgment. However, I believe I am expressing the opinion of the country when I suggest that measures adopted for raising additional tax revenues should reflect two objectives. The first is that taxes should come from the portion of the population

which can best afford to pay them, with due regard to the taxes they now pay to the State, local and Federal Governments. Care should be taken especially to design the taxes so that they will not fall on that portion of the population which can least afford to pay them.

"The second objective is that taxes should have a minimum of disturbing effects on the furtherance of Government and smooth working of economy and accordingly shall avoid as far as possible the discouragement of productive activity and employment. The carrying through of these recommendations for increasing revenue will greatly reduce the deficit.

"I would like to indicate to the country that from now on, barring rearmament expenditures, the budget will be brought annually more near balance. Those taxes which are levied for the express purpose of additions to the national defense should remain in operation only so long as there is need for special rearmament."

White: That is the thing you read this morning.

H.M.Jr: Oh, no.

Hanes: No, that is what we —

White: It is identical with this morning.

Hanes: We put in the section - what he said.

White: I think you have read the wrong sheet.

Hanes: That was my idea of what he said.

White: That is the same as you read this morning.

Blough: This is the way Phil Young and I left it at 10:00 o'clock.

White: I see, before I came up.

H.M.Jr: This is quite different.

White: Well, there is this paragraph that is left out of that, which I take it is embodied —

Hanes: Read that paragraph.

White: "I felt it desirable that the sum required for the special expenditures on national defense be obtained from new and special taxes levied for the specific purpose of meeting our national defense program. These taxes should be adequate to cover the complete cost of the additional armament expenses and should be raised only so long as those additional expenditures are called for."

Hanes: That is just changing my last paragraph.

White: I don't think you had that in there.

Hanes: I said in the last paragraph, "Those taxes which are levied for the express purpose - " well, for the national defense, should remain in operation only so long as they are needed for special rearmament. That is the end of the whole statement.

White: Did you have in there that "I feel it desirable that the sum required for these special expenditures for national defense be obtained from new and special taxes levied for this specific purpose of meeting our national defense program"?

Hanes: I didn't have it in those words, but that is implied. I take it these are new taxes. Then I say they should be specific for this purpose and should be levied only insofar as they are necessary for rearmament.

H.M.Jr: The thing to do is to put this side by side. Harry, you emphasized that it should be new sources.

Hanes: I think you have got the right message in accordance with the practical consideration of our recommendations and at the same time as to how he is going to raise these revenues and some revenues are not new.

H.M.Jr: May I say this: It seems to me that this comes very closely to what I think you ought

to have. I think that - I still think that he needs a lead. Wouldn't it be possible seeing we are ninety percent in agreement, that the thing could be rewritten so that it would be a transition of paragraphs so the things would fit in? I don't think there is much argument.

Hanes: I know we are not far apart.

Bell: I think we are pretty close. There is one matter of policy in the wording.

H.M.Jr: What is that?

Bell: That is the parity statement. Are we actually going after the revenue for that or are we putting it in knowing that we are not going to get it, I mean looking at it from the practical standpoint? Do we want a billion dollars worth of revenue from this budget or are we just putting in the four thirty-seven, knowing that we are not going to get it?

H.M.Jr: Now look, Dan. From the few talks I have had with the President on this thing, I think, one, that he hasn't made up his mind, two, that for a month or two he has had five hundred million dollars in mind. Five hundred million dollars should be raised within the fiscal year, beginning with July 1. I think that the money for parity payments is for trading purposes with Congress. When we started in '38 he never pounded the desk and said, "I have got to have it.". You and I almost got it. If he had really wanted it then, he could have got it the first year. It is the same thing as the seed loans. He could have stopped it after the first year, but he has never stopped seed loans. Am I answering you?

Bell: Yes. The reason I asked that is —

H.M.Jr: I don't think he wants that. I do think he wants five hundred million.

Hanes: But I do think that at the same time if he told you over the telephone that he wants

the message on this basis and therefore - I think we ought to give it to him.

H.M.Jr: Definitely, but I think the punch should be put in the five hundred million for the "B" budget.

Hanes: My suggestion is to write the thing entirely separate so that he can strike out that paragraph on parity payments if he wants to.

H.M.Jr: He can't after his press conference yesterday.

Hanes: Oh, yes, he can. That was very indefinite. He said, "You may hear some more talk about this."

H.M.Jr: If you are asking me for what spirit he is in, I think I can only guess. I can only guess the spirit or mood he is in. Does that answer?

Bell: I agree with that, it can't be anything else.

H.M.Jr: It will be in the way it is written up.

Bell: I don't care how you write it. Congress isn't going to appropriate - or raise the revenue four hundred thirty-seven million dollars to meet those parity payments.

H.M.Jr: I agree with you.

Bell: I think you are going to have two hundred twenty-five million put back into this year's budget and you are not going to get it. If we want a billion dollars worth of revenue, let's go after it on another basis.

H.M.Jr: I agree with you and I don't think the President is ready to do it. I think we are giving him just what he wants.

Hanes: That is what he asked for.

H.M.Jr: You heard him say when I said that - the way it was written this morning you had two of the three things. Then I asked - the only thing you didn't have in was money for --

Hanes: Four hundred thirty-seven million.

H.M.Jr: No, you had that in. You didn't have the one for parity payments yet to be voted. Right?

Hanes: Yes.

H.M.Jr: So we put in all three and he said, "What do you think," and I said, "I think that is right."

Gaston: I would like to ask an opinion on what you think of this just as a method of organization, not any particular attention to the language.

"In view of the extraordinary expenditures required to put our national defense in the condition made necessary to safeguard us in a world at war and of expenditures incurred outside the executive budget, I desire to direct the attention of the Congress to the need at this time for additional sources of revenue."

H.M.Jr: You are tying the two together?

Gaston: You don't want them tied together?

H.M.Jr: No.

Gaston: Would you like to start with, "Efforts have been made to reduce expenditures, but I believe that further reduction should be made which can only come from revenue," and then go into the --

H.M.Jr: I think he ought to start the statement - after all, I take it that the way the budget is usually set up, the first part of the thing is what he has done to cut expenditures. Isn't that what is done first, Dan?

Bell: Yes, that is all right.

H.M.Jr: Now, what he does, he lists how he has cut the expenditures in his message. Then he takes a deep breath and says,

"Well, I have been damned good, look what a good boy I am. Now, let's talk about the revenue." I think that is the way we ought to approach it. I think first he lists expenditures and then he goes into revenue.

Hanes: That is right, he says first there are the ordinary expenditures and then the extraordinary expenditures. Then he says the actual cost of the work relief - I think I am expressing the thought of the most farsighted students that it would be unwise to curtail expenditures. Then his recommendations.

Bell: I have a little difficulty in finding where the effort has been made to reduce expenditures in all the other Departments except the military.

H.M.Jr: Don't get too factual.

Bell: I think that is one thing that is going to be tacked on - one thing that is going to be tacked on when we come out with a statement like that.

Gaston: I raised that question and you showed me where they had cut the normal expenditures last year by about six or seven hundred million.

Bell: No, I don't think you put it up in connection with the effort that is being made. That is a reduction, there is no question about it, but —

H.M.Jr: I don't think you are fair, Dan. The expenditures in 1940 are eight billion eight hundred ninety-one million and in '41 eight billion one hundred sixty-one million and that is seven hundred thirty million dollars less. I say that is saving money.

Bell: All due to W.P.A. reductions, which will go back, no doubt, and due to expenditure - less expenditure in '41 over '40 of W.P.A. where the appropriation runs out. It isn't reduction, it is automatic.

H.M.Jr: Look, Dan —

Bell: I think there are extraordinary items that fit into the picture which we have to look at.

H.M.Jr: All right. Now look, we are doing some ghost writing here. I listened to what the President said and he thinks he has worked hard. I am not going to say he hasn't. I think he has. I think it is a tough job and I think he has made for himself an extraordinary effort and I am willing to put the words in his mouth and I am willing to defend them.

Hanes: I think that is the right attitude.

Bell: I think he has made an effort.

H.M.Jr: O.K. But don't quarrel with me.

White: You will agree it is a good job if he prevents it from increasing.

H.M.Jr: After all, he has got Harry White to kill a peace plan for him.

White: If he had, his problems would be over.

Hanes: It seems to me the way he is saying it here, Dan, if the Congress doesn't do what he recommends, then, by Jove, he is in a mighty strong position. He is not going to weaken his position any. If Congress doesn't do what he is asking them to do he can say, "Well, I can't run the Congress."

H.M.Jr: Well, Mr. Bones, do you think that you (Mr. Hanes) can give me something that these people would be ninety percent satisfied with tomorrow morning?

Hanes: I was going to suggest this, that Herbert is a good draftsman. He knows what your ideas are now and he can take this statement here and cut it up any way he likes and bring it back here tomorrow morning well edited and take these words that are harsh and irritating out of it and put it in good language in the order that it is, if that is what you want. I am satisfied with it if everybody else is.

H.M.Jr: Let's put it this way: Are you willing to undertake that?

Gaston: Yes, but I would need to talk to Johnny a little bit to get a little clearer about what the order should be.

Hanes: I am taking the order from him. I think you (H.M.Jr) ought to state now - I don't care how it goes. I think it would be well in transposition of this kind to bring out the past. He is reciting history. Bring the past out first and let that parity payments be entirely separate and let it die.

H.M.Jr: Let it be the last.

Hanes: All right, I don't care, as long as you keep it separate from the body - the main thought which you are really going after.

Gaston: My understanding of your idea is that you start by some reference to his work in cutting down expenditures and - but we still need some - to improve the deficit by some additional revenue. Particularly we need revenue to finance these extraordinary expenditures for national defense. We go into that and indicate where they might come from. Then we say in this connection, "I want to call the attention of the Congress to what has happened about these parity payments," and that is all.

H.M.Jr: Well, look, why not let's do it this way. Can you fellows meet again tomorrow morning, let's say from 9:00 to 10:00, and somebody get up a draft? Then I will meet with you at 10:00 o'clock. How is that?

Hanes: That is all right. We can continue right on now if you want. I would just as soon work right on now until you finish it.

H.M.Jr: I didn't want to make that suggestion. Then I would be ready at 9:00 tomorrow morning.

White: Just one further question.

H.M.Jr: Would you be willing to do that, John?

Hanes: Yes.

H.M.Jr: I will be here at 9:00 tomorrow morning and then we will finish it and send it over.

White: One further question. Would you want to put in —

H.M.Jr: I think it is better if the crowd sticks together until you get something. There won't be any chances - nine out of ten, I will take what you give me.

Hanes: I think we understand what you want. You want the parity payments last.

H.M.Jr: I wouldn't even say that. I simply say that there needs to be a transition. I agree with you that when he says five hundred million for national defense he should say it the way he means it and when he says, "I want some four hundred and some odd million dollars for parity payments," he ought to say it very soft and the two things should be separate. Which things come first, I don't care.

Bell: It ought to be like a newspaper article, way over on the last page in the corner.

Gaston: If parity payments come first, you will have to pick them up in your summary on the other thing. I think you will have to add them as an afterthought.

Hanes: Well, let's go on working.

White: I just have one thought that I want you to be sure that you don't want in there. Do you want this thought included?

"I feel it highly desirable that the new and special tax should come from that portion of the population which can best afford to pay." That is in there now. This is the new thought. "And from those

corporations and individuals who are obtaining special gains from the armament program and from the war situation abroad." That is an implication of some kind of a war profit tax.

H.M.Jr: I wouldn't introduce that.

White: I just wanted to see.

H.M.Jr: Then you might as well go the whole way and say how. Then the other thing, though, as I understand it, when we go over there and give this to the President and he says, "How are you going to raise five hundred million dollars," we are going to have something in our pockets.

Bell: But not nine hundred thirty-seven.

White: We haven't talked about that and I don't know if you expect us to.

H.M.Jr: Did I or didn't I send that thing over that you gave me?

Blough: You did.

H.M.Jr: And I delivered that to the President, didn't I?

Blough: So you said later.

H.M.Jr: Well, I am truthful.

Blough: I am sorry, I didn't mean that. But that won't raise five hundred million in fiscal '41.

Hanes draft used at meeting
12-20-39 at 4 pm.

During the 1938 Congressional session I specifically called to the attention of Congressional leaders the fact that if Congress appropriated funds for parity payments for agriculture it should finance them by providing new revenues. An appropriation of $212,000,000 was made for parity payments for fiscal 1939. No revenues were provided but Congressional leaders promised to provide them at the 1939 session. In my message of January 3, 1939, accompanying the 1940 budget, I again called attention to the fact that such appropriations should be matched by additional revenues. The amount of $225,000,000 was appropriated for fiscal 1940. No additional revenues were provided for either of the two appropriations. Congress has thus appropriated $437,000,000 for parity payments for which it has provided no source of funds. I again point out that ways and means should be found of financing in full by new revenues such amounts for parity payments as the Congress may decide to appropriate.

20A

put on
file

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE December 20, 1939.

TO Secretary Morgenthau

FROM Mr. Haas

If you have not already mentioned, in one of your conferences with the President, the misunderstanding that he had that $70 billions of national income would produce $7 billions of Federal revenue, and wish to send him a letter on the subject, the attached letter is a suggestion.

Original letter from Milton's office with unused "suggestions"

20D

THE SECRETARY OF THE TREASURY
WASHINGTON

My dear Mr. President:

At our luncheon conference last week, you mentioned that it was your understanding that if we had a national income of $70 billions we would get $7 billions of receipts. The table which you carried in your Budget Message last year, which was based on Treasury estimates, indicated that with a level of national income of $70 billions paid out, we could expect approximately $6 billions in tax liabilities. These tax liabilities would not be collected in the same year, however, as a large percentage of such tax collections as income tax, estate taxes, and contributions under the Federal Unemployment Tax Act of the Social Security law, are collected in the calendar year following the year in which the liabilities occur.

In your Message you stated that "the estimates are rough and may vary somewhat either way", which is another way of saying that there is no one answer as to the amount of revenue which will be received by the Government at a given level of national income. We do not tax national income but rather particular components thereof and tax revenues, therefore, depend on the relative proportions of national income received by various groups in our economy. Another important factor affecting tax liabilities in relation to national income is the trend of that national income upward, downward, sidewise or irregularly fluctuating.

The present estimates of revenues, which are $5,644 millions for fiscal year 1940 and $5,951 millions for the fiscal year 1941, are not inconsistent with the indicated tax liabilities at various levels of national income which were contained in your 1940 Budget Message.

The following tabular presentation shows the estimates of national income paid out for calendar years 1937-1940, inclusive.

20E

National income 1/

(in billions of dollars)

Calendar year	National income paid out
1937	70.7
1938	65.0
1939	69 *
1940	75 *

1/ U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce.

* Estimated by Robert Nathan, Research Division of the Bureau of Foreign and Domestic Commerce, December 15, 1939.

For your convenience there is appended herewith a copy of that portion of your Budget Message for fiscal year ending June 30, 1940 which refers to "The Budget and the National Income".

Since this statement was based in part on Treasury material, I am also attaching a copy of the table and comments prepared by the Treasury Department and on which this part of your statement was based.

Faithfully,

The President,

The White House.

Attachments

Copy of suggestions submitted by the Treasury Department to the Budget Bureau in connection with the President's 1940 Budget Message

The Budget and the National Income

Taxes yield practically all of the revenues of the Federal Government. While tax rates are one factor of importance in determining revenues, the amount of the national income is also important. There is no one answer as to the amount of revenue which will be received by the Government at a given level of national income. The distribution of that national income and its trend -- upward, downward, sidewise, or irregularly fluctuating -- also influences the amount of the revenues.

I fully recognize the difficulties of estimating the revenues which will most probably be associated with given future levels of national income. Nevertheless, I feel it highly important that for policy formation purposes you have before you an indication of the relative magnitudes of the revenues which the Government may expect to receive at varying improved levels of our national income. It is estimated that at national income payment levels of $70, $80, $90 and $100 billions, the revenues of the Federal Government at calendar year 1938 tax rates would be $6.0, $8.0, $10.6 and $15.9 billions, respectively. The evidence of the estimates, therefore, indicates that we should strive to increase national income payments as one method of achieving a balanced budget.

Estimated Federal Receipts* by Principal Sources, at Various Assumed Levels of National Income Based on December 1938 Tax Rates

(In billions of dollars)

	National income paid out			
	$70	$80	$90	$100
Income taxes	2.5	3.9	5.7	8.0
Miscellaneous internal revenue	2.2	2.6	3.1	3.8
Customs	.4	.5	.7	.8
Miscellaneous receipts	.2	.2	.2	.2
Payroll taxes	.7	.8	.9	1.1
Total	6.0	8.0	10.6	13.9

* Tax liabilities excluding trust accounts. Payroll taxes at calendar year 1938 rates.

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My dear Mr. President:

At our luncheon conference last week, you mentioned that it was your understanding that if we had a national income of $70 billions we would get $7 billions of receipts. The table which you carried in your Budget Message last year, which was based on Treasury estimates, indicated that with a level of national income of $70 billions paid out, we could expect approximately $6 billions in tax liabilities. These tax liabilities would not be collected in the same year, however, as a large percentage of such tax collections as income tax, estate taxes, and contributions under the Federal Unemployment Tax Act of the Social Security law, are collected in the calendar year following the year in which the liabilities occur.

In your Message you stated that "the estimates are rough and may vary somewhat either way", which is another way of saying that there is no one answer as to the amount of revenue which will be received by the Government at a given level of national income. We do not tax national income but rather particular components thereof and tax revenues, therefore, depend on the relative proportions of national income received by various groups in our economy. Another important factor affecting tax liabilities in relation to national income is the trend of that national income upward, downward, sidewise or irregularly fluctuating.

The present estimates of revenues, which are $5,644 millions for fiscal year 1940 and $5,951 millions for the fiscal year 1941, are not inconsistent with the indicated tax liabilities at various levels of national income which were contained in your 1940 Budget Message.

The following tabular presentation shows the estimates of national income paid out for calendar years 1937-1940, inclusive.

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National income 1/

(in billions of dollars)

Calendar year	National income paid out
1937	70.7 ✓
1938	65.0 ✓
1939	69 *
1940	75 *

1/ U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce.

* Estimated by Robert Nathan, Research Division of the Bureau of Foreign and Domestic Commerce, December 15, 1939.

For your convenience there is appended herewith a copy of that portion of your Budget Message for fiscal year ending June 30, 1940 which refers to "The Budget and the National Income".

Since this statement was based in part on Treasury material, I am also attaching a copy of the table and comments prepared by the Treasury Department and on which this part of your statement was based.

Faithfully,

The President,

The White House.

Attachments

AFO'Dmin 12-16-39

DIVISION OF
AND STATISTICS

Prepared by

Date 12/16/39

Checked by J. B. Stanley

Date 12/16/39

Excerpt from The Budget of the United States Government
for the Fiscal Year Ending June 30, 1940

The Budget and the National Income

"Taxation yields almost all of the income of the Government, leaving less than 5 percent to come from miscellaneous sources. Revenue from taxes depends mainly on two factors: The rate of taxation and the total of the national income. This holds true not only of direct taxes on personal and corporate income but also of what are known as ad valorem taxes or other forms of indirect taxes, for the very good reason that the volume and value of goods produced or articles imported vary with the rise or fall of the Nation's total income.

"We can and do fix the rate of taxation definitely by law. We cannot by a simple legislative act raise the level of national income, but our experience in the last few years has amply demonstrated that through wise fiscal policies and other acts of government we can do much to stimulate it.

"Today the Nation's income is in the neighborhood of 60 billion dollars a year. A few years ago it was much lower. It is our belief that it ought to be much higher.

"In order that you may know the amount of revenue which the Government may expect under the existing tax structure as the national income rises, the following table is submitted. It shows the estimated revenues which may be derived when national income reaches certain levels between 70 billion and 90 billion dollars.

Estimated Federal receipts 1/ by principal sources, at certain assumed levels of national income based on December 1938 tax rates
(In billions of dollars)

National income	70	80	90
Income taxes	2.5	3.9	5.7
Miscellaneous internal revenue	2.8	2.8	3.1
Customs	.4	.5	.7
Miscellaneous receipts	.2	.2	.2
Pay-roll taxes	.7	.8	.9
Total	6.0	8.0	10.6

1/ Tax liabilities excluding trust accounts. Pay-roll taxes at calendar year 1938 rates.

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"The table is not intended to indicate the national income for any particular year and, of necessity, the estimates are rough and may vary somewhat either way. Since taxes are paid from one month to fifteen months after income is realized, the achievement of a 90 billion dollar national income in one year will not, for instance, mean tax collections of 30 billion dollars in that same year. This table is an indicator and not a gauge."

Copy of suggestions submitted by the Treasury Department to the Budget Bureau in connection with the President's 1940 Budget Message

The Budget and the National Income

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Estimated Federal Receipts by Schedule Series, at Various Annual Levels of Estimated Income Based on Calendar 1950 Tax Rates

(In billions of dollars)

	Estimated income yield at			
	[illegible]	[illegible]	[illegible]	[illegible]
Income taxes	2.5	3.9	5.7	6.0
Miscellaneous internal revenue	2.2	2.6	3.1	3.6
Customs	.4	.5	.7	.8
Miscellaneous receipts	.2	.2	.2	.2
Payroll taxes	.7	.8	.9	1.1
Total	[illegible]	[illegible]	[illegible]	[illegible]

* Tax liabilities excluding trust accounts. Payroll taxes at calendar year 1950 rates.

THE SECRETARY OF THE TREASURY

WASHINGTON

December 21, 1939.

My Dear Mr. President:

I believe the attached excerpt from your Budget Message for the fiscal year ending June 30, 1940 is relevant to our conversation at Luncheon last week when we discussed the relation between Federal revenue receipts and the national income.

The table shows that a national income around $70 billions may be expected to yield about $6 billions in Federal revenues. This is, of course, only a rough approximation since we do not tax national income as a whole, but rather particular components thereof. Actual receipts, at any given level of national income, will depend on the distribution of that income as between different groups and, also, since many taxes are paid after a considerable lag, upon the trend.

The effect of these specific factors may be illustrated by comparing our present estimates of revenues, $5,944 millions for fiscal year 1940 and $6,[illegible] billions for fiscal year 1941, with the most recent estimates of national income through 1940.

1/

National Income
(In billions of dollars)

Calendar Year	National Income Paid Out
1937	70.7
1938	65.0
1939	65 *
1940	75 *

1/ U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce.

* Estimated by Robert Nathan, Research Division of the Bureau of Foreign and Domestic Commerce, December 15, 1939.

As the table shows, national income is now characterized by a rising trend. Our revenue estimates, therefore, though falling roughly in the 6 billion dollar range, corresponding to a 70 billion dollar range for national income, nevertheless show a lag reflecting the lower levels of national income in 1938.

Faithfully,

The President,

The White House.

Attachment

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The effect of these specific factors may be illustrated by comparing our present estimates of revenues, $5,644 millions for fiscal year 1940 and $5,951 millions for fiscal year 1941, with the most recent estimates of national income through 1941.

1/

National Income
(In Millions of dollars)

Calendar Year	National Income Paid Out
1937	70.7
1938	65.0
1939	68 *
1940	72 *

1/ U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce.

* Estimated by Robert Nathan, Research Division of the Bureau of Foreign and Domestic Commerce, December 15, 1939.

As the table shows, national income is now characterized by a rising trend. Our revenue estimates, therefore, though falling roughly in the 6 billion dollar range, corresponding to a 70 billion dollar range for national income, nevertheless show a lag reflecting the lower levels of national income in 1938.

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The President,

The White House.

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The Budget and the National Income

"Taxation yields almost all of the income of the Government, leaving less than 5 percent to come from miscellaneous sources. Revenue from taxes depends mainly on two factors: The rate of taxation and the total of the national income. This holds true not only of direct taxes on personal and corporate income but also of what are known as ad valorem taxes or other forms of indirect taxes, for the very good reason that the volume and value of goods produced or articles imported vary with the rise or fall of the Nation's total income.

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TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE DEC 20 1939

TO Secretary Morgenthau

FROM Mr. Foley

Re: Newly-Mined Domestic Silver.

As then modified, the newly-mined domestic silver Proclamation of the President of December 21, 1933 expired on June 30, 1939. It provided that silver to be eligible thereunder had to be delivered to a mint on or before that date.

During July 1939, it was represented to the Department that there was a certain amount of silver which had been mined on or before June 30, but which had not been delivered to a mint by that date, and a certain amount of silver which was mined on July 1, 1939, for which there was payable neither the 64-cent price under the Proclamation, nor the 71-cent price under section [illegible] of the Act of July 6, 1939 which provided for silver mined subsequently to July 1, 1939. In view of the powers under the Thomas Amendment having been continued by the July 6, 1939 Act, a Proclamation was issued by the President on July 25, 1939 which provided in part that the newly-mined domestic silver Proclamation of December 21, 1933:

> "as heretofore and hereby modified, shall remain in force and effect until the 31st day of December 1939, with respect to silver mined subsequently to December 21, 1933, and on or before July 1, 1939 * * *."

The Department has received one request that a further extension beyond December 31, 1939 be made for the receipt of silver under the Proclamation, and, of course, other requests may be received.

In this connection, it may be noted that in September, 1937, in view of the prospective expiration of the Proclamation on the last day of that year, it was announced with the approval of the President, that the mints might continue after December 31, 1937, to accept under the Proclamation silver mined prior to midnight of that date. Such action was taken in view of the fact that a considerable period of time normally elapses between the date silver is mined and the date it can be delivered to a mint. Without

such action or an extension of the Proclamation much of the silver mined during the latter months of 1937 could not have received the benefit of the Proclamation. Similar action was taken in July 1938 under similar circumstances.

The situation which exists at present is distinguishable. Because of the provisions of the July 25, 1939 Proclamation the mints will continue to receive eligible silver which was mined on or before July 1, 1939, provided such silver is delivered on or before December 31, 1939 either physically or by acceptance of an instrument of transfer. An instrument of transfer may provide for the deposit of silver thereunder as long as five months after the date thereof. Accordingly depositors of eligible silver mined on or before July 1, 1939 will have as a minimum approximately eleven months in which to refine and deposit the silver, if instruments of transfer are tendered and accepted during the latter part of December.

It would seem that adequate time has thus been afforded for the delivery of silver mined on or before July 1, 1939. In view of the efforts which have been made both by the Government and the industry to make possible the receipt of all eligible silver, there is probably comparatively little eligible silver which cannot be delivered on or before December 31 either physically or by instrument of transfer.

If you approve, those who may inquire will be advised that silver to be eligible for receipt under the December 21, 1933 Proclamation, as modified, must be delivered to a United States coinage mint on or before December 31, 1939, either by physical delivery or by the acceptance on or before such date of a duly executed instrument of transfer; and that a further extension of such Proclamation is not anticipated.

F. N. Foley Jr.
General Counsel.

APPROVED:

December 20, 1939.

MEMORANDUM FOR THE SECRETARY:

Attached is a short statement of what went on at the meeting of the Fiscal and Monetary Committee to discuss the Income Certificate Plan for Agriculture, held in your office Monday, December 18th.

It was thought that you might wish a report of this kind for your records.

RB

Subject: The meeting of the Fiscal and Monetary Committee to discuss the Income Certificate Plan for agriculture held in the Office of the Secretary of the Treasury, December 18, 1939, at 10 A.M.

Those present were: The Secretary of the Treasury; the Secretary of Agriculture; the Under Secretary of the Treasury; the Chairman of the Federal Reserve Board; the Director of the Budget; Mr. Rudolph M. Evans, the Administrator of the Agricultural Adjustment Administration; Mr. Carl B. Robbins, the President of the Commodity Credit Corporation; Mr. Frederic A. Delano, Chairman of the National Resources Planning Board; Dr. Lauchlin Currie, Administrative Assistant to the President; Daniel W. Bell, Assistant to the Secretary of the Treasury; Mr. Roy Blough and Mr. L. L. Ecker-Racz, Treasury Department, Division of Tax Research.

The Secretary of the Treasury indicated that the purpose of the meeting was to discuss the Income Certificate Plan for agriculture.

The Secretary of Agriculture sketched the character of the farm problem and the need for an agricultural program. The objective of the program is to restore to farmers that share of the national income which they received before the World War. Even in the pre-War period the farmers' per capita net income was only 60 percent of the per capita net income of the non-farm groups. Since that time their relative position has deteriorated further. Other groups in the economy have increased their share of the national income at the expense of farmers. This maldistribution is one of the explanations of the present relatively low national income.

At present 7 million farm families comprising a fourth of the population are educating 31 percent of the children of school age but receive only 11 percent of the national income. Their average annual income lacks approximately $1,250,000,000 of parity. This situation is the result of the fact that agriculture has lost its bargaining power with the other economic groups.

The reasons for agriculture's loss in bargaining power are: (1) During the last War, farmers expanded their production capacity by plowing up 40 million extra acres of land to satisfy the War demand for crops; (2) After the War the United States changed from a debtor to a creditor nation, making it more difficult to export our surplus farm products; (3) The automobile, truck, and tractor displaced the horse and thereby released 35 million acres formerly used in supplying feed; (4) European nations have been fostering self-sufficiency and developing their own agricultural output; (5) New countries have entered into competition with the United States for exports to foreign countries; (6) The United States has raised its tariff barriers, prompting other countries to retaliate by shutting out our farm products; and (7) Industrial monopoly and price-fixing has increased, resulting in an increase of the prices of commodities the farmers buy.

This situation was further aggravated by industrial unemployment which has reduced the cities' demand for farm products and aggravated the surplus problem.

By 1933 the farm problem reached a critical condition. The Agricultural Adjustment Act of 1933, financed from processing taxes, undertook to meet this problem in a satisfactory way. At the beginning of 1936, the Supreme Court threw out this Act. Subsequent legislation regained many of the objectives and improved upon the technique of the 1933 Act. However, the continued source of revenue lost by the invalidation of the processing taxes has never been restored. Instead, appropriations from the General Fund were provided for the conservation programs and for parity payments. These have enabled agriculture to do a good job. This year, for the first time, the program has the cooperation of the farmers of the country, with the exception of those in New York and California. All this, however, is at present endangered by the possibility that in an effort to provide for national defense the appropriations for agriculture will be cut. The budget for next year does not provide for parity payments.

A permanent source of revenue is needed to continue the agricultural program. The farmers cannot understand why they alone should be required to petition Congress annually for appropriations when the other groups do not need to do so. The laws providing bargaining powers for labor and those imposing tariffs for industry need not be renewed every year.

To meet the present needs of agriculture and since the President has indicated approval of parity payments, provided the necessary revenue is found, Agriculture has proposed the Certificate Plan. In brief, this plan constitutes a processing tax which would not appear on the books of the Treasury. The adoption of the Certificate Plan is one of four possible alternatives. The other three are: (1) Do nothing about restoring parity income to the farmers; (2) Adopt a system of price-fixing whereby prices of agricultural commodities would be set by the Government; and (3) Finance parity payments from manufacturers' sales tax, taxes on luxuries, or additional income taxation. The Certificate Plan appears to be the most desirable of these alternatives.

At the request of the Secretary of the Treasury, Mr. Blough read, at this point, the summary of the Treasury Department's analysis of the Income Certificate Plan as incorporated in the several bills introduced during the 1939 regular session of Congress. The Secretary of Agriculture indicated that in some respects the present plan of the Department of Agriculture differs from that incorporated in these bills. He specified disagreement with the cost of production concept in the Wheeler wheat bill. He further indicated that if changes in the plan, particularly with respect to its administration, would make the plan more acceptable to the Treasury Department, such changes could probably be made.

Thereupon, Mr. Robbins read a memorandum which discussed the need for an agricultural program and the manner in which that need would be met by the Certificate Plan. In general, he expressed the view that since the Government's policy has placed agriculture at a relative disadvantage compared with industry, steps should be taken to reestablish the pre-War balance between agriculture and industry. Such a balance can be reestablished by providing farmers parity incomes and parity prices.

With reference to the proposed certificate tax, the Secretary of Agriculture expressed the view that the contemplated tax, when considered in conjunction with the distribution of benefit payments, would not be regressive and may be viewed, in fact, as progressive. This would be its net effect because it would transfer income from the more prosperous industrial groups to the less prosperous farm groups.

The Secretary of the Treasury inquired how the Fiscal and Monetary Committee could best perform its functions with respect to the plan under consideration. The Chairman of the Federal Reserve Board indicated that the Fiscal and Monetary Committee is sympathetic with the condition of agriculture, but is interested in the plan primarily from the point of view of employment and purchasing power. The Secretary of the Treasury added that the Committee was interested also in the elimination of extreme fluctuations in business activity. The Chairman of the Federal Reserve Board noted that the transfer of purchasing power from

industrial to agricultural groups, contemplated by the plan, may involve some transfer from the industrial unemployed to the relatively prosperous agricultural groups. Mr. Robbins indicated that 95 percent of agricultural benefit payments are distributed in amounts of $200 or less; that there were limitations upon the amounts payable to individual farmers.

The Secretary of the Treasury scheduled another meeting for Thursday, December 21, 1939, at 3 P.M. The Secretary instructed Mr. Blough to make copies of the Treasury's analysis of the Certificate Plan available to the Secretary of Agriculture, the Chairman of the Federal Reserve Board, the Director of the Budget, Mr. Delano and Dr. Currie. The Secretary of the Treasury and the Secretary of Agriculture suggested that members of the staffs of the two departments might confer with respect to the points raised in the memoranda presented at the meeting. The meeting was adjourned at 12 o'clock noon.

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E-R:hhj
12/19/39

Tentative and Confidential

December 20, 1939

SUMMARY DESCRIPTION OF THE
FARMERS' INCOME CERTIFICATE PROGRAM

I. THE NEED FOR INCREASED AGRICULTURAL INCOME, PRODUCTION ADJUSTMENT, AND SOIL CONSERVATION.

A. The need for increased farm income:

(1) A substantial gain has already been made in increasing the gross farm income (including benefit payments) for the United States from $5,284,000,000 in 1932 to $8,811,000,000 in 1938, which represents an increase of 67%; but

(2) Farmers still receive only a seriously deficient share of the national income: Agriculture today has approximately 25% of the total population, and 31% of the Nation's children, but only 11% of the national income.

B. The need for agricultural production adjustment:

In order to preserve a reasonable balance between agricultural and industrial production, it is necessary to adjust farm production to compensate for (a) the loss during recent years of markets for agricultural products, as compared with the markets for industrial products, and (b) the greater inherent tendency of agriculture, as compared with industry, to increase production.

(1) Need for adjustment to compensate for loss of markets: Under the stimulus of the World War an additional 40 million acres of farm land was brought under cultivation. Since the World War and primarily as a result of the erection of trade barriers in various forms, and the shift in our country's position from a debtor to a creditor nation, Agriculture has suffered the loss of its foreign market for the products of 25 to 30 million acres of land. The substitution, beginning during the World War, of machines for horses and mules has decreased the market for corn, oats, and hay in an amount equal to the product of approximately 25 million acres.

(2) Need for adjustment to compensate for greater inherent tendency of agriculture, as compared with industry, to increase production: The production of both industry and agriculture is stimulated by increasing prices but,

speaking generally, agriculture is basically unlike industry in that the pressure of low prices usually causes a large and prompt decrease in industrial production, whereas it tends to drive agriculture into the increased production of soil-mining cash crops and the abandonment of soil conserving practices. This greater inherent tendency of agriculture to increased production is one of the fundamental causes of farm distress and disequilibrium between industry and agriculture. It must be offset before a reasonable balance between agricultural and industrial production can be expected.

(a) Increased agricultural production could be beneficial to farmers as well as to consumers if it were accompanied by increased industrial production. In fact, greater industrial activity is a basic requirement not only for urban prosperity but also for the full recovery of agriculture. Regardless, however, of such highly desirable and essential improvements as may occur in industrial activity it will remain necessary, in order to preserve a healthful balance between agriculture and industry, to continue some means of offsetting the inherently greater tendency of agriculture to increase production. In other words, the real difficulty is not the total overproduction of industrial and farm products. That would hardly be possible so long as there were proper balance. The trouble is too little or too much production of one group of commodities in relation to the production of other commodities and services. Consequently, the term unbalanced production is more accurately descriptive of the condition that needs to be avoided than the more common but somewhat misleading term overproduction.

C. <u>The need for increased soil conservation:</u>

(1) The welfare of agriculture and other groups over a long period is fundamentally dependent on the conservation of our soil resources. Fortunately, it has been found possible to progress simultaneously toward the two essential objectives of production adjustment and soil conservation by means of the AAA programs. They have furnished an incentive to preserve our soil resources and adjust production by bringing about a decrease of approximately 40 million acres of commercial soil depleting crops and the substitution of soil conserving and home consumption crops.

(a) It should also be noted that the use of marketing quotas in the regulation of interstate commerce in agricultural commodities also tends to avert unbalanced production. Programs for the relief distribution, as well as the export, of surplus production are also proving effective. With these necessary and sound bases for the stability and prosperity of agriculture already established, it is possible to proceed with additional measures. But if the measures to be adopted for these purposes are to result in the maximum advance toward the equitable participation of farmers in the national income, they must support rather than impair the incentives under the existing programs to avoid a condition of unbalanced production and soil destruction.

II. PRINCIPAL ALTERNATIVES FOR INCREASING FARM INCOME:

A. Increase direct governmental payments: Under the existing circumstances this alternative is not considered to be either practical or desirable. In the first place, the deep-rooted feeling of people generally against grants of aid appropriated from a public treasury means, in terms of practical possibilities, that the large farm group could not expect to obtain sufficient payments from that source to give it a fair participation in the total national income. In the second place, the possibilities of obtaining increased appropriations for farm payments at the present time are especially limited by the amount of the current deficit and the needs for increased national defense. And in the third place, to oblige agriculture to rely upon appropriations for increased income would place farmers in a vulnerable position because of the great uncertainty that large appropriations of public funds would be maintained under changing Administrations.

(1) The degree of success of an effort to bring about a fair and equitable participation by farmers in the national income will depend in large part on the selection of the source from which additional income is to be sought. Except for the possibility of obtaining improved prices from export sales through the operation of an international agreement, there are only two possible sources from which the income of farmers may be increased, namely, appropriations of funds from the public treasury and increased prices to domestic consumers.

(a) We should most probably have a far more judicious and equitable allotment of public subsidies among the various groups in our population if instead of having some of our subsidies in indirect form, such as tariffs, quotas, franchises, patents, corporate powers, and labor legislation, all grants of public aid had, from the beginning, been only in the form of direct and outright appropriations of public funds. But since this was not done, and since the possibility of bringing about such an idealistic arrangement is exceedingly remote and impractical under the existing circumstances, we shall be obliged, however reluctantly, to resort to an even wider use of indirect subsidies if we are going to attain a reasonable degree of equity in the distribution of public grants of aid.

(b) We, therefore, find ourselves confronted with an unwelcome fact which must be taken into consideration in planning a course of action to achieve an equitable result. The history of most efforts by groups to improve their circumstances through governmental aid has emphatically demonstrated that for a variety of reasons the appropriation route, as compared with increased prices, is the hard way. Long ago the manufacturing industries as a whole were compelled to recognize and act on this phenomenon. When in search of government aid, they usually pass over the possibilities of obtaining appropriations of public funds, and confine their requests to various devices, such as tariffs and quotas, for increasing their selling prices. These groups have found that in terms of the practicalities of the situation only one dollar of increased income can be obtained through appropriations when, let us say, five dollars can be obtained in the form of increased selling prices. This practical situation determines the result to such a great extent that it is difficult to believe that farmers are going to have a fair and equitable share of the national income so long as they are handicapped, as compared to industry and labor, by being obliged to receive increases in their income primarily through appropriations rather than improved prices.

B. Increase commodity loan rates and export subsidies: These alternatives would also oblige farmers to rely to an undesirable extent on government appropriations. The greater the commodity loan rates fixed by the Government, the greater the appropriations of funds required for export subsidies. Moreover, if a price pegging loan program is to be successful, the production must be decreased and domestic prices advanced to a point that permits liquidation of the loans without loss. Yet higher domestic prices, which could be brought about at least temporarily through higher price pegging loans, would tend to encourage increased production and withdrawals from the present AAA adjustment and soil conservation programs. This, in turn, would tend to defeat the higher loan program and convert it, by requiring appropriations to cover loan losses, into a system of increased direct government payments without having secured production adjustment and soil conservation. It is doubtful that a system of marketing quotas could fully offset these tendencies. Any loan program, as the experience of the Federal Farm Board demonstrated, can be swamped by continued excesses of production. A more desirable alternative for increasing farm income would be one that not only would avoid the necessity of increased loan rates and export subsidy payments but also would strengthen the programs for production adjustment and soil conservation.

C. Fix prices at higher levels by governmental decree: This alternative would not encounter budgetary difficulties, at least until a possible lack of production adjustment had overcome the program with unmarketable surpluses after a period of two or three years. Although it is obvious that a program of outright price fixing could not long endure in the absence of a strong incentive for production adjustment, most price fixing proposals omit any arrangement for production adjustment or soil conservation. It is also difficult to envision how an adequate production adjustment program could be made effective under a price fixing plan. Moreover, so far as any one has yet been able to suggest, it would also be necessary under a system of prices fixed by governmental decree, and especially in the case of export crops, for the Government either to take over much of the buying and selling functions from the established and normal channels of trade or to undertake the policing of literally millions of transactions. It also seems clear that neither of these alternatives for effectuating a fixed price program could be expected to command the widespread public support that would be necessary for its continued operation.

D. Apply the internal tax or certificate principle. This would, as explained below, promise more equitable returns, avoid budgetary difficulties, provide a permanent method of financing, strengthen the production and soil conservation programs, and not give rise to any major administrative difficulties.

III. ANALYSIS OF THE FARMERS' INCOME CERTIFICATE PROGRAM.

A. The Certificate Program, since it would seek additional income through the more practical method of increasing domestic prices rather than through attempting to increase appropriations from the Treasury, would promise to accomplish more than any of the other three alternatives toward bringing about a fair participation of agriculture in the national income. The only possible exception is a fixed price program, but as has been mentioned, this would tend to defeat the production adjustment and soil conservation programs, give rise to either extremely difficult administrative problems or the taking over by the Government of certain functions of the established trade, and probably in the end become swamped with excessive supplies and create a large budgetary problem.

B. Wherever applicable the Certificate Program would give agriculture a more dependable and permanent form of financing, and one that would be more nearly comparable to that now enjoyed by industry and labor through legislation providing for tariffs, quotas, franchises, corporate powers, patents, wages and hours, and collective bargaining.

C. The Certificate Program would strengthen the AAA production adjustment and soil conservation plans by adding to the present cash payments for soil conservation the excess of the value of the certificates over the amount of the present so-called parity payments, as an additional incentive to cooperate in the AAA programs.

D. The Certificate Program would permit possible reduction, or at least avoid any necessity for increases, of commodity loans and export subsidies by making it possible to increase the income of farmers from the domestic market but without making high farm prices necessary. Higher loans mean higher farm prices, which in turn require export subsidies.

E. The Certificate Program would reduce the need for the non-budgetary appropriation item, of more than $200,000,000, commonly known as the parity payment fund, and thus decrease the deficit that would otherwise be incurred.

F. The Certificate Program could be conveniently administered primarily by the existing facilities of the Department of the Treasury without a great increase in expenses.

a. There are several fundamental reasons for distinguishing between the Certificate Program and those forms of taxation usually regarded as regressive: It should be noted that the question is not who pays for the increased income to farmers. Consumers do. The only question is whether the ultimate effect of the Certificate Program would be regressive.

(1) One principal factor that sets the Certificate Program apart from ordinary sales taxes and similar regressive levies is that the proceeds are to be used exclusively for the benefit of one of the lowest income groups among the population. In view of the fact that all of the revenue derived under the Certificate Program would be used to benefit a group whose income is substantially less than the income of those on whom the cost would fall, it is evident that upon being considered in all its aspects, the net result of the Certificate Program would be somewhat similar to progressive taxation in that it would transfer purchasing power from a higher to a lower income group. In this connection it may be pointed out not only that the average per capita income is lower for the total farm group than for the total non-farm groups, but also that some of the lowest income farm groups (for instance, share-croppers) have incomes below those of some of the lowest non-farm groups (for instance, WPA workers).

(a) The data available on cotton indicate, for this product, that the certificate principle would work progressively rather than regressively. About 80% of the returns from the Certificate Plan would go to families on cotton farms having annual incomes of less than $750, whereas in order to account for the consumption of 78% of the cotton one must include consumer groups having annual incomes up to $3,000. Likewise, twenty-five percent of the cotton farm families in the lowest income brackets have annual incomes of less than $400, whereas one must include groups of consumers having incomes up to $1,200 in order to account for 25% of the cotton consumption. In the case of wheat the effect of the Certificate Program probably would be neither progressive nor regressive, but about the same as the effect of so-called proportionate taxation.

(2) Another principal factor that distinguishes the Certificate Program from typically regressive levies is that it would be used only to bring farm income up to a level, namely parity, such as is reasonably required on even a low

historical basis to compensate for the man power and soil resources utilized in bringing about an adequate supply of food and fiber. Certainly no measure should be regarded as regressive which would barely offset the gratuitous advantage which consumers have enjoyed with respect to farm products during the depression. Agriculture, no less than industry, deserves to be on a self-sustaining yield basis; and it seems only reasonable that consumer prices should reflect the cost of soil maintenance and personal well-being for farmers just as consumer prices reflect depreciation expense and the cost of the real social security provided for industry.

(a) The relative disadvantage under which farmers are laboring is indicated by the fact that non-farm group incomes now have a purchasing power for food approximately 25% greater than in the 1920s.

(b) Very few consumers object to the payment of prices not in excess of those required to give farmers a parity or other reasonable return.

(3) A third principal factor which deserves consideration in this connection is that the Certificate Program would be accompanied by programs for the free distribution of surplus agricultural products to the lowest income groups. The Certificate Program, as it happens, is best adapted to those commodities, such as cotton and wheat, for which moderate changes in the price of the raw product have little effect on consumption. Moreover, the Food Stamp Plan is being used to benefit the lowest income non-farm groups and to protect the public, as well as the farmers, against a decrease in consumption.

(4) A fourth principal factor, which it is believed should be considered in appraising this matter, is that the burden of the public aid which would be granted agriculture under the Certificate Program, would be distributed among the population in a manner largely similar to the distribution of the burdens imposed for the benefit of industry and labor in the form of tariffs, quotas, franchises, corporate charters, patents, and labor legislation.

E. Despite its obvious budgetary balancing aspect, the net effect of the Certificate Program probably would not be deflationary. There are two reasons for this:

(1) In the first place, the establishment of the revolving pool to purchase certificates from farmers and resell them to manufacturers would insert a substantial (perhaps at its peak as much as $300,000,000) of purchasing power into the economy in the form of increased government credit. This would come about because, on the average, farmers would get paid for their certificates several months in advance of the date on which the manufacturer would be obliged to acquire the certificates and return them to the Government.

(2) In the second place, there will probably be a strong and effective demand upon Congress for a substantial appropriation to finance a general expansion of the Food Stamp Plan which has proved to be beneficial not only to farmers and persons on relief in urban centers, but also to the numerous retail merchants who are usually among the most important customers of local newspapers. If the so-called parity payment fund were rendered unnecessary by an adoption of the Certificate Program, Congress might be expected to appropriate a similar sum for extension of the Food Stamp Plan with the consequence that there would be no net decrease in government spending. Further unbalancing of the budget would be avoided, but with the injection of the purchasing power to be derived from the establishment of the revolving pool for certificates, there would be a substantial initial net increase in the purchasing power of the population.

IV. OPERATION AND MANAGEMENT OF THE PROGRAM.

A. Each producer of certain eligible crops (including at least cotton, wheat, and rice) who cooperates in the AAA production and soil conservation programs would receive certificates representing his normal production.

B. The certificates would be assigned a face value equal to an amount estimated to be required to give producers the difference between (a) the market prices plus government payments, and (b) parity prices, on the domestically consumed portion of the crop.

C. Processors and importers would be required, upon the sale of their products, to surrender to the Government a certain ratio of certificates for each unit of the raw material consumed in manufacturing

the products sold. This ratio would be so determined that all the certificates distributed to growers would be returned by manufacturers and importers with respect to products consumed domestically. Certificates would be refunded to manufacturers with respect to finished products exported.

D. A Government pool would be established to purchase certificates from farmers and sell certificates to manufacturers and importers. The pool would be financed by a revolving fund supplied by the Commodity Credit Corporation. Through the operation of the pool the market prices of the certificates would be maintained at their face values, and an adequate supply of certificates would always be available to manufacturers and importers.

E. The management and operation of the Certificate Program would come primarily within the Department of the Treasury. Presumably, the Department of Agriculture would be called upon only to advise the Department of the Treasury with respect to the necessary names, addresses, and amounts of certificates, for delivery to producers. It is believed that the operation of the revolving pool for the purchase and sale of such certificates as the farmers, and the manufacturers and importers, might wish to sell or purchase through the Government, should be operated by the Department of the Treasury. Moreover, it is believed that the Department of the Treasury should carry out the task of receiving the certificates to be turned in to the Government by manufacturers and importers.

V. COMMENTS ON QUESTIONS RAISED ABOUT THE FARMERS' EFFORT INCENTIVES PROGRAM IN THE DEPARTMENT OF THE TREASURY'S MEMORANDUM OF DECEMBER 15, 1939.

1. QUESTION, (p. 40): "The increased prices to consumers may greatly reduce the market demands, increase surpluses and hence government expenditures for the disposition of surpluses."

   COMMENT: On the contrary the Certificate Program would substantially strengthen the AAA production adjustment program. Moreover, the domestic consumption of wheat, cotton, and rice does not appear to be particularly responsive to changes in price.

2. QUESTION, (p. 45): "Another weakness of the certificate plan from the point of view of agriculture stems from its failure to recognize variations in type, quality and regional differences as reflected in the market prices of any one general agricultural commodity."

COMMENT: Under the certificate program the open market price would continue to reflect differences in quality, type, and location of the commodity. The relation between prices for different qualities would change to the extent necessary to take into account the uniform price of certificates just as it now changes to reflect increases or decreases in transportation costs or other distributing charges imposed at flat rates. It is true that returns to producers distant from market and to those in surplus-producing areas would be increased relatively more than returns to producers near the market or in deficit areas. This occurs whenever the price of the commodity increases because location differentials largely reflect flat rate transportation and handling costs. This is desirable because prices for farm products are relatively lower and the need for an increase is greater in areas most distant from market.

3. QUESTION, (p. 46): "Landowners as the equity holders in farm enterprise would, of course, be the largest gainers. Unless the plan resulted in a substantial increase in the wages of farm labor (not likely in view of the relatively large supply of farm workers) it would probably be of little benefit to that group. In fact, it is quite likely that agricultural labor, insofar ~~as it consumes~~ food and clothing, would be a substantial loser as a result of increased consumers' food and clothing prices."

COMMENT: On the contrary, large landowners prefer to obtain the maximum amount of their returns in the form of market price because they have found that in their bargaining with tenants and share-croppers they can obtain a larger share of the increment in total income for the farm if it is obtained through price rather than through government payments (of which the certificates would be an equivalent) the sharing of which is controlled in part by the Government. Wage rates and employment of agricultural labor fluctuate primarily with changes in returns from agricultural production. The increase in the cost of living for farm laborers as a result of the operation of the Certificate Program would be insignificant as compared to the increase in their wage income resulting from the higher returns received by farmers.

4. QUESTION, (p. 48): "... the necessity of absorbing any small part of the tax would seriously affect their [processors] profits. Such necessities doubtless arise when the addition of the tax to the price would require a fractional price adjustment."

COMMENT: The processors of most agricultural commodities are accustomed to continual fluctuation in the cost of these commodities and, apparently, are able to make appropriate changes in selling prices from time to time. Operation of the Certificate Program would tend to stabilize the cost of the commodity to the processor and to reduce the need for changes in selling prices of their products.

5. QUESTION, (p. 52): "... it should be noted that the tax would constitute a heavy burden on those who, as well as farmers, are receiving less than parity incomes. There are other depressed industries in the same general condition as agriculture. Furthermore, the whole body of unemployed and under-employed laborers in all industries have less than parity incomes and would be subjected to a heavy burden on account of the tax."

COMMENT: All of the proceeds derived under the Certificate Program would be used to benefit a group whose income is substantially less than those upon whom the cost would fall. Not only is the average per capita income lower for the total farm group than for the total non-farm groups, but also some of the lowest income farm groups have incomes below those of some of the lowest non-farm groups. Agriculture, no less than industry, deserves to be on a self-sustaining yield basis; and very few consumers object to the payment of prices not in excess of those required to give farmers a parity or other reasonable return. The burden of the public aid that would be granted agriculture under the Certificate Program would be distributed among the population in a manner largely similar to the distribution of the burdens imposed for the benefit of industry and labor. Finally, the Certificate Program is to be used in conjunction with an expanded program (Food Stamp Plan) of surplus distribution among the low income groups and thus protect domestic consumption.

6. QUESTION, (p. 53): "The increased cost of living due to the taxes may indirectly raise expenditures for relief purposes."

COMMENT: To such extent as this is true it is also true of plans to increase farm prices, of tariffs, quotas, franchises, patents, corporate powers, wage and hour legislation, etc. Moreover, as noted above, increased surplus distribution is an integral part of the whole plan.

7. QUESTION, (p. 54): "When an expenditure for a particular function is not only excluded from the Budget but is even excluded from annual Congressional review, control over financial policies is seriously curtailed."

COMMENT: It is more appropriate to compare the Certificate Program with tariff legislation or minimum wage and collective bargaining legislation than with expenditures under the Budget. The issue is primarily one of agricultural policy rather than fiscal policy, except as it may affect other appropriations. One objective is to avoid the special penalties—low income and vulnerability—that appropriations for agriculture, and increased prices for other groups, place on farmers.

8. QUESTION, (p. 55): "Finally, the plan would establish a dangerous precedent, which other economic groups would strive to emulate."

COMMENT: On the contrary, the Certificate Program for agriculture would follow the methods now in effect and the precedent long ago established for industry and labor. These groups are not obliged to receive Government aid in the form of appropriations of public funds but do receive such aid through devices which increase selling prices and wages.

Strictly Confidential

December 20, 1939

SUMMARY OF THE POLITICAL ASPECTS OF THE FARMERS' INCOME CERTIFICATE PROGRAM

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A. Despite the 67% increase in farm income since 1932, Agriculture still has 25% of the total population but only 11% of the national income. Therefore, much more needs to be done, and the farm vote may be the decisive factor in the 1940 election. The proposed Farmers' Income Certificate Program would assure a greater increase in farm income than could be expected under any other practical and permanent alternative.

B. If the Democratic Party should adopt the Farmers' Income Certificate Program, the Republicans would find that they had lost their thunder in the form of various domestic allotment plans and would have only two major alternatives, namely: No farm program, or outright price fixing. Since farmers will demand a program of some kind, and since outright price fixing by governmental decree is so vulnerable, it would seem that the Democrats could hardly place themselves in a better position on the farm front.

C. The Farmers' Income Certificate Program is a simplified method of achieving the advantages of the processing tax principle without involving the appropriation of public funds. It would be consistent with the original New Deal farm program. In fact, its adoption would show that after having been forced by an adverse Supreme Court decision into increased direct government payments, commodity loans, and export subsidies, the farmers and the Congress had found that the basic principle of the original Democratic farm program is still the best alternative available.

D. The Farmers' Income Certificate Program should have a substantial appeal to several large groups not only because of its budgetary balancing aspect but also because it would permit a possible reduction, or at least avoid the necessity for an increase, of commodity loan rates and export subsidy payments.

E. Under the Farmers' Income Certificate Program, the farmers would cash their certificates from the U. S. Treasury's revolving pool several months before consumers would be affected through the obligation of manufacturers to purchase the certificates from the pool for delivery to the Department of the Treasury upon the sale of their finished products. Consequently, the Program would inject a large increase of purchasing power into our economy beginning in the midsummer. This should have a stimulating effect on general business conditions at a time when many economists are agreed that it may be most needed.

F. Adoption of the Farmers' Income Certificate Program should make possible the release of funds heretofore appropriated for parity payments, to be used in the future for an expansion of the Stamp Plan which is a benefit not only to farmers and persons on relief but also to the numerous and politically powerful wholesalers and retailers. This should avoid what otherwise might prove to be an unfortunate contest on the part of the retailers, who are such important customers of most local newspapers, to obtain funds for the Stamp Plan by raiding the regular WPA or Agricultural appropriations.

EXECUTIVE OFFICE OF THE PRESIDENT
NATIONAL RESOURCES PLANNING BOARD
WASHINGTON, D. C.

December 20, 1939.

The Honorable,

The Secretary of the Treasury.

My dear Mr. Secretary:

I am in receipt of your letter of December 19 enclosing two copies of the memorandum prepared by your Department on the subject of the Certificate Plan for Agriculture. I shall study it with a great deal of interest.

It seems to me that Mr. Wallace's objective is certainly most important, and if there were any way in which we could help the farmer, just as the manufacturer for a hundred years has been helped, by an indirect and comparatively painless tax whose incidence would not be seriously objectionable, it would be a fine thing to do. It may be that if this plan, though imperfect, can be worked over and improved, it may be the solution. The Retail Stamp Plan had very few friends when it was introduced, and yet I understand that it is working very well and helping the small consumer while also operating as a help to the agriculture-producer.

Sincerely yours,

Frederic A. Delano

Frederic A. Delano
Chairman

GROUP MEETING

December 20, 1939.
9:30 a.m.

Present: Mr. Hanes
Mr. Bell
Mr. Thompson
Mr. Graves
Mr. Cochran
Mr. Harris
Mr. Reifler
Mr. Schwarz
Mr. Gaston
Mr. Viner
Mr. Foley
Mr. White
Mr. Cotton
Miss Chauncey

H.M.Jr: Are you going to have something?

Hanes: Yes, I am. It is direct, short and to the point.

H.M.Jr: Good. You will be in here, won't you, and Herbert? Is that all?

Hanes: Yes

Gaston: I don't know anything new. We are getting statements from everybody who saw the Arauca and the Orion and trying to find out where and when the Orion fired the shot. Mr. Harris' men and the Coast Guard are getting statements.

H.M.Jr: Does anybody know what happened to the Columbus?

Gaston: They scuttled the ship and set her afire. The Tuscaloosa just happened to be there.

H.M.Jr: How?

Gaston: Just happened to be in that neighborhood.

H.M.Jr: Yes, but what made her scuttle the ship?

Gaston: Another British destroyer arrived in the same neighborhood.

H.M.Jr: Yes, but what the hell was the Tuscaloosa doing there?

Gaston: She was patrolling the Panama Zone. Three hundred

miles East of Cape Cod is the line.

H.M.Jr: Lucky it wasn't one of those little Coast Guard cutters, wasn't it. Five hundred and fifty were on board the Columbus. I still want to know what made her scuttle it. You don't know, do you?

Gaston: A British cruiser or destroyer was there ready to sink them.

H.M.Jr: And the old Tuscaloosa was just on the Panama patrol?

Gaston: Yes, very fortunately.

Hanes: Do those Germans have to be interned in this country?

Gaston: It is a merchant ship.

H.M.Jr: Well, it is a new kind of warfare. Anything else, Herbert?

Gaston: No.

Foley: Here is a duplicate copy of the closing agreement on Consolidated that I would like to have you sign. You only sign the original.

H.M.Jr: When are you giving out that statement on the closing agreement?

Foley: We are going to clear it with the Navy, probably today.

H.M.Jr: What else?

Foley: Nothing.

H.M.Jr: Is your office keeping in touch or at least watching the record, what R.F.C. is doing with the Bank of America?

Foley: Well, not specifically.

H.M.Jr: Don't you think it would be nice to have a Tuscaloosa along side?

Hanes: The N.L.R.B. asked us for a copy of the statement. Do you know about that?

H.M.Jr: Well, they asked me and I never did anything about it. It came in one of those days about five thirty and I never personally did anything about it.

Hanes: I did something about it the day I went to the Cabinet meeting. We took a note to the President in answer to his letter to you requesting that you get together with the N.L.R.B. —

H.M.Jr: The President, you mean?

Hanes: Yes. The Comptroller's office wrote a note to the President suggesting that we contact them direct. He had gone to the President and asked the President to direct the Comptroller to give them the report, so we answered the President's letter to you by saying that we would contact them direct. Cy Upham then was delegated to go and talk it over with those people and try to give them certain information that they wanted without giving them the report. Now, whether he had to give that report or not, I don't know.

H.M.Jr: Would you (Miss Chauncey) ask Mr. Upham? That brings me up. I just wondered. I remember one day late they asked me for a report and I said I couldn't —

Hanes: You know what they are trying to prove?

H.M.Jr: No.

Hanes: They are trying to prove that the Bank of America is operating in interstate commerce across State lines and therefore the employees are subject to the National Labor Relations Act.

H.M.Jr: Well, aren't they operating across State lines?

Hanes: Yes, they are, but I don't know about their law. They wanted to prove through our records that they do operate across State lines.

H.M.Jr: Just in case the N.L.R.B. should fire a torpedo, I think we ought to have a Tuscaloosa standing by. I think you (Foley) ought to know about it.

Foley: Well, I know all that.

Hanes: I didn't know about that and I didn't know what was going on.

H.M.Jr: Ed dictated a letter to the President, didn't you, Ed? I know you were there at the time. I carried it to the Cabinet, as a matter of fact.

Foley: Some time when you were away.

H.M.Jr: Well, I just found out what is going on. Anything else?

Foley: No.

Cochran: Handy and Harmon raised their silver price yesterday to thirty-five and one-eighth, so we didn't get any. They are waiting for the new regulations to come out from India with regard to imports.

H.M.Jr: Anything else?

Cochran: No.

H.M.Jr: Wallace has changed his date three times now. I think it is Friday now, I am not sure. Every day they call up Mrs. Klotz and change it. I don't know just what - I think it is Friday. Do you know?

Chauncey: I don't know.

Cochran: That is the date I saw on the memorandum.

H.M.Jr: And on the advise of Walter Stewart, we told Mr. Pincent I would not see Lord Riverdale.

Cochran: That is right.

H.M.Jr: That I keep my own contacts with Mr. Purvis. Purvis was - what is his name - the financial fellow?

Cochran: Pincent?

H.M.Jr: Yes. He was kind of annoyed, but I can't help it. We asked him what was the status of Lord Riverdale. Well, he has no status, so I think that - I don't want these fellows - you men either - Purvis either does represent the allied buying mission or he doesn't. I don't know where Lord Riverdale fits in the picture. You may hear about it.

Cochran: The meeting on Colombia the other day, you said you thought there was some similarity between the Colombians and the Turks. I thought it might interest you to know that Turbay, the Colombian Ambassador here, is half Turkish.

H.M.Jr: I smelt a Turk. I love that. I think that is marvelous. How does he come that way?

Cochran: He had a Turkish mother and a Colombian father.

Viner: Probably Syrian, I take it, because there are a lot of Syrians down there.

White: The first part of his name is Tur, isn't it?

Cochran: Yes.

H.M.Jr: Well, maybe that is why he wants a little extra bargaining.

Hanes says that Jones is ill.

Cochran: I hadn't heard that. I sent stuff over to him yesterday.

H.M.Jr: I am waiting to hear. That conversation I had here a few minutes ago was with Traphagen simply telling him that we are waiting and he says that he has heard nothing. What I said was to wait until they approach him, but not to approach them. So I am waiting on you South Americans.

White: Do I understand that the - Mr. Welles is waiting to hear from you with respect to Peru and Bolivia? That is what Collado told me. I didn't know whether you knew they were waiting to hear from you.

H.M.Jr: Last time Collado had information on that he was wrong also.

Cotton: On that, I might say Duggan came over and had a talk with me yesterday and said he hoped - there seemed to be some disposition not to go forward with these other things. He hoped one could go ahead.

White: Whom does it rest with?

Cotton: He said Welles was hesitant about taking it up. He had sort of a feeling that over here - we said we might as well do Colombia first. There isn't any money anyway, which is quite true. Duggan hopes we might go ahead with a little bit anyway, even if it is on a somewhat hypothetical point.

White: As long as the Secretary says it is not waiting for him —

H.M.Jr: No, definitely, because Mr. Welles said within the last few days, "Now, just the minute we are through with Colombia I want to take up Peru."

White: There was a letter in which he said he wanted to take up Peru.

H.M.Jr: He sat on that thing with Collado pretty hard and said he had no right to say this. In the last couple of days he said he wanted to do Peru next.

Cotton: If Welles would bring up what he wants - according to Duggan he didn't want to make a formal request about it.

H.M.Jr: And I wish you would tell Duggan this, that there is no reason for waiting for Colombia, because if they want to start the Brazil, we can start the Brazil. If Duggan somehow or other would go on these things so I could have the contact with him direct, I would like that very much. As far as Sumner Welles and myself are concerned, he isn't waiting on me for anything.

Dr. Viner?

Viner: Nothing.

H.M.Jr: Dr. Reifler?

Reifler: Nothing.

H.M.Jr: Dr. Harris?

Harris: Nothing.

H.M.Jr: Dr. White?

White: Mr. Hurley called me up and asked me if I wanted to attend their meeting at 10:00 o'clock this morning at which they are going to discuss the question, possibly, that control of the bank or prospective bank and the question as to whether it shall be an inter-Government bank or an inter-central bank.

H.M.Jr: O.K., sure. What else?

White: That's all.

H.M.Jr: Chief?

Schwarz: Nothing.

H.M.Jr: Harvey? Bell?

Bell: Nothing

H.M.Jr: Did you get my message that just as I was leaving Lehman for the third time the Secretary of War said that we could refinance Panama and raise additional money that way?

Bell: Yes sir

H.M.Jr: Whether that is right or wrong and - and that we ought to finance the new third lock that way and he told the President that and I don't expect you to do it now, but if you would be ready —

Bell: Well —

H.M.Jr: I would like you to sit in at 10:00 when we are working on this budget message for the

President and after that if you would stay behind I want to tell you - I can tell you the rest of what happened.

Incidentally, I gave that letter to the President on the question of the debt limit. He read it carefully, received it graciously and made no comment but kept it. I want to thank you all who worked on it, because the tone in which it is written evidently is quite acceptable to him.

Bell: You did write the Secretary of War in May, 1939, telling him that we had no authority to issue bonds against the Panama Canal. Congress did at one time authorize the issue of Panama Canal bonds and we used about half of the authority, but when the Liberty - Second Liberty Bond Act came along, he picked up that balance and threw it under the Liberty Bond Act and it is there for purposes authorized by Congress in a general manner rather than specific, public expenditures, in other words.

H.M.Jr: As I understand it, this new lock is going to cost two hundred seventy million dollars plus, and there is some twenty-three million dollars in the Bill. Could we write a letter pointing out to the President and saying that if in his message he would say that he wants authority to sell two hundred seventy-three million dollars worth of additional Panama bonds against this lock and that these would be retired out of revenue - is that feasible?

Bell: Why, I suppose it is feasible. I have the letter here. I don't think the additional locks are going to increase the revenue. They are clearly military for the next twenty years and you are paying for them out of revenue based on the original lock. It comes from the original canal.

H.M.Jr: Again the President said, "Well, haven't we retired some of those bonds?"

Bell: Yes

H.M.Jr: Let's put it another way. Is there enough revenue from Panama to issue another two hundred seventy-three million dollars worth of bonds, pay the interest and retire the bond out of the revenue?

Bell: Probably. I would have to check a little.

H.M.Jr: Well, if there is - if that is true, then let's write it. Do you see what I mean?

Bell: Yes

Gaston: Wouldn't you want to explore the prospect of guaranteed bonds instead of direct Government obligations?

Bell: I take it that is what he has in mind.

H.M.Jr: Yes

Gaston: The present Panama is a direct Government obligation.

H.M.Jr: Yes. Make it a Panama Authority like the Holland Tunnel.

Bell: Like T.V.A.

H.M.Jr: Yes

Bell: I thought that is what he had in mind.

H.M.Jr: I don't have that in mind, but he did. While we are doing that, wouldn't we find out that the other places - find out the other places that have authorities to be created and bonds sold against them?

Bell: In other words, repeat the recommendation of last year in the budget message.

H.M.Jr: I am not up to date on that.

Bell: He did that last year.

H.M.Jr: Did he?

Bell: He pointed out the Boulder Canyon Dam as an example.

H.M.Jr: Couldn't we make up all of them, including Panama, that he could make authorities on with this revenue? Could that be done today?

Bell: I think so. I think we have them pretty well —

H.M.Jr: Including the Panama?

Bell: Yes sir.

H.M.Jr: But I told him yesterday, "If you are going to do this, Mr. President, wherever there are revenues, create authorities and issue enough bonds to - so the thing is on a self-supporting basis." I remember that the only one with a conditional authority was Boulder Dam.

Bell: Yes, that is right.

Foley: You mean additional revenues?

H.M.Jr: Where we could issue bonds today, as I remember, was Boulder Dam. Wasn't that the only one?

Bell: It was, completed. Panama Canal is a part of the zone. That is a revenue producing project.

Foley: There is not enough - there won't be enough revenue to support it for some time.

Bell: That is right. There is enough revenue on the T.V.A. to support a hundred million dollars.

H.M.Jr: Lauch Currie sent him a memorandum that has this in mind. The R.F.C. had more capital than it needs. He could reduce the capital of the R.F.C. I don't know whether that is true or not.

Bell: That is a matter of conjecture.

H.M.Jr: I think we could give him a letter on various authorities of Panama, Boulder Dam, or any others to be done during the next fiscal year.

Bell: That is all right.

H.M.Jr: He wanted to pick up eight million dollars very badly - eight hundred million dollars very badly.

Bell: Is that all he needs?

H.M.Jr: That is all he thought he would need, but he is wrong. Harold Smith is sending the figures over.

Bell: Lauch called me and said he would be over here around 10:00.

Foley: I understand there is a meeting at half past 10:00.

Harris: Called off.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE December 20, 1939

TO Secretary Morgenthau

FROM Mr. Cochran

CONFIDENTIAL

Extremely quiet conditions continued to prevail in the foreign exchange market today, although the sterling turnover increased over that of the past few days. Sterling opened at 3.94-1/2 bid, and shortly thereafter the Federal Reserve Bank of New York received an order from the Bank of Latvia to sell about £505,000. Since there was a firm undertone in the market throughout the day, the Federal was able to execute the Latvian order in full without depressing the rate. Sterling was quoted at 3.95 soon after the opening and remained steady for the rest of the day. It closed at 3.94-7/8.

Sales of spot sterling by the four reporting banks and the Federal Reserve Bank of New York totaled £730,000, from the following sources:

By commercial concerns	£ 77,000
By foreign banks (Far East and Europe)	£ 148,000
By Federal Reserve Bank of New York (for Latvia)	£ 505,000
Total	£ 730,000

Purchases of spot sterling amounted to £387,000, as indicated below:

By commercial concerns	£ 249,000
By foreign banks (Europe and Far East)	£ 138,000
Total	£ 387,000

The following reporting banks sold cotton bills totaling £29,000 to the British Control at the official rate of 4.02:

£ 26,000 by the Guaranty Trust Co.
£ 3,000 by the National City Bank
£ 29,000 Total

The other important currencies closed as follows:

French francs	.0223-7/8
Guilders	.5309
Swiss francs	.2243-1/2
Belgas	.1666-1/2
Canadian dollars	11-3/16 discount

We sold $2,000,000 in gold to the Bank of Portugal to be added to its earmarked account.

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

$10,000,000	from the Bank of France
240,000	from the National Bank of Belgium
$10,240,000	Total

The State Department forwarded to us cables from the Consulate Generals in Budapest and Hong Kong which stated that invoices were certified for the following shipments of gold:

$3,048,000	from Hungary, shipped by the National Bank of Hungary to the Federal Reserve Bank of New York. The disposition of this shipment is unknown at the present time.
620,000	from Hong Kong, shipped by the Banque Belge pour l'Etranger to the Bank of America N.T.&S.A., San Francisco.
506,000	from Hong Kong, shipped by the Chartered Bank of India, Australia and China to the Bank of California N.A., San Francisco.
231,000	from Hong Kong, shipped by the Chase Bank to the Chase National Bank, San Francisco.
166,000	from Hong Kong, shipped by the National City Bank to the American Trust Company, San Francisco.
$4,571,000	Total

All of the shipments from Hong Kong will be sold to the U. S. Mint at San Francisco.

Bombay followed the practice of the last few days by setting only one price for silver and that for delivery January 7. The U. S. equivalent, less the import tax, was 43.45¢, slightly lower than yesterday's price.

A despatch on the Dow Jones ticker today from London stated that speculators in Bombay are believed to be acting on the theory that there will be a good harvest this year and that consequent up-country demand for silver will ultimately raise its price. It was also estimated that the Indian Government's reserves of silver amounted to 150,000,000 ounces and that speculative stocks in Bombay now total approximately 50,000,000 ounces. According to this despatch, the Indian Government was understood to have granted licenses for the importation of silver but we do not know under what conditions the licenses were obtained.

Handy and Harman's price for silver today was set at 36-1/8¢, a gain of one cent over yesterday's price. It was reported that the Chase Bank had purchased 150,000 ounces of silver at 36-1/2¢ for delivery Friday. It is understood that Chase intends to ship this silver to India, and in view of the small amount, it may be in the nature of a test shipment. The Treasury's price for foreign silver was unchanged at 35¢ and no purchases were made under the Silver Purchase Act.

The prices fixed in London for spot and forward silver were 23-7/16d and 23-5/8d, both off 1/16d. The U. S. equivalents were 41.63¢ and 41.54¢.

CONFIDENTIAL

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE December 20, 1939

TO Secretary Morgenthau

FROM Mr. Cochran

STRICTLY CONFIDENTIAL

At 11:30 this morning the Minister of Sweden telephoned me. He stated that he had a matter to take up with the Secretary, somewhat along the lines of that discussed a few days ago, but of greater importance. I told him that I would be glad to receive him and go over the proposition and then submit it to the Secretary. The Minister told me, however, that he had definite instructions to see the Secretary, so I arranged with the Secretary to receive him at 11:50.

Five minutes after talking with the Minister by telephone, I received from the Department of State the paraphrase of cablegram #310 of December 19 from Stockholm, in which Minister Sterling reported the information he had obtained from Governor Rooth of the Bank of Sweden in regard to instructions which had been sent the Swedish Minister in the United States to make informal inquiries of the Secretary of the Treasury in regard to financial assistance. I sent a copy of this paraphrase to the Secretary at once.

When the Swedish Minister arrived, accompanied by his Commercial Counselor, Mr. Eriksson, I talked for a minute or two with them in the Secretary's reception room. The Minister told me briefly that he had had a cablegram from his people, and had just finished talking with Governor Rooth, in regard to the possibility of raising $100,000,000 for Sweden with the Federal Reserve Bank of New York. Without mentioning the cablegram which we had received, I inquired whether approach to private banks was envisaged. The Minister replied that he desired to try the Federal Reserve first, and go to private banks only if this should be necessary after seeing the Federal Reserve people.

When the Secretary received the two visitors, the Minister put forward the proposition as one involving a loan of $75,000,000 to run from two to five years, together with a running credit of $25,000,000. When the Minister asked if the Federal Reserve Bank could take care of this, the Secretary expressed his serious doubts. Mr. Cochran explained that the credit transactions which the Federal Reserve Bank of New York at present is making vis-à-vis foreign central banks are limited to credits granted against gold earmarked with the Federal Reserve Bank of New York, and for seasonal purposes. Mr. Cochran said these credits were 90 day operations, renewable two or three times for a similar period.

The Secretary read to the visitors the cablegram which we had received from Minister Sterling. It became apparent in the conversation that the Swedish Minister had not yet been fully instructed as to just what his people desired and, furthermore, had a very vague understanding as to financial matters. The Secretary told the Minister that he would have Mr. Cochran telephone Governor Harrison of the Federal Reserve Bank of New York and find whether or not, or to what degree, his institution could be of possible assistance in the premises.

When the Minister asked the Secretary to look over a list of private banks with the view to recommending certain thereof as the best ones to approach if it was found that private financial aid was required, the Secretary declined, stating that he never did this.

The visitors made an appointment to see Mr. Cochran at 4 o'clock. The Minister explained that he had not had ample time to develop his case before coming to the Treasury. When the Minister and his Counselor returned to see Mr. Cochran at 4 o'clock they said they had talked again with Governor Rooth. Connection had not been perfect and the Minister was not yet perfectly clear as to what was desired. Nevertheless, the Legation had drawn up a memorandum setting forth their understanding as to what was desired. This memorandum, dated December 20, was left with Mr. Cochran and is attached hereto.

Seeing that the visit was principally exploratory, Mr. Cochran made what suggestions he could to assist the Minister. He explained that if the flotation of a public issue was really involved, as the Minister suggested from time to time, this would require the usual private banking services, the approval of the Securities and Exchange Commission, etc. The difficulty of making such an issue in present circumstances with Scandinavian foreign bonds depressed because of the threat to Scandinavia by Russia and Germany, was pointed out. It was further explained that there was no possibility of a Treasury loan unless Congress should specifically authorize it. The agency in Washington which might most appropriately consider the request was the Export-Import Bank whose funds are depleted for the present, but which will endeavor to obtain new allotments after Congress reconvenes. While the Minister thought such sum as might be acquired through this channel would be entirely inadequate for Swedish needs, he did indicate an interest in visiting the Export-Import Bank, and Mr. Cochran telephoned Mr. Pierson and arranged for the latter to receive the Minister after he left Mr. Cochran's office at 5 o'clock.

It will be noted from the attached memorandum that the Riksbank is not prepared to freeze its gold holdings as a collateral for credits. When Mr. Cochran asked the Minister what security his people had in mind, the Minister was shocked that any security should be suggested. Mr. Cochran explained to the Minister at this point that he had spoken with Governor Harrison by telephone, following the visit of the forenoon, and had set forth the Swedish problem. Governor Harrison had found the information insufficient for the basis of any decision, but had expressed his entire readiness to receive such proposition as Sweden might submit, to welcome the Minister or his representative, and even to put them in touch with private banking circles if his Bank could not take care of the proposition. Governor Harrison had confirmed Mr. Cochran's understanding that current credit transactions to foreign central banks are being limited to credits for seasonal purposes against gold earmarked in New York. Governor Harrison added that there had been some credits granted in the past, such as that to the National Bank of Hungary, which had been secured by bills.

When these two types of credits were mentioned by Mr. Cochran to the Swedish Minister, the latter indicated no interest in a credit which involved pledging of gold. As to a credit to be secured by bills, the Minister asked if notes of the Swedish Government debt office could be accepted as collateral. Mr. Cochran

preferred to consult the Federal Reserve Bank before going further into the matter. With the visitors still present, he telephoned Governor Harrison, but the latter was absent from his office, and connection was had with Vice President Knoke. The latter explained that the only bills which could be accepted were commercial bills covering actual business transactions. Consequently, bills or notes of Governments or their agencies were ruled out. Mr. Knoke assured the visitors, through Mr. Cochran, as had Governor Harrison, that they would be shown every consideration if they desired to come to New York for a consultation.

When the visitors then asked Mr. Cochran what he thought of the chance of of their obtaining a loan from private banks, he suggested that they get in touch with those banks which did the bulk of the American business with Sweden, such as the National City, Brown Harriman, the Guaranty Trust, etc. When the Minister asked whether these banks would require security, Mr. Cochran said this would have to be learned from the banks, but that he felt it unlikely, in present circumstances, that banks would undertake any transactions other than their usual credit lines without security.

When the visitors had spoken with the Secretary in the forenoon, they had asked if he would give his approval to the Swedish borrowing in question on the American market. The Secretary said that there was no question of his approval being required. He presumed they would talk with the State Department. When the Minister returned in the afternoon, he had already spoken with Under Secretary Welles, who was familiar with the Swedish proposition, as cabled by Minister Sterling.

When the visitors left at 5 o'clock they were to call at once on Mr. Pierson. Mr. Cochran offered to make an appointment for them with the Federal Reserve Bank of New York if they desired. He advised them that it was not necessary that they consult with the Board of Governors of the Federal Reserve System in Washington. It was explained that the proposition should first be talked over with the Federal Reserve Bank of New York. If something concrete could be developed, this would first have to be submitted to the Directors of the New York bank for approval, and then referred to the Board of Governors of the Federal Reserve System for final approval.

LEGATION OF SWEDEN
WASHINGTON, D. C.

Rec'd. 4 Dec 41 from Sweden Memo by [illegible]

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MEMORANDUM

To facilitate the financing of current trade operations and to create a contingency reserve for future use, the Riksbank contemplates raising a loan in the United States.

It may be pertinent to note that the Swedish purchases in the United States have been exceptionally heavy during the last two years, while the imports from Sweden to this country have not increased to the same extent. The European war has caused a further diversion of trade to the United States and additional large orders will probably be placed here by Sweden in the near future. According to the American trade statistics for October, Sweden was the second largest European market for American exports during that month. For the first ten months of this year, the United States had an active trade balance with Sweden of over forty million dollars. The development of Sweden's foreign trade, if viewed as a whole, does not give rise to uneasiness, but belligerent blockade measures, the seasonal nature of some of Sweden's export trade, together with transfer difficulties have made it desirable to create a currency reserve in the United States to ensure the unhampered flow of trade.

Sweden has also borne the brunt of the international assis-

tance extended to Finland. In relation to the resources of the country immense direct contributions have been made, and Sweden has had to lend a helping hand in financial transactions by the Finnish Government.

The Riksbank had in mind the creation of two types of credit, (a) the establishment of an acceptance credit for twenty-five million dollars in New York, preferably with the Federal Reserve Bank there; (b) a loan of seventy-five million dollars either from the Federal Reserve Bank, the Reconstruction Finance Corporation, or private banks. In neither case is the Riksbank prepared to freeze its gold holdings as a collateral for the credits. The acceptance credit should take the form of a current account to be drawn against by the Riksbank and to run for one year. The loan might run from two to five years.

The Riksbank has, however, not taken any decisions in these matters and would gladly consider any alternative which would serve the purpose in mind, namely to create a currency reserve for the purpose of safeguarding of trade operations between the United States and Sweden. The Riksbank would be particularly glad to consider any advice the Treasury or the Federal Reserve Board might extend informally and confidentially.

Washington, D.C., December 20, 1939.

MEMORANDUM

TO: Secretary Morgenthau December 20, 1939.

FROM: Mr. Duffield

Joe Alsop telephoned me today and made the following three requests:

1. He wished to get from you orally the story of Treasury events following your return from Europe.

2. He asked that he be given the two memoranda, one by Foley and one by White, which you previously had deleted from his notes and he promised not to use them in direct quotations.

3. He again asked for an opportunity to talk to you about the French airplane mission.

Most of our conversation was on this latter point.

Alsop argued that he was not being treated fairly because he had understood that he would have an opportunity to talk his notes over with you and he also argued that it was not sensible from your own point of view to refuse to discuss the story.

I told him that as to the fairness of treatment, I thought there must have been some misunderstanding, since I believed that you made no commitment beyond correcting their notes. I further told him that you alone could decide whether your course was a sensible one and that his private judgment of what was sensible for you to do in your public office could never overrule your own judgment on that matter, since the responsibility was yours and not his. I promised only to notify you that he had renewed his request and he ended the conversation by saying once more not to press you if you were disinclined to discuss the French mission.

December 20, 1939

Memorandum to The Secretary

From Mr. Riefler
WR

Subject: Suggestion of Flexible Formula
for
Settlement of Colombian Debt.

I believe it is important to introduce the principle of flexible debt service into the settlement of debts owed by Latin American countries to foreign bondholders. The economies of these countries are all heavily dependent upon a relatively small number of raw materials which are typically subject to wide price variations. It is inevitable, under the circumstances, that periodically they should be heavily pressed to find foreign exchange for debt service. In the past, these recurring crises have frequently offered an occasion for default on service of foreign debts. While these defaults have sometimes had considerable justification at the time of their occurrence, they have been permitted to run on into periods of improving economic conditions. The result has been heavy losses to bondholders, preponderantly American, and the destruction of the public credit of a great many Latin American countries. Had charges under the debt service been flexible, so that they afforded little or no justification for default in periods of depression, important gains would have ensued both to our economy and theirs.

The application of flexible debt service provisions, however, is difficult from the point of view of the foreign bondholder inasmuch as the bondholder wants to be sure (1) of a fixed annual money receipt on his bond, and (2) of a ready market for its sale at a relatively steady price. These market requirements militate severely against flexible provisions in new bond issues. The fact that we are now preparing to arrange settlements on a considerable number of bonds in default offers an opportunity, however, to attempt to meet the basic economic requirements of these economies by experimenting with flexible provision arrangements.

Colombia

The settlement of the Colombian debt would seem to me an admirable case to begin. To make the example as concrete as possible, I offer for criticism by the group, the following plan for settlement of the National Debt of Colombia. There are now $45,000,000 of these bonds outstanding.

Proposed Plan for Settlement of the National Debt of Colombia

(a) Fixed Service Provision

I propose that interest service on the bonds be resumed immediately at 3 percent. The amount now needed to meet this charge is $1,350,000. I propose that that sum be fixed as an annually recurring charge on the Colombian National budget for service of these debts irrespective of economic conditions, to be continued until all of the bonds have been retired out of the sinking fund outlined below. As these bonds are retired out of the sinking fund, the dollar amount needed to continue interest at 3 percent will gradually decrease to zero. I propose, consequently, that the difference between this diminishing amount needed for interest and the fixed charge of $1,350,000 be used for sinking fund purposes.

This fixed service provision will allow the bondholders a fixed annual income known in advance, and will give the market a fixed promised return on which to evaluate the worth of these obligations. The irreducible charge which it puts on the Colombian Government would be only $1,350,000 U. S., or less than 3 percent of their annual budget.

(b) Flexible Charge Provision

I propose that in addition to the fixed charge of $1,350,000 the debt settlement include a flexible provision by which the Colombian Government would agree annually to turn over to the trustees, for sinking fund and interest arrears, an additional sum in dollars equal to 10 percent of the amount by

which the peso value of their exports each year exceeded 146,000,000 pesos. This figure of 146,000,000 pesos represents the annual average value of Colombian exports from 1933 to 1938. It includes some of the worst years, economically, in Colombian history. Whenever the annual value of exports were equal to or less than this amount, consequently the aggregate debt service on the budget would be limited to $1,350,000 U. S. When exports were in excess of 146,000,000 pesos, the aggregate debt service would equal $1,350,000 U. S. plus the dollar equivalent of 10 percent of the value of that excess. 1/

The following table shows that, had such a provision been in effect from 1933 to 1938, the annual service traceable directly to this flexible provision would have ranged from zero in the two years, 1933 and 1935, to a maximum of $2,091,000 in the very good year 1937. For the six years as a whole, the provision would have produced $4,374,000, an average of $729,000 a year. Had this provision been in effect during this period, therefore, the average annual debt service would have averaged $2,079,000.

1/ This part of the calculation is stated in pesos rather than dollars to avoid providing an incentive in the terms of the debt settlement for fluctuations in the Colombian currency.

Table I

Calculation of Dollar Value of 10 percent of the Annual Exports of Colombia that were in Excess of their Average Exports from 1933 to 1938.

Year	1. Exports (Million of Pesos)	2. Excess, if any, of annual exports, over six year average (Millions of pesos)	3. Dollar value of Col. 2 (Millions of dollars)	4. 10 percent of Col. 3 allocable for interest arrears of sinking fund
1933	73	--	--	--
1934	152	6	3.68	$ 368,000
1935	143	--	--	--
1936	158	12	6.85	685,000
1937	183	37	20.9	2,091,000
1938	168	22	12.30	1,230,000
Total	877			4,374,000
Annual Average	146			729,000

(c) Interest Arrears

I propose that, in return for the bondholders accepting a flat 3 percent rate on their bonds, and refraining from seeking to raise this rate to 4 percent, the settlement recognize the face value of the interest arrears in full, and that one-half of the amount accruing in any year out of the flexible charge provision be used to retire such

arrears, such retirement of interest arrears to continue until all of the arrears on bonds outstanding have been eliminated. No interest would be paid on the arrears, however. In other words the interest arrears would be limited to the face amount of the coupons due, and would be paid as funds became available under the flexible provision. Had this provision been extant during the six years from 1933 to 1938, $2,187,000 would have become available to eliminate interest arrears.

(d) Sinking Fund

I propose that the remaining 50 percent of the amount made available under the flexible service provision be allocated to the sinking fund so long as any interest arrears are outstanding, or thereafter, that 100 percent of the amount accruing under the flexible service provision accrue to the sinking fund. The sinking fund, consequently, would receive funds from two sources, first, from the fixed debt service charge of $1,350,000, representing the difference between this amount and 3 percent of the face value of outstanding bonds, and second, from the amounts above described under the flexible service provision. I propose that this sinking fund be devoted to purchasing and retiring bonds from the market so long as they are outstanding and available at less than par. If under any circumstances they should rise to par, including rights under the interest arrears provision, I propose that they be called by lot and retired at that price.

General Effects

This settlement would seem to be reasonably fair both to the bondholders and the Colombian Government. Had it been in effect during the six years from 1933 to 1938, the annual charge on the Colombian budget would have been as follows:

Annual Debt Service Charge on Colombian Budget
from 1933 to 1938 under Proposed Settlement

	Fixed Service Charge	Flexible Charge	Total Charge
1933	$ 1,350,000	--	$ 1,350,000
1934	1,350,000	$ 368,000	1,718,000
1935	1,350,000	--	1,350,000
1936	1,350,000	685,000	2,035,000
1937	1,350,000	2,091,000	3,441,000
1938	1,350,000	1,230,000	2,580,000
Average	1,350,000	729,000	2,079,000

Certainly these charges could have been paid in the years in which they fell. In bad years they would have amounted to only $1,350,000, while in the good year 1937, when capacity to pay was greatly improved, they would have risen to $3,441,000.

(DEPT:FE:EJB)

Air Mail

AMERICAN CONSULATE GENERAL
American Foreign Service, Hanoi, Indochina,
December 20, 1939.

No. 30

Subject: Shipment of Freight to Kunming during November.

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The Honorable

The Secretary of State,

Washington.

Sir:

I have the honor to refer to my despatch no. 25 of December 9, 1939, regarding the utilization of freight capacity on the Indochina-Yunnan Railway. The Department will recall that mention was made in that despatch (pages 2 and 3) of the diversion of railway cars from the purpose for which originally allotted. I have now received in confidence a summary of the car shipments during the month of November, which is believed to confirm the previously expressed opinion that railway cars allotted for the use of the Chinese Government have been "sold" to private concerns to the detriment of Chinese Government interests.

It would appear that neither the Chinese Government nor the petroleum companies supplying the Chinese Government received their full share, respectively 4/9ths and 2/9ths. Thus, of the 12,900 tons arriving at Kunming (this total does not agree with statistics furnished by the railway) only 6,120 tons were utilized by the Chinese Government and the petroleum companies, as against the 8,600 tons which should have been assigned to their use. In other words, the Chinese Government and the petroleum companies received 2,480 tons less than they should have received. At the same time, shipments of cement (theoretically set at 1/9th) amounted to only 920 tons as against 1,433 tons, a loss of 513 tons. On the other hand, private concerns (entitled to 2/9ths) shipped 5,860

tons

tons as against a quota of 2,867 tons. Accordingly, there can be little doubt but that at least some of the cars destined for the Chinese Government, for the petroleum companies and for cement were diverted to other interests.

The Department may be interested in the categories of cargo shipped by the private concerns. Of the 5,860 tons, cotton shipments amounted to 1,750 tons, cloth 690 tons, automobiles and parts 100 tons, machinery 240 tons, paper 280 tons, cigarettes 130 tons, gasoline and oil 90 tons, iron and steel 410 tons, and miscellaneous 2,170 tons. One of the shipments of miscellaneous cargo was 10 tons of bibles. As a matter of fact, I am informed that missionary and educational interests in China have obtained and constantly demand space for the shipment of their supplies. In this connection, at the present time an American missionary is at Haiphong with a truck and trailer, for the transportation of which he has asked the Chinese Government to supply him with 3 flat cars, or an equivalent of 30 tons of cargo. Demands such as these, in addition to the diversion of railway car allotments, reduce substantially the amount of much needed cargo which can be transported to China.

I must say that conditions are now much better insofar as the diversion of railway cars is concerned. A commentator (a large oil shipper) recently reported to his company:

> "It is our considered opinion that the distribution of railway cars has never been handled strictly as agreed. It is a well known fact to everyone who has been in Haiphong or Hanoi for any length of time that railway space could be obtained if a sufficient monetary inducement was offered, although in some, but not in all, cases the shipper had to forward his stock either by truck or water to points other than Haiphong in order to get the cars.
>
> "We should like to add that since December 1st there has been a remarkable improvement and for the first time we feel the distribution of cars, at least as far as the oil companies are concerned, is being properly handled."

It is believed that Mr. Chen Tsu Chen (C. T. Chen) is largely responsible for the improvement noted by the above commentator. His efforts are enabling the Chinese

Government

Government to reap the maximum benefits from the increase in railway freight capacity.

In summary in the past there has evidently been a not inconsiderable amount of "selling" cars allotted for the use of the Chinese Government; an effort is being made to do away with this more or less open scandal; and fortunately this effort is resulting in the Chinese Government obtaining more space for the shipment of needed supplies.

Respectfully yours,

For the Consul at Saigon,

CHARLES S. REED II,
American Consul.

Original and 2 copies to the Department.
Copies to Embassy, Chungking and Peiping.
Copies to Consulates, Kunming and Saigon.
Copy to Consulate General, Hong Kong.

811.4

CSR:cer

December 20, 1933.
9:31 a.m.

H.M.Jr: Hello. Hello.

John Trapnagen: Hello Mr. Secretary.

H.M.Jr: How are you?

T: I'm fine. I hope you're well.

H.M.Jr: I'm very well. I just wanted to tell you that we haven't made any progress around here and to use the vernacular, I'd like you to sit tight and keep your shirt on.

T: You'd like me to do what?

H.M.Jr: Keep - sit tight.

T: Oh, right. I'll be glad to do that.

H.M.Jr: And we're doing some work down here but I think if you and your group would just be a little patient.

T: Very good, we're perfectly willing to wait. I haven't said a thing to the Colombians.

H.M.Jr: Not - well I think that for the moment it would be just as well not to approach them but if they approach you it's all right.

T: Yes.

H.M.Jr: If they want to see you I'd certainly see them but I don't think I'd make any advances to them for the time being.

T: Very good. Well I'll sit perfectly tight until I hear from you.

H.M.Jr: Fine. If you hear anything give me a ring.

T: I will. I take it that ultimately I will hear something from you.

H.M.Jr: Oh, definitely.

T: Very good. We'll sit tight until we get word from you.

H.M.Jr: We're trying to do a little work at this end.

T: Very good. Well I hope you're going to have a very

nice Christmas.

H.M.Jr: Same to you.

T: Thank you very much.

H.M.Jr: I'll be in the country.

T: Very good.

H.M.Jr: Goodbye.

T: Goodbye. Thank you for calling me.

December 20, 1939.
10:00 a.m.

H.M.Jr: Hello.

Jesse Jones: Hello Henry.

H.M.Jr: I hear you're a little under the weather.

J: Yes, it kind of knocked me out the other day.

H.M.Jr: Well, what knocked you out?

J: Well I had had a tough day, the day I saw you last.

H.M.Jr: Oh, I'm sorry.

J: Next morning I was hardly able to get out, but I was up a good deal yesterday and I'm still at home today.

H.M.Jr: I see.

J: I'll get that thing over to you.

H.M.Jr: Yes.

J: Probably during the day Henry.

H.M.Jr: Good.

J: I don't see a great deal of point in hurrying it because -

H.M.Jr: In doing what Jesse?

J: In hurrying it .

H.M.Jr: In hurrying it.

J: For the reason that I'd like Henry to kind of - when Congress gets here, which will be pretty soon, to kind of get some, to see if we can get some sense of the feeling up there.

H.M.Jr: Yes.

J: On matters of this kind.

H.M.Jr: I see.

J: Although I don't wish to delay this matter.

H.M.Jr: No.

J: I want us to go right along and keep on the negotiations.

H.M Jr: I see.

J: But I do feel and particularly I've been looking over this China thing while I'm here at home, and I think it's going to take the best we've all got to get what we need to have and get this thing without - and get it from Congress, and I believe we can get it.

H.M.Jr: Well I think this. I think we ought to keep it moving and - whatever the normal rate of speed would be.

J: I agree to that.

H.M.Jr: And I think that we can move along to keep - I mean, answering them up to the minute, I think there would be plenty of delay on the other side anyway.

J: I think you're entirely right about that.

H.M.Jr: And I don't want the State Department to feel that we're holding it up.

J: Well I'll get a memorandum to you today or by - in the morning anyway.

H.M.Jr: Thank you Jesse.

J: All right. Thank you.

H.M.Jr: Goodbye.

J: Goodbye.

December 20, 1939.
11:32 a.m.

H.M.Jr: Hello

Jerome Frank: Hello, Jerome talking.

H.M.Jr: How are you? Henry.

F: Yes, sir. Two - I've got two suggestions on lawyers for you.

H.M.Jr: Oh, good.

F: One of them is a man that we lost with great reluctance, did everything to keep him.

H.M.Jr: Yes.

F: To Thurman Arnold. Neil Andrews. He was our top trial man, he left us because Thurman offered him more money and more activity.

H.M.Jr: Yes.

F: He had been Assistant District Attorney in Atlanta, where he made a marvellous record.

H.M.Jr: I see.

F: I don't think you could get a better fellow.

H.M.Jr: Good

F: We wanted him for - we wanted to keep him here to handle Giannini when John Rogge quit but he left us.

H.M.Jr: I see.

F: Now the other man is your own fellow, Joe O'Connell.

H.M.Jr: Oh yes.

F: He's done a marvellous job up at TNEC.

H.M.Jr: I see.

F: The only reason I'd hate to see you use him is that he helps us so much up there that we'd - it'd be a terrible loss.

H.M.Jr: I see.

F: But Joe, I'm sure, could build a record, and he's a tough guy.

H.M.Jr: Uh-huh.

F: But pleasant, I mean he's always very sweet and nice, but you can't push Joe around.

H.M.Jr: Good.

F: And Neil Andrews is another one. I think Neil, probably the two, has had much more trial experience.

H.M.Jr: I see.

F: And I think - I don't see how Thurman could refuse to let you have him.

H.M.Jr: Well thank you for thinking about the problem.

F: All right. Thank you.

H.M.Jr: Are you following this NLRB case with Bank of America?

F: No. I didn't know they were in it.

H.M.Jr: Oh yes.

F: Is that going on now?

H.M.Jr: Yes.

F: Oh, I'll have to watch that.

H.M.Jr: Yes, it is. It's right on now in San Francisco.

F: Oh is it, I didn't know about that. Thanks very much for telling me. Oh by the way, I was out of town when the British called on you.

H.M.Jr: Yes.

F: Did they give you any explanation, why they left?

H.M.Jr: Well I want to sit down and talk to you about that whenever you've got time because I'm quite upset about it, quite upset about the role that Kennedy has played in that.

F: Well when I, give you a ring perhaps, come over tomorrow.

H.W.Jr: Any time that suits you.

F: All right, thank you.

H.W.Jr: Just give me a little advance notice.

F: Thank you.

H.W.Jr: Will you?

December 20, 1939.
2:25 p.m.

86

H.M.Jr: Hello

Operator: Governor Hill.

H.M.Jr: Hello

Governor Hill: Hello

H.M.Jr: Hill?

H: Yes.

H.M.Jr: Morgenthau.

H: Yes, sir.

H.M.Jr: Are you still Governor?

H: Well I haven't heard.

H.M.Jr: Well now listen fellow -

H: What's that?

H.M.Jr: I'm going over there at 11:30 tomorrow morning to see Wallace.

H: Yes.

H.M.Jr: On the President's request.

H: Yes.

H.M.Jr: So stay put until 11:30 will you?

H: Well I've already sent my resignation to Early.

H.M.Jr: Well - how many times have you sent it?

H: What's that?

H.M.Jr: Once or twice?

H: Well let's see, it's twice.

H.M.Jr: Oh did you send it the second time?

H: That's right.

H.M.Jr: Oh! When did you do that?

H: This morning.

H.M.Jr: Oh! Well there isn't much use of my going over there tomorrow, is there?

H: Well I don't know, it depends on the President's attitude on the thing.

H.M.Jr: Well he's asked me to see Wallace and -

H: In other words - in other words, frankly, Mr. Secretary, I've just been in an impossible position on that thing. I mean I - I sent one over there frankly, and then they requested that the thing be rehandled which, as far as I was concerned, indicated a direct request from the top, and although I was refused an audience on the thing I just didn't feel - I felt I'd be in a completely impossible position in view of the statement which Mr. Early made, which presumably came directly from the top to just say, "Well I'm going to sit here until you throw me out".

H.M.Jr: Uh-huh. Well -

H: I'd like to go over that with you sometime, when this thing is over, but I just felt that - in other words, I didn't step out on Wallace's request, I asked for an audience with the President on the thing, then word came back to me that the President would see me after I had resigned.

H.M.Jr: Uh-huh.

H: Well then I didn't take that at its face value, but I sent over a letter which indicated that at their request I was tendering my resignation. Then I was called from the White House, called by Steve Early, and he said they'd like to have me change that, which again indicated and frankly he said it had been discussed with the President. While he didn't say the President requested the change that he, Early would like to have the thing changed. I mean just one of those things that in the seven years nobody had ever gone out under those circumstances.

H.M.Jr: Sure.

H: Well I didn't want - I didn't want this thing to get in a position where it was a personal issue.

In other words where I'd broken all, shall I say diplomatic usage on the thing, but it did seem to me, in view of Early's request and the fact that he had discussed it with the top that there could be absolutely no doubt about the President's concurrence in the matter.

H.M.Jr: Well, anyway I'm going over there at eleven-thirty tomorrow.

E: Yes.

H.M.Jr: And we'll see what will happen.

E: Yes. Well I just, I want to say this, as far as I'm concerned, and the Farm Credit is concerned, I certainly appreciate what you tried to do on this thing.

H.M.Jr: Well Farm Credit, I think should go on and I'm very much interested in it, I think it's something cooperative credit should, must continue.

E: And I -

H.M.Jr: That's what I'm interested in.

E: Yes well I know that, and of course that's all I'm interested in. As far as I'm concerned there's nothing personal in this damned thing. If it were set up as an independent agency with somebody else to run it, if they don't think I can run it, why hell, I'd be only too glad to step out. But this other thing is a complete - another kind of an animal.

H.M.Jr: That's right.

E: And of course I don't know, I could be entirely wrong but I think it's going to be most unfortunate for the President's standpoint because I don't think this fight is going to stop here by a jugful.

H.M.Jr: O.K.

E: O.K. Thank you Mr. Secretary.

H.M.Jr: Goodbye.

December 20, 1939.
3:06 p.m.

Laughlin Curtie: Hello Mr. Secretary.

H.M.Jr: Hello Lauch. Laugh, I've got a hell of a day, but if it's something that's urgent I'll make room.

C: No, no, it's not at all urgent. It's not official, it's more personal really. I want to have a chance just for about fifteen minutes to talk some things over with you.

H.M.Jr: Uh-huh.

C: So it can wait until you have plenty of time.

H.M.Jr: Well -

H.M.Jr: You want to clean up - when - how soon?

C: Well -

H.M.Jr: How about staying behind tomorrow?

C: That would be fine.

H.M.Jr: How would that be?

C: That would be fine.

H.M.Jr: Would that be O.K?

C: If you had a few minutes then, yes.

H.M.Jr: What's that?

C: If you had a few minutes then.

H.M.Jr: I'll have all the time you want.

C: Fine.

H.M.Jr: If you had said you wanted to do it today, I'd make room.

C: No, no, it's not that urgent at all.

H.M.Jr: All right

C: Thank you so much.

December 20, 1939.
4:11 p.m.

H.M.Jr: Hello.

Henry Wallace: Hello.

H.M.Jr: Henry.

W: Yes.

H.M.Jr: I've just read on the ticker that Hill has resigned.

W: Yes.

H.M.Jr: And Mr. Black has been appointed.

W: Yes.

H.M.Jr: So there's no sense of my coming over tomorrow.

W: Oh, I see.

H.M.Jr: So let's skip it. I'll see you in the afternoon.

W: Yes. All right. I didn't know - as I said I didn't know that was coming out today at all.

H.M.Jr: I see. Well, I don't know what's been going on but there's certainly no use of my wasting my time or coming over.

W: Yes, all right Henry.

H.M.Jr: Goodbye.

PARAPHRASE OF TELEGRAM SENT

TO: American Embassy, London, England

DATE: December 20, 1939, 12 p.m.

NO: 1651.

The following is confidential for Butterworth from Secretary Morgenthau.

Mr. Arthur B. Purvis has sent me a letter reading in substance as follows:

Mr. Butterworth telephoned to Mr. Purvis before he left for the other side, advising that it was understood there is an acute shortage of extruded tubes and bars of aluminum which is delaying the aircraft production program of the British Government. Mr. Butterworth said that it might be possible to help in overcoming the shortage at this end.

Will you please let me know by telegram who requested you to contact Mr. Purvis in this regard.

HULL
(FL)

EA:LWW

December 20, 1939

To: Dr. Feis

From: Secretary Morgenthau

Will you kindly send the following cablegram:

"AMERICAN EMBASSY

LONDON

Confidential for Butterworth from Secretary of Treasury.

I am in receipt of the following letter from Mr. Arthur B. Purvis quote Before he left for the other side Mr. Butterworth telephoned advising it was understood there is an acute shortage of aluminum extruded bars and tubes which is holding up the British Government's aircraft production program stop He stated it might be possible to assist at this end in overcoming the shortage stop End Quote Please cable me who asked you to make this request of Mr. Purvis."

December 20, 1939

931

To: Dr. Feis

From: Secretary Morgenthau

Will you kindly send the following cablegram

"AMERICAN EMBASSY

LONDON

Confidential for Butterworth from Secretary of Treasury.

I am in receipt of the following letter from Mr. Arthur B. Purvis quote Before he left for the other side Mr. Butterworth telephoned advising it was understood there is an acute shortage of aluminum extruded bars and tubes which is holding up the British Government's aircraft production program stop He stated it might be possible to assist at this end in overcoming the shortage stop End Quote Please cable me who asked you to make this request of Mr. Purvis."

December 30, 1939

To: Dr. Feis

From: Secretary Morgenthau

Will you kindly send the following cablegram:

"AMERICAN EMBASSY

LONDON

Confidential for Butterworth from Secretary of Treasury.

I am in receipt of the following letter from Mr. Arthur R. Purvis quote Before he left for the other side Mr. Butterworth telephoned advising it was understood there is an acute shortage of aluminum extruded bars and tubes which is holding up the British Government's aircraft production program stop He stated it might be possible to assist at this end in overcoming the shortage stop End Quote Please cable me who asked you to make this request of Mr. Purvis."

12-20-

FROM: MR. GASTON'S OFFICE

95

TO: ~~The Secretary~~

[illegible] Arauca, which left a [illegible] Florida, she observed this [illegible] the Florida coast close [illegible] chased by a British cruiser. [illegible] cruiser fired a shot across the [illegible], that vessel then being estimated [illegible] miles east of Fort Lauderdale. ~~The [illegible] of violation [illegible] claim the [illegible] have been.~~

WKB

The Arauca immediately headed [illegible] land and got safely inside [illegible] 3-mile limit. The cruiser [illegible] retreated the line. Arauca will [illegible] probably dock in to Fort Lauderdale, Tenn.

12-20-39

FROM: MR. GASTON'S OFFICE

96

TO: The Secretary

3 p.m.

The tanker Arauca (Ger) is now at the entrance to Port Everglades awaiting a pilot. Miami air station is keeping close observation.

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE Dec. 20, 1939.

TO CONFIDENTIAL FILES

SUBJECT TELEPHONE CONVERSATION WITH BANK OF ENGLAND.

FROM L. W. Knoke

97

I telephoned Mr. Bolton at 12:17 p.m. today. I did not know, he said, what a change it was again to speak to some one who was in a free market. I referred to the better tone of sterling in recent days supposedly due to Japanese buying although nobody seemed to know how much or for what purpose this Japanese buying was. I told him of the £500,000 order we had received from Latvia today.

I then referred to Mr. Cattern's cable of the 14th authorizing us to allow Mr. Morgenthau personal and confidential access to the Special Account A. I mentioned that Mr. Johnson of the Commission here had asked that we give them formal advice of the amount now placed at the disposal of Messrs Purvis, Johnson, etc. and of any future remittances. I assumed, I said, that it was in order for us to comply with Mr. Johnson's request, which seemed a logical one but that we did not want to act without the Bank of England's approval. There was no objection on their part, Bolton said, as long as we were willing to do it. We also intended, I continued, to send to Mr. Purvis in New York and possibly also to Mr. Osborne in Ottawa periodical statements of Account A, assuming again that this was satisfactory to the Bank of England. Bolton replied that that also was entirely in order and he would confirm the whole matter to us by cable.

As regards the situation in London, he thought the control, at least as far as he could see, had settled down to wartime conditions.

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE Dec. 20, 1939.

TO CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH BANK OF ENGLAND.

FROM L. W. Knoke

98

There was no longer any delay. The general procedure was working smoothly and all applications for foreign exchange made during one day were attended to the same day. Probably early next year they would issue new regulations concerning the transfer of sterling from domestic to foreign accounts (that is, making such transfer subject to a special license) ~~and transfers~~ which, of course, would be done for the purpose of tightening up the control, getting better supervision over the import trade and restricting the amount of sterling available for sale in outside markets. Whether the plan would succeed or not remained to be seen.

I referred to the very substantial payments (more than $100,000,000 during the second half of November, if I remembered correctly) ordered by them to the debit of their regular account with us to commercial banks in this market for account of commercial banks in London. Just what did they represent? Originally I had assumed that they were made in settlement of sterling contracts for forward delivery entered upon just prior to the outbreak of the war; if that were so I was puzzled by the fact that these payments were continuing. Bolton replied that the November payments were exactly as I has surmised, that the forward contract position had now been cleared up and that no such contracts were outstanding. Payments now ordered from day to day were to the extent of from 70% to 80% in payment of imports. They covered the imports of the whole British Empire from the so-called

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE Dec. 20, 1939.

TO CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH BANK OF ENGLAND.

FROM L. W. Knoke

"dollar area" other than the purchases made in this country by the British Purchasing Commission for which latter payments would be made over Account A of the Bank of England. I thanked Bolton for this very interesting information.

LWK:KW

December 20, 1939.
10:00 a.m.

100

RE BUDGET MESSAGE

Present: Mr. Hanes Mrs. Klotz
Mr. Gaston
Mr. Bell
Mr. White
Mr. Blough

Hanes: The President at his press conference yesterday was a little bit confused, I think. We can't find the five hundred fifty million. He said that Congress owes Treasury five hundred fifty million. Our figures are somewhat less than that. We will get to that in the second part of it. Four hundred thirty-seven million, I think, is our figure.

H.M.Jr: Let me just explain to Bell and White. I haven't had a chance.

Yesterday at luncheon the President asked me to have Treasury prepare a statement for him on taxes. What we are saying is quadruple confidential. The nearest I can make out, what he had in mind, his ultimate aim, I think, was, he is trying to fix it so the deficit is just under two million, you see. Now, in order to arrive at that, he was trying to put pressure on me to increase our revenue, which I can't do, because after all somebody in the Treasury has got to go up and defend that and I can't do that, because - well, we have just got to put in Congress' lap all the statistics and everything else showing how we arrived at it, and I just can't raise it all over two hundred or three hundred million to please the President.

So he had in mind yesterday when I saw him the figure of trying to get an additional five hundred million revenue, because as of yesterday his figures were - as of last Friday, you see, he called up Harold Smith. He thought that the deficit was 2,6. It is nearer 3,1 or 3,2, as we figure it. Therefore, he had in mind what should he say to Congress in connection with raising five hundred million dollars, you see. He told the Cabinet and me that we were two or three hundred million dollars short and he would have to get that somewhere. So he wanted five hundred million from revenue and two or three hundred million, "If I sunk the Navy,"

to use his own expression. I told him that I thought it was a mistake to make recommendations as to specific taxes, but he and I talked it out and agreed that the taxes - if there were new taxes they should fall on those who could best afford to pay them and should not fall on that group who could least afford to pay them.

Am I repeating it about right?

Then I asked Hanes whether he could get in touch with the situation. I can't take my mind off it. I thought I would send a message to the President that we were ready any time to see him, that I would rather see him with Hanes Friday morning, because by that time we would have some kind of a report from this fiscal and monetary committee as to processing tax, you see, because his definition of what he didn't want eliminates the processing tax.

Hanes: Whether he will agree with us or not, this is something for all of us to shoot at. We wanted to put him in the position of letting Congress determine what kind of tax, instead of having him go out on the limb and say, "I recommend this kind of tax, or that kind of tax," at the outset. Do you want me to read this out loud?

H.M.Jr: Yes.

Whose typewriter is this, is it in your office?

Blough: Yes.

H.M.Jr: Would you mind asking Mrs. Klotz what type we use? I can't read this.

Hanes: "In view of the special expenditures needed to put our national defenses in the condition required to safeguard us in a world at war, it is desirable to consider the position of the Federal revenues. While drastic measures would be unwise we can and should increase our tax revenues moderately, and the budget for 1941 has accordingly been drawn to show the amount of five hundred thousand dollars to be raised by additional taxes. I feel confident that this sum will prove adequate to cover such

additional armaments as will be required in the next fiscal year.

"Since it is the function of Congress to determine how revenues should be raised, I leave the choice of particular tax measures to its judgment. However, I believe that I am expressing the sentiment of the country when I suggest that measures adopted for raising additional tax revenues should reflect two objectives. The first is that the taxes should come from the portion of the population which can best afford to pay them, with due regard to the taxes they now pay to the State, local and Federal Governments. Care should be taken especially to design the taxes so that they will not fall on that portion of the population which can least afford to pay them. The second objective is that the taxes should have a minimum of disturbing effects on the further recovery and smooth working of the economy and accordingly should avoid as far as possible the discouragement of productive activity and employment. During the 1938 Congressional session I specifically called to the attention of Congressional leaders that if Congress appropriated funds for parity payments for agriculture it should finance them by providing new revenues. An appropriation of two hundred twelve million dollars was made for parity payments for fiscal 1939. No revenues were provided, but Congressional leaders promised to provide them at the 1939 session. In my message of January 3, 1939, accompanying the 1940 budget, I again called attention to the fact that appropriations be matched by additional revenues. The amount of two hundred twenty-five thousand dollars was appropriated for fiscal 1940. No additional revenues were provided for either of the two appropriations. Congress has thus appropriated four hundred thirty-seven million dollars for parity payments for which it has provided no source of funds. I again point out that ways and means should be found of financing in full by new revenues such amounts for parity payments as the Congress may decide to appropriate."

H.M.Jr: This is the first thing I want to clear up for myself. I don't understand it. Does the President of the United States, after what he said yesterday, want five hundred million dollars additional revenue from the processing tax or does he want another five hundred million dollars? In other words, does he want five hundred million or does he want a billion?

Hanes: I tell you what I - I think he keeps shooting at five hundred million dollars all the time. Yesterday he mentioned five hundred million. He has mentioned that before about four different times. I think his total is about five hundred million. The way this thing is written, this would be interpreted now as asking the Congress to produce five hundred million and if you decide to pay parity payments to the farmers, for whatever amount you may decide, then I would put the responsibility upon the Congress of raising that amount of revenue in addition to raising the five hundred million for which he is asking for national defense. That would do what you said yesterday, that would get the eight hundred million dollars. You said he wanted to find the —

H.M.Jr: The back payments.

Hanes: No, we are not asking for that. This doesn't ask for that.

Bell: You say, "If appropriated," don't you?

Hanes: You see, we point out that they owe us four hundred thirty-seven million dollars, just as he did here, but —

H.M.Jr: Four hundred thirty-seven?

Hanes: For thirty-eight and thirty-nine, but we say in the last sentence, "I again point out that ways and means should be found of financing in full by new revenues such amounts for parity payments as the Congress may decide to appropriate." In other words, he is putting the responsibility

on Congress. "If you appropriate," then tax.

H.M.Jr: But John, I am going to keep arguing. That would be as to future parity payments.

Ramey: That is right.

H.M.Jr: Check. We agree on that. But he didn't say that. What he said yesterday was, "Congress owes me five hundred fifty million dollars for two back parity payments." Am I right?

Bell: Well, I think he is a little off in his figures. I think Johnny is right in his figures.

H.M.Jr: Johnny is correct, but let's say - didn't the President say that - you see what I am getting at?

Bell: That is the way I read the President's report, that he said Congress owed him for parity payments.

Ramey: He said that he recalled that in 1938 Congress appropriated two hundred fifty million for farm benefits and passed a joint resolution that at the next session it would enact a tax to bring in that two hundred fifty million. We can't find that joint resolution.

Bell: There wasn't any. It was a promise of the leaders just before they went out. It was right at the close of the session.

H.M.Jr: Do the leaders admit that?

Bell: It is in the record. "We can give consideration to the tax matter in the next session, we haven't got time this session to consider the tax program." There was no resolution.

Ramey: This is not correct, because they didn't pass a joint resolution, as far as we can find out. Then he says that last year Congress appropriated three hundred million dollars for the same purpose. The President said he figured that Congress owes the Treasury five hundred fifty million dollars.

Bell: What he is doing is including one hundred million or approximately one hundred million for surplus commodities, which is not part of the parity payment program. He says three hundred million.

H.M.Jr: Let me - I am just thinking of what I will telephone the President now. "Now, Mr. President, what I want to ask you is this: Do I understand that, one, you want Congress to make up the amount of the two parity payments which they have voted, which would amount to four hundred thirty-seven million?" Is that right?

Bell: That is right.

H.M.Jr: If he says, "How do you get at that," then which was the first one, the thirty-nine?

Bell: Thirty-eight.

Hanes: Thirty-eight. They appropriated two hundred twelve million.

H.M.Jr: In 1939?

Hanes: Two hundred twenty-five.

H.M.Jr: "Do I understand, Mr. President, that you want Congress to make up the four hundred thirty-seven million dollars that they owe you for the two parity payments and, three, if they vote another parity payment, do you want them to provide the taxes for that?"

Do you get it so far?

"Now, do I understand, Mr. President, that in addition to that you want sufficient money of new taxes to pay for whatever is in your "B" budget for armament or do you simply want either the money that Congress owes you for the parity payment or enough money to pay for the "B" budget," so that there is really three things.

Wouldn't that be all right, the three alternatives?

Bell: That lays down certain of the three things that are probably in his mind at the present

time, but there is some doubt about —

Hanes: The way this is written now, he would be asking Congress to provide five hundred million dollars for armaments, number one. Number two, "If you appropriate for parity payments, then set up whatever sum of money in the future in taxes to pay for that."

H.M.Jr: But how about the back payments?

Hanes: We are not saying anything about that. We are not asking for that.

H.M.Jr: But that is what he said yesterday. If I could get that, wouldn't that be clearing it up?

Hanes: We certainly should have it, if he has got in mind getting that back plus the two twenty-five to be appropriated plus the five hundred million.

White: I should be inclined to think that he would want that, because he would like to place a little more responsibility upon Congress by having increased the public debt by five hundred million, which he would do when he brings it to their attention, that he acquiesced to the parity payments on the understanding that they would consider past taxes later.

Hanes: My understanding is, Harry, that the two twenty-five is cut out of the budget so that he can't say that he has included this in the budget unless he puts back —

White: I am speaking of the last two budgets. The outstanding debt is higher by four hundred thirty-seven million dollars, by virtue of the fact that Congress did not, in the President's opinion, keep to their agreement and he is reminding them of that agreement.

H.M.Jr: May I interrupt you? I can either get him now or have great difficulty getting him. Do you want to say something?

Blough: There is one other possibility.

H.M.Jr: Excuse me, Harry.

Blough: And that is that the five hundred billion is in here and then he will say, "If you people had given me that four hundred thirty-seven, why, I would have the five hundred, I wouldn't need to ask for it." He might have had that in mind.

H.M.Jr: You see, what he needs if he is going to do the thing with the figures we have got now, he needs the four thirty-seven. He needs the new thing for '40 and he needs the five hundred million. In other words, his deficit is over three billion. If he is going to bring it below two, he needs all three of them.

Hanes: Sure he does.

H.M.Jr: But there is no use - there is no use of us arguing what we think he wants if we can find out.

Bell: There are two questions I raise before you telephone. One is that you keep throwing back into the laps of Congress this parity thing and asking for taxes, which makes Congress mad and they have said on the floor a good many times, "Well, the President can send up any kind of a budget he wants and show a deficit of two billion or four billion and he never asks for taxes, but the minute Congress increases taxes by two or three hundred million dollars we have got to have taxes." That is one thing.

The other is that you are asking for an increase of taxes of five hundred million to meet your "B" budget. There was also a "B" budget last year. That is hidden, however.

H.M.Jr: I told him that you and I said that if he wanted the "B" budget, the "B" budget ought to be over a billion.

Bell: If taxes are popular for national defense purposes, then he could get it all —

E.R.Jr: I told him that. The last year it was five hundred. You add five hundred to this year, so it is really a billion and fifty dollars. So his answer to that was, "Well, no, we have to spend a billion and a half on arms and make up what Mr. Hoover didn't do." I didn't want to get into any argument on it. I told him that last year they had a special armament budget and that you and I felt that the normal armament thing is a billion dollars.

Bell: And his whole argument in his supplemental message was because of world conditions.

E.R.Jr: Personally, I don't know how anybody else feels, not only if he asks for this will he drive us into a certain plan - "O.K., if that is what you want, we will give you a certain plan - " but I think he is on much safer ground everywhere than if he said on account of the world conditions, "I need 'X' hundreds of millions of dollars extra for rearmament purposes and as long as this is going on I am going to put a special tax on the country for that and we will label it the rearmament tax." Just as soon as world conditions improve, that tax would go off.

Bell: I think that would be popular.

Hanes: That would be popular as the devil. That would go.

E.R.Jr: Last year I even talked about a special stamp with a battle ship in one corner and something for the Army in the other and an aeroplane in the other and that something or other, the people would know when they pay this it is going for aeroplanes and things - I agree with Dem, if you put this God damned four hundred thirty-seven million back in Congress' laps, they will say, "O.K., we will give you this certificate."

White: Isn't he going to push the certificate plan?

E.R.Jr: I understand he is supposed to it.

White: You do?

H.M.Jr: Sure. How can he help but be opposed to it, Harry, if he doesn't believe in putting any more money on the lower bracket? And that is where the thing falls.

White: It is better, certainly, than the processing tax.

Blough: Oh my, no. It is the same thing, only worse.

White: I think it is better. I don't want to argue that here.

H.M.Jr: Have you seen his (Blough's) study? He has got a swell study and you ought to see it. I think you are wrong there.

White: I think that is what is going to go through, too. I think the President is probably going to end up by backing that. However —

H.M.Jr: Well, we are in the process of studying it for him. There is no use jumping to any conclusions.

Bell: You might have some difficulty getting taxes authorized in the next session which will materially affect your 1941 budget.

H.M.Jr: Would you mind letting me just sort of clear my mind for my conversation? Just hold it.

Do you know how much the "B" budget is?

Bell: No, I don't.

(pause).

H.M.Jr: Now, do you want to talk?

Bell: I just said that I thought it might be difficult to get taxes through the next Congress which would materially effect the 1941 budget. I shouldn't think they could make them retroactive on the income taxes.

White: A tax such as the Secretary suggested with that kind of a buildup might well begin January 1, 1940.

Bantum: You mean a sales tax?

Ritter: No, any kind of a tax. I mean for that purpose, designated as a special tax for special conditions, would justify making it retroactive, which ordinary taxes - I mean it doesn't matter where it was applied as much as —

Bantum: We assume if it were an excess profits tax or State tax, we assume it would be effective January 1, 1940, but your revenue wouldn't come in during the fiscal year 1941. That is, you would only get about thirty or fifty-five percent of an income tax in the fiscal year 1941, even though it applied the first of January, which we are assuming it would apply.

Bell: If you had miscellaneous taxes they would take effect probably sixty days after the act.

H.M.Jr: Well, I think before - talking for myself, to be very intelligent about this, I want to know what he wants. There is no use trying to guess at it.

Bennett: We are in the dark. We have called here for seven hundred twenty-five million dollars, provided the parity payments stay at two hundred twenty five.

Blough: Five hundred of which would be in the budget and two hundred twenty-five of which would be outside the budget. It wouldn't affect his budget deficit.

H.M.Jr: Two hundred twenty-five?

Blough: Yes.

H.M.Jr: Why not?

Blough: Because he isn't putting the parity payments in the budget, either.

Bell: It would only be affected in case Congress added the parity payments.

H.M.Jr: It wouldn't figure on either side.

Blough: No.

H.M.Jr: I don't see how you get the seven - five hundred million new taxes.

Hanes: And if, we say, and if you put back this parity payment, which you have taken out of the budget, then provide the revenue.

Gaston: In either event only five hundred will apply on the deficit.

Blough: That is right.

H.M.Jr: Well, one thing - have you gentlemen got documentary evidence on the two hundred twenty-five and the two hundred twelve, just what did the President do?

Blough: I have documentary evidence on the two hundred twenty-five right here. Here is the statement he issued after he signed the Bill. He says, "Notwithstanding all that I have said, an additional sum of two hundred twenty-five million dollars has been added to this year's Bill. No provision has been made by the Congress for raising the additional revenue needed."

We don't have the documentary here on the two hundred twelve.

Bell: We couldn't find a similar statement when he signed the Agricultural Bill for 1935.

Blough: I suppose we could have, but we only had a few minutes and we got what we could.

H.M.Jr: Do you want to go through your stuff, Dan?

Bell: He says that they passed a joint resolution that at the next session they would consider an appropriation. There is no joint resolution.

Hanes: We can't find any.

Blough: That is what Danny said.

H.M.Jr: I think we ought to have the documentary evidence.

Blough: It says, "Gentlemen's agreement" in this statement. This is what the President said on June 30, 1939, last June. He said, "In 1938 I approved a large addition, chiefly for parity payments to farmers with a definite gentlemen's agreement that the Congress at the beginning of the following session would enact some form of tax to make up the extra appropriation."

H.M.Jr: That is '38?

Blough: He says in '39 that that is what happened in '38.

H.M.Jr: I see. Well, I still think the chances of collecting four hundred thirty-seven are just nil.

Blough: That is a dead horse.

White: That his chances of getting five hundred million more are better if we also plug for the four hundred thirty-seven and in any case he can put a little more responsibility on Congress for political purposes. He can say, "I O.K.'d that only with a definite understanding which you have broken." I don't know whether the gentlemen's agreement was that they would consider taxes or whether they would make it up. They may have said, "Sure, we had a gentlemen's agreement. We considered it and we decided it wasn't appropriate."

Gaston: What Dan says —

H.M.Jr: That it wasn't gentlemanly. "We decided it wasn't gentlemanly."

Gaston: What the Congressional records show apparently is that they said on the floor that they would consider it at the next session, but the President claims that aside from that he had a gentlemen's agreement with the leaders.

H.M.Jr: I would like to find out what he has in mind or have him make up his mind. I think that is the thing, that he has to make up his mind and then we can put it down.

White: It seems to me in any case he would have to refer that to his budget speech. Otherwise, it would seem very peculiar that there is no further reference to the fact that they didn't come across with his understanding after he had made that a condition at his acquiescence to the expenditure of four hundred million dollars.

H.M.Jr: Evidently that is what he had in mind at his press conference yesterday.

Paston: I think this draft that Johnny has gets over that idea very well.

H.M.Jr: Just as a matter of verbiage, he has got two objectives. The second is --

Paston: That is a part of the first. The second is that they shall have minimum disturbing effects.

H.M.Jr: Well now, on this business, January 1938 Congressional session, can you give exactly what he did then, specifically? I mean give - I would like a quote. During the 1938 session.

Blough: We have enough evidence to know that this was done and the materials are being collected.

H.M.Jr: You can put this is a quote form?

Blough: Yes.

H.M.Jr: Well, this may be what he wants. This will give him four hundred thirty-seven and five hundred, that is what I figure.

Hanes: No.

H.M.Jr: Why not?

Hanes: Well, we are not asking that you go back and return the four thirty-seven. We are asking for - what we are asking for is, "If you add to my budget, I now have left out of this budget two hundred twenty-five million dollars and if you add to my budget, the deficit is thus increased by the amount you add and I demand that you bring revenues to that amount."

H.M.Jr: Where do you see that?

Hanes: Right down on the last line. "I again point out that ways and means should be found for financing in full by new revenues such amounts for parity payments as the Congress may decide to appropriate."

H.M.Jr: Then you are saying four thirty-seven is what they owe him, "But two twenty-five if you pass anything more, plus five hundred million"?

Hanes: We don't put it - that isn't what this means.

H.M.Jr: Why couldn't I draw that deduction from this?

Gaston: I think what you are saying there is that in 1938, "I didn't provide for parity payments in the budget and I told you if you did vote parity payments you should provide the revenue and you didn't. The same thing happened in 1939 and I repeat again if you provide for parity payments this year, you should provide the revenues."

H.M.Jr: That is what this says?

Gaston: "In addition to what I am recommending for national defense, which would be seven hundred twenty-five millions, approximately."

Hanes: That is the way we mean it.

H.M.Jr: Well, the press statement says Roosevelt says that it is a pretty good guess that he will remind Congress that they failed to keep a solemn promise to raise five hundred fifty in taxes for the farm benefit.

Hanes: If this press conference is what he means, then we have written this a different way than the last and just being purely practical, I think that is about as far as we can raise the money. This isn't any place to find the money now unless you are going into a sales tax. You might just as well face it. It just isn't there.

Gaston: What I think is possible is a processing tax or certificate plan for the two hundred twenty-five

million and a capacity to pay a combination of taxes which will yield you about five hundred million on a calendar year but won't yield you five hundred million in a fiscal year, fiscal '42.

Vinson: I am afraid the certificate plan won't turn the trick, because under that plan the specific gain or taxes on each commodity go to the producers of that specific commodity. They only suggested the certificate plan for three commodities, wheat, rice and cotton. A good many other types of parity payments aren't in there and which they don't contemplate putting in for one reason or another and they said over here the other day they didn't anticipate this would reduce the appropriations in the budget or regular appropriations out of the general funds of the Treasury for agricultural purposes, if I understand them correctly.

Bell: That has been a policy for five years, that whenever they have an agricultural program it is always in addition to what has gone before. It is never substitution.

Vinson: Is I understand you to say, Roy, that they felt that if the certificate plan were put into effect that it would be in addition to the parity payments, equal to what they had last year?

Vinson: No. The parity payments for the other crops would have to be continued.

Vinson: How much do they amount to?

Vinson: That I can't say. A substantial part of the two hundred twenty-five.

Bell: I think I can clear up Harry's question. He said that his figures that he gave us here the other day, that this certificate plan on these three commodities was contemplated to raise about four hundred forty-eight million. Deducting the two hundred twenty-five would leave you approximately two hundred fifteen million dollars, which would be the net addition in revenue.

Vinson: That is what my understanding is.

Blough: The corn and hog farmers would still insist on parity for their products.

Bell: You would have to provide appropriations for those commodities that don't come under the certificate plan in order to have parity payments.

Blough: Then they want to fill in any gap that may be left by more surplus commodity distribution appropriations.

Barton: There ought to be some level of commodity prices where a certain plan wouldn't impose a tax and where there would be no payments to pay.

Blough: That is correct.

Barton: If we get a sufficient rise in the commodity markets that would --

Blough: When that happened back in the early years, they then changed their definition and decided they wanted something else besides parity price.

White: Roy, if this certificate plan is to raise four hundred forty-five million and it doesn't take care of certain parity payments and if they have to take care of those parity payments that are not taken care of under the certificate plan, have you any rough idea of how much more that would involve? Is it a hundred, two hundred, fifty --

Blough: My guess is that is less than half of the two twenty-five, I should think about a third. I wouldn't think it would be over a hundred million dollars. I would have to check, but that would be my guess.

Ramey: It was what I was going to say.

Bell: Then they would probably want an increase for the surplus commodity.

Blough: They said here that they did want such an increase and furthermore, of course, with

the very nice parity payments under the certificate plan it is entirely possible that the corn and hog farmers and beet farmers and peanuts and so on will want still higher parity payments and come in here and ask for them.

H.M.Jr: Give White a copy of your statement and the one that Wallace left with us yesterday. See that he has a copy of that.

I still say that what you fellows have written may be what he wants, but it is so important I am going to try to find out.

Eanes: I would, too. If we have got to go, there is no use in us going over there with something he doesn't want.

H.M.Jr: I think you can get the documentaries on this thing.

Bell: Laughton is having it looked up and I think there are enough memoranda written in the budget file that we can get the whole history in the thing.

White: Is this statement that the President never suggests the particular character - I mean, it is thought that the President never suggests the particular source of revenue?

Gaston: That isn't true. He has in the past. He did specifically in 1936.

White: Yes, I don't know - that isn't precluded if he should want to do it again.

Eanes: No.

White: You are merely passing the buck - I mean not the buck, but —

Eanes: Yes.

White: But he could do it the other way if he wished.

Eanes: Sure.

H.M.Jr: You said yesterday, didn't you, Herbert, that in one instance the President had?

Gaston: In 1936, in his message to Congress, he told about the loss of the processing taxes and the need for additional revenues to cover the immediate budget and the immediate bonus payment, set out the amount that would be necessary and provided for raising that over a period of years, and then he has proceeded to recommend a specific tax by which that amount could be raised, to wit, the undistributed profits tax.

White: I should imagine that would be definitely the function of an executive to suggest what he regards —

Gaston: It is certainly within his powers.

White: It is certainly true of every other Government.

Hanes: You can't keep him from it, if he wants to do it.

H.M.Jr: What?

Hanes: There is nothing to keep him from it if he wants to. We just thought it was smarter politics not to get into that.

Blough: Here is his difficulty. If he suggests in his budget the precise methods, then those methods must raise five hundred million in fiscal '41, otherwise he has no right putting his five hundred million in the budget. It is going to be very difficult to find the kind of taxes he asks for here which will produce five hundred million dollars in fiscal '41. If he just suggests and Congress comes back and gives him that type of tax but it didn't come in all in fiscal '41, he can sit back and say, "Well, you didn't do what I asked you to, but it is pretty good and it is acceptable."

White: Roy, do you feel that you could suggest a proposal?

Blough: Yes, I can suggest a proposal but it would have all the earmarks of a "fix" and I am afraid it would be subject to considerable criticism on that ground.

H.M.Jr: What?

Blough: A "fix". It would have to be finagled. You would have to put all the collections, for example, in the first two installments or you would have to change the installments instead of having them equal, twenty-five percent in four installments, provide for thirty-five percent in the first installment and thirty-five percent in the second installment and fifteen in the third and fifteen in the fourth.

White: I didn't make my question fully clear. Do I understand that you don't feel that you could recommend or find any tax or group of taxes along these principles which would raise - sooner or later - whether it would come in a little later or not, but would be applicable to the year 1940, that would raise five hundred million dollars?

Blough: We have already given the Secretary such a proposal.

White: Then there is such a proposal?

Blough: Oh, yes.

White: Then why did you say —

Blough: He puts it in the budget for '41. Then he proposes taxes which can't possibly bring in five hundred million dollars during 1941.

White: Can you propose taxes that would?

Blough: Yes, I can, but I say it would mean working them around.

White: Without what you call finagling, I mean straight forward?

Hanes: Nothing but quick acting taxes.

White: Whatever it may be, I am just wondering if it is impossible.

Hanes: What Roy is saying is that the income tax and

inheritance tax - if you levied an increase in the State inheritance taxes, for instance, they are not payable until fifteen months after death, see, so that would mean that we would only get - well, a maximum of, say, half or much less than that. I think it would probably be a ten or twenty percent amount of the total that we realsed in 1941, because they are not payable to - if you died on January 1, 1940, when this Bill was passed, you still wouldn't be liable for the tax for fifteen months after January 1, 1940.

Blough: And if the tax isn't passed until April 1, it can't become effective until April 1.

White: Conceding all that - I don't know, I am just asking. You say that it is impossible to legitimately --

Blough: I don't say that. You could provide a million dollar tax increase which would give you five hundred million dollars --

Gaston: A billion.

Blough: Yes.

Gaston: That might fall afoul of our own interpretation of this second objective that it should not have a greatly disturbing effect on our economy.

Blough: That is right.

Hanes: We set down all the ways we could think of. This is all the ways we could think of to get the tax within the budget limit of 1941. In other words, the President can't say that these taxes were raised for the next fiscal year, five hundred million, unless they were due it, and in the income tax the only way we could think of was to make a retroactive tax passed in '40 for that 1939 income, payable in two installments so that more than one-half would be payable in the first half of 1941. Then levy two times as much tax in order to collect the fifty-five percent to get your full five hundred million. The thought was to offer

inducements for prepayment, such as interest and so forth, to get them to prepay the taxes. That is something like the Bowen Bill which calls for payments quarterly during the year of current income.

Now, on the State tax we can't figure out any way at all of getting - because of the fact that when a man dies he has still got fifteen months to settle the estate, so that it leaves you - it comes down to a question of levying quick acting taxes, which are processing taxes or sale taxes or transaction taxes or privilege taxes of some kind paid currently.

H.M.Jr: Turnover taxes.

Hanes: Yes, turnover tax or a sales tax.

Gaston: I still think you could increase the tax on alcoholic liquors seventy-five cents a gallon and get substantial additional revenue without greatly increasing the difficulty of enforcing it.

H.M.Jr: You are getting five hundred million dollars now out of alcohol.

White: I think we have gone as far as --

Gaston: I don't think so. We are getting about five hundred million dollars now.

White: If you take a glass of whiskey, you are practically supporting the Government.

Gaston: Oh, no.

Hanes: We got five hundred eighty-eight million last year.

Gaston: We have two and a quarter a gallon against five dollars in Canada.

White: If one sets aside for the moment the question of moral implications, which might be a very mute question, it certainly is a tax which falls --

Gaston: I don't think we are anywhere near the point of diminishing returns on alcohol.

White: Why should you be? Why should we tax alcohol as much as it can stand?

Gaston: Yes.

White: Do you feel that way about cigarettes, too, Herbert, get as much as you can get on them?

Gaston: I don't feel the same way about cigarettes.

Hanes: We would get approximately a billion two out of those two taxes.

Bell: Somebody printed revenue stamps that would provide ten bottles of liquor for every man, woman and child in the United States during 1939. Ten bottles that had revenue stamps on them.

Hanes: I didn't drink mine.

Blough: I didn't drink mine.

Bell: I didn't drink mine, so somebody had thirty.

Hanes: I didn't drink mine in 1939, but I probably will in 1940. I went on the wagon. I am going to get off next year.

White: It is that sort of thing which makes it impossible for the revenue estimators to work.

Hanes: You can't tell when you are going to have ulcers.

Bell: More drinkers and less ulcers. You might pass a simple resolution that the two last quarterly payments on the calendar year income should be made in the fiscal year 1941. That would leave the next President in the hole.

White: I suppose he has exhausted all the possibilities, I don't know, but —

H.M.Jr: Have you got one in your hip pocket that isn't alcohol?

White: No, I wouldn't be disposed to putting any more on alcohol, myself.

Blough: I don't say that is all of them. I say that is all we have been able to think of at the moment.

White: I take it that you have thought for more than a moment on it.

H.M.Jr: Herbert, while we are waiting here, is there anything in this introductory language that you question?

Gaston: No, I don't think so.

H.M.Jr: A description of what the tax should or shouldn't do.

White: Are you going over that now?

H.M.Jr: Yes, while we are waiting.

Captain Langdorff of the Graf Spee committed suicide.

Hanes: It would have been very dramatic if he had gone down with his ship.

Blough: Apparently that is what he wanted to do.

Hanes: Do you think he was afraid to go back to Germany?

White: I don't think he did his country a service. It has a kind of depressing effect at home.

Gaston: He acted on direct orders from Berlin.

White: No, I mean to commit suicide.

Hanes: He would have done a much greater service if he had stood on the bridge and gone down with the ship.

H.M.Jr: With all guns going.

Hanes: Sure.

(Discussion off the record.)

H.M.Jr: This paper is from the Budget Aid Program.

Bell: The first two columns represent the appropriations. The last two columns represent the expenditures.

H.M.Jr: Well now, 1941 expenditures are eight billion one sixty-one. That comes to the "B" program, doesn't it?

Bell: 1941 expenditures. There are eight --

H.M.Jr: What should we take, expenditures or appropriations?

Bell: We should take expenditures.

H.M.Jr: It comes to eight --

Bell: Four ninety-eight.

H.M.Jr: But that includes the "B" budget.

Bell: Yes.

H.M.Jr: The "B" budget is three thirty-seven.

Bell: For 1941.

Hanes: That is the addition.

H.M.Jr: Yes. It comes to roughly eight and a half billion, doesn't it, including --

Bell: Yes.

H.M.Jr: Total - including the "B" budget but excluding --

Bell: That is right. Do you take expenditures and the appropriations?

White: Yes.

Bell: That is what you have to finance.

H.M.Jr: Estimated receipts, excluding taxes applicable is five million three hundred forty-eight thousand and the net deficit is three one five zero. Gross deficit, three two five zero.

There you are. I said three one three two yesterday, didn't I?

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Bell: Yes.

Hanes: It is three two five zero. We have got to take care of these figures. They are terrifically confidential.

Gaston: If he wants to keep the net deficit under two billion, he has got to raise another two billion dollars somehow.

White: Mr. Secretary, you keep referring to the "B" budget. Is it a simple difference?

H.M.Jr: "B" budget is the amount he has upped his Navy and Coast Guard - Army and - Coast Guard doesn't amount to anything here. He has upped it three hundred thirty-seven. What he is saying for himself, "I have had to add that conditional because there is a war on in Europe."

White: And the "A" budget is without it?

Bell: Yes.

H.M.Jr: The figure two three five zero includes everything. Of that, the "B" budget is three three seven. Does that answer you?

White: Yes, and the "A" budget is without that additional?

Bell: Yes, that is right. It is eight billion one sixty-one.

H.M.Jr: You take eight billion one sixty-one and add three three seven and you get eight and a half billion. Substract the revenue and it brings you down to three one five zero and you add a hundred million for debt and it brings you to three two five zero.

Bell: The figures you were interested in for tax purposes, the figure is forty and forty-one in the "B" budget, which

aggregates four hundred ninety-two million. The one hundred fifty-five million expenditures in the "B" budget for 1940 and three hundred seven million for 1941.

Hanes: What does "B" mean, where did he get that from?

H.M.Jr: I haven't the slightest idea.

Gaston: He sent those national defense budgets up in two sections, the "A" section for normal expenditures and the "B" section for new armaments.

Bell: This is what he has contemplated in this budget.

Gaston: They are considering them now up on the Hill. The budget has sent them along that way.

Bell: The "B" budget is emergency, beginning with his executive orders expanding the Army and Navy in September.

H.M.Jr: Well —

Hanes: I just didn't understand where that designation came from.

Bell: The "A" budget is everything that has been in there before.

Hanes: We were right in guessing five hundred million. He knew he had five hundred million in his mind, because he said it about four times in his press conferences, he mentioned that figure.

Blough: This one fifty or whatever it is is new appropriations this year for this year, is that the idea?

Bell: Yes.

White: Danny, how much of that five hundred million would he be apt to spend in a year?

Gaston: That is an estimated expenditure in a year. Three thirty-seven.

Bell: I might explain - he apparently contemplates sending up supplemental estimates for the Army and Navy and Coast Guard and the Bureau of Investigation of Justice, two hundred twenty-seven million for 1940, of which he anticipates spending one hundred fifty-five million. In 1941, including his budget estimates, three hundred two million for those same purposes and of that three hundred two plus what is left over from 1940 he expects to spend three hundred thirty-seven million in 1941.

White: What was that last figure?

Bell: Three hundred thirty-seven million.

White: That will still leave some carry-over.

Bell: That is right. In other words, he is asking for an appropriation for this emergency of five hundred seventy-four million and he contemplates spending in the eighteen months four hundred ninety-two million.

White: In the eighteen months beginning January 1?

Bell: That is right.

Hanes: Is this appropriation of Treasury, for instance, cut down to two hundred twenty-four million dollars - is that a cut in the - is that a cut of that amount in the appropriations for the Treasury?

Bell: Well, there are some items there - large items. You took Public Health and Procurement over to Public Works and there are some other Farm Credit things eliminated.

Hanes: It isn't a cut from the Treasury now outstanding?

White: Danny, does that only include ten million from the stock pile for strategic materials?

Bell: I don't know, Harry. There was an estimate came along here, as I recall, for ninety million dollars. It went along quite late. I don't

know whether they had included that or are going to send it up as a supplemental and put part of it in this year.

White: I thought I heard they got only ten million of the hundred they asked for.

H.M.Jr: I got a letter from the Budget which allowed fifteen more, which makes a total of twenty-five.

Bell: Out of the ninety-one?

H.M.Jr: Yes.

Bell: They had a hundred million dollars supplemental items which may include things like that.

(Unrecorded telephone conversation with the President).

H.M.Jr: He said yes, don't you think so?

Gaston: Well, that is a request for a billion dollars of new revenue.

White: Not quite.

Blough: More than a billion.

Gaston: More than that if they get a new parity payment.

White: And less if they don't.

Gaston: That is right.

White: But under the assumption that part of that should have been done last time —

H.M.Jr: You don't have to change this very much, do you?

Blough: No, not very much.

H.M.Jr: I would sort of like to sweat this thing through now. I think I told you he has got nothing on his budget message. If we can get something over to him this afternoon and have an answer from him, we will be ahead of the game and won't have to be working on it on Christmas Day. That has happened, hasn't it? Have you ever worked on Christmas Day?

Bell: I have, many times.

H.M.Jr: Anyway, you are going to fix up the documentary stuff, are you, you and Roy Blough? I would like to have what he did or did not say on the parity payments.

Bell: All right.

H.M.Jr: Let's just start in to take this thing sentence by sentence. "In view of the special expenditures needed to put our national defenses in the condition required to safeguard us in a world at war, it is desirable to consider the position of the Federal revenues."

If you don't mind, Johnny, I don't think that is the way to start the thing off. Let me give you the idea I have. I won't give the words. Let me just think out loud. I am trying to get something like this: "Congress owes me back revenues. It is the President's desire to reduce the deficit." That is what he is trying to do, isn't it? I think he could do this sort of thing, he could say, "I have made an extraordinary effort to reduce the expenditures of this year in every Department with the exception of the Army and Navy. On the one hand, I have. On the other hand, in order to attain my wishes to reduce the deficit, it was necessary that I increase the revenue. Therefore, I wish to bring Congress' attention to the situation and particularly in regard to parity payments." Then go on with the - what they owe him on the parity payments, you see. Then I would go and say just what you (Hanes) have said.

"In view of the special expenditures" and so on, and I think that would come along there. Now, how does that sound?

Hanes: Of course this, I assume, will be fitted in the connecting sentences connecting it with his budget message somewhere. This will fit in his budget message. We are assuming he would lead up to this in his budget message some way and that is what you are trying to do now, is lead up.

Roosevelt: I am trying to do it for him.

Hanes: We didn't attempt to do it. We can do that.

Roosevelt: What I am trying to get over for him is what I feel is motivating him, namely, he has made a heroic effort to reduce all expenditures in all Departments with the exception of the Army and Navy and he ought to say so. Now, having done that he is calling on the Congress to make an equal effort to raise the revenues.

Hanes: I see.

H.M.Jr: And out of that he will accomplish what he wants to, namely, to greatly reduce the deficit and to indicate to the country that from now on, barring re-armament expenditures, the country can expect a tendency to lesser deficit. That is the little speech he has given me at the Cabinet. So, there are two things. One is the money that Congress owes him for back parity payments. They will owe it to him if they pass another parity payment and he wants whatever the amount is for the "B" budget. What do you think of that approach?

Bell: I think it is all right.

H.M.Jr: Harry?

White: I think it sounds all right.

H.M.Jr: No, speak your piece now.

White: I think that is the logical approach to the problem; just how it will be presented is, I take it, to be worked up later.

H.M.Jr: That is what I gathered that he feels.

White: I think the point should be made that the Department has made a great effort to cut the expenditures and it is a good thought to say now it is the task of the Government to make —

H.M.Jr: Johnny, so that you and I - is this something that strikes a sympathetic cord with you?

Hanes: Yes.

H.M.Jr: Are there any basic differences?

Hanes: No. If he would say what you have just said, I think it would be the wisest thing he could possibly say.

H.M.Jr: Well, what I would like to do is, if you fellows adjourn now and I have nothing this afternoon and I am available at 3:00 o'clock and then —

Hanes: Why don't we go back - as I understand it now, he wants to get four hundred thirty-seven plus two hundred twenty-five if they appropriate it and he is leaving that out of the budget, plus the "B" budget, five hundred million. That is what he wants now in this message here.

H.M.Jr: When I said that to him, he said, "Don't you think so, Henry," and I said, "Yes." I don't know what he has in his mind, but after all, we can put it all in and then he could boil it down, but he has elected me - he says this is the way he feels and I just think I would add one other sentence in there, one other thought, that the tax that he is asking to pay for the "B" budget, that that tax would only remain as long as the necessity exists to do the things which he is asking to be done in the "B" budget.

White: That could well come in the other paragraph.

H.M.Jr: That this is not a recurring tax, that it is only a tax which would be put in for special rearmament purposes.

Gaston: I question that, because we are three billion dollars from a balanced budget now and do we want to take that tax off and still leave a huge deficit?

White: His basis for asking this is not to balance the budget but to meet the new expenditure.

H.M.Jr: In order to get what is in my mind, I want you to have everything. I thought last year I would feel this year that the sooner we come to a special tax for armament purposes, the sooner we can put this country on a sound fiscal basis. We have yet to do it. We may have to do something which may hurt everybody, I mean it may be something within the calendar year which may be - take a little fat off - each person. It may be something quite stringent and in order to make it at all - the fellows say, "This is only as long as this thing lasts." I am going to say something much further. If the people know what armament costs

and that it is something which really hurts, they are going to think twice before they want us to get into this scrap over here and if we just go along and pay it out of the alcohol or cigarettes or certificate plans, this armament thing - I don't know that I am personally contributing anything to help - I am not conscious of it, and the sooner we are conscious of it - and if on the other hand we do get into the war, then we know how to finance it. I personally, talking for myself, would very much like to see something that I, Henry Morgenthau, Jr., know that I am paying, which goes for re-armament purposes. If I don't like re-armament, I know it is going. If I don't like war, I know it is going. If I feel the country has to get into this thing, I know that that thing I am paying goes for that purpose, at least I can evaluate it.

I differ with you, Herbert. Let the people know, though, that this is for next year. Next year is another story.

White: When the time comes to introduce it —

H.M.Jr: I want you to know what I am thinking.

Gastom: My feeling is that in our present budget situation the time has come for heavier tax measures raising a large amount of revenue, and I don't think we will be able to take them off even if the war emergency ends.

White: Why worry about it now?

H.M.Jr: That has nothing to do with what I am arguing. I am arguing for a recognizable armament tax.

Haas: Tax consciousness.

Gastom: That is probably good strategy at this time.

H.M.Jr: And I think for the President to say - I think he ought to say that here is this thing and that it is for this year only and next year will take care of itself.

White: It is more than good strategy, Herbert.

I think it goes deeper than just good strategy.

E.M.Jr: I tell you how much deeper - I mean that the people are entitled to know and not to have us rearming out of a whole group of taxes. Why not let the people vote on the thing, do they want to rearm? Now, vote on this tax to rearm.

Dan, I am talking much more than I do usually, because I want you to know where I stand. You can do the documentary stuff, can't you?

Bell: I have got somebody working on that now.

E.M.Jr: John, will you carry the ball on this? I am going to ask these fellows all to make this number one. Before you go, is there anything you want to make a speech to me on? I will sit down and --

Bates: No, not a thing in the world. This makes the burden that much greater on trying to find out what we are going to do - when we go to talk to him we have got to say, "This thing is possible." We don't want the criticism to fall on him and let him make some statement which it isn't possible to fulfill. We ought to have the ways and means of doing it ready by the time we get that message to him, don't you think?

E.M.Jr: Oh, yes. I think that if we could get this so that he could have it tonight - whatever you are doing, Harry, I consider this more important, see. You make yourself available too, will you?

White: I am available.

12-20-39 ?

Draft #1

In view of the special expenditures needed to put our national defenses in the condition required to safeguard us in a world at war, it is desirable to consider the position of the Federal revenues. While drastic measures would be unwise we can and should increase our tax revenues moderately, and the Budget for 1941 has accordingly been drawn to show the amount of $500,000,000 to be raised by additional taxes. I feel confident that this sum will prove adequate to cover such additional armament as will be required in the next fiscal year.

Since it is the function of Congress to determine how revenues should be raised I leave the choice of particular tax measures to its judgment. However, I believe I am expressing the sentiment of the country when I suggest that measures adopted for raising additional tax revenues should reflect two objectives. The first is that the taxes should come from the portion of the population which can best afford to pay them, with due regard to the taxes they now pay to the State, local and Federal governments. Care should be taken especially to design the taxes so that they will not fall on that portion of the population which can least afford to pay them. The second objective is that the taxes should have a minimum of disturbing effects on the further recovery and smooth working of the economy and accordingly should avoid as far as possible the discouragement of productive activity and employment.

These notes were submitted by Mr. Leffingwell to the TNEC to supplement his oral testimony in Washington on December 20, and were made public in Washington January 18.

Mr. Russell Leffingwell

12/23/29

Notes for T. N. E. C.
by R. C. Leffingwell

I. Idle Money.

The amount and velocity of individual bank deposits are determined by the depositor, not by the bank. A depositor selects his bank for safety, for financial accommodation and service, and because of propinquity and convenience. It is the depositor who decides when and with whom and in what amount he deposits his money. It is the depositor who decides when and from whom and how often to draw checks. The banker has nothing to do with these things, or precious little. His business is to keep himself in a position to honor the checks when they are presented, to run a safe and sound bank. And the banker who undertook to tell the depositor how to manage his business, when he could and when he could not draw checks, how often or how seldom, would soon have no deposits to worry about. That is the depositor's business.

But the amount and activity of the depositor's account is influenced and indeed almost controlled by economic conditions and policies. His account will be active if his business is active; and nowadays his business is not active, or not as active as it should be, because of conditions and policies which retard recovery.

Note. This paper and the one following deal with two subjects which involve similar considerations and inevitable repetition.

In times of good business, deposits are often created by the banks lending money and crediting the depositors with the proceeds of the loans, subject to withdrawal by the depositors at once or from time to time as required. In bad times, such as we have had for ten years, deposits are not so much created that way. In these times the immense expansion of bank deposits is the result of the inflow of fright money from Europe, the devaluation of the dollar, and our own Government's spending and deficit financing.

Evidently these three major factors in the expansion of bank deposits are of a character to discourage velocity of bank deposits rather than to stimulate it, because they upset business confidence.

I cannot agree with those who criticize the Government for going off gold in 1933. Then all the banks, including the Federal Reserve Banks, had to close their windows and stop payment. It was sheer grim compulsion that took us off gold. But it is evident that there was nothing very bright and cheerful and encouraging for business about it.

Similarly the flight money from Europe expanded bank deposits here. But these deposits were running away because of the fear of war and revolution in Europe and Asia. The same fear tended to keep deposits idle here.

Government spending and deficit financing also carried their own antidote against recovery. They are perhaps at first stimulants. But, too long continued, they become depressants. Nobody doubts that the Government was bound to look after the poor and the unemployed liberally and freely and generously. Government spending for relief was most necessary. But Government spending for recovery defeats itself. Government spending for materials and made work, that is work that does not need to be done, is definitely discouraging to business, retards recovery and deprives deposits of their velocity. When the Government bids for materials and supplies and for labor, in competition with business, and, still more, when Government itself engages in or subsidizes enterprises directly competitive with business, for instance housing, public utilities, inland waterways, transportation and banking, there is a plain indication to enterprise to stay out of those fields. No business man supposes that he can compete successfully with the Government of the United States in any field whatever.

Furthermore the fact of the immense deficit which results from Government spending fills the minds of business men with a sense of apprehension. The public debt, including guaranteed debt, of the United States has been multiplied by about three in the last nine years, while the United States is at peace. It is about 39 billion dollars greater than at the war peak twenty years ago. Sensible people are concerned about this. This fear retards recovery and keeps bank deposits still and sterile.

Our tariff system and our tax system have not been devised with a view to producing revenue so

much as with a view to retarding imports in the one case, and redistributing the wealth of wealthy persons and corporations in the other. The tariff, and the excessive burden, and the wholly unequal burden, of taxation, retard trade and recovery, and therefore retard the circulation of bank deposits.

The Government itself has had latterly a definite policy to prevent a rise in prices. In pursuance of that policy in 1936 and 1937 it increased the reserve requirements of member banks, sterilized gold and announced that some prices were too high. These drastic deflationary steps brought on a severe depression. Even now Government is considering measures to prevent a rise in prices. Now if Government does, as it has been doing, take steps to increase the cost of labor and taxes on the one hand, and, on the other hand, prevents prices from rising, it is obvious that business is going to be ground between the upper and nether millstone. Rising costs and frozen prices will surely take the profit out of the profit system. This discourages enterprise and freezes deposits.

Another thing that keeps money idle is that business finds itself perplexed by ever-increasing bureaucratic interference with its normal processes. Government manages our money and plans our economy. Government creates more and more bureaus, and sometimes puts the bureaus in charge of men without large practical experience either in the civil service or in business. Business must and should, and

on the whole it does, obey the law. It is difficult however for business to adjust to the changing decrees of bureaus. This is one of the things that retards recovery and slows down the velocity of deposits. I do not say that critically. I don't believe any group of Government managers, however able, can manage the business of 130 million Americans successfully. I think you have to leave it to the individual enterprise and initiative of all these people in all these cities and towns and hamlets and farms and mines. And I do not believe, even if you could make a success of a central bureaucratic government, it would be worth doing, because the people would become just a nation of robots. And then we shouldn't be worth saving.

II. Managed Money and Planned Economy.

Turning now to more detailed consideration of managed money and planned economy: Few persons seem to realize how far economic conditions in this country are due, not only to the Great War of 1914, and the international policies and disturbances which followed, but also to monetary management and economic planning by our own Governmental authorities. Until twenty-two years ago we had on the whole a free economy, subject to the laws but not to the management of Government authorities. But since the United States entered the war in 1917, the Government has in large measure managed our money and planned our economy.

I do not say this critically. For the Government's monetary and fiscal policies from 1917 to 1920 I was, as war-time Assistant Secretary of the Treasury, in part responsible. With some other and more recent policies—such as going off gold in 1933, to mention one of the most controversial—I was in full sympathy, and publicly expressed my approval. I have been outspoken in my approval of the easy-money policy, of the tripartite agreements and of the able administration of the Treasury by Secretary Morgenthau. Government could not do otherwise than face and deal with the war crisis in 1917, the deflation crisis in 1933. Government must and should minister without stint to the relief of the poor and the unemployed.

It is our duty, not to criticize, but to learn from experience, not to waste time justifying or blaming past decisions, but to weigh them and their effects for our future guidance.

The point is that Government has for twenty-two years managed our money and to a great extent planned our economy.

The inflation of 1917-1919 was caused by war-deficit financing. The deflation of 1920-1921 was caused by raising the Federal Reserve Bank rate to 6% and then to 7% in the first half of 1920. The recovery from the end of 1922 on was facilitated, and the disastrous inflation of 1927-1929 was stimulated, by easy-money policies of the Federal Reserve Banks, which were always beneficent in intention though they worked out very badly in the latter period. The inevitable collapse of 1929 was precipitated by raising the Federal Reserve Bank rate to 6% in August 1929, a step too long deferred by the Federal Reserve Board. The deflation of 1931-1933 was caused by upholding nobly the pre-war gold standard for a year and a half after England had gone off it. Honorably and to keep our pledged word, for a year and a half, we let the gold go cheap to foreigners who were willing to pay more for it; and deposits were necessarily deflated many times the gold withdrawn, until the banks all closed.

Wisely, and of necessity, the Government suspended gold payments in the spring of 1933. Unwisely, under Professor Warren, Government bid up

the price of gold and sold the dollar down in the last half of 1933. Having thus cheapened the dollar and overvalued gold, Government raised the official price of gold from $20.67, the price before April 1933, to $35 an ounce in January 1934.

The dollar was cheapened with the intention of raising the commodity price level, some said to the 1926 level. However, having, after N.R.A. was abolished, got real recovery and a lift in prices in 1936 and early 1937, Government's commodity price policy was reversed, and deflationary measures were adopted to prevent the rise of commodity prices for fear of inflation.

These deflationary measures brought on, in the latter part of 1937, the swiftest and most abrupt depression recorded. Steps in this managed deflation were (1) the increase in the reserve requirements of the member banks, (2) the sterilization of gold imports, (3) the official announcement that some prices were too high. Simultaneously Government expenditures were curtailed, and the Government collected in the fiscal year 1937-1938 in taxes and social security payments about as much money as the Government was spending, resulting in the elimination of net deficit financing during that fiscal year and some reduction in the publicly owned public debt of the United States.

These deflationary policies were in part reversed in 1938, and a measure of recovery has followed.

That is the economic history in a nutshell of twenty-two years of managed money and planned economy in the United States.

Let us consider some by-products of these policies, and some collateral policies.

On the one hand by paying $35 an ounce instead of $20.67 Government is paying foreigners a premium, of nearly 70%, above the old gold price, for gold we don't want and can't use since the banks' reserves are excessive already. On the other hand Government is again using its authority or influence to prevent some prices from rising at home in response to increased demand. So we are selling dollars cheap for gold and keeping prices of commodities cheap too. This gives a double discount to foreign buyers of American goods and securities, but it has not brought full recovery or employment here.

That is partly because our policies have been undermining other economies, have had a deflationary influence upon world gold prices, and have hampered the trade of the world.

The Fordney-McCumber and Hawley-Smoot tariffs contributed to the world breakdown and to our own. I agree whole-heartedly with Secretary Hull and what, against great handicaps, he has been trying to do about this. I wish he could go faster and further.

The chief use of gold in the modern world is to settle international balances, to move to and fro

III

across the boundaries of nations—like a shuttle, to and fro. When we make a one-way street for it, all to and no fro, we deprive it of much of its usefulness. When we restrict our buying and lending abroad, when we try to sell everything and to buy little, except gold, and for that one thing we are prepared to outbid the world and pay a fancy price, we imperil the economy of the world and measurably impair the usefulness of gold itself as a monetary metal. When on top of that we sterilize the gold we buy, and, by such deflationary measures as I have described, prevent it from reflecting itself in our price level, we make an immense contribution to world deflation and so to world distress and disorder.

We used to call India the Sink of the Precious Metals because her princes and peoples drained all the gold and silver they could away from the mines and currencies of the world and buried them. But today America has outdone India as a hoarder. The most forward-looking country of the West has replaced India as the Sink of the Precious Metals. We have blind faith in our tariff against imported goods, goods which would be of use to us, and we are gluttons for gold, which we cannot use and have to bury.

We subsidize exports, penalize imports, embargo loans and credits, and suck gold out from the mines and currencies of the world. So we do our bit to make the world a worse place for us and our democracy to live in.

II

Notwithstanding the evils I have pointed out, I do not favor changing the price of gold again. It is too bad to have had to change it at all. To increase the price of gold again when we are already paying too much for it, and have too much of it, would be sheer lunacy. That would be a hair from the tail of the dog that bit us. To *decrease* the price of gold would be politically impossible, deflationary, and destructive of what confidence remains in our monetary stability. We don't want more deflation. We have had enough of that. We don't want to destroy what confidence remains. We have *not* enough of that. It is well to have something fixed in a disintegrating world.

Therefore the wise course is to allow commodity prices to rise somewhat, and thus reduce the present gross disparity between the gold price and the commodity price level. A gently rising level of prices is to be desired. This should reduce the burden of debts, bring recovery of business and employment, increase profits, increase income and Treasury tax receipts, reduce and ultimately remove the need of relief and made work, and so balance the budget.

Rising costs, for taxes, wages, working conditions and social security on the one hand, and low prices for manufactured goods on the other, tend to make business wholly unprofitable, or at best not profitable enough to attract enterprise and initiative to new undertakings.

Capital is plentiful. It is not timid. It is always ready to take a chance. But when enterprise is confronted by Government policies which tend to make business unprofitable, then enterprise won't hire the money. It knows it hasn't got a chance. Rising costs and low prices will surely make enterprise unprofitable. We cannot permanently keep the profit out of the profit system without making unemployment permanent, nor without bankrupting the Treasury.

Our recent peace-time deficit has nearly tripled the public debt, including guaranteed debt, in nine years. It is 20 billions greater than at the war-time peak. Extraordinary budgets, recoverable budgets, and financing through subsidiary corporations of the United States Government, cannot help matters much. Everybody knows that there is only one test, whether the public debt is rising. And it is. And that scares business and retards recovery.

This deficit has actually been financed by the fear of Hitler. Flight money from Europe has been financing our deficit for us. That, and the depression at home, keep money plentiful, idle and cheap while the Government borrows and spends.

There are other things that we could do better than we have done:

We should have cooperation between business and Government. And I mean cooperation, not dictation by Government, nor vituperation by business.

No economy can work well when business and Government are at loggerheads.

We need cooperation between Government, management and labor, to increase the output, and the efficiency, and the real income, of labor as a whole. Present labor policies seem to retard recovery and reemployment, and to perpetuate unemployment of the millions who are unable to get or keep jobs in a depressed economy. High wage rates and short hours for the lucky ones who have jobs do not help the unemployed millions who are out of work.

We should have taxes for revenue only, and not to penalize thrift, or to distribute or destroy wealth, or to stop trade. We should not increase taxes. We can never balance this budget by increasing the burden of taxes. We can do it by increasing the incomes and profits of the people so that tax receipts, instead of tax rates, will be bigger, and the people will be better able to pay the taxes.

Finally, I believe we have had twenty-two disturbed years and a ten-year depression, we have idle men and idle dollars, partly because our money has been managed and our economy has been planned by Government.

The American economy isn't worn out. We are in our adolescence as a people. We have only scratched the surface of the resources of this great continent. Our inventive genius puts new tools and new toys forever at our disposal. Our appetites, our desires, our needs are insatiable. We shall succeed in the

struggle for existence and for the common welfare if more reliance be placed on the old-fashioned virtues of individual enterprise and thrift.

I suspect that no man or group of men chosen to govern us can be wise enough to manage our money and plan our economy for us. The infinite variety of human affairs, the infinite desires and aspirations of tens of millions of self-willed people, with their hopes and fears, their loves and hates and ambitions, are too much for any central Government to control and regulate wisely and well. The citizens themselves are likely to produce a healthier, happier and more prosperous country. I suspect that the more money is managed, the more economy is planned, the more business is canalized and regimented, the more the individual is controlled by Government,—then so much the more the national economy will run down hill, will deteriorate and be depressed, at first slowly to be sure, then faster and faster, until the rulers of that economy are forced to seek more desperate remedies, more autocratic powers. It is a vicious circle. I believe the future of the human race, and above all the future of the Americans of the United States, is in the freedom of the individual, not in the aggrandizement of the powers of the State. I long for peace in our time and a government of laws and not of men.

December, 1939.

MA

GRAY

Berlin

Dated December 20, 1939

Rec'd 6:20 p.m.

Secretary of State

Washington

2412, December 20, 9 a.m.

After declining 227 million marks during the first week in December bill holdings of the Reichsbank increased 587 million marks during the second week to a total of 10,507 million marks. On the other hand the miscellaneous assets of the Reichsbank declined 355 million marks during the first two weeks of the month indicating a repayment of direct government borrowing from the institution. During the first half of December Reichsbank holdings of eligible securities continued to decline. From August 23 to October 31 the institution's holdings of eligible securities had increased from 983 million marks to 1440 marks. Since then they have steadily decreased to the December 15 figure of 878 million marks which is the lowest figure recorded since May. The Reichsbank has been taking advantage of easy money conditions to unload the Reichs securities which it had purchased in pursuance of its open market policy especially during the first few weeks of the war.

The Reichsbank holdings of coin and renten bank notes

showed

showed only negligible changes at mid-month. Note circulation increased by 47 million marks to 10,969 million marks during the second week of December, only 5 million short of the November 30 figure. However, sight deposits at the Reichsbank decreased by 185 million marks during the second week of December following a small increase of 32 million marks the previous week. Thus there was a net decrease of 138 million marks in Reichsbank money-- note circulation plus sight deposits -- during the second week of December and of 158 million marks since November 30.

According to the November statement of the Reichsbank subsidiary, the Rentenbank, only 57 million marks of Rentenbank notes were issued in November as compared with 161 million marks in October and 400 million marks in September. Since the Reichsbank's holdings of Rentenbank notes decreased during November by 26 million marks the increase of Rentenbank notes in circulation during this period was 83 million marks as equivalent an increase in circulation of 151 million marks in October.

The November 30 statement of the Reichsbank's subsidiary the Gold Diskont Bank shows a large reduction of 461 million marks in its bill portfolio to a total of 1,595 million marks and on the liabilities side a

386 million marks reduction in deposits, a 78 million marks reduction in sola bills and 10 million mark reduction in miscellaneous liabilities. The amount of sola bills at present outstanding is only 519 million marks, having been reduced to this figure from a high of 1,552 million marks on May 31 indicating sola bills are gradually being replaced by Reich treasury bills and certificates in the portfolios of the credit institutions.

Repeat to Treasury.

KIRK

RR

JT

GRAY

PARIS

147

Dated December 20, 1939

Rec'd 5:45 p.m.

Secretary of State,

Washington.

3013, December 20, 7 p.m.

FOR THE TREASURY FROM MATTHEWS

Jenny devoted a recent leading article in LE TEMPS to the Franco-British financial accord. He explained for his readers how France and Great Britain can maintain the existing relationship between the pound and the franc without such transfer of gold. He emphasized the reciprocal facilities for purchases of products within the two empires if an unduly high balance is accumulated by one government in the currency of the other (he did not attempt to estimate whether the costs of the British expeditionary forces in francs and other British purchases in the French Empire would in fact exceed French needs of sterling)

(END OF SECTION ONE.)

BULLITT

(Garbled groups have been serviced)

EMB:JRL

HSM

GRAY

Paris

Dated December 20, 1939

Rec'd 6:35 p. m.

Secretary of State,

Washington.

3013, December 20, 7 p. m. (SECTION TWO).

There has been some speculation here as to how the mutual efforts to prevent undue divergence of price levels in the two countries (please see Article XVI of the agreement, my telegram No. 2951, December 11, 4 p. m.) will operate and some unkind critics have mentioned an inconsistency between Reynaud's firm declaration of his intention to preface price inflation in France (see his speech of December 13, my telegram No. 2976, December 14, 5 p. m.) if a simultaneous greater price rise continues in England and the provisions of the accord for mutual demurrage to maintain equilibrium. Touching on this point Jenny wrote "It is to be supposed moreover that the two governments will endeavor to avoid as far as possible excessive accumulations of the currency of one country by the other. The contacts provided for by the coordination of their price policies is concerned with this line of thought. It is certainly

desirable

desirable that a divergent trend of prices in the two countries be prevented for such development modifying the relationship between the respective purchasing powers of the franc and the pound while exchange rates remain fixed for a more or less extended period would put a strain on the system and favor to that extent the accumulations concerned and which it is precisely the object to limit". He lauded the decision not to increase barriers against Franco-British trade and the recent British decision to modify to some extent the existing prohibitions against French luxury articles. Turning to what in my opinion is the most important objective of the agreement, namely, the preservation of dollar resources he said: "for expenditures in dollars or in gold that the two allies must make an equitable sharing is provided for in the Simon-Reynaud accord.

BULLITT

DDM
RR

EBM

GRAY

Paris

Dated December 20, 1939

Rec'd 8:10 p. m.

Secretary of State,

Washington.

3013, December 20, 7 p. m. (SECTION THREE).

What does that mean? We believe that the two finance ministers have not fixed any rigid rules. The formula adopted apparently implies that the foreign exchange resources of the two countries are up to a certain point pooled just as their economic resources and their available maritime tonnage are pooled. But the division thereof has probably not been decided in advance; it will doubtless vary according to the expenditures. Let us imagine an important joint purchase of a product of which the necessary quantity cannot be entirely obtained within the sterling area and the French Empire. Let us say that there is sufficient in the British Empire approximately to satisfy English needs but that the quantity available in the French Empire will only cover a small part of French requirements. In such case--it is only a supposition designed to give an idea of what may be understood by 'equitable' sharing--it would not be fair that the

payment

payment in gold which would have to be made for the supplementary purchase abroad that is to say the most burdensome payment should be made entirely by France; it would be natural that for example it should be divided between the two countries pro rata to their total needs to the extent that the latter cannot be satisfied in the two countries". Jenny likewise in order to dispel any doubts on the subject in France asserted that in dividing certain expenditures on the basis of 60% and 40% respectively for Great Britain and France "the authors of the accord have not estimated that the proportion of national wealth of France and that of Great Britain is of two to three (which would not correspond to the fact) nor that (begin underlining) all (end underlining) war expenditures shall be divided between the two countries in the aforesaid proportion. What that clause signifies is that the national wealth of Great Britain, being notably superior to that of France, the latter will not have to bear but two-fifths of (begin underlining) certain (end underlining) common expenditures" namely, loans to allies and so-called blockade purchases. He closed with the following note of praise of the agreement: "It is with reason that the British press sees in the accord a valuable financial and monetary alliance and it is with legitimate pride that Monsieur Paul Reynaud has insisted on the increased strength that the two allies are going to derive from it."

BULLITT

RR

PARAPHRASE OF SECTION FOUR, TELEGRAM NO. 3013 OF DECEMBER 20, 1939, FROM PARIS.

In Paris there have been reports circulating that there is about to be floated a joint Franco-British long term loan with an exchange guaranty - including a dollar guaranty. To me it has seemed that to float a loan with an exchange guaranty clause at this time would be extreme shortsightedness, particularly since it would be easy to float a French long term issue of substantial size without such a guaranty today. In addition, it would seem to be wholly contrary to the policies of Finance Minister Reynaud. I had lunch today with Rueff at the Bank of France. He confirmed this impression, and said that they do not contemplate such an issue. Rueff continues to express optimism about the near term financial outlook in France, and about the success of the Government in the smoothness and rapidity with which the large sums spent by the Government are returning in the form of taxation, and particularly in subscription to government issues. - However, from time to time reports come to me about apparently well-founded complaints of the slowness of payments for purchases and requisitions by the Government.

END SECTION FOUR.

BULLITT.

RA:LMW

BG

GRAY

Paris

Dated December 20, 1939

Rec'd 9:05 p.m.

Secretary of State,

Washington.

3013, December 20, 7 p.m. (SECTION FIVE)

The Government has presented to the Chamber Finance Committee which is expected to report it out on Friday its estimate of appropriations for national defense for the first quarter of 1940. These estimates total 55034 million francs. They are divided among the different Ministries as follows (in millions of francs): War 21832; Armament 13116; Navy 5600; Air 12592; Colonies 811; Finance 38; Labor 220; Agriculture 35; Public Works 192; Merchant Marine 420; Postal Administration 96. While in fact it has seemed feasible to present national defense estimates only by quarters (please see my telegram No. 2215, September 27, 8 p.m.) a general preliminary estimate for the entire year placing such expenditures at 249 billion francs has been given out. The breakdown of such preliminary estimate is as follows: (in millions of francs) War 36,620: Armament 87,287; Navy 15242; Air 106,139; Colonies 854; Agriculture 140; Public Works 730; Merchant Marine 2,100.

It

-2- #3013, December 20, 7 p.m.(SECTION FIVE) from Paris

It is reported that supplementary expenditures due to the war have produced a deficit in the 1940 budget of the city of Paris of 1200 million francs and that as further tax increases are impossible a loan issue of 600 million francs is to be floated. The remaining 600 millions to the extent that reform of the city's figure will not permit the latter to cover the deficit are to be advanced by the Government.

BULLITT

CSB

Paris

Dated December 20, 1939

Rec'd 9:27 p. m.

Secretary of State,

Washington.

5013, December 20, 7 p. m. [SECTION ONE]

It is reported from Amsterdam that the Dutch Prime Minister has declared that subscriptions to the national loan issue have not come up to expectations; and that they only amount to 100,000,000 florins which together with the 60,000,000 already taken by government financial institutions is only a little more than half the required 300,000,000.

The Paris securities market reacted today under selling pressure which led to reductions throughout the list. The selling movement commenced with a drop of 10% in rubber securities affected by a special war tax decreed in today's JOURNAL OFFICIEL on rubber exports from Indo-China. (The rate of this special war tax on all rubber exports from Indo-China (applicable after January 1st) will be set monthly by the Governor General of the Colonies and will be equal to 80% of the difference between the last Singapore rate prior to the opening of hostilities

hostilities and the current monthly average rate of that market.) There has been some feeling that many issues were over-valued and probably the actual figures of national defense estimates were sufficient to shock bull interests. Rentes followed the downward movement losing from 20 centimes to 2 francs. General security losses varied between 2 and 3 per cent.

(END MESSAGE).

BULLITT

NLP

December 20, 1939.

A Memorandum on

Allowances for "Extraordinary" Obsolescence. 157

by Jacob Viner.

Past Policy of the Internal Revenue Bureau.

The sudden changes in demand for particular products, upward and downward, which are likely to mark a wartime period, and the excess-profits tax provisions in the Vinson-Trammell Act, are very likely to increase the importance of, and the public interest in, the provisions for deduction of obsolescence allowances for purposes of taxation. The income tax law grants to the taxpayer the benefit of "a reasonable allowance for obsolescence", but does not particularize further, nor define "obsolescence". Reasonable allowance for obsolescence for tax purposes is proper because it is necessary if the taxpayer is not to pay taxes on amounts in excess of his true income, and if the income tax is not to operate as a serious barrier to capital investment in enterprise industries peculiarly liable to obsolescence. The determination of "reasonable" allowance is obviously not a simple matter, and must be handled with great care if it is not to operate unfairly either to the taxpayers or to the Treasury.

The stated position of the Internal Revenue Bureau with respect to the application of the obsolescence provision was at least until a few years ago arbitrary and unduly restrictive, if the Bureau Bulletin "F" (revised January, 1931) "Income Tax, Depreciation, and Obsolescence, Revenue act of 1928", correctly reflected its position. In this bulletin the following definition of "obsolescence" (as distinguished from "normal obsolescence" or the gradual exhaustion of the usefulness of particular property as the result of minor changes in technology, etc., which is taken care of as part of "depreciation" for tax purposes) is given:

> "Obsolescence may be defined as the process of becoming obsolete, brought about by the progress of the arts and sciences, changed economic conditions, legislation, or otherwise, whereby it can be predicted with reasonable accuracy that property used in the trade or business will be useless at a definite future date prior to the expiration of the normal useful life of the property." (Page 2.)

Since gradual and moderate, or "normal", obsolescence is handled for purposes of taxation as if it were included in the concept of depreciation, this definition must be understood as dealing only with "extraordinary" obsolescence, or obsolescence irregular in appearance and substantial in its annual amount when it occurs. It is, in any case, only this type of "extraordinary" obsolescence with which this memorandum purports to deal.

The same bulletin later states that:

> "In every case the burden of proof is entirely upon the taxpayer to establish a claim for obsolescence by facts and evidence that are reasonably indisputable.
>
> .... The allowance will be confined to such items, or such portion of the property on which obsolescence is definitely shown to be sustained. .... Nor can obsolescence be allowed retrospectively in the light of subsequent events or happenings not anticipated during the period for which the obsolescence is claimed." (Ibid., page 11).

These do not appear to me to have been 'reasonable' statements, and if they had been strictly applied they could have been used to prevent almost completely any allowances for "extraordinary" obsolescence, or obsolescence due to sudden or unanticipated changes industrial technique or in market conditions for products.

(a) Such obsolescence has, by its very nature, a very large measure of uncertain prospectivity, so that the insistence upon "reasonably indisputable" facts and evidence, the requirement that obsolescence must be "definitely shown" to have occurred at the time when the claim is being made, and the requirement that "it can be predicted with reasonable accuracy that property used in the trade or business will be useless at a definite future date", if literally interpreted, would provide a basis for the rejection of practically all claims for extraordinary obsolescence deductions. Such statements, moreover, provide no positive help to the taxpayer as to the extent of his lawful claims.

(b) The statement that for deductible obsolescence to exist there must be a prospect that the property concerned will be "useless" at some future date, and that this date must not only be predictable "with reasonable accuracy" but must be "prior to the expiration of the normal useful life of the property", seems to me to have no basis in the law, which merely grants the taxpayer the right to "reasonable" allowance, not in the nature of obsolescence, which is not to be identified with the state of being fully obsolete or worthless but with the process of losing worthiness (resulting from certain types of causes). When, if ever, the state of complete uselessness is reached, and whether this date is the same or prior to the expiration of the "normal useful life of the property" seem to me to be irrelevant in the early years of life of a specific asset, and to be so treated in the literature on the subject except where the Bureau of Internal Revenue pronouncements have exercised an undue influence on the writers. The time sequence of the progress of obsolescence can have an infinite variety of patterns, and while obsolescent equipment may generally become wholly useless earlier than non-obsolescent equipment, there is no logical reason apparent to me why this should be universally true, or why it should be regarded as significant for taxation purposes.

(c) Obsolescence is peculiarly a phenomenon whose dimensions can be under most circumstances only vaguely foreseen in advance of its occurrence, and only dimly perceived even while it is actually occurring, and whose measurement therefore most urgently requires the aid of subsequent (or retrospective) information. The provision in Bulletin "F" that obsolescence cannot be "allowed retrospectively in the light of subsequent events or happenings not anticipated during the period for which the obsolescence is claimed" can be so read as not to conflict with this view. But there is reason to suppose that it has been understood as substituting that information available subsequent to the period for which the claim of obsolescence is made, and not merely events or happenings subsequent to that period, are not to be appealed to in support of such claim. The major difficulty in connection with allowance for obsolescence in fact results

from the general time-lag between the rate of accrual from year to year of obsolescence, on the one hand, and the flow of information which makes that rate of accrual fairly ascertainable, on the other hand. The obsolescence provision of the law surely does not prohibit, and the Bureau surely knows how to attain, reasonable adjustment of tax liability to this time-lag.

(d) The undue stress which the Bureau lays on complete uselessness as a necessary and definitely predictable outcome of the process of obsolescence apparently has led the Bureau to resist claims to obsolescence deductions with respect to an asset unless its abandonment or complete disuse of the property had already occurred or could be predicted to occur at some definite date in the near future, with an obvious tendency to promote the anti-social practice of abandoning or scrapping or maintaining idle, for purely tax reasons, productive facilities which still had actual or potential (as in emergencies) though modest possibilities of serviceability in production.

The Supreme Court and Obsolescence.

The U. S. Supreme Court in 1931 decided against the Government certain tax cases involving claims for obsolescence rejected by the Bureau. These decisions, I understand, must now be accepted as "leading cases" with respect to deductions of obsolescence for tax purposes. How decidedly the Court differed from the Bureau's position as stated in Bulletin "F" with respect to reasonable allowances for obsolescence is sufficiently indicated by the following passages from the court decisions:

"It is well understood that exhaustion, wear, tear or obsolescence cannot be accurately measured as it progresses and undoubtedly it was for that reason that the statute authorized 'reasonable' allowances to cover them in order equably to spread that element of operating expenses through the years." (282 U. S. 638 at 645).

"It is a familiar rule that tax laws are to be liberally construed in favor of taxpayers.... It would be unreasonable and violate that canon of construction to put upon the taxpayer the burden of proving to a reasonable certainty the existence and amount of obsolescence. Neither the cost of obsolescence nor of accruing exhaustion, wear and tear that is properly chargeable in any period of time can be measured accurately. A reasonable approximation of the amount that fairly may be included in the accounts of any year is all that is required....There is no hard and fast rule, as suggested by the Government, that a taxpayer must show that his property will be scrapped or cease to be used or useful for any purpose, before any allowance may be made for obsolescence." (282 U. S. 648 at 654-55).

Present Policy of the Bureau.

In the latest Volume of Regulations issued by the Bureau, the only general statement with specific reference to allowances for obsolescence is the following (Regulations 101, Income Tax, page 81):

"Art. 23 (l)-6. Obsolescence.--With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a future date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost or other basis at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation, may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. No deduction for obsolescence will be permitted merely because, in the opinion of a taxpayer, the property may become obsolete at some later date. This allowance will be confined to such portion of the property on which obsolescence is definitely shown to be sustained and cannot be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due."

In this regulation the propositions which appeared in Bulletin "F" and which were avowedly criticized by the Supreme Court in 292 U. S. 633 and 292 U. S. 640 are not present. There is still, however, a reference to "abandonment", which, I repeat, seems to me irrelevant except as "abandonment" is demonstration of 100 percent obsolescence and in derogation, and a reference to the date of the end of the "normal useful life" of the asset in question, which appears to me wholly and unqualifiedly irrelevant. The words "already worn" also may be too strong. The whole regulation, moreover, seems to me to be too brief, too negative, and too vague, to give any substantial guidance to the taxpayer as to his lawful claims (or to Internal Revenue agents as to how to administer the allowance for obsolescence), and thus very seriously to fall short of fulfilling the requirements of an adequate regulation.

Another regulation (Regulations 111, sec. 17-6d) headed "Loss of Useful Value", does not contain specific reference to the statutory provision to which it pertains, and in the material paragraph does not use the word "obsolescence", but obviously has bearing on the question of allowances on account of obsolescence of a specific kind. The relevant portion of this regulation is as follows:

> "Art. 17(a)-7. Loss of useful value.—When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the basis (adjusted as provided in section 113(b) and articles 113(a)(12)-1, 113(b)-2, 113(b)-4, and 113(b)-5) and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, in which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not

extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be fully explained in the return of income."

As I understand it, this regulation permits the taxpayer, when because of a sudden change in business conditions the usefulness of capital assets is suddenly terminated, to make discontinuance of the business, or permanent disposition of the assets from use in such business, a basis for claiming of loss for tax purposes (where generally sale or exchange of the property is necessary to establish an allowable loss). This obviously fails to meet the situation of partial and irregularly progressing obsolescence which has not yet, and may not for an indefinite period into the future, given into 100 percent obsolescence--plus--depreciation.

<u>The Memorandum to the Secretary on Obsolescence Allowances, etc.</u>

The essence of the portion of this memorandum dealing with obsolescence allowances is the insistence that the Vinson-Trammell Act does not grant any greater or other privileges with respect to allowances for obsolescence than those available to all taxpayers under the income tax act. It is not clear that it deals successfully with the pertinent question whether the deductible allowances for obsolescence are identical for the purposes of the ordinary income tax and for the purposes of the excess-profits tax provisions of the Vinson-Trammell Act). There is some discussion of the conditions under which deductions for obsolescence are generally allowable, written largely in the same sort of language and carrying the same ideas as Bulletin "F" and thus suggesting that the restrictive decisions of the Bureau have survived the blasts from the Supreme Court, and are not yet 100 percent obsolete as far as the Bureau is concerned. Some specific comments on the text of the memorandum follow:

The phrases "reasonably certain", "ascertainable in amount", "reasonable degree of certainty", used in connection with the description of the kind of evidence of loss of useful value necessary to provide a basis for claims of allowance for obsolescence, are too exacting to be appropriate to the right of "reasonable allowance for obsolescence" granted by the law, for, as has already been argued, the measure of obsolescence is inherently incapable of "accuracy" or "certainty". That in the mind of the drafter of the memorandum the curse is not sufficiently taken off these terms by qualifying them by the adjective "reasonable" is sufficiently demonstrated, I think, by the conclusion drawn in the memorandum from the discussion in which these terms are used:

> "It follows that, in the case of permanent buildings and standard machinery, the fact that it is impossible on the basis of available evidence to compute any greater than the normal amount of depreciation and obsolescence forbids the execution of closing agreements determining in advance an extraordinary obsolescence allowance for such permanent buildings and standard machinery. To do otherwise would be to purport to grant private manufacturers of armament more than they are entitled to under the law." (Page 8 of memorandum).

This conclusion is apparently regarded as following from the propositions previously affirmed, which in effect are that obsolescence is deductible only:

> (a) When its occurrence is "reasonably certain" and its amount is "ascertainable".
>
> (b) When there are substantial reasons for believing that the property in question will become obsolete prior to the end of its ordinary useful life. (This is a recurrence of the stress on 100 percent obsolescence, which seems to me irrelevant).
>
> (c) When the likely time of its becoming obsolete (i.e., 100 percent obsolescent) can be known to a reasonable degree of certainty. (For reasons stated above, this seems to me to be totally irrelevant.)

The word "compute" in the conclusion quoted above also seems to me to be unfortunate as suggesting a greater degree of precision than can reasonably be demanded. The task of determining a reasonable allowance for obsolescence in an industry expanding to meet a demand which has suddenly increased and which by its very nature is liable to sudden and drastic decline in the near future, is certainly not a question of "computation".

The final conclusion of the memorandum, although undoubtedly intended to give hope to the taxpayer, really warns him that the taxpayer will obtain "the full benefit of the reasonable allowance for obsolescence granted by the Congress" only when he meets also additional, and often absolutely impossible, conditions arbitrarily laid down by the Internal Revenue Bureau:

> "...it is safe to predict that whenever the fact of obsolescence can be definitely shown and the point of time of complete disappearance of value other than salvage value can be definitely ascertained, the taxpayer will obtain the full benefit of the reasonable allowance for obsolescence granted by the Congress." (Page 11 of the memorandum, underlining mine).

Actual Practice of the Bureau.

From consultations with several members of the staff of the Internal Revenue Bureau, and especially with Mr. Martin, an engineer specializing in obsolescence matters, I obtain the definite impression that there is a decided disparity between the formal or office position of the Bureau in its general pronouncements and its actual operations in specific cases, and especially in the field, and that the actual practice is not, or is not seriously, open to the criticisms which I have made above of Bureau doctrine. I gather from Mr. Martin that in practice the criteria laid down by the Bureau are not enforced, and are largely unenforceable.

The Memorandum to the President and Letters to the Secretaries of the Army and the Navy.

These communications should be so formulated as to give more light as to the circumstances and the extent to which the taxpayer can claim obsolescence allowance, and should be framed with reference to what the Bureau can and

does reasonably do in practice, as well as with reference to what it cannot do, in the way of giving the taxpayer reasonable treatment. I think it should especially emphasize the fact, if it is a fact, that the taxpayer does not run the risk of being restricted from making deductions for obsolescence against the incomes of the years in which output is large, if these are also the years in which the obsolescence can reasonably be held to have occurred, even if the information which makes this seem reasonable becomes available only sometime after. What manufacturers fear is that their claims for obsolescence deductions will be allowed, if at all, only as against the incomes of the years after the collapse of demand, when the incomes will be small or negative, and the deductions therefore of little or no value. If the law permits a reallocation of obsolescence between the respective years whenever information justifying such reallocation becomes available, with appropriate readjustment of income (and excess-profits tax) liabilities for the respective years, the communications to the President and to the Secretaries of the Army and the Navy should make this clear. In any case, there should be less emphasis on the fact that the taxpayer has the opportunity to be said no to at higher and higher levels of the Bureau of Internal Revenue hierarchy, and more stress on the readiness of every division of the Bureau to deal with claims for obsolescence in a reasonable way. If the Bureau really applied the obsolescence provision according to the letter of its own formal position, the availability of several appeal stages would operate merely to add insult in the form of expense and irritation to the injury in the form of unreasonable execution of the mandate in the law. The taxpayer of course may bring action in the courts if he feels himself aggrieved by Bureau rulings, but insofar as possible the taxpayer should be able to get reasonable treatment without recourse to the courts.

Economists and the Bureau.

The way in which the Bureau has formulated its position with respect to allowances for obsolescence is supporting evidence for the merit of my contention, which I have urged upon the Treasury as often as I dared, that there is not sufficient collaboration between the Bureau and the economic staff of the Treasury in matters affecting the administration of provisions of the tax laws which have an economic bearing. It seems to me clear that it would be in the

interest of the Bureau if as a matter of ordinary routine such memoranda as the one under discussion here were not permitted to leave the Bureau until an economist definitely assigned to the Bureau for economic counsel had had the opportunity to comment on it.

December 20, 1939

MEMORANDUM FOR THE SECRETARY:

Attached is a summary report of the projects which have been worked on in the Division of Tax Research since the adjournment of the 1939 regular session of Congress. This report is furnished in accordance with your request of December 18.

RB

Report on projects in the Division of Tax Research
July 11 to December 19, 1939

1. Taxpayers' opinions

At the invitation of Under Secretary Hanes, taxpayers conferred with Treasury representatives during the months of September, October and November. Members of the Division of Tax Research participated in these conferences and are preparing a report summarizing the major recommendations submitted. This report, which is in final stages of review, is to be submitted by Mr. Hanes to the Subcommittee on Taxation of the House Ways and Means Committee.

2. Cosmetics tax

The Subcommittee of the Ways and Means Committee has requested that the Treasury prepare a report on the cosmetics tax. Accordingly Mr. Hanes directed this Division to make the study. A report is in final stages of preparation.

3. Certificate plan for a processing tax

A report has been completed covering the economic and financial aspects of the income certificate plan for processing taxes, an Agriculture Department proposal contained in several bills introduced in the 76th Congress, 1st Session.

4. War-profits and excess-profits taxes

Mr. Carl Shoup has prepared several memoranda on the problems of taxation during a period of neutrality and time of war. He has prepared a list of questions to be answered before a war-profits or excess-profits tax statute can be drawn and is continuing work.

5. Wartime taxes

A report was prepared for the Under Secretary on wartime taxation. In this connection an historical tabulation of all Federal taxes in effect during the period 1914-18 was made. Brief memoranda have also been prepared on wartime taxes in Canada and Great Britain.

6. Income tax study (W. P. A.)

Since October 1936 a study of income tax returns has been carried on at Philadelphia with W. P. A. funds. The study is continuing and the tabulations are nearing final stages of preparation.

7. Shipping taxes

In connection with a report to the President on the taxation of shipping by a joint committee of the Treasury, War and Commerce departments (Mr. Philip Young and Mr. Blough were members of the committee) the Division prepared a report on the taxpaying ability of the shipping

industry, an analysis of the taxes paid by the shipping industry and of its financial condition. This study was used as a confidential document by the Committee but is to be revised for future reference.

8. Chart of Federal, State and local revenues and expenditures

An estimate was made of Federal, State and local taxes and expenditures for the year 1938, and published in the August Treasury Bulletin. On the basis of these data a chart, "Estimated Flow of Federal, State and Local Government Funds, Fiscal Year Ending in 1938," was prepared in color and distributed to Congressional members, important Federal, State and local officials, and to others especially interested in tax conflicts.

9. Possible revenue sources

Memoranda have been prepared on various methods of raising additional revenue. The most recent report completed shows the possibilities of increasing the revenues from the income, estate and gift taxes. A report is in process describing a large number of possible sources of increased revenue.

10. Chronological table of Federal tax rates, 1928-1939

The chronological table of Federal taxes which has been brought up to date for each year for some years has

been further expanded and now shows comparatively Federal tax rates 1928-1939.

11. Revenue legislation

In accordance with annual practice, a statement has been prepared for the Annual Report of the Secretary for the fiscal year 1939 reviewing revenue legislation during the year.

12. Tax-exempt securities

(a) In accordance with annual practice, there was prepared for publication in the Annual Report of the Secretary of the Treasury for 1939 an estimate of Federal, State and local tax-exempt securities outstanding as of June 30, 1939.

(b) A report is being prepared to show the distribution of tax-exempt securities by net income brackets with particular reference to holdings of such securities by persons in high income brackets.

13. Data on public employees

In connection with studies relating to the exemption of salaries of public employees prior to the Public Salary Tax Act, a report was prepared showing the number and compensation of Federal, State and local public employees.

14. Income tax

(a) Personal exemptions, credit for dependants and the earned income credit.

The levels of personal exemptions, credit for dependants and the earned income credit have been analyzed and a report prepared on the economic and social bases for such allowances and the effects of various methods changing them. The memorandum is ready to be submitted as soon as a few revisions are made in it.

(b) Capital gains and losses

Studies have been made of available statistics relating to capital gains and losses and also of the desirability of changing the holding periods by shortening the period for long-term capital gains and losses to one year.

(c) Deductions

A report has been prepared on a proposal of the staff of the Joint Committee on Internal Revenue Taxation to allow individuals with net incomes of less than $5,000 a deduction of 10 percent of gross income in lieu of present statutory deductions.

(d) Consolidated returns and intercorporate dividends

Memoranda were prepared on the economic problems relating to consolidated returns and the taxation of intercorporate dividends. Also, a statement on these subjects was prepared for the use of Mr. Hanes before the Subcommittee on Taxation of the Committee on Ways and Means.

(e) Undistributed profits tax

Analyses of statistics relating to the undistributed profits tax have been undertaken. The report on this subject awaits the 1937 income tax data for completion.

15. Estate tax

A report on the possibilities of excluding from gross estate (a) insurance used in payment of taxes and (b) special securities issued by the United States Government used in payment of tax is in final stages of preparation. In this connection the general problem of liquidity of estates and hardships imposed under present law were studied.

16. Incentive taxation

From time to time the Division has analyzed the possibilities of making certain changes in the income tax law

designed to act as incentives to investment and employment. A preliminary report has been prepared and recent proposals are under consideration.

17. State and local finance

Information on State and local tax laws, rates and collections is being kept current so far as practicable. Several studies have been made on selected subjects of State and local finance that relate to Federal tax problems.

18. Foreign taxes

The Division is continuing to compile information on foreign taxes and foreign tax systems insofar as essential for its current studies of Federal tax problems. Brief reports are prepared from time to time on recent changes in the tax systems of major foreign countries.

19. Articles, speeches, etc.

The Division has prepared material for the use of the Under Secretary in addresses. Articles on taxation have been prepared for publication in the Britannica Year Book and the National Encyclopedia.

20. TNEC studies

Pursuant to an agreement with Mr. Willard L. Thorp of the Department of Commerce, the Division of Tax Research is reviewing the TNEC studies on corporation taxes.

21. Review of publications, etc.

The Division of Tax Research reviews Treasury Department publications, releases and tax forms. Among those recently reviewed were Statistics of Income for 1937 and the preliminary reports for 1938, the Annual Report of the Commissioner of Internal Revenue for the fiscal year ending June 30, 1939, and Statistics on Wine for the year ended June 30, 1939, and the 1939 individual and corporation income and other tax returns and instructions.

22. Statistics

The Division supervises and participates in the planning of the statistical work of the Bureau of Internal Revenue. In this connection it is advised by an intra-departmental committee on Statistics of Income.

23. Correspondence

The Division of Tax Research handles correspondence pertaining to tax problems.

TELEGRAM SENT

AC

GRAY

December 20, 1939

4 p.m.

AMEMBASSY

LONDON

1644.

From Secretary of Treasury for Butterworth.

For your information and forwarding by mail to American Embassies Paris and Berlin.

Reference Department's 1588, December 11, 1939.

Secretary of the Treasury announced today that reports from the Federal Reserve banks indicate that $1,301,182,100 of Treasury Notes of Series A-1940, maturing March 15, 1940, have been exchanged, $1,018,176,100 for the 2-1/4 per cent Treasury Bonds of 1951-53 and $283,006,000 for the 1 per cent Treasury Notes of Series C-1944. In addition to the exchanges, $73,006,000 of the bonds have been allotted to Government investment accounts, within the $100,000,000 reservation.

HULL
(HF)

EA:HF:LWW

178

DEC 20 1939

Dear Mr. President:

I have the honor to recommend the appointment of Honorable John L. Sullivan of New Hampshire, as Assistant Secretary of the Treasury, to fill an existing vacancy.

Mr. Sullivan has been serving as Assistant to the Commissioner of Internal Revenue since September 5, 1939.

I am transmitting herewith the usual nomination in (corrected form) the event you approve Mr. Sullivan's appointment.

Faithfully yours,

(Signed) H. Morgenthau, Jr.

The President,

The White House.

December 21, 1939

10:15 am

Present:

Mr. Irey
Mr. Sullivan
Mr. Wolfe

HM,Jr: Let me see this 2% fellow (Mr. Sullivan).

Mr. Irey: We think he's 100%, but I think you are thinking of something else.

HM,Jr: Mr. Sullivan, without giving me too many details, I want to know what your set-up is in the field now in Indiana. How are you handling this thing? Whom have you got? How are you going about it and where are we going?

Mr. Sullivan: Right now we are breaking into the so-called slush fund. All the work we have done heretofore has been background to go into that fund. That probably is the biggest fund they collect over there and have not accounted for.

HM,Jr: I am going to interrupt you. Where does the revenue come from that comes into the slush fund?

Mr. Sullivan: It comes from people who deal with the State on bids. They have to kick back with the politicians to get favorable action on the bids.

HM,Jr: That has nothing to do with office-holders.

Mr. Sullivan: Oh, yes. A large percentage of it finds its way into the 2% fund, which is used for campaign funds and the balance retained by office-holders.

HM,Jr: Take a couple of minutes to tell me where the money originates and where it goes under the slush fund.

Mr. Sullivan: We don't know what happens to that.

That's why we are going into Court on it now. We have information tending to show that a large part of the slush fund came from contracts on roads and it was disbursed for the manager of McNutt, both in lining up organization items and also to take care of State delegates outside of the State of Indiana; in other words, they have sent money into Michigan, Ohio and other States to influence delegates there who may be favorable to him. So we have the fund, some of it spent in Indiana, some of it in surrounding States.

HM,Jr: Any of that coming from local people?

Mr. Sullivan: A certain percentage of it comes from local people.

HM,Jr: Do you think the liquor people have to kick in every year?

Mr. Sullivan: Oh, yes! Their permits are renewed every year. They have to get a permit in November and there has been kick in.

HM,Jr: Only a one-year permit?

Mr. Sullivan: One year.

HM,Jr: I see. I did not know that. Who is the fellow who has charge of the slush fund?

Mr. Sullivan: Bowman Elder.

HM,Jr: And is he also the fellow who has charge of the 2% fund?

Mr. Sullivan: He was up to November 18th. On November 18th he made a public announcement that he resigned from the 2% club, but he's still over there and still in charge.

HM,Jr: Who is Bowman Elder?

Mr. Sullivan: Well, he comes from a very good family there in Indiana. His father was Collector of Internal Revenue back in 1919-1920 and his wife is -- I

forget his wife's name -- but she is one of the outstanding families in Indiana and well fixed. So is he. He has a very good reputation -- that is Bowman Elder.

HM,Jr: So far.

Mr. Sullivan: Well, I am talking about his standing in Indiana.

HM,Jr: And does he devote all of his time to this?

Mr. Sullivan: No. He's Receiver of the Indiana Railroad, which is quite a good paying job and from which he paid Frank McHale, his friend, $25,000 in one year's legal fees and he's in several activities. We have not checked him so much -- that is, his private activitives.

HM,Jr: I see. Well, this thing here -- you got to go a little faster. This thing can't drag out too long. And I want to strike -- well, wherever I strike I want to be sure, but even if we don't have the whole picture -- this thing can't go on for months.

Mr. Sullivan: Yes. I realize that.

HM,Jr: What part can you give me that you are sure of?

Mr. Sullivan: Relating to what?

HM,Jr: Anything in Indiana; that is, where they have not paid proper tax.

Mr. Sullivan: We have the income of the 2% club. That's taxable. The tax on that is about $150,000 plus delinquency penalties and interest. They have admitted about $100,000 in this slush fund, which is outside the 2% income, so far, and the indications are that the slush fund will probably exceed the income of the 2% club they reported, which was about $750,000 from 1933 to 1938.

HM,Jr: $750,000 to which fund?

Mr. Sullivan: That's the 2%. That's the fund they collected by imposing 2% on the State employees salaries.

HM,Jr: You have that one finished?

Mr. Sullivan: Yes, that's completed. At one point in that where we are trying to find out how they disbursed it.

HM,Jr: That's where we want Court orders?

Mr. Sullivan: That's right.

HM,Jr: If you get your Court Orders, how long would it take you?

Mr. Sullivan: It won't take long because the Judge - that's a civil hearing - we apply to the Judge for an order. He issues the Order directing them to answer questions and if they don't answer, they are in contempt of Court. You don't have to resort to indictment or pleadings.

HM,Jr: Well, when can you ask for that?

Mr. Sullivan: We can get that right after the first of the year.

HM,Jr: Why can't you get it on the 26th?

Mr. Sullivan: The principal reason is the District Attorney is sort of opposed to it. The Judge was away. He was attending a meeting of Federal Judges in Chicago. He's back -- yesterday. The United States Attorney is going away. I talked to him about it and it was his idea that once we start pressure by Court Orders we should follow it right up and not have any delays which would be encountered between now and the end of the year.

HM,Jr: Why would there be any delay?

Mr. Sullivan: The Judge would be away over Christmas.

HM,Jr: Well, all right.

Mr. Sullivan: And the United States Attorney is not a local man. He comes from Evansville and he's going down to Evansville to be with his family. It may be possible to get that thing started before the end of the year, right after Christmas. I will be back there about the 27th or 28th and might get Orders started then if the Judge and the Attorney are available.

HM,Jr: Where are you going?

Mr. Sullivan: Massachusetts.

HM,Jr: Are you on your way now?

Mr. Sullivan: I hope so!

HM,Jr: Well, I will tell you. We will make a little bargain with you. Before you go to Massachusetts supposing you find out whether you could make an appointment with the United States Attorney for the middle of next week from here. You can use the phone.

Mr. Sullivan: Yes, I can call him.

HM,Jr: And say you are in Washington and Washington would like to know how early after Christmas you can meet him. Do you have to be with the Judge too?

Mr. Sullivan: No. We have to get the Judge to sign the Order.

HM,Jr: That you are calling from here and these hard-boiled babies won't let you go home for Christmas until you can tell them when you and the Attorney and the Judge can sit down next week, and if you can get that answer you can go home for Christmas.

Mr. Sullivan: Well, I will take care of that, if possible.

HM,Jr: We will let you go home anyway. But I am — you have to contact two people to get your answer?

Mr. Sullivan: But it's up to the Attorney. He, in

turn, has to go to see the Judge, and whether he's going to be there next week .....

HM,Jr: I am telling you you can go home, but you don't have to tell him that. I am afraid the longer we wait, the longer we give these boys a chance to build up their interference.

Mr. Sullivan: They are about ready to disintegrate now. I mean, the 2% club.

HM,Jr: Can you see any objection?

Mr. Irey: Not at all. The reason he's hesitating, you have to handle the Judge with gloves.

HM,Jr: Here's Washington raising hell with you and you want to go home and trim the Christmas tree..

Mr. Irey: Sullivan can go back tomorrow and stay over Christmas.

HM,Jr: I am not asking him to. I want him to go home. But I thought you could use this.

Now, supposing we get this Court order and we go ahead, that gives you information where the $750,000 has gone?

Mr. Irey: If they do testify.

Mr. Sullivan: If they testify.

HM,Jr: And if they don't?

Mr. Irey: They are in contempt of Court and may go to jail, but we have an audit job then and we have to go in and audit ourselves and find things they refuse to tell us.

HM,Jr: How about the slush fund? When can you move in on that?

Mr. Sullivan: The Court order will develop both and the same fellows who control the disposition of the

slush fund had knowledge of the 2% slush, so the Court order will strike at both of them.

Mr. Jr: Who is going to represent you legally when you appear before the Judge or the Federal Grand Jury?

Mr. Sullivan: It's a civil proceeding before the Judge. You don't need any help.

Mr. Jr: Who is going out from here to see that everything is in order?

Mr. Sullivan: It's just a matter of issuing a Court order.

Mr. Jr: Well, you call Ed Foley that when this comes up I want somebody from Mr. Foley's office to be sitting next to him.

Mr. Ivey: Fine!

Mr. Jr: I want Foley to send somebody from here to be sitting alongside of him.

Mr. Sullivan: This United States Attorney was appointed by this group out there, but he's working with us in this suit.

Mr. Jr: I still say once we start, I want somebody from Foley's office sitting next to him.

Mr. Ivey: I have been keeping Foley advised of this.

Mr. Jr: Right! You should.

Mr. Ivey: They offered this Attorney one of the best licenses and he turned it down.

Mr. Jr: This not going so fast — it's going to cost anything?

Mr. Sullivan: No. The whole investigation, up to now, is to develop the income of the 2% fund and from or it came into the slush fund.

HL Jr: But rushing it isn't going to spoil anything?

Mr. Sullivan: No. And they are anxious -- I get round-about information -- they are anxious to get results on it anyway.

HL Jr: Are you familiar with the laws of the State of Indiana which would cover all of this?

Mr. Sullivan: I have a copy of their Election Laws and General Laws.

HL Jr: Somebody tells me they are very strict.

Mr. Sullivan: They are, but they are not strictly interpreted.

HL Jr: Is there anything in the Election Laws that covers this 2% club and the use of the money.

Mr. Sullivan: Yes. They had to amend the Election Laws in 1936 to try and cover up the activities of the 2% club and it had been in existence for five years.

HL Jr: Is there a Democratic Governor there now?

Mr. Sullivan: Yes.

HL Jr: Well, you can't expect much help from the State of Indiana.

Mr. Sullivan: Well, the former U. S. Attorney, a Republican, Griffiths, I talked to him and he said the amendment they put through on Election Laws to cover the 2% club is not legal anyway.

HL Jr: What are the Federal laws these fellows like Bowman Elder have been breaking?

Mr. Sullivan: I don't know. Outside of income tax, you mean?

HL Jr: Yes.

Mr. Sullivan: There is a possibility on road contracts, where the Government supplies the whole or part of that money and they have the contractors kick back to them. There may be violation of some other law.

Mr. Ivey: If these funds were used for a National candidate, there would be a Federal law violation.

Mr. Sullivan: Maybe on election.

Mr. Ivey: If they should use that for a National candidate, then the Federal laws come into it.

Mr. Sullivan: That's your Federal Practices Act, yes.

Mr. Ivey: What I am going to ask you is go back and see Mr. Foley when you leave here.

How much does it look as though McCutt received that he has not accounted for? Where, in your mind, do you think McCutt is going to end on this picture?

Mr. Sullivan: You mean as far as the investigation is concerned?

Mr. Ivey: Yes; he, personally.

Mr. Sullivan: He's going to be charged with a certain amount of income that he derived from this slush fund and a lot of his personal expenses have been paid out of either the 5% or the slush fund; in other words, he will give a cocktail-out party in Washington, costs $2,000 or $4,000, presumably himself, but part comes from the 5% club and part from the slush fund and they reimburse him. Those are items of income to him.

Mr. Ivey: Are they?

Mr. Sullivan: Uh, yes!

Mr. Ivey: You are going to have a hard job proving that to a jury if you say that.

Mr. Sullivan: They are clearly tax items. But there will be other items. He has had large stock brokerage transactions.

HM,Jr: But that's something else.

Mr. Sullivan: That's a tendency -- to show his expenses had been paid by this organization. They all tend to show it. No one alone would make a case, but if you get enough they certainly establish that fact.

HM,Jr: I think you can try and get these people together without irritating the Judge. I don't mind irritating the United States Attorney, but if the latter knows that you are here, that I am putting pressure on you and we want to go forward, it will be very wholesome, because that's what happened to Bill Campbell. Bill Campbell, in Chicago, is my pal. Every time he gets into trouble he comes to see me, and he will want some friends and if we can go on the same relationship that Bill Campbell feels -- whenever he's in trouble he comes to me to have me back him up against interference from Justice, so Campbell feels he can come over here and get backing. I want this fellow to feel on the same basis -- to come here if he gets into hot water.

Mr. Sullivan: We may have interference in Justice. McNutt brags about the fact that Murphy and he were roommates at school and very close friends.

HM,Jr: No, because at Cabinet, the other day, Frank Murphy said, "When are you going to give me that Indiana case?".

Mr. Sullivan: Well, that disposes of that, but McNutt brags of that.

Mr. Irey: Some fellow, Peters, been in Washington and claims to have had a talk with the President. He's connected with Federal Housing.

HM,Jr: The President knows about this.

I am glad to have met you and if you don't get what you want, you have no one to blame but yourself.

Mr. Sullivan: We will get active on it.

oOo-oOo

December 21, 1939

My dear Mr. Secretary:

This Department has received inquiries concerning the expiration on January 26, 1940, of the Treaty of Commerce and Navigation with Japan, dated February 21, 1911, with respect to the imposition of discriminating duties under section IV, paragraph 7, subsection 1 of the Tariff Act of 1913, 38 Stat. 195 (U.S.C. title 19, sec. 126; title 46, sec. 146), saved from repeal by section 651 (d) of the Tariff Act of 1930, 46 Stat. 763.

There is attached hereto for your consideration a draft of a proposed circular letter to be issued by the Bureau of Customs. I should appreciate an expression of your views as whether you perceive any objection to the issuance of the circular letter.

Very truly yours,

(Signed) H. Morgenthau, Jr.

Secretary of the Treasury.

The Honorable

The Secretary of State.

(Sent to Hiss by hand 12/21/39 - 2:30 p.m.)

BUREAU OF CUSTOMS
CIRCULAR LETTER NO. _____.

TO COLLECTORS OF CUSTOMS AND OTHERS CONCERNED:

Inquiries have been received concerning the expiration on January 15, 1940, of the Treaty of Commerce and Navigation with Japan, dated February 21, 1911, with respect to the imposition of discriminating duties under section IV, paragraph J, subsection 1 of the Tariff Act of 1930, 46 Stat. 195 (U.S.C. title 19, sec. 1338; title 46, sec. 146), saved from repeal by section 651(d) of the Tariff Act of 1930, 46 Stat. 700. Attention is directed to the coordinate provision of the Act of May 24, 1828, 4 Stat. 308, substantially reenacted in section 4228 of the Revised Statutes of 1875, as amended by the Act of July 24, 1897, 30 Stat. 214 (U.S.C. title 46, sec. 141), authorizing the President, under certain conditions, to issue a proclamation suspending discriminating duties. Attention is also directed to a proclamation issued by President Grant on September 4, 1872 (17 Stat. 956), suspending discriminating duties with respect to Japan. Since that proclamation appears not to have been revoked, the Treasury Department has reached the tentative conclusion that the proclamation will again be operative upon the expiration of the Treaty of Commerce and Navigation with Japan and that no discriminating duties under the statute cited above will be imposed, in the absence of Executive or Congressional action.

In view of the foregoing, no estimated or other duties shall be collected under 46 Stat. 195 (U.S.C. title 19, sec. 1338; title 46, sec. 146), unless and until this circular is superseded by further instructions.

Commissioner of Customs.

TREASURY DEPARTMENT
Washington

FOR RELEASE, AFTERNOON NEWSPAPERS
Friday, December 22, 1939

Press Service
No. 29-75

The Commissioner of Customs, in response to inquiries from importers, today issued a circular letter of instructions to collectors of customs advising them that the 10 percent ad valorem discriminating duties under Section IV, paragraph J, subdivision 1 of the Tariff Act of 1930 are not to be collected unless and until further instructions are issued. The question of application of the duties had arisen, according to importers, because of the impending expiration on January 26, 1940, of the Treaty of Commerce and Navigation with Japan, dated February 21, 1911.

The text of the circular letter is as follows:

December 21, 1938

[illegible]
[illegible] Office No. [illegible]

[illegible]

Instructions have been received concerning the application on January 15, 1939, of the Treaty of Commerce and Navigation with Japan, dated February 21, 1911, with respect to the exportation of discriminating duties under section 24, paragraph 4, subparagraph 3 of the Tariff Act of 1930, 46 Stat. 590 [illegible] title 19, sec. 1401 title 46, sec. 141], which was repealed by section 411(b) of the Tariff Act of 1930, 46 Stat. 701. Inasmuch as [illegible] provisions of the Act of May 24, 1934, 48 Stat. 772, substantially reenacted in section 4202 of the Internal Revenue Code of 1939, as amended by the Act of July 12, 1937, 50 Stat. 518 [26U.S.C. title 26, sec. 3421], authorizing the President, under certain conditions, to issue a proclamation suspending discriminating duties. Attention is also directed to a proclamation issued by President Roosevelt on September 14, 1937, 50 Stat. 1843, suspending discriminating duties with respect to Japan. Since this proclamation appears not to have been revoked, the Treasury Department has reached the tentative conclusion that the proclamation will again be operative upon the application of the Treaty of Commerce and Navigation with Japan and that no discriminating duties under the customs laws will be imposed, in the absence of instructions to the contrary.

In view of the foregoing, no enforcement of other action shall be initiated under 19 Stat. 590 [illegible] title 19, sec. 1401; title 46, sec. 141], unless and until you further be advised by Bureau instructions.

[illegible]

[illegible] of Customs.

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: December 21, 1939, 8 p.m.

NO.: 3024

FROM MATTHEWS FOR THE TREASURY DEPARTMENT.

This morning I called on Couve de Murville at the Ministry of Finance. I told him I was a little curious to know what mechanism they would use to keep a relative equilibrium for British and French price levels, as provided in the Franco-British financial accord, Article XVI - reference: telegram No. 3013 of December 20. It seemed to me, I said, that in the long run the success of the agreement might well hinge on that question; Couve de Murville smiled and said that frankly that is the weak point of the agreement. He said they had not succeeded in getting the British to act, although there have been lengthy discussions on the question. He mentioned that the French have kept their prices down in large part by limiting maximum wage payments. However, no such steps have been taken by the British, who are still unwilling to do so because the trade unions oppose it. Eventually, the French hope, the British will come to that decision, for it would seem to be the only solution if they are to avoid dangerous inflation, and if some balance between the price structures of the two allies is to be maintained. My friend said they would continue to press the matter.

I then made reference to the recent instruction to banks

banks by the foreign exchange governing board not to include in their declarations of holdings abroad their clients' assets - reference: telegram No. 3001 of December 13 from the Embassy. It was my understanding, I said, that said clients likewise do not have to include in their declarations of holdings any assets carried in an account or dossier with a bank in France regardless of where such holdings are actually located - reference, telegram No. 2390 of October 9 from the Embassy.

END SECTIONS ONE AND TWO.

BULLITT.

EA:LMW

My friend confirmed this understanding, and I remarked that it did not seem to me the inventory of French holdings abroad would be complete, even though I supposed French bank examiners would check up on such accounts. He frankly admitted that their inventory would not be complete and it was regretted that this was so, but they felt it would be difficult to obtain one, in any event. Incidentally, he said he believed the figures of the Federal Reserve Board - which the Ambassador had been asked by Reynaud to send to him - with regard to French holdings of American securities were too "optimistic" from the allied point of view. He said that with respect to British dollar securities, the British were inclined to take the same view.

He likewise said that the French do not contemplate issuing a long term loan with an exchange guaranty. He said it would be "idiotic" to take such an unnecessary step at this time - reference: telegram No. 3015 of December 20 from the Embassy. The current flow of armament bond subscriptions and tax receipts seemed to be satisfactory to him. I asked whether any measures of importance in the financial field are being contemplated by the French just now, and he said there were none.

In view of the foregoing I plan to spend five days in the French Alps, leaving Paris tomorrow night.

BULLITT.

EA-LEW

PARAPHRASE OF SECTION FIVE, TELEGRAM NO. 3024 OF DECEMBER 21, 1939 FROM AMERICAN EMBASSY, PARIS.

The Paris securities market was again weak today though rubber issues which led yesterday's decline were steady. Rentes were down from 30 centimes to 1.20 francs and losses in other securities ranged from 2% to 3%.

The state drew another 400,000,000 from its advance account with the Bank of France during the week ended December 14. (In accordance with the suggestion conveyed to me through Butterworth we shall no longer cable Central Bank statement figures in the absence of some unusual development.)

LE TEMPS this evening reports that an agreement was signed yesterday in Paris between representatives of the French and Japanese Government settling the long existing dispute between the city of Tokyo and French holders of the 5% 1912 loan of that city.

Reports from Amsterdam indicate that the failure of the recent loan may result in a relatively near future in a "semi-forced loan".

There has been a rise in the "black market" rate for dollars from 51 francs (quotation of a few weeks ago) to 57 or 58; however, there continues to be a small volume.

END OF MESSAGE.

BULLITT.

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Berlin, Germany

DATE: December 31, 1938, 5 p.m.

NO.: 3458

The Reich Treasury, by decree of December 11, has ordered that henceforward fifty pfennig pieces shall be made from aluminum instead of from nickel. On the thirty-first of December, 1938, the nickel content of the 199,400,000 coins of this denomination in circulation was approximately 698 metric tons; this is roughly one-sixth of the German nickel which was imported in 1938, exclusive of ore. On December 31, 1938, the nickel content of the 340,000,000 one-mark pieces in circulation was about 3300 metric tons. It is not known how many one-mark pieces were withdrawn from circulation, but the number is believed to be considerable, in view of the increased circulation of the one-mark Rentenbank notes which are replacing them. The issue of Rentenbank notes, presumably all in denominations of one, two and five marks, has since the beginning of the war increased by 600 million marks. Judging by the proportionate number of one, two and five mark pieces in circulation on the thirty-first of December, 1938, probably about 180 million marks of this increase in Rentenbank notes were one-mark notes. Therefore approximately 840 metric tons of nickel was obtained, assuming that these all represented replacements of the former nickel coins.

It is requested that this telegram be communicated to the Treasury Department.

END OF MESSAGE.

DA:LWV

WSR.

VRH PLAIN 198

London

Dated December 21, 1939

Rec'd. 7 a.m.

Secretary of State,

Washington.

2683, December 21.

Confidential For The Secretary Of The Treasury From Butterworth.

Your 1651, December 20, noon.

When I returned to New York from Washington on the afternoon of Saturday, December 9, I saw Ambassador Kennedy at the Waldorf. He told me that before leaving London he had been advised of the shortage of the product named in your 1651, December 20, 12 midnight, and that the matter was regarded as both very urgent and very secret and that he had discussed this with the President when he saw him on December 8. He instructed me, inasmuch as he was leaving New York and could not do so, to get in touch with Purvis and ascertain whether he had detailed information on this question and was in a position to act immediately and desirous of doing so. The Ambassador instructed me if this were the case to telephone Miss Le Hand at the White House.

After

-2- # 2683, December 21, 7 a.m. from London

After communication with his associates in Ottawa, Purvis telephoned me on Sunady, December 10, that his information was that there was an urgent need for such products though details were lacking but that an expert w as being sent from London who was either on the point of departing or at sea. Purvis was anxious to ensure that when he arrived such help as was possible or contemplated would be accorded him. I communicated with Mr. Kennedy, who gave his approval to the follow ing procedure: that there was no point in telephoning Miss Le Hand and that Purvis should be informed that when his expe rt arrived contact should be made in the usual way with the Chairman of the Committee set up by the President, but that mention could be made of the fact that Mr. Kennedy had discussed this matter with the President. I immediately communicated this to Purvis by telephone.-

JOHNSON

McL.

FR-

FILE

LONDON

Dated December 21, 1939

Rec'd 4:22 p.m.

Secretary of State,

Washington.

2695, December 21, 7 p.m.

FOR TREASURY FROM BUTTERWORTH.

Wigham and Gifford arrived in London yesterday. When I saw Montagu Norman last evening and Phillips this morning neither of them had yet seen them. It was quite clear (from?) that these conversations that the Bank of England was prepared to accept and act upon Wigham's and Gifford's proposals and that it was the British Treasury which caused the delay. In his conversation with me Phillips did not mention gold but emphasized the rate at which foreign sales had continued although he admitted that they tended to decline recently. In this connection he pointed out that the British fund had gained since the war the equivalent of about $20,000,000 from these voluntary liquidations of American securities. Phillips also stated that the first thing he intended to tell Wigham when he saw him that afternoon was that he expected him to return to the United States shortly.

Phillips said

Phillips said that the British Treasury was still in the period of Indian summer as regards domestic finance, that although the spending departments had put in large estimates of sterling expenditure they were still in the stage where they were not able to use the money as readily as anticipated but that many of them were on the point of being able to do so. As regards the British fund it had on balance gained gold and foreign exchange in September, October, and November through the imposition of the defense finance regulations but that it had begun during December the inevitable process of losing.

I asked Phillips if he had revised his figures of expenditure in America for the first year of the war and obtained the following information: that the gross expenditure of the United Kingdom in the United States would amount to about £170,000,000, that the net amount of money to be found would be the equivalent of £105,000,000 this figure being obtained by deducting £65,000,000 representing British exports visible and invisible to the United States plus the net favorable balance of the sterling empire (that is excluding Canada, Hong Kong, and New Foundland). Phillips added that the fighting services were almost daily putting up cases of requirements, which

170
680

requirements, which have much to be said for them, entailing dollar expenditures. These could be granted if the war was limited by statute to a short period but that in the given circumstances many if not most of them were being turned down and every attempt was being made to make armament progress move on a fairly even front.

Phillips did not seem immediately concerned about the recent wage increases which he pointed out were less than the increase in the cost of living and he emphasized the importance of maintaining the morale of labor which was very good. He indicated that individual rationing of certain foodstuffs etc. would begin on January 8 and that it would be launched with suitable publicity. He was much encouraged about the way in which the savings certificates were being bought. He said that the response had surprised the Treasury. I asked him what percentage of the savings certificates taken up did he estimate to be capital outlays and what was really tapping current savings of the working and lower middle classes. He said he felt confident that at least 80% was represented by the latter.

Phillips also seemed encouraged by the progress that had been made in general economic coordination which is not

which is not unnatural inasmuch as aside from the Stamp, Henderson, Clay Committee the Treasury is the organization responsible therefor.

JOHNSON

EMB

FEDERAL LOAN AGENCY
WASHINGTON

Enclosure
-04

JESSE H JONES
FEDERAL LOAN ADMINISTRATOR

Enroute
December 21, 1939

Gentlemen:

It does not seem to me that we three should assume too much authority with respect to the Colombian government debt to United States nationals. On the other hand, Colombia should recognize her existing debt, and arrange to service it, if the Export-Import Bank is to consider extending any credits to the Colombian government.

I would think a new 30-year bond at a fixed rate of 3%, and to include past due interest at 3%, should be as favorable a settlement as the Colombian government could ask for. Adding the past due interest at 3% would bring the debt to approximately $53,000,000, the interest on which at 3% would be about $1,590,000.

The debt service fund might be fixed at $150,000 a month for the first year, $175,000 a month for the next four years, and $200,000 a month thereafter, the excess, after interest, to be used annually or semi-annually to buy bonds on tender.

Such a plan as this adhered to by Colombia, would, in all probability, retire all the bonds before their maturity, as enough holders would tender bonds at a heavy discount each year as to make a very substantial saving to the Colombian government.

The Colombian government should also undertake to service the guaranteed Agricultural Mortgage Bank debt at some similarly adjusted interest rate.

Sincerely yours,

Jesse Jones
Administrator

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

Honorable Sumner Welles
The Under Secretary of State
Washington, D. C.

CONFIDENTIAL

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

605

DATE December 21, 1939

TO Secretary Morgenthau

FROM Mr. Cochran

The foreign exchange market was uneventful today with a considerable reduction in the volume of sterling transactions. After opening at 3.94-3/4, the sterling rate moved off slightly on some small selling to 3.94-1/2. Moderate buying by Japanese banks in the late afternoon lifted the rate to 3.94-7/8. Sterling closed at 3.94-3/4.

Sales of spot sterling by the four reporting banks totaled £371,000, from the following sources:

By commercial concerns	£ 163,000
By foreign banks (Europe and Far East)	£ 208,000
Total	£ 371,000

Purchases of spot sterling amounted to £277,000, as indicated below:

By commercial concerns	£ 192,000
By foreign banks (Europe and South America)	£ 85,000
Total	£ 277,000

The following reporting banks sold cotton bills totaling £95,000 to the British Control at the official rate of 4.02:

£ 88,000 by the Chase National Bank
£ 7,000 by the Guaranty Trust Co.
£ 95,000 Total

The other important currencies closed as follows:

French francs	.0223-3/4
Guilders	.5310-1/2
Swiss francs	.2243
Belgas	.1666
Canadian dollars	11-5/8% discount

The Mexican peso receded to .1708, a new low for the current movement.

The Federal Reserve Bank purchased 20,000 guilders for the account of the Bank of Latvia.

We sold $2,000,000 in gold to the Central Bank of Argentina, to be added to its earmarked account.

The Federal Reserve Bank reported the following shipments of gold:

$2,800,000	from India, representing two shipments by the National City Bank, Bombay, to the National City Bank, New York, for sale to the U. S. Assay Office at New York.
2,256,000	from the Netherlands, shipped by the Netherlands Bank to the Federal Reserve Bank of New York to be earmarked for the account of the Netherlands Bank.
$5,056,000	Total

The State Department forwarded to us a cable from the American Consulate General, London, stating that invoices were certified for the following shipments of gold from England:

$415,000	shipped by Sharps & Wilkins to the National City Bank, New York.
58,000	shipped by Mocatta & Goldsmid to the Banque Belge pour l'Etranger, New York.
36,000	shipped by Sharps & Wilkins, London to the Chase National Bank, New York.
$509,000	Total

These shipments of gold will be sold to the U. S. Assay Office at New York.

We have learned that the gold shipment of $3,048,000 from Hungary, listed in yesterday's report, was shipped by the National Bank of Hungary to the Federal Reserve Bank to be earmarked for the account of the B.I.S.

Today's Bombay price for first settlement silver (delivery January 7) worked out to the U. S. equivalent, less the import tax, of 43.59¢.

In the New York silver market, Handy and Harman fixed a price of 36-1/2¢ for foreign silver, up 3/8¢ from yesterday's price.

One fact emerges from the numerous unconfirmed reports that have reached us regarding silver dealings by Bombay operators: Bombay silver traders have made bids for silver on a dollar price basis in the New York market during the last two days and several transactions were consummated. The highest price paid by Bombay dealers was 36-1/2¢, this price being for silver f.o.b. New York (i.e., all expenses of shipment to Bombay to be paid by the buyers).

The Treasury's price for foreign silver was unchanged at 35¢, with no purchases being made under the Silver Purchase Act. The prices fixed in London for spot and forward silver were 23-3/8d and 23-1/2d. Their respective U. S. equivalents were 41.52¢ and 41.32¢.

December 21, 1939.
10:05 a.m.

H.M.Jr: Hello.

Operator: General Arnold.

H.M.Jr: Hello.

General Arnold: Good morning, sir.

H.M.Jr: Good morning General.

A: I just want to correct a figure that I gave you yesterday.

H.M.Jr: Yes.

A: I don't want any erroneous figures going out from my office.

H.M.Jr: Yes.

A: I told you yesterday the British had ordered twenty-six hundred engines.

H.M.Jr: Yes.

A: That is wrong. They have a total of sixteen hundred approximately on order.

H.M.Jr: Oh!

A: Now out of that sixteen hundred they have ordered over six hundred within the last month.

H.M.Jr: Well then that's the five-fifty order that I heard about.

A: They've ordered those within the last month.

H.M.Jr: Well that was the order that they were talking to me about.

A: Yes, that's the one. Now for your information, all the nations have ordered ninety-eight hundred and ninety engines. That's the number of engines they - I'm going to order right this minute.

H.M.Jr: That's wonderful.

A: Ninety-eight hundred and ninety engines they've ordered, and out of that order however France has

got the most. France is the one that's going to dump the apple cart, because she put in orders for seventy-seven hundred engines.

H.M.Jr: Yes.

A: Well seventy-seven hundred from ninety-eight, you see, only leaves about twenty-two hundred for the rest of the countries.

H.M.Jr: The rest of the world. General, while I've got you on the wire, this may be helpful to you, I asked the Commissioner of Customs yesterday what would be the procedure to get this spitfire plane out.

A: Yes, sir.

H.M.Jr: And he said that all the English have to do would be to ask for a license from the Munitions Board, which he could see no reason why it shouldn't be granted and for export or re-export to Canada.

A: Well I'll take that up right away with air Attache and see if I can't get it started.

H.M.Jr: But that's the legal way to do it.

A: Yes sir.

H.M.Jr: And I don't - as far as I know there'd be no publicity, I mean I don't see why there should be any publicity.

A: I don't see any reason for it.

H.M.Jr: But all they've got to do is to ask for a re-export license from the Munitions Board to send this up to Canada and it would go out, I think there's about one chance in fifty that anybody would know anything about it.

A: Well I appreciate that very much.

H.M.Jr: But that's the way to do it.

A: O.K. I'll get the wheels started.

H.M.Jr: Righto.

A: O.K.

H.M.Jr: See you again.

December 21, 1939.
12:55 p.m.

H.M.Jr: Hello

Operator: Mr. Hamilton. Go ahead.

H.M.Jr: Hello.

Maxwell M. Hamilton: Hello Mr. Secretary, this is Hamilton.

H.M.Jr: Right.

H: I'm sorry to bother you about this matter but it's in - it happens to be of some urgency from our point of view. It's in reference to this notice which I think has been put on your desk of a proposed circular letter to collectors of customs and others concerned in regard to the question of the imposition of discriminating duties against Japanese shipping upon expiration of the treaty.

H.M.Jr: It hasn't come to me yet.

H: Oh, we understood from your man over there, that it had been put on your desk.

H.M.Jr: No. Who told you that?

H: Cairns, is there a man named -

H.M.Jr: Yes.

H: It was Mr. Cairns. Well perhaps it was just sent to your office.

H.M.Jr: No.

H: Well there's unfortunately been a misunderstanding some weeks ago we got a letter from the Secretary of Commerce asking for our views on that question. In preparing our reply to that letter we consulted with officials in the Bureau of Customs. We prepared our reply, we also consulted with officials in the Maritime Commission.

H.M.Jr: Yes.

H: Then we, at Mr. Welles' suggestion, we sent our reply to the President and he approved the reply. We didn't learn until yesterday the matter had

never been brought to your attention.

H.M.Jr: That's right.

H: We have this memorandum from the President stating that I agree that we should defer action applying a ten per cent tonnage letter on Japanese ships beginning January 26, 1940. In addition the President has suggested that we try to use this - our decision with the Japanese in a diplomatic way in an effort to impress on them that this is just a temporary decision and carried the implication that something may happen if conditions don't improve in general. Now in connection with discussions at Tokyo between Mr. Grew and the Japanese Foreign Minister, we are preparing a reply in which reply, we have wished to use a statement of fact to the effect that the Treasury Department is issuing this notice to collectors of customs and others concerned.

H.M.Jr: Yes.

H: But we also sent that telegram to the President and got his O.K. This was all before we found out that - yesterday afternoon, that you didn't know anything about any of this.

H.M.Jr: Well I don't even - well as I say, I'm not familiar with the matter.

H: Yes. Well from our point of view we'd like very much to get that telegram off to Mr. Grew this afternoon.

H.M.Jr: In other words you're out on the end of a limb.

H: Well, we are insofar as that particular paragraph of the telegram is concerned.

H.M.Jr: Yes. Well I'll tell you what I'll do. I'll get hold of Basil Harris, who is Commissioner of Customs.

H: Yes.

H.M.Jr: And tell him to look into the thing and find out whether it is something that we can honorably go along with.

H: Yes. Our legal people and your legal people in

the Bureau of Customs have been over it as well as the legal people in the Maritime Commission.

H.M.Jr: I have so much trouble along this line and these things should flow from Mr. Hull to me in a formal manner, then there wouldn't be these difficulties.

H: Huh-huh. But of course the letter was written to us from Commerce.

H.M.Jr: Yes.

H: And we've - the reason I called was to explain the urgency and also the fact that we've got certain documents in our files, in other words the documents prepared by the lawyers explaining certain of the technical aspects of the thing which you haven't and which we'd be very glad to bring over there.

H.M.Jr: Well, Hamilton -

H: If you think that would be useful.

H.M.Jr: Hamilton, just because it doesn't go regular way won't be that - I'll not try to be helpful.

H: No, well I -

H.M.Jr: I'll try my best to be helpful, but please see that it doesn't go that way again, huh?

H: Sure, well I - we didn't know anything about this until yesterday, that it hadn't gotten up to you. We had a conference incidentally, with the people from Commerce and the Treasury and our Department and the Commerce people had cleared with their own Secretary.

H.M.Jr: Well -

H: And we unfortunately assumed that your people had too.

H.M.Jr: Right. Well let me get at it right after lunch and I'll ask Commissioner Harris to give it his prompt attention.

H: And if there's any - if we can help any by bringing

some of these documents over and giving you people a chance to look at them I'll be very glad to bring them over.

H.M.Jr: Thank you Mr. Hamilton.

H: All right, thank you.

H.M.Jr: Goodbye.

BSM

PLAIN

London

Dated December 21, 1939

Rec'd 3:10 p. m.

Secretary of State,

Washington.

2698, December 21, 7 p. m.

FOR TREASURY FROM BUTTERWORTH.

Since returning I have talked with Montagu Norman, Phillips, Waley, Sir Horace Wilson, Leith-Ross, Mr William Brown, Clay and a good many other officials and non-officials. As regards Government mechanism I find that the information contained in my 1631 of September 13, 6 p. m., on the economic organization and my 1647 of September 14 on price policy is not as out of date as it should be. I have the sense that during the past six weeks great progress has been made in ironing internal departmental organization and procedure and an almost too elaborate committee system has been built up with a view to coordinating action involving the concurrence of more than one department. Progress has been made in providing physical facilities for the various departments. The civil service personnel and the new non-civil service personnel has naturally grown

and in dealing with each other which has had an important effect upon the efficiency of the British Government machine basically rests on personal contact.

On the other hand despite the appointment of Stamp who is mentioned by Henderson and Clay (see my No. 1931 of December 8th) my off-hand impression is that little progress has been made in formulating and putting into effect a positive coordinated economic policy. I get the feeling that Stamp has not been a startling success. There is considerable political force behind the campaign for a Minister for Economics in the War Cabinet and this campaign bears striking resemblances to that waged before the war for a Minister of Supply. Several officials with whom I talked felt that such a move was coming but most of them were basically sceptical as to its efficacy.

It is fair to say that there is still no wheat policy as such. Although foodstuffs have risen 14 percent this is to a substantial extent due to depreciation of sterling, increased insurance, freight, etc. and although the Ministry of Food is in some products now losing money the aim is to keep the price of basic foodstuffs more or less stable. Wholesale prices of other essential supplies are being allowed to move irregularly, fluctuations being made on an individual basis.

T

-3- #2698, December 21, 7 p.m., from London.

I asked Harold Wilson about this and he emphasized that whereas a great deal of thought was being given to this problem and to the other decisive economic problems such as wages, and whereas there was a fairly clear determination present in the minds of responsible officials concerned the state of British public opinion was such as to make it unwise to move hastily. He and all the other British officials with whom I have talked have emphasized the difficulty of grappling immediately with the problem in the absence of a type of war activity which would bring home the need to the people themselves. Montagu Norman for instance pointed out the need for "dragooning" and the difficulty of doing so with a people whose instincts and outlook is geared to a democratic economy unless the presence of the war is tragically evident. Needless to say there are others with whom I have talked who emphasize the tragic absence of forward leadership. Wilson felt that it might be necessary to "drift along for another four or five months" and that by that time the character of the war would have laid the foundation in public opinion for the necessary drastic action. In defending this point of view in terms of the wage raises that have taken place during recent weeks

he

he pointed out the strength and flexibility of the British system of labor, that it had facilitated the rearmament program without causing one single serious labor dispute during a three year period. The defects of the rigidity of the French system had been illustrated during the past few years in France, from the effects of which France was still suffering in her aircraft and other munitions works. He said that when Raynaud was over here and had chided him about the slowness with which Great Britain was moving in stabilizing British wage rates he asked Raynaud what sanctions he applied in France, to which Raynaud replied "mobilization and the highest idea". On the other hand there are those who feel that British public opinion was during the initial stages of the war ahead of the British Government and Crowther, the editor of the ECONOMIST, mentioned for instance that he was considering publishing Raynaud's speech of December 13 and Simon's speech of November 29 in parallel columns as the most devastating possible criticism of British inaction.

Rationing is starting in the new year but according to Maurice Hutton of the Ministry of Food, it is being adopted because stocks have reached such a low point that it has become necessary. For example during the past month British consumers have required 20 per cent more sugar than

during

during the corresponding period before the war and it is estimated that at least a substantial part of this has not just been stored but actually consumed. This and other cases are forcing a change of policy despite the fact that Winston Churchill is said to feel that rationing would reflect upon the efficiency of the British navy.

In the matter of exports although the November figures show a return to the August level whereas in September they were 40 per cent down the position is not as good as this would indicate since much of the November rise represents October exports piled up on the docks ready for shipment. Brown of the Board of Trade is having his difficulties in apportioning resources with the fighting services who, having in mind the experience of the last war are inclined to order for more than their immediate needs. For example the army ordered 6 million blankets shortly after war was declared and has increased that order since although there is no expectation of such a number being used for a long time. Attempts are being made to deal with these and the other usual ills arising out of the transition from a peace-time to a war-time economy. But as yet there is little talk of costs hindering the movement of exports, the emphasis is on internal organization. But the latter stage may be expected when the question of facilitating British exports

through

through Schachtian bookkeeping or by exchange vouchers which will come up.

Likewise the Ministry of Economic Warfare is in certain cases finding it difficult to take away from Germany key products produced in contiguous neutral countries. There are faint signs that some of these countries are not anxious to acquire sterling as such and that they go down that goods can be obtained with such sterling when that and the things they want most are the things which Germany certainly can least spare. Doubtfully anti-direct gain are the most sought after export and Germany is very really still able to export them to the Danubian countries as well as some machine tools and specialized steels. The British Treasury is making a number of payments agreements which to meet these circumstances will entail making dollars available. I shall report further on this point when possible. The British feel that the Anglo-French economic agreement was foisted on them in the form it was signed for internal French political reasons. They regard an arrangement as both necessary and desirable but a formal document, the meaning of which in its some parts obscure to the authors, they considered unnecessary. Moreover they feel progress has been made in Anglo-French coordination. Likewise the

Anglo-French

Anglo-French financial agreement in its present form is regarded as a domestic French political move: since Poincaré through Monnet had arranged a public economic conference, Reparations had to arrange a financial one and at the same time make it clear that finances did not fall in Monnet's sphere. As to the former agreement it seems to me that the differences in the standard of living between the two countries will be found to lie at the crux of the settlement of many questions and most of the officials with whom I talked admitted that it was difficult for Great Britain to resist French demands so long as there existed such a disparity between the standards of living of the two countries. As to the latter agreement apparently both the British and French estimate that on the present war basis it will take about ten months for the French balances in London to be exhausted. After that France has agreed to release these credits to which the British attach great importance. But it should be noted that the agreement does not that automatically any changes in exchange rates between the franc and the pound. My impressions are of necessity without bias I cannot help feeling that Montagu Norman was right when he said that there is a long row to hoe in the economic field and that many difficulties and difficult times remain to be overcome and endured. I leave for Scotland tonight for the Christmas holidays.

JOHNSON

SSM

GRAY

London

Dated December 21, 1939

Rec'd 1:07 p. m.

Secretary of State,

Washington.

2695, December 21, 6 p. m.

FOR THE SECRETARY OF THE TREASURY FROM BUTTERWORTH.

I lunched with Leith-Ross who asked me to inform you that the reply to the questions which you put to Purvis is being formulated and that the delay has been somewhat occasioned by the obtaining of a joint Anglo-French reply but that he hopes to be able to get it off by the end of the week.

JOHNSON

CSB

6-231

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TREASURY DEPARTMENT

PROCUREMENT DIVISION

WASHINGTON

OFFICE OF THE DIRECTOR

December 21, 1939

MEMORANDUM FOR THE SECRETARY

An order has been placed with the Brewster Company by the Government of Finland for 44 planes at a price of $54,000 each, including 50,000 rounds of ammunition for each gun.

These planes are single-seated fighters powered with Wright 1820 Single Row Cyclone Motors, 950 HP, capable of developing 300 miles per hour. The armament consists of 4 guns, 1 of 30-calibre and 3 of 50-calibre. The planes are also designed to carry approximately 200 pounds of bombs and have a range of 1,000 miles.

The Navy had on order with the Brewster Company 54 planes of this type at a price of $28,000 each, which price, however, was exclusive of the engine, propeller, radio, guns, bomb racks, and starters. The Navy had made a progress payment of $550,000 and had had delivered 11 planes. The $440,000 unamortized of the $550,000 advanced has been returned to the Navy, thereby clearing title to such material and work in progress as the Brewster Company may have on their floor at this time. The new plane which the Navy is to get to replace those not delivered under their original contract will be powered with an improved Wright engine which will give an additional 3,000 feet of critical altitude and will develop a speed of 328 miles per hour.

The delivery of the planes to the Government of Finland is beginning immediately and will be completed by February 1, 1940.

J. S. Gallers

Director of Procurement

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE December 21, 1939

TO Secretary Morgenthau

FROM Mr. White

Subject: Domestic exports to U.S.S.R. in the first week of December.

In the first week of December the United States domestic exports to U.S.S.R. amounted to $4.2 million, which was the approximate average monthly exports during the past few years.

Copper and copper products constituted the bulk of our exports during this week. Refined copper exports were $2,300 thousand, copper products amounted to $118 thousand, and brass and bronze manufactures, $200 thousand. Prior to November 1939 we exported practically no copper or copper products to Russia.

Exports of molybdenum were $292,527 in the first week of December.

Principal items exported to Russia in the first week of December were as follows:

	Values in thousands of dollars
Total domestic exports	$ 4,213
Copper and copper products	2,377
Power driven planers, shapers and grinders	512
Molybdenum ore and concentrates	293
Other brass and bronze manufactures	199
Diesel and semi-Diesel engines	164
Electric motors, starters and controllers	97
Power driven boring, milling and drilling machines	96
Metal working and forging machinery	75
Industrial electric furnaces and heating devices	51
All other commodities	349

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE December 20, 1939

TO Secretary Morgenthau

FROM Mr. White

Subject: Domestic Exports to U.S.S.R.

1. United States domestic exports to Russia in November amounted to $7,027,000, an increase of 29 percent over October.

2. Exports of copper and copper products during November were more than one hundred times larger than they have been during the whole of the previous 16 months. They were $2,069,000 in November as compared with $17,000 for the whole of the previous 16 months.

3. Exports of gasoline, wheat, Diesel engines, and certain kinds of machinery increased over previous months and were much higher than pre-war months. Molybdenum exports dropped from October levels, but were still higher than pre-war exports.

4. Appended is a list of our exports to Russia which were greater in November than the average monthly imports during the preceding 16 months.

United States Domestic Exports to U.S.S.R

(thousands of dollars)

	Monthly Average		
	1939		July 1938 to August 1939
	November	September and October	
Total domestic exports	7,027	3,620	4,233
Molybdenum	732	1,069	271
Gasoline, other than aviation	782	583	75
Gasoline, aviation	2	-	-
Planers, shapers, and grinders	778	238	473
Wheat	436	108	64
Diesel and semi-Diesel engines	128	94	13
Forging machinery and parts	105	67	90
Abrasives	57	70	31
Electric motors, starters and controllers	175	44	36
Other metal working machinery	140	50	123
Industrial electric furnaces and heating devices	155	26	102
Iron and steel advanced manufactures	118	3	12
Copper, refined in ingots and bars	1,082	-	1
Copper, old and scrap	462	11	1
Other brass and bronze, including wire	525	18	1
All other commodities	1,300	1,239	2,940

JR

PLAIN

London

Dated December 21, 1939

Rec'd 1:05 p.m.

Secretary of State,

Washington.

2698, December 21, 6 p.m.

FOR TREASURY FROM BUTTERWORTH.

Officials in both the British Treasury and Bank of England who are concerned with the exchange control problem are of the opinion that the measures thus far undertaken are effective in preventing the flow of British funds from moving to free currency centers. Foreign holders of sterling balances are still for the most part free to move their balances since individual accounts are not blocked and it is still possible for a British importer to pay in sterling to a willing foreign exporter who, if he so desires, may sell the sterling on the unofficial market and for a British exporter to be paid in sterling by the foreign importer who acquires that sterling on the unofficial market. There is still discussion as to the desirability or otherwise of blocking individual accounts and requiring all payments for importations to be made in the foreign exchange of the country of origin so that the British control would be the sole source from which such foreign exchange could be

obtained,

obtained, and of undertaking corresponding measures regarding exports. Although I find no concern here regarding the immediate situation there is a recognition that if the war is to be a long drawn out affair the exchange control will have to be tightened. Foreign balances were low even before the war (see 2nd paragraph of my No. 1248 of August 25, 2 p.m.) but transfer as the British are successful in canalizing trade with such countries as the Argentine and are unable to provide sufficient goods to absorb the accrued sterling balances they will have to block these balances and or induce partial repatriation by such countries.

I am authoritatively informed that the British fund has not (repeat not) operated to date in the unofficial market in New York.

WINANT

CSB

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

CONFIDENTIAL

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TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE December 21, 1939

TO Secretary Morgenthau

FROM Mr. Haas

Subject: Current Developments in the High-Grade Securities Markets

SUMMARY

(1) Except for very minor declines registered on Wednesday, December 20, the entire Government security market has been moving upward for the past two weeks. The average yield of long-term Treasury bonds has declined nine basis points (Chart I). The sharp upswing has brought prices of all Treasury securities to new high levels for the recovery movement (Chart II).

(2) The new Treasury bond is in line with the market but the new Treasury note is somewhat out of line on the upside (Chart III). Since the offering, the course of the price movements of the two issues has differed (Chart IV) but this was to be expected. Reporting member banks increased their Government bond holdings by $167 millions during the week which included December 6, the date of issue of the recent cash offering of Treasury bonds (Chart V).

(3) Recent operations in Government securities have resulted in very substantial lengthening of the Federal Reserve Open Market portfolio. Only 10 percent of the Reserve holdings now mature in one year and less than 50 percent within five years (Chart VI).

(4) Life insurance companies purchased net more than twice as many corporate securities as Governments during the last twelve months. The decided shift to corporates, which started in 1937, can be explained in terms of technical factors rather than interpreted as indicating the end of the insurance company demand for Governments.

(5) Last week high-grade corporates and municipals made new high prices for the recovery movement. Corporates lagged behind Treasurys, however, the spread between the yields widening slightly (Chart I). Corporate and municipal offerings were the largest for any week since the middle of August.

(6) British Government securities have been quiet. French rentes declined this week, losing part of the sharp advance scored during the first part of the month.

I. Governments Reach Post-Crisis High

Except for very minor declines registered on Wednesday, December 20, the entire Government securities markets have been generally moving upward for the past two weeks. The average yield of long-term Treasury bonds has declined nine basis points during the period, closing on Wednesday at 2.32 percent. This yield compares with the all-time record low yield of 2.07 percent reached on June 5 and with an average yield of 2.19 percent reached on August 19, just prior to the outbreak-of-war crisis (Chart I).

The sharp upswing in the market during the past few weeks has brought prices of all Treasury securities to new high levels for the recovery movement (Chart II). The relative movements for the past two weeks are shown, by maturity classes, in the following table:

	Average Price Change December 6 - December 20
	(In thirty-seconds)
Notes	
1-3 years	+ 9
3-5 years	+ 21
Bonds	
Under 5 years to call	+ 4
5-15 years to call	+ 25
Over 15 years to call	+ 43

It will be noted that the short Treasury bonds — those under five years to call — have done relatively poorly in relation to the other maturity classes. This poor performance seems to be due principally to the very high premiums generally prevailing in this class of bond and the short period over which such premiums have to be written off. The bonds in this class all give a very high "current return" (i.e., before amortization) and their holders can count it a good week when the bonds merely hold their own from a price point of view.

The rise in the market was accompanied by further sales of Government securities by the Federal Reserve banks. Total sales from the Open Market portfolio have amounted to $17 millions since Friday, December 15, when such sales were resumed after a temporary suspension due to the Treasury financing.

II. The New Issues and the Market

On the basis of when-issued quotations at the close on Wednesday, December 20, the new Treasury bond (1951-53) was well in line with the market. The new Treasury note was still out of line on the upside, however, selling one basis point less than the June 1944 note, which matures three months earlier, and on the same basis as the March 1944 note which matures six months earlier (Chart III). Ordinarily, there is an increase of a couple of basis points between issues maturing three months apart at the long end of the note market, even though the yield curve is relatively flat in that sector, possibly because of the great demand for the longest notes by wealthy individuals desiring fully tax-exempt securities.

The small volume of the March note exchanges into the September 1944 notes may well provide the explanation of the out-of-line position of the new note. Presumably few private holders of the March notes exchanged into the new notes, unless they desired a new fully tax-exempt security without the trouble of engaging in a market operation. Had they been inclined to trade in the market, they could have made a better deal by selling their rights and purchasing an outstanding note issue. The new notes, therefore, are very likely held principally by persons disinclined to trade. They are, accordingly, in a very strong technical position, and may sell out of line on the upside for a protracted period.

In studying the two new issues it is interesting to note that the course of their price movements has been quite different. The lack of parallelism was to have been expected, however, for the price of the notes was temporarily brought close to the price of bonds by attempted arbitraging operations engaged in as long as the subscription books remained open. After the books were closed, however, the price of the note moved along its own course — which, it happened, was away from that of the bond (Chart IV).

Early this week figures became available showing reporting member bank holdings and insurance company purchases of Governments during the period which included December 8, the date of issue of the recent cash offering of Treasury bonds (the 1948-50's offered on November 28). Weekly reporting member banks increased their Government bond holdings by $167 millions during that weekly period (Chart V) and insurance companies made gross purchases of Governments (direct and guaranteed) aggregating $80 millions.

The statistics cover different seven-day periods, but they each include December 8, the day that the cash offering was paid for by the purchasers.

Although these preliminary data do not set out information with respect to the 1948-50's separately, they would seem to imply that at the time of the original subscription this issue turned out to be as popular with banks as advertised. We shall obtain definite information in this respect within a few weeks, when the Federal Reserve banks will provide us with their regular analysis reports on the subscriptions to the cash offering. In the meantime, however, it seems safe to say that it is quite probable that these figures, when they arrive, will show that commercial banks as a class subscribed to about half of this cash offering of bonds. This compares with 39 percent of the last cash offering of bonds (1960-65's) and a high of 49 percent in the past few years (in the case of the 2-1/2's of 1945, offered in December 1937).

III. The Maturity Distribution of the Federal Reserve Portfolio

The action of the Federal Reserve authorities in exchanging the major portion (62 percent) of their March notes into longer-term securities continues the customary procedure that has been followed in the past on the occasion of previous Treasury offerings of two or more securities in exchange for maturing notes. The current operation, accompanied as it has been by the runoff of Treasury bills and the sale of securities in demand in the market, has resulted in a very substantial lengthening of the Government portfolio held by the Federal Reserve banks. In addition, the portfolio as now constituted contains no very near-term maturities at all, the shortest issue held, the June notes, maturing a little more than five and one-half months hence.

Chart VI shows the changing character of the maturity distribution of the Federal Reserve portfolio. It shows the percentage distribution by maturity classes of the holdings of United States securities at the end of each year since 1936. In 1936, it is noted, one-third of the Federal holdings matured in one year and more than 80 percent within five years. By the end of 1938 these proportions had moved slightly toward the long end. During the year 1939, however, the lengthening has been quite pronounced, so that at the present time only 10 percent of the holdings mature in one year and less than 50 percent mature within five years.

In view of the foregoing, it is very difficult to find a reason in the field of credit control for the decision of the Reserve authorities to exchange the major part of their "rights" for new bonds. An exchange entirely into new notes would have been a more logical move from this point of view.

IV. Life Insurance Company Investments in 1939

Forty-nine life insurance companies, holding about 92 percent of the total life insurance company assets in the United States, purchased net* more than twice as many corporate securities ($584 millions) as United States securities ($262 millions) during the last twelve months. These figures, along with other information on insurance company investments during this calendar year, were released last week at the annual meeting of the Association of Life Insurance Presidents. They are preliminary estimates of December 31, 1939 figures and are, therefore, subject to revision.

The insurance figures are interesting because they indicate that the decided shift from Governments to corporates in the companies' investments which started in 1937, continued during 1939. In the years 1934 through 1936, the companies made aggregate net purchases of about $3,000 millions of U. S. Government and $1,100 millions of corporate securities. In 1937 they bought about the same amount of each ($650 millions). In 1938 and 1939, however, aggregate net purchases of U. S. Governments totaled only $450 millions as against $1,300 millions of corporates.

The shift from Governments to corporates can be more reasonably explained in terms of technical factors than interpreted as indicating the end of the insurance company demand for Governments. Insurance companies are able to purchase large quantities of Governments only when the Treasury is making large cash offerings, or when the banking system, the largest holder of Governments, is liquidating them in quantity. Neither of these conditions has obtained since the end of 1937, and the market is too thin to permit insurance companies to purchase substantial quantities of Governments without bidding up prices significantly.

On the other hand, the effective supply situation with respect to corporates has improved considerably for the insurance companies because of the large increase in the volume of private placements.

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* Net purchases are defined to mean gross purchases less sales and redemptions.

These amounted to about $450 millions in 1937, $750 millions in 1938, and $1,250 millions in 1939. Insurance companies were the largest purchasers of those offerings, and this has placed a large supply of corporates at their disposal at the expense of other previous holders irrespective of any change in the total supply of corporate securities.

V. Other Domestic Securities Markets

Last week corporate and municipal bonds both made new high prices (low yields) for the recovery movement. On Friday, December 15, our average of the yields of high-grade corporate bonds stood at 2.83 percent compared with 2.89 percent for the Saturday before (December 9). Corporates lagged behind Treasury's in the upward movement, however, and the spread between their yields has widened slightly (Chart I). At last night's close the yield of the corporates had risen two basis points from the low made on Friday.

Long-term municipals paced long-term Treasury bonds during the week. The Dow-Jones average yield of twenty 20-year bonds closed at 2.60 percent on Saturday, December 16 -- only two basis points short of the record mark for the year established last June. On the same day long-term Treasury bonds closed at 2.34 percent, 27 basis points above their June record.

There was a considerable volume of new public offerings of corporate and municipal bonds last week, the total offerings in the New York market ($69 millions) representing the largest weekly total since the middle of August. The bulk of this total was represented by $45 millions of Northern Indiana Public Service Company, 3-3/4's of 1969. The new issue market continued active during the first three days of the current week, total offerings through Wednesday, December 20, having amounted to more than $40 millions.

VI. Foreign Government Securities

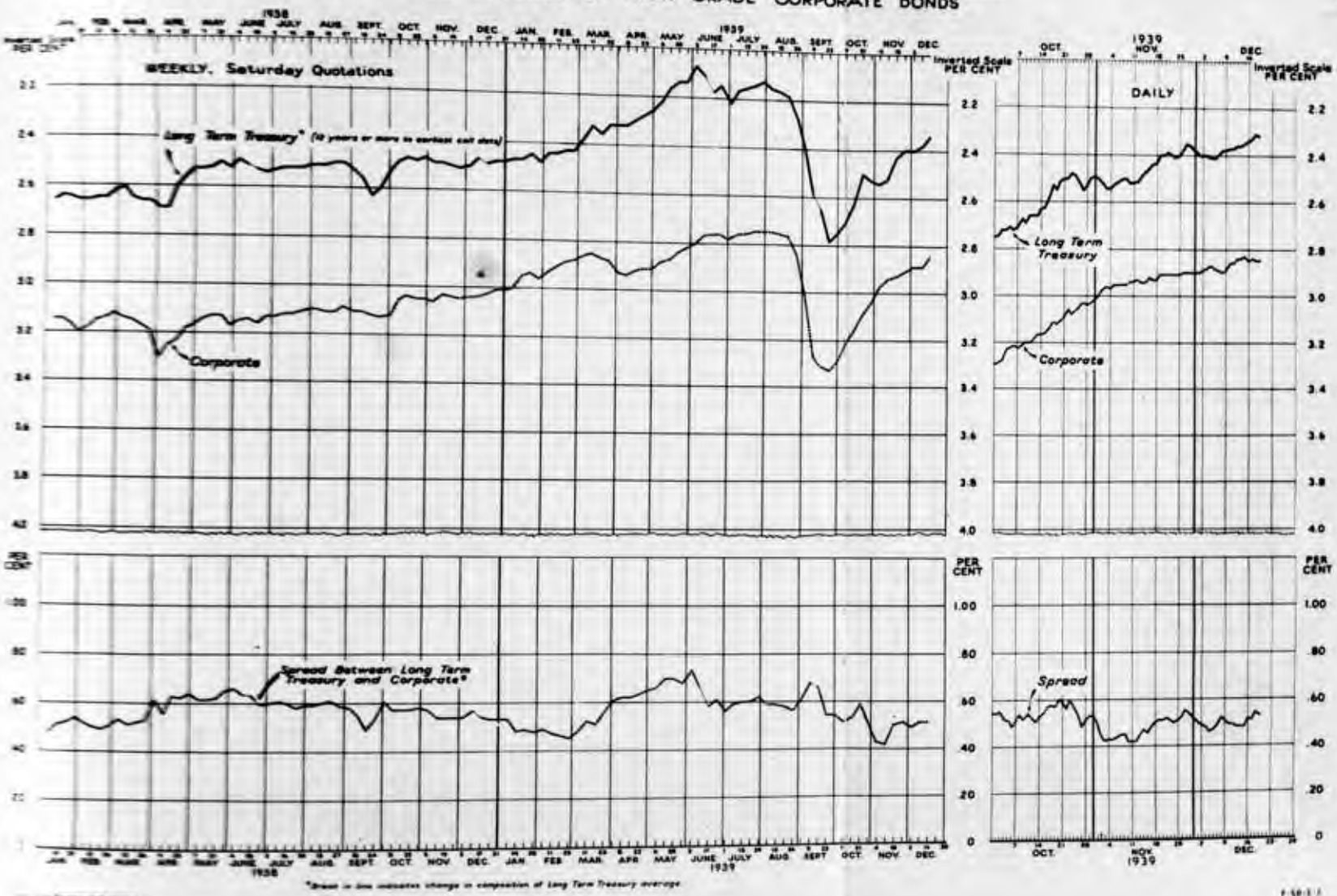
British high-grade security markets have remained quiet since the beginning of the month, the prices of the 2-1/2 percent consols having remained practically unchanged. In Paris, French rentes were weak and lost a part of the sharp advance scored during the first part of the month. The 3 percent perpetual rentes closed on Wednesday, December 20, at 72.50, as compared with a price of 74.75 on December 13.

Last week the Prime Minister of Holland announced a new government loan to consolidate the rapidly increasing floating debt. The loan consisted of 40-year, 4 percent bonds offered at par. The total issue aggregated 300 million guilders, equal at current rates of exchange to $159 millions.

Attachments

Chart I

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



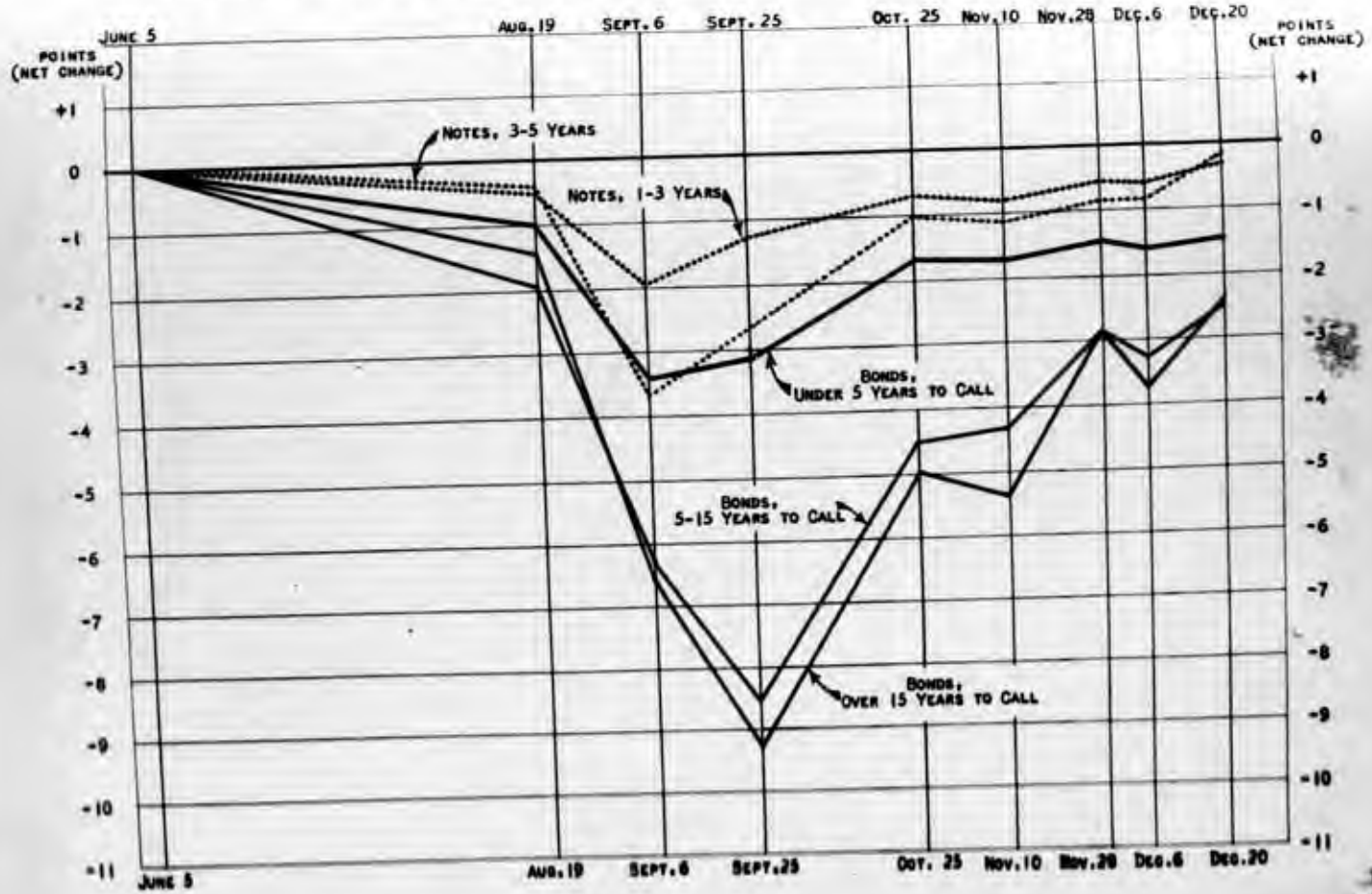
*Shows in line indicates change in composition of Long Term Treasury average

F-50-1-1

Chart 1

CHANGES IN THE PRICES OF U.S. SECURITIES SINCE JUNE 5, 1930

Points Plotted Represent Differences from Average Price of Each Maturity Class on June 5.



Prepared by the Secretary of the Treasury
Office of Research and Statistics

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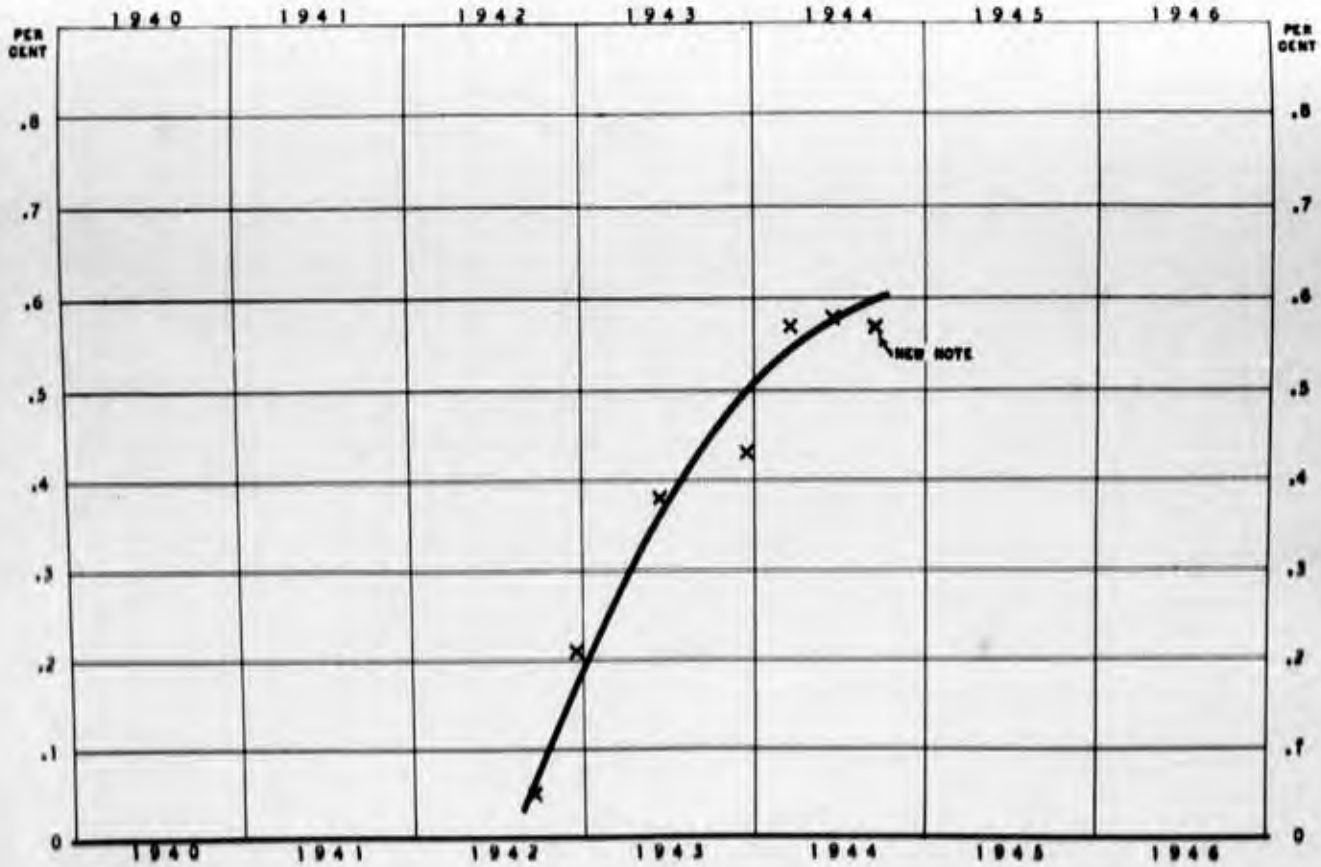
CHART 1[illegible]

YIELDS OF TREASURY NOTES

Based on Closing Quotations, Wednesday, December 20, 1939



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

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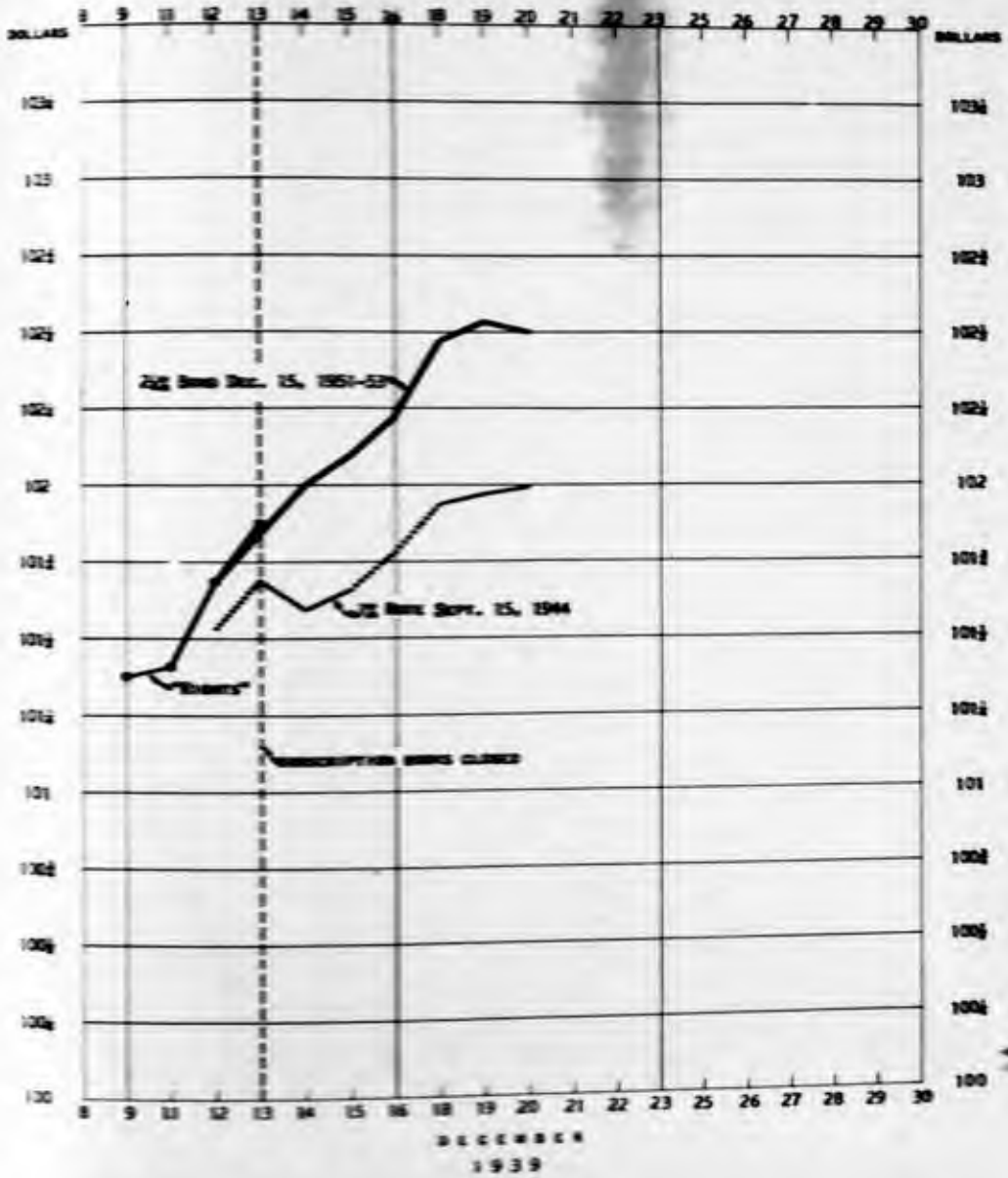
Chart IV

PRICES OF THE NEW TREASURY BOND, THE NEW TREASURY NOTE AND "RIGHTS"

(Closing Bids)



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

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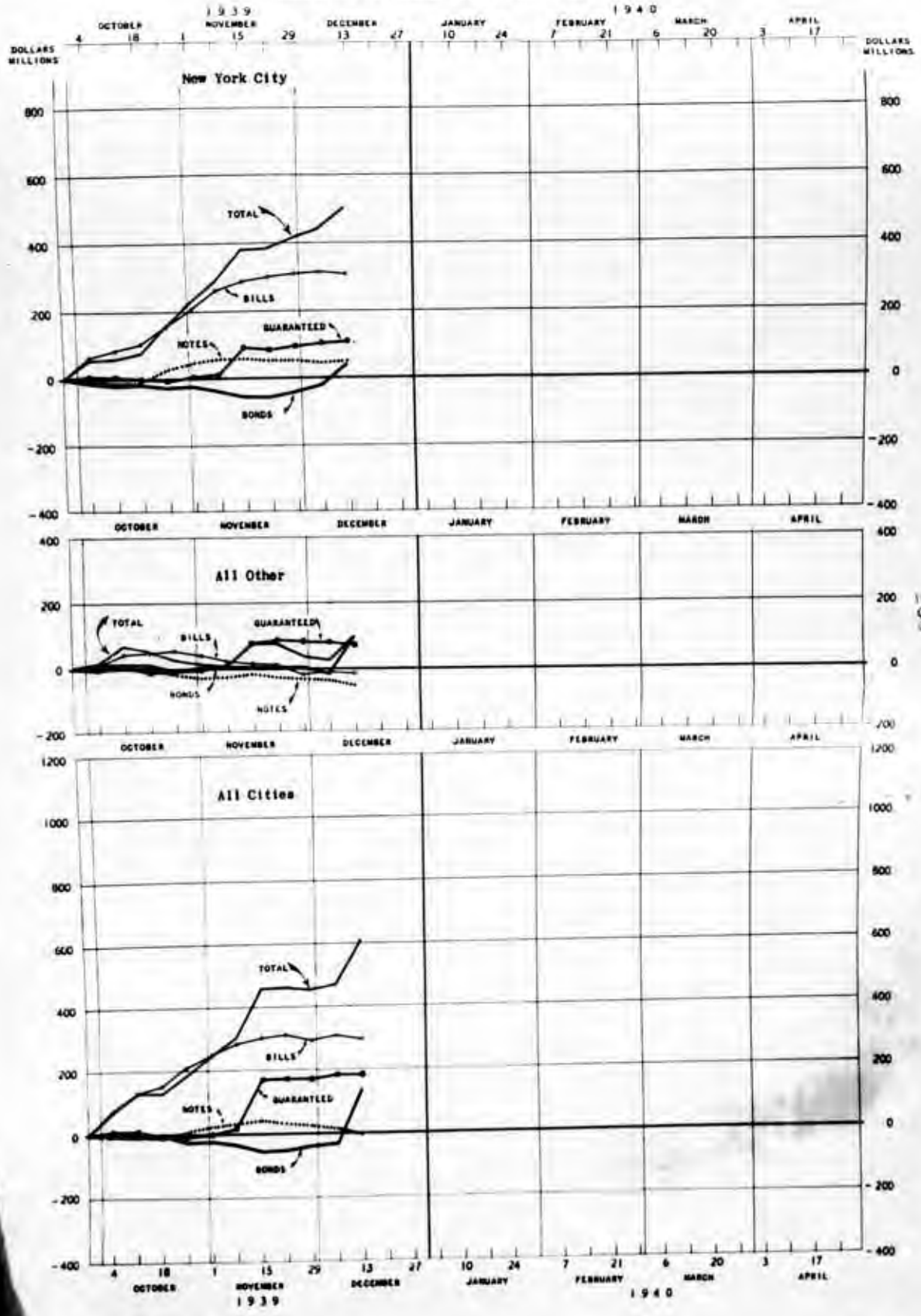
U. S. GOVERNMENT SECURITY HOLDINGS, WEEKLY REPORTING MEMBER BANKS

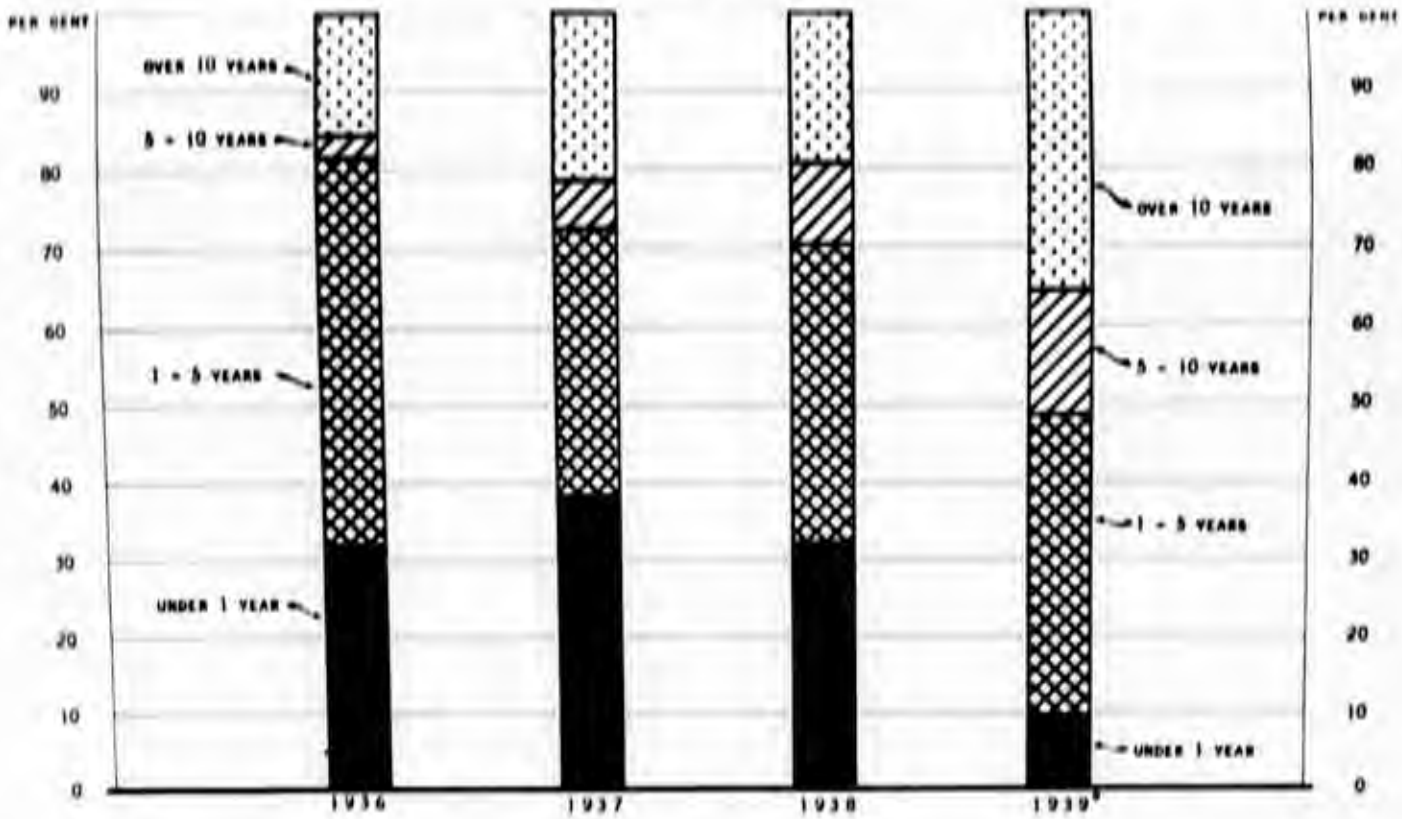
Cumulative Net Change from September 27, 1939



Office of the Secretary of the Treasury

PERCENTAGE DISTRIBUTION OF FEDERAL RESERVE BANK HOLDINGS OF U.S. SECURITIES BY MATURITY CLASSES

December, 1936 - 1939



*ADJUSTED TO REFLECT EXCHANGE OF SECURITIES ON DEC. 22, 1939

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

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December 21, 1939

HM,Jr called General Watson at 9:30 and told him that he and Hanes had a tax statement prepared and were ready to show it to the President.

December 21, 1933

My dear Mr. President:

I think you should know the following facts.

The meeting between Henry Wallace, Louis Brownlow, William H. McReynolds, Herbert Gaston and myself will not take place this morning.

Wednesday afternoon I learned from the news ticker that Governor Hill of F.C.A. had resigned and Dr. Black appointed in his place. I then telephoned Henry Wallace and said it was useless for us to meet.

I feel very badly that I was not given the opportunity to carry out your wishes as telephoned to me Sunday evening by Bill Bassett, namely, that Henry Wallace and I meet and talk over the Farm Credit situation before Governor Hill resigned.

Sincerely yours,

The President,

The White House.

December 21, 1939

My dear Mr. President:

I think you should know the following facts.

The meeting between Henry Wallace, Louis Brownlow, William H. McReynolds, Herbert Gaston and myself will not take place this morning.

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Sincerely yours,

The President,

The White House.

My dear Mr President:

I think you should know the following facts:

The meeting between Wallace, Brownlow, McKenzies, Gaston and myself will not take place this morning. Wednesday afternoon I learned from the news ticker that Hill ~~[illegible]~~ of F.C.F. had resigned and Black appointed in his place. ~~Called~~ I telephoned Wallace ~~after~~ and said it was useless for us to meet. ~~[illegible]~~

I feel very badly that I was not given the opportunity to carry out your wishes ~~and~~ as given to me Sunday evening by Mr. Hassett namely that Wallace and I meet and talk over the Farm Credit situation before Hill resigned.

Sincerely Pa Jr

RE: BUDGET MESSAGE

December 21, 1939.
9:15 a.m.

Present: Mr. Hanes
Mr. White
Mr. Young
Mr. Blough
Mr. Bell
Mr. Gaston
Mrs. Klotz

H.M.Jr: "Through diligent effort and the sharpest possible scrutiny and challenge of every proposed item of expenditure - " I will read it through without making any comment, how is that? ".....and the sharpest possible scrutiny and challenge of every proposed item of expenditure, material reductions have been made in allowances for the operation of the Government in the fiscal year 1941 with the exception of the one surpassingly important item of making provision for the national defense. The deficit, even including the proposed expenditures for the enlarged national defense program, has been substantially reduced as compared to the contemplated deficit for this fiscal year.

"Faced with the necessity of putting our defenses in strong condition to safeguard us in the midst of a world at war, I cannot conscientiously recommend any smaller appropriations for this purpose than I indicated in this message. If we are to make the further progress that I believe should be made at this time in lessening the deficit we must seek additional revenue.

"I am convinced that the emergency fully justifies an extraordinary national effort. Therefore, I recommend that provisions be made for financing the additions to the national defense in the present fiscal year and the fiscal year 1941 through special taxation. To cover the expenditures contemplated, this special addition to our revenue structure should yield approximately five hundred million dollars on an annual basis, but the application of the tax should not extend beyond the period necessary to provide revenue sufficient to defray the cost of the additions to our defenses. Since it is the function of Congress to determine how revenues should be raised, I leave the choice of particular tax measures to its judgment.

"However, I believe I am expressing the sentiment of this country when I suggest that measures adopted for raising additional tax revenues should reflect two objectives. The first is that the taxes should come from the portion of the population which can best afford to pay them, with due regard to the taxes they now pay to the states, local and federal governments. Care should be taken especially to design the taxes so that they will not fall on that portion of the population which can least afford to pay them. The second objective is that the taxes should have a minimum of discouraging effects on the further recovery and growth working of the economy and accordingly should avoid as far as possible the discouragement of productive activity and employment.

"Another matter concerning revenue is essential in this connection in calling to the attention of the Congress the fact that parity payments for appropriations were added to the executive budget in both of the last two fiscal years in a total amount of 437 thousand dollars without any provision having been made for revenue to finance them. Therefore, I again urge, as I have in the two previous years, that provision be made for new taxes to finance any new authorization for parity payments that may be made for the fiscal year 1940, and also that the Congress give consideration to raising some provision for recovering through new taxes the amounts expended outside the budget for the fiscal years 1939 and 1940.

"Enactment of the supplementary revenues here proposed will enable us to proceed with our program of making the substantial annual reductions in the deficits which the progress of recovery warrants. I should like to indicate to the country that from now on there will be no interruption of that program. This can be accomplished if we resolve to finance the enlarged expenditure next through a special national effort which will be put forth only so long as the emergency endures."

What is the program?

Gastons: The program of making substantial annual reductions that the progress of recovery warrants.

F.R.Jr: I thought you meant recovery. I see. As to the ideas, swell. There are certain word changes I would like to make. What is the next thing?

Bames: That is an alternative that goes to the parity payments, goes into a little more detail.

Eastom: If you wanted to have a long explanation of the parity payments. I didn't think it was wise.

F.R.Jr: "In the fall of 1937 when the new agricultural program was under consideration in Congress, I strongly urged that if its cost should exceed the $500,000,000 already in the Budget to finance the Soil Conservation and Domestic Allotment Plan, additional revenues should be provided to finance the excess. The Agricultural Adjustment Act of 1938, approved by me on February 16, 1938, authorized parity payments, the cost of which was in addition to the Soil Conservation and Domestic Allotment program, but no provision was made for financing these payments. When I signed this bill I said publicly that no parity payments ought to be made until Congress had provided the necessary revenues. While Congress has taken no steps to provide this additional revenue, it did appropriate in 1938 and again in 1939 a total of $437,000,000 for making parity payments. Congress has thus added to the aggregate deficit $437,000,000 for this purpose. If further appropriations are made for parity payments I strongly urge that revenue be provided for financing them. I think the Congress should also give serious consideration to providing added revenues to reimburse the Treasury for the amounts expended in parity payments in the last two fiscal years."

What I would do is, I would send it to the President, if for no other reason to let him know in a very polite way that he was wrong the other day.

Bames: We thought you were going to take this - sometime maybe you would be there and could read it and if we didn't make that paragraph on parity payments strong enough, you could pull this one out of your pocket and say, "Well, here is one that is a little stronger." We all seemed to think that the shorter paragraph - now, we will do this first paragraph.

"Through diligent effort and the sharpest possible scrutiny and challenge of every proposed item - " I don't like the word "sharpest".

Gaston: Closest.

Bell: Why not just diligent efforts?

H.M.Jr: I am just going to say the things I don't like. This sort of thing keeps changing anyway.

"Through the diligent efforts - "

Blough: Careful scrutiny.

White: Careful scrutiny of every proposed item and extraordinarily careful, if you want to make it —

Gaston: Most careful scrutiny.

H.M.Jr: I just don't like sharp. It is just as bad as saying shrewd.

"....material reductions have been made in allowances - " Is that a good word, allowances? "material reductions have been made for the operations - "

White: Appropriations.

Gaston: This refers to estimates of expenditure, rather than appropriations.

H.M.Jr: Will you give me something else, please?

"With the exception of the one surpassingly important item - " I don't like the word "surpassingly".

Gaston: Just let it go, "the one item".

H.M.Jr: "With the exception of the one important item of making added provision for the national defense. The deficit, even including the pungent expenditures for the enlarged national defense program, has been substantially reduced as compared to the contemplated deficit for this fiscal year."

Do we have to use the word "contemplated"?

[illegible] Estimated?

F.D.R. Estimated.

[illegible] Could you put out the word "important" before the word "item"? There are a lot of other important items.

F.D.R. The estimated deficit for this fiscal year. I am going to say the things I don't like and you can try to fix it up, but you will recast that anyway.

[illegible] Yes.

F.D.R. "Faced with the necessity of putting our defenses in strong condition to safeguard us in the midst of a world at war, I cannot conscientiously recommend any smaller appropriations for this purpose than I indicated in this message."

[illegible] I wonder whether that sentence may not be recast.

F.D.R. It is a defeatist one. I don't like it.

[illegible] Could we say, "Faced with the necessity of putting our defenses in a sufficiently strong condition to safeguard us in the midst of a world at war, any smaller appropriation than indicated in this message would not be adequate"?

F.D.R. Leaving out "not conscientiously"?

[illegible] Yes.

F.D.R. Something like that.

[illegible] "In the midst of a world at war," or "In the midst of world conditions."

F.D.R. Something along those lines.

"If we are to make the further progress that I believe should be made at this time in lessening the deficit we must seek additional revenue.

"I am convinced that the emergency fully justifies an extraordinary national effort. Therefore, I recommend that provisions be made for financing the additions to the national defense in the present fiscal year and the fiscal year 1941 through special taxation. To cover the expenditures contemplated, this special addition to our revenue

structure should yield approximately $500,000,000 on an annual basis - " Do you mean fiscally annual?

Gaston: Either way.

E.N.Jr: ".....but the application of the tax should not extend beyond the period necessary to provide revenue sufficient to defray the cost of the additions to our defenses.

"Since it is the function of Congress to determine how revenues should be raised, I leave the choice of particular tax measures to its judgment. However, I believe I am expressing the sentiment of the country when I suggest that measures adopted for raising additional tax revenues should reflect two objectives. The first is that the taxes should come from the portion of the population which can best afford to pay them, with due regard to the taxes they now pay to the state, local and federal governments."

I have been wanting to ask Johnny why he sticks that sentence in, "Taxes they now pay to the state, local and federal governments".

Eames: The expression "ability to pay" is generally assumed to mean those in the highest income and our feeling is that those in the highest income are least able to pay at the moment because of the extraordinarily high tax in the 1935 tax bill.

White: I should be inclined to leave that out.

E.N.Jr: That isn't the question. I am asking, would you regard the taxes now paid to state, local and federal governments --

Eames: Well, that is what it is. Those having the greater ability to pay, taking into consideration taxes which they already have to pay.

White: Congress will be sure to take that into consideration, whereas it seems as though --

E.N.Jr: No, I think he is right.

White: That phrase means much more, I think --

E.N.Jr: Than what?

White: I think it means just that that - in the ability to pay, they take all matters into consideration and by speaking it out this way I was speaking politically, because I don't think it will change Congress' action at all, but I am thinking purely from the point of view of popular reaction to the President's statement, not because I think this won't be taken into consideration by Congress or that what he will say about it will affect it, but I think politically it is a much stronger statement. He says the population which can best afford to pay them. The moment you add that phrase beyond there, it cancels out almost that first part so far as political effect is concerned.

H.M.Jr: I disagree with you.

Hanes: I think we are just trying to make him say what he honestly believes. If he doesn't believe that you should take into consideration when levying taxes the burden that is already borne by a specific group, why then he ought to take it out.

White: That should be implied when you say "the ability to pay." That is what you mean. You can't pay something that you have already paid out.

Hanes: The ability to pay phrase, Harry, I think, by a common usage has grown to mean those that have the highest incomes and those that have the highest incomes today have the smallest net income at the same taxes.

Gaston: It means something quite different to me. I would like to see it included for two other reasons. One is that I don't think enough attention is paid in the whole tax problem either by the states or the federal government to the whole burden that they have to pay, which from the standpoint of capacity to pay you have to think of all the taxes they have to pay and the other reason is this, that in the low income groups, there is a heavy burden of excise taxation which is pretty largely state and local, which needs to be taken into consideration also.

White: Aside from the second objective, the second objective takes care of the justification of not taxing too high. It is not what a man pays in taxes - in taxes that relates to his ability to pay, it is what he has left after he gets through paying his taxes. Now, the reason why he may not want to tax people higher is because it would

interfere with your second objective. Having the second objective in mind, there is less justification for the clause.

Bernstein: I think he ought not to neglect any opportunity to call attention to this problem of the overlapping of federal, state and local taxation.

Eccles: I have been bursting to get in. This is the President paying his respects to overlapping taxes and I think it is good policy. I am not thinking that the fellow in New York State who has to pay in the high brackets, plus the federal as a result of which he gets 78 percent --

Wilson: You would strengthen that point by cutting out the word federal.

Blough: I think the word federal has this value, that there is a very common feeling in drawing up tax legislation just to look at the gross income. You take statistics of income and you look at the gross income of people and that does not have deductions for income taxes in it. I think it is necessary to call the attention of Congress to the fact that these statistics which they get of peoples' incomes are not statistics after taxes but before taxes, especially income taxes, and that federal, state and local, all three ought to be named in there.

Eccles: Well, I will go a step further. I believe that we should, in connection - if we have a whole revision program, which I am not in favor of at this session - but if they were going to have a whole new one, both the President and I said last year they should reduce the higher brackets. He said last year he was going down to 60 percent, if I remember. But certainly - what I hope would be - I would hope somebody could give him a very nice little package all wrapped up in pink ribbons and say, "This will produce $500,000,000," and get an agreement between both Committees and get it through in a month and not have forty-eight suggestions on how to revise the general tax form.

White: I should like to make one further comment and we will stop on this. The justification for the reduction of the high brackets lies in the second, in the amplification of the second objective on the basis of equity. On the basis

of sharing the burden of the government, the question is not what a man pays, it is what he has left to enjoy the good things of life and what the government has to offer him in the way of peace, security, opportunity to make that money, etc., and from that point of view certainly the sole criterion is what a man has left after all his expenses, including taxes that should determine whether he should pay more or less. The second objective is the important one in which you don't want to tax men so much that it interferes with attainment of a high national income, because it stultifies their productive effort, etc. I say that not in reference to this but I just wanted to make that point in general.

Blough: I don't wish to argue, but I wish to suggest there is a good deal to be said against that specific statement of the point of view because inevitably if you break your taxes up and view them from that point of view you reach only one inevitable end and that is taxation to produce equal incomes on the part of everybody.

White: You can reduce any principle to an absurdity by pushing it to unreasonable lengths.

H.M.Jr: All right, children.

White: Well, it is not important at this point.

H.M.Jr: At twenty minutes of ten, as of the 21st, I want to say this, so that you know everything - I sincerely hope we don't have a rewrite of the tax bill at this time. If we do, then I would write an entirely different letter for the President, entirely different. Wouldn't you?

Bates: Sure.

H.M.Jr: I would think that he wants to get $500,000,000 on the run and never slow up while he gets it, grab it and grab it just as fast as possible. If you take Mr. Randolph Paul's plan of the forty-eight suggestions and all the suggestions you have got and everybody else in the Treasury has got - in a presidential year --

Bates: The sad part about it is that you can't get what you want. You can't get in and out quickly this trip. That is the unfortunate thing about having to open it up at all.

H.M.Jr: Well, I am not trying to - I would be glad some Saturday afternoon to listen to Mr. Blough and Mr. White -

Banes: Let's put then on the national Forum.

Blough: We are not very far apart, really.

White: No, just about miles.

Gaston: What is that in stellar space, Harry?

H.M.Jr: What is that to Einstein?

White: We are not very far apart compared to others.

H.M.Jr: Are you going to let him have the last word?

Blough: I don't care. I have been married for sixteen years.

White: I have had longer experience, Boy, that is why I got the last word.

H.M.Jr: Are you (Mrs. Klotz) going to let him get away with that?

Mrs. Klotz: Yes.

Banes: I heard Mrs. Klotz get the last word one day. Remember when you went to Boston?

Mrs. Klotz: Oh yes, yes I did. It turned out all right.

Gaston: That is not news, Johnny.

H.M.Jr: Are we all through?

"Another matter concerning revenue is the fact that parity payments for agriculture were added to the executive budget in both of the last fiscal years in a total of $437,000 without any provision having been made for revenue to finance them."

White: That first sentence has to be changed. I should think it should be, "Another matter concerning revenue, to which I should call your attention - "

H.M.Jr: "Therefore, I again urge, as I have in two previous years, that provisions be made for new taxes to finance any new authorization for parity payments that may be made for the fiscal year 1941

and also that the Congress give consideration to making some provision for recouping through new taxes the amounts expended outside the budget for the fiscal years 1939 and 1940."

I like that last paragraph.

"Enactment of the supplementary revenues here proposed will enable us to proceed with our program of making the substantial annual reductions in the deficit which the progress of recovery warrants. I should like to indicate to the country that from now on there will be no interruption of that program. This can be accomplished if we resolve to finance the enlarged armaments cost through a special national effort which will be put forth only so long as the emergency exists."

White: I am troubled by one thought. He says, "I should like to indicate to the country that from now on there will be no interruption of that program." This is his last, presumably, budget message for the eight years. It looks a little funny. If you don't get that reaction, maybe I am wrong.

F.D.R.Jr: I could interpret it this way - no, he gives another budget message.

Bell: Next year, unless the law has changed.

F.D.R.Jr: Let's say he doesn't. This would take on particular significance that after he is out he hopes that his program will continue.

White: It is not a hope, he says - well, if you don't get that impression --

Gaston: Suppose we introduce the words, "I should like to be able to indicate to the country". That qualifies it to take - to make a condition of Congress and his successors carrying out that idea.

Hanes: How would you like it if you said, "I should like to indicate to the country the hope that from now on there will be no interruption of that program."

F.D.R.Jr: No. If you said what Gaston says, "I would like to be able to indicate to the country - I would

like to be able to run again." I would like to leave it the way it is.

Gaston: Yes, I think so. But I should like to indicate --

H.M.Jr: I like the way it is. It is very sphinx-like.

White: If you cut out "from now on", you might be able to avoid that difficulty.

"I should like to indicate to the country that there will be no interruption to that program.

H.M.Jr: I like that.

Blough: From now on is a certain admission.

May I make one point? No criticism, I like it very much. It sort of commits the Administration to the idea that aside from the war the present revenue system will take care of things if we continue to get recovery.

H.M.Jr: Well, would it?

Blough: It is very doubtful.

White: If you had continued recovery? I don't see what your idea is.

Gaston: It doesn't quite commit you to that.

White: Even if it did, your national income will increase with continued recovery.

H.M.Jr: You mean on an 80 billion dollar country? We haven't got a sufficient tax revenue?

Blough: You can get an 80 billion dollar country and stick to it and if you can get your Congress to reduce expenditures swelling when it goes up, yes, but an 80 billion dollar country is a rather unusual thing, rather than a common thing.

H.M.Jr: Unless I had some hope that that would come about, I had better go home.

White: That is a terrible indictment against your economic system if you don't think you can reach an 80 billion dollar income some day.

Blough: The question is, can we reach it and maintain that level about half the time. The present revenue system will produce enough in a very good year, but it won't produce enough year in and year out if we have ups and downs with anything like the present expenditure program.

Gaston: That is the next year's and for the year after.

Blough: This is all right.

H.M.Jr: It looks all right to point it out, but -

Blough: I didn't mean to raise it in connection with this at all.

H.M.Jr: You don't raise it for this?

Blough: I don't think we should change this a bit.

H.M.Jr: If you want to philosophize, that is something - I don't think anybody in the room, if he had the exclusive right to change the revenue system and expenditure system, would do it as it is done now. Everybody would want to do it differently. I know I would.

Gaston: I would do both. I would cut the expenditures much more drastically than they have been cut and I would have this much increase in revenue.

H.M.Jr: I bet you everybody in this room would do it differently.

White: I certainly would do it differently than that, so so far you are one hundred percent right.

H.M.Jr: Wouldn't you, Johnny?

Eanes: I should say so.

H.M.Jr: Bell, wouldn't you do it differently?

Mrs. Klotz: I sure would.

Bell: I'm happy about the whole thing, I would leave it alone.

Blough: The reason I mention it is that there is a common belief that the revenue system now in operation will produce enough to run the country on this other program which is in operation and I very much doubt it.

H.M.Jr: Without being sarcastic, that is your privilege. I mean, everybody in the room has his doubts and has a different program in the back of his head, but this is being, I take it, as helpful as we can to the President under very difficult circumstances and that is all I am trying to do.

Hanes: I don't think he is out on a limb on this one. He is out on a limb asking for $1,200,000,000. He isn't going to get it, but that puts him in a very strong position.

H.M.Jr: Could you fix this so if we get a call we will be ready?

Through diligent effort and the sharpest possible scrutiny and challenge of every proposed item of expenditure, material reductions have been made in allowances for the operation of the Government in the fiscal year 1941 with the exception of the one surpassingly important item of making provision for the national defense. The deficit, even including the proposed expenditures for the enlarged national defense program, has been substantially reduced as compared to the contemplated deficit for this fiscal year.

Faced with the necessity of putting our defenses in strong condition to safeguard us in the midst of a world at war, I cannot conscientiously recommend any smaller appropriations for this purpose than I indicated in this message. If we are to make the further progress that I believe should be made at this time in lessening the deficit we must seek additional revenue.

I am convinced that the emergency fully justifies an extraordinary national effort. Therefore, I recommend that provisions be made for financing the additions to the national defense in the present fiscal year and the fiscal year 1941 through special taxation. To cover the expenditures contemplated, this special addition to our revenue structure should yield approximately five hundred million dollars on an annual basis, but the application of the tax should not extend beyond the period necessary to provide revenue sufficient to defray the cost of the additions to our defenses. Since it is the function of Congress to determine how revenues should be raised, I leave the choice of particular tax measures to its judgement.

However, I believe I am expressing the sentiment of the country when I suggest that measures adopted for raising additional tax revenues should reflect two objectives. The first is that the taxes should come from the portion of the population which can best afford to pay them, with due regard to the taxes they now pay to the state, local and federal governments. Care should be taken especially to design the taxes so that they will not fall on that portion of the population which can least afford to pay them. The second objective is that the taxes should have a minimum of disturbing effects on the further recovery and smooth working of the economy and accordingly should avoid as far as possible the discouragement of productive activity and employment.

Another matter concerning revenue is warranted in this connection in calling to the attention of the Congress the fact that parity payments for agriculture were added to the executive budget both of the last two fiscal years in a total amount of 437 thousand dollars without any provision having been made for revenue to finance them. Therefore, I again urge, as I have in the two previous years, that provision be made for

new taxes to finance any new authorization for parity payments that may be made for the fiscal year 1941, and also that the Congress give consideration to making some provision for recouping through new taxes the amounts expended outside the budget for the fiscal years 1939 and 1940.

Enactment of the supplementary revenues here proposed will enable us to proceed with our program of making the substantial annual reduction in the deficit which the progress of recovery warrants. I should like to indicate to the country that from now on there will be no interruption of that program. This can be accomplished if we resolve to finance the enlarged armaments cost through a special national effort which will be put forth only so long as the emergency exists.

In the fall of 1937 when the new agricultural program was under consideration in Congress, I strongly urged that if its cost should exceed the $500,000,000 already in the Budget to finance the Soil Conservation and Domestic Allotment Plan, additional revenues should be provided to finance the excess. The Agricultural Adjustment Act of 1938, approved by me on February 16, 1938, authorized parity payments, the cost of which was in addition to the Soil Conservation and Domestic Allotment program, but no provision was made for financing these payments. When I signed this bill I said publicly that no parity payments ought to be made until Congress had provided the necessary revenues. While Congress has taken no steps to provide this additional revenue, it did appropriate in 1938 and again in 1939 a total of $437,000,000 for making parity payments. Congress has thus added to the aggregate deficit $437,000,000 for this purpose. If further appropriations are made for parity payments I strongly urge that revenue be provided for financing them. I think the Congress should also give serious consideration to providing added revenues to reimburse the Treasury for the amounts expended in parity payments in the last two fiscal years.

Through diligent effort and the sharpest possible scrutiny and challenge of every proposed item of expenditure, material reductions have been made in allowances for the operation of the government in the fiscal year 1941 with the exception of the one surpassingly important item of making added provision for the national defense. The deficit, even including the proposed expenditures for the enlarged national defense program, has been sharply reduced as compared to the contemplated deficit for this fiscal year.

Faced with the necessity of putting our defenses in fit condition to safeguard us in the midst of a world at war, I can not conscientiously recommend any smaller appropriations for this purpose than are indicated in this message. If we are to make the further progress that I believe should be made at this time in lessening the deficit we must seek additional revenue.

I am convinced that the emergency fully justifies an extraordinary national effort. Therefore, I recommend that provisions be made for financing the additions to the national defense in the present fiscal year and the fiscal year 1941 through special taxation. To cover the expenditures contemplated this special addition to our revenue structure should yield approximately $500,000,000 on an annual basis, but the application of the tax should not extend beyond the period necessary to

provide revenue sufficient to defray the cost of the additions to our defenses.

Since it is the function of Congress to determine how revenues should be raised I leave the choice of particular tax measures to its judgment. However, I believe I am expressing the sentiment of the country when I suggest that measures adopted for raising additional tax revenues should reflect two objectives. The first is that the taxes should come from the portion of the population which can best afford to pay them, with due regard to the taxes they now pay to the State, local and Federal governments. Care should be taken especially to design the taxes so that they will not fall on that portion of the population which can least afford to pay them. The second objective is that the taxes should have a minimum of disturbing effects on the further recovery and smooth working of the economy and accordingly should avoid as far as possible the discouragement of productive activity and employment.

I feel warranted in this connection in calling to the attention of the Congress the fact that parity payments for agriculture were added to the Executive budget in both of the last two fiscal years in a total amount of $437,000 without any provision having been made for revenue to finance them. Therefore, I again urge, as I have in two previous years, that provision be made for new taxes to finance any new authorization for parity payments that may be made for the fiscal year 1941, and also that the Congress

give consideration to making some provision for recouping through new taxes the amounts expended outside the budget for the fiscal years 1939 and 1940.

Enactment of the supplementary revenues here proposed will enable us to proceed with our program of making the substantial annual reductions in the deficit which the progress of recovery warrants. I should like to indicate to the country that from now on there will be no interruption of that program. This can be accomplished if we resolve to finance the enlarged armament cost through a special national effort which will be put forth only so long as the emergency exists.

ALTERNATIVE PARAGRAPH

In the fall of 1937 when the new agricultural program was under consideration in Congress, I strongly urged that if its cost should exceed the $500,000,000 already in the Budget to finance the Soil Conservation and Domestic Allotment Plan, additional revenues should be provided to finance the excess. The Agricultural Adjustment Act of 1938, approved by me on February 16, 1938, authorized parity payments, the cost of which was in addition to the Soil Conservation and Domestic Allotment program, but no provision was made for financing these payments. When I signed this bill I said publicly that no parity payments ought to be made until Congress had provided the necessary revenues. While Congress has taken no steps to provide this additional revenue, it did appropriate in 1938 and again in 1939 a total of $437,000,000 for making parity payments. Congress has thus added to the aggregate for this purpose. If further appropriations are made for parity payments I strongly urge that revenue be provided for financing them. I think the Congress should also give serious consideration to providing added revenues to reimburse the Treasury for the amounts expended in parity payments in the last two fiscal years.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

CONFIDENTIAL

DATE Dec. 21, 1939.

TO Secretary Morgenthau

FROM Mr. Haas

Subject: A very brief exposition of the estimates of Federal revenues for the 1941 Budget: revised estimate for the fiscal year 1940 and original estimate for the fiscal year 1941.

The attached tables show in detail and in summary form the present estimates of receipts for fiscal years 1940 and 1941 compared with actual receipts in fiscal year 1939.

The tax revenue from practically every major source is directly dependent, although in varying degree, upon business conditions during the period in respect of which the tax is levied. In making these estimates of future revenue it was, therefore, necessary to forecast the general business situation for the period ending in June 1941. In forecasting the business trend for 1940 we have given consideration to the unusual degree of uncertainty in the present outlook due to the unpredictable course which the European war may take. It is recognized that conditions may change overnight either to the advantage or to the disadvantage of business in this country.

Certain facts seem sufficiently clear, however, to warrant our belief that the forecast outlined below is a reasonable expectation for 1940, and neither too optimistic nor too conservative. It is clear that industrial production in the last quarter of 1939 has exceeded actual consumption; that new orders in recent weeks have shown a steep decline; that the bunching of orders for steel and other products this fall, due to war-stimulated fears, has taken considerable potential business from 1940; and that this foreshadows a corrective decline. Such a decline can be avoided only if large war orders come in soon, or if expenditures for capital equipment in early 1940 should undergo a marked expansion. Neither of these possibilities can at present be anticipated.

On the other hand, no maladjustments have as yet occurred that would warrant a business setback comparable to that of 1937. The business situation was sound before the war began and remains fundamentally sound. Following the expected decline, an improving business trend seems probable during the second half of the year.

After a careful weighing of these diverse influences, we forecast an average of 111 for the Federal Reserve index of industrial production for the calendar year 1940. If this forecast is realized, it will mean that the average index in 1940 will be higher than the 1939 average, and higher than the average for any other year since 1929, but not as high as in the last quarter of the current year. For the first six months of calendar year 1941 we forecast that this index will average 113.

We also forecast that the Bureau of Labor Statistics index of wholesale commodity prices (1926 = 100) will average 79.2, two points higher in calendar year 1940 than the level of 77.2 which is estimated for calendar year 1939. For fiscal year 1941 this index is estimated to average 81.0.

Our judgment as to these forecasts of business indices has been confirmed by the average judgment of competent persons whom the Treasury consulted in this connection. Included among these consultants were:

Mr. Walter Lichtenstein, Vice President,
First National Bank of Chicago.
Mr. Joseph S. Crews,
Barrett Associates.
Mr. F. Leslie Hayford, Economist,
General Motors Corporation.
Mr. Seymour L. Andrew, Chief Statistician,
American Telephone and Telegraph.
Mr. Ragnar Naess, Vice President,
Tri-Continental Corp.
Col. Leonard P. Ayres, Vice President,
Cleveland Trust Co.
Mr. George B. Roberts, Vice President,
National City Bank of New York.
Dr. W. L. Crum, Professor of Economics,
Harvard University.
Mr. Frederick L. Thomsen, Principal Agricultural
Economist, Division of Statistical and
Historical Research, Department of Agriculture.
Mr. Robert Nathan, Economic Analyst, Research
Division of the Bureau of Foreign and Domestic
Commerce, Department of Commerce.
Mr. Frank Garfield, Senior Economist, Board of
Governors of the Federal Reserve System.

Fiscal year 1940

We estimate that fiscal year 1940 receipts will amount to $5,644 millions, which is $24 millions less than the actual receipts of $5,668 millions in fiscal year 1939. In spite of the approximately equal magnitude of the two totals, the composition of the total revenues in each of the two years differs.

Percentage distribution of total revenues and receipts in fiscal years 1939 and 1940

Source	Actual 1939	Estimated 1940
Internal revenue:		
Income taxes	38.5	34.6
Tax on unjust enrichment	.1	.1
Miscellaneous internal revenue taxes	39.4	41.7
Employment taxes	13.1	14.7
Total internal revenue	91.1	91.1
Railroad Unemployment Insurance Act	-	.1
Customs	5.6	5.0
Miscellaneous revenues and receipts	3.3	3.8
Total	100.0	100.0

The two principal items of decrease in the revenues are the estimates of revenues from income taxes and from customs. The decrease in the estimated income tax receipts is explained partly by the fact that fiscal year 1939 receipts reflect the upward effect of the undistributed profits tax whereas no comparable effect is felt in the estimated income tax receipts in fiscal year 1940. The customs estimate is lowered because of the disruption of international trade caused by the war.

Other taxes, the yield from which responds more quickly to improvement in business than do the income tax receipts are estimated to nearly offset the estimated decrease in receipts of income tax and customs.

Income taxes. Whereas the $2,182 millions of income taxes collected in fiscal year 1939 represent collections of liabilities on incomes in calendar years 1937 and 1938, the estimate of $1,953 millions for fiscal year 1940 represents collections of liabilities on incomes in calendar years 1938 and 1939. Thus a portion of the liabilities for calendar year 1938 appears in each fiscal year's collections. The principal components of the decrease of $229 millions in the estimated income tax for the fiscal year 1940 (as compared with fiscal year 1939) are the estimates of decrease of $98 millions in the current corporation income tax collections and of $127 millions in the current individual income tax collections. These decreases are attributable not only to the higher level of incomes in calendar year 1937 as contrasted to the estimated incomes in calendar year 1939, but also to legislative changes. Receipts in fiscal year 1939 partly reflect collections in respect of calendar year 1937 liabilities when the undistributed profits tax of the Revenue Act of 1936 was in force and partly reflect the legislative changes made by the Revenue Act of 1938 wherein the undistributed profits tax was practically eliminated and the more liberal treatment of capital gains and losses was enacted. The changes made by the Revenue Act of 1938 are fully reflected in the fiscal year 1940 estimates. The Public Salary Tax Act of 1939, effective beginning with calendar year 1939 incomes, which will tend to increase individual income tax collections, will be only partially reflected in the fiscal year 1940 receipts. The individual income tax provisions of the Revenue Act of 1939 will not affect the fiscal year 1940 receipts to any appreciable extent.

Tax on unjust enrichment. The liability for the unjust enrichment taxes now being collected was incurred in calendar year 1936. The tax now is, therefore, a back income tax. It was shown as a separate item on the daily Treasury statement originally because of the interest in the item when it was a current tax and of much larger magnitude than at present. The $6 millions estimated to be collected in fiscal year 1940 represents the net amount of the unjust enrichment tax which will be collected after offsets are allowed certain unjust enrichment taxpayers for claims for refunds of processing taxes.

Miscellaneous internal revenue. Miscellaneous internal revenue receipts in fiscal year 1940 are estimated at $2,356 millions, an increase of $124 millions or 5.6 percent, over the receipts of $2,232 millions in fiscal year 1939. Each of the major groups of taxes on commodities is estimated to yield more revenue in fiscal year 1940 than in fiscal year 1939. One of the minor taxes on commodities, namely the tax on toilet preparations, is expected to yield $6,200 thousands, a reduction of 46.2 percent from the collections in fiscal year 1939. This reduction is attributable to the modification of this tax in the Revenue Act of 1939.

The capital stock tax for fiscal year 1940 is estimated at $132 millions, an increase of $5 millions over the actual collections of $127 millions for fiscal year 1939. This estimated increase is due to a higher declaration of aggregate capital stock value because of increased earnings anticipated by corporations for calendar year 1939.

Estate tax receipts in the fiscal year 1940 are estimated at $338 millions, a slight increase over receipts in fiscal year 1939. The estimated increase is principally attributable to the tax on a single exceptionally large estate already received. Estimated collections for the gift tax in fiscal year 1940 are $33 millions, an increase of $5 millions over actual receipts in fiscal year 1939.

Employment taxes. Total employment taxes for fiscal year 1940 are now estimated at $827 millions, an increase of $87 millions over the $740 millions receipts in fiscal year 1939.

Receipts under the Federal Insurance Contributions Act, formerly title VIII of the Social Security Act, are estimated at $599 millions as compared with $530 millions in the fiscal year 1939, an increase of $69 millions or 13 percent. The estimate of $599 millions will be the highest figure attained since taxes were first received under this Act in 1937. Since the rates of tax are the same, the estimated increase in revenues is the result of an anticipated higher level of taxable payrolls and a net increase in coverage brought about by the Social Security Act Amendments of 1939, approved August 10, 1939. The major changes in coverage under this Act were the inclusion of service on American vessels, employees of member banks of the Federal Reserve System, individuals aged 65 and over, and the exclusion of certain groups of farm workers.

Inasmuch as the inclusion of individuals aged 65 and over was made retroactive to January 1, 1939, taxes for five quarters will be collected in the fiscal year 1940. The other major changes in coverage become effective January 1, 1940, so that revenues from such coverage will be included in the fiscal year 1940 receipts to the extent of only one quarter's liability. It should be noted that the Social Security Act Amendments of 1939 prevented the 50 percent increase in rates on January 1, 1940 which would have applied to payrolls paid in calendar years 1940, 1941 and 1942.

The Federal Unemployment Tax Act, formerly title IX of the Social Security Act, is expected to yield $105 millions as compared with $101 millions in the fiscal year 1939. Here again, as in the case of the Federal Insurance Contributions Act, the higher level of taxable payrolls contributed toward the rise in receipts. Another element making for higher receipts is the fact that this is the first time that all liabilities collected within a fiscal year are based upon the 3 percent rate of tax. On the other hand, the Railroad Unemployment Insurance Act, placing employees of railroads under a separate unemployment compensation system, became effective July 1, 1939, and therefore such taxes upon railroads will not be included in Federal Unemployment Tax Act receipts as was the case heretofore. Generally speaking, the passage of the Social Security Act Amendments of 1939 does not affect receipts under this tax in the fiscal year 1940 because the amendments become effective on January 1, 1940, and payment of the calendar year 1940 liabilities will be made partly in the fiscal year 1941 and partly in the fiscal year 1942.

The Carriers Taxing Act of 1937 is expected to return $124 millions, a gain of $15 millions over receipts of $109 millions in the fiscal year 1939. This estimated increase results primarily from the anticipated higher level of railroad payrolls in April 1939-March 1940, the period for which liabilities are paid in the fiscal year 1940, as compared with payrolls in the corresponding period of the previous year. A relatively small part of the gain is attributable to the rise in the rate of tax from 2 3/4 percent on both employees and employers on calendar year 1939 liabilities to 3 percent on both employees and employers on calendar year 1940 liabilities. One quarter's tax liabilities will be collected at the 3 percent rate in the fiscal year 1940.

Railroad Unemployment Insurance Act. Beginning July 1, 1939, carriers were required to pay contributions under the Railroad Unemployment Insurance Act (approved June 25, 1938) rather than under the Federal Insurance Contributions Act, formerly title IX of the Social Security Act. Ten percent of the contributions so received are to be deposited to the credit of the Railroad Unemployment Insurance Administration Fund. Although the new Act will be in effect throughout the fiscal year 1940, receipts which are estimated at $5 millions, will include contributions covering only three quarters' liabilities because of the lag of one quarter in making payments of liabilities under this Act.

Customs. Customs receipts for fiscal year 1940 are estimated at $283 millions. This represents a decrease of $36 millions from the actual receipts of $319 millions in the fiscal year 1939. Because of the currently disrupted situation in international trade due to the war, the estimated customs receipts do not bear the same relationship to the forecast business conditions as in previous years. Customs receipts for the fiscal year 1940 through December 9, 1939, were running $12 millions above receipts in the corresponding period of fiscal year 1939. This excess was largely in the nature of non-recurring demand caused by panicky consumer purchasing of sugar and imported liquor immediately following the outbreak of the war. For example, the volume of imports of liquors in September has been exceeded in only two months since the repeal of the 18th Amendment, namely in December 1936 and December 1937. Total duties collected on liquor in September 1939 amounted to $5,161 thousands as compared with $1,930 thousands in August 1939, $2,537 thousands in September 1938, and a monthly average of $2,091 thousands in the first eight months of calendar year 1939. Sugar imports in September 1939 brought in $8,346 thousands as compared with $5,313 thousands in August, $5,188 thousands in September 1938, and a monthly average of $2,975 thousands for the first eight months of calendar year 1939.

The future effects of the war on customs receipts have been estimated by making an analysis of each of the leading dutiable commodities with reference to the demand, supply and price of such commodities and the country of origin. Commodity experts in various governmental departments were consulted in this connection. The disruption of international trade because

of the war has a direct effect on dutiable imports. For example, shipping facilities have been upset both directly by the war and indirectly by the Neutrality Act of 1939. The diversion of men from productive work to war-time activities has taken place not only in belligerent nations but also in neutral nations. Imports from Germany, including Austria, Czechoslovakia and Poland, have, to all intents and purposes, ceased.

There are many indirect effects of the war which tend to lower the customs receipts. An example is the change in the conditions of importing sugar. On September 11, 1939, the President removed the marketing quotas established under the Sugar Act of 1937 whereby the amount of sugar supplied by domestic sugar-producing areas, the Philippine Islands and foreign countries was prorated. The abrogation of the quotas automatically raised the duty on imports from Cuba from .9 cent a pound to 1.5 cents a pound. It is expected that the abrogation of quotas together with the increase in tariff protection will increase the amount of sugar supplied, both from stocks and current production, by domestic beet and cane sugar producers and duty-free imports from the Philippine Islands, Puerto Rico, and Hawaii, with the result that imports from Cuba will decline.

In the case of other products, we will be forced to turn to domestic production. There will be a new demand by belligerents for products we normally import so that such imports will not be available to us, at least in the usual volume.

Miscellaneous revenues and receipts for fiscal year 1940 are estimated at $214 millions, an increase of $26 millions over actual receipts in fiscal year 1939.

Fiscal year 1941

Fiscal year 1941 receipts are estimated at $5,951 millions, an increase of $283 millions over actual receipts in fiscal year 1939 and of $307 millions over the estimated receipts in fiscal year 1940. Each of the broad classifications of revenue with the exception of customs contributes to this increase. In the case of estimated customs receipts, the entire fiscal year 1941 estimate assumes war conditions throughout, whereas the first portion of fiscal year 1940 was not affected in the same manner.

Income taxes. Total income tax receipts for fiscal year 1941 are now estimated at $2,191 millions, an increase of $238 millions over estimated income tax receipts for fiscal year 1940. The major income tax changes effected by the Revenue Act of 1939 will apply to incomes received in the calendar year 1940 and will therefore be reflected in income tax collections in the last half of fiscal year 1941. The most important provisions of the Revenue Act of 1939 are those relating to the corporation tax rates, the more liberal treatment of capital losses and the allowance of an operating loss carryover. The full effect of the Revenue Act of 1939 on corporate incomes will not be reflected in corporation income tax receipts until fiscal year 1943 because losses incurred prior to calendar year 1939 are not allowed as part of the two-year operating loss carryover.

The current corporation income taxes for fiscal year 1941 are estimated at $1,044 millions, an increase of $179 millions over the estimated receipts for fiscal year 1940. Since collections in respect of calendar year 1939 liabilities are common to fiscal years 1940 and 1941, the increase in the estimates for fiscal year 1941 as contrasted to fiscal year 1940 reflects the forecast of better business conditions in calendar year 1940 than obtained in calendar year 1939.

Individual income tax receipts are estimated at $870 millions, an increase of $60 millions over the estimated receipts for fiscal year 1940. In the case of the individual income tax receipts, we have had a steady decline in the amount of income subject to the highest bracket rates of tax. This trend is more than offset by the expectation of generally higher incomes in the calendar year 1940 as contrasted to calendar year 1939.

The excess-profits tax for fiscal year 1941 is estimated at $22 millions, an increase of $4 millions over the estimate for fiscal year 1940. The estimated higher calendar year 1940 income levels account for the estimated increase in the excess-profits tax revenues.

Tax on unjust enrichment for fiscal year 1941 is estimated at $4 millions, a decrease of $2 millions from the estimate for fiscal year 1940. Since this tax is in the nature of a back tax, the Bureau of Internal Revenue expects that the revenues will decrease as the outstanding cases are settled.

Miscellaneous internal revenue receipts in fiscal year 1941 are estimated at $2,393 millions, an increase of $37 millions over the estimate for fiscal year 1940. In general, the principal sources of revenue are expected to continue to increase in line with our expectation of higher consumer incomes and price levels. Certain minor sources of revenue are expected to show decreases because of special situations. For instance, the revenues from the excise tax on imported distilled spirits are expected to be reduced by $1,700 thousands as a result of lower imports from Canada.

The capital stock tax for the fiscal year 1941 is estimated at $137 millions, an increase of $5 millions over the estimated receipts of $132 millions for fiscal year 1940. The increase is attributable to the fact that corporations are expected to declare higher capital stock values in 1940 because of the estimated increase in earnings of that year over 1939.

Estate tax receipts in fiscal year 1941 are estimated at $329 millions, a decrease of $9 millions from the estimated receipts in fiscal year 1940. The decrease is caused by the exceptionally large tax collection from one estate which was received early in fiscal year 1940. Gift tax receipts are estimated at $33 millions.

Employment taxes. Total employment taxes for fiscal year 1941 are estimated at $861 millions, an increase of $34 millions over estimated receipts in fiscal year 1940.

Receipts under the Federal Insurance Contributions Act, formerly title VIII of the Social Security Act, are estimated at $633 millions. This represents a gain of $103 millions over receipts of $530 millions in the fiscal year 1939 and $34 millions over estimated receipts in the fiscal year 1940. The major part of the rise in estimated receipts in the fiscal year 1941 is attributable to the inclusion of a full year's receipts from groups brought under this Act by the Social Security Act Amendments of 1939 as compared with receipts of only three months' liabilities for such groups in the fiscal year 1940. Such gains are somewhat offset by the receipts of four quarters' liabilities from individuals aged 65 and over in the fiscal year 1941 as compared with the receipts of five quarters' liabilities in the fiscal year 1940.

Receipts from the Federal Unemployment Tax Act, formerly title IX of the Social Security Act, are expected to decline to $94 millions from fiscal year 1940 estimated receipts of $105 millions and fiscal year 1939 receipts of $101 millions. The drop will be the first since taxes under this Act and its predecessor were first received in 1936. The passage of the Social Security Act Amendments of 1939 is primarily responsible for the decline in revenues, because it effected a decrease in coverage of individuals' wages which more than offset a net increase in coverage of employees. Another reason for the decline is the fact that railroad employees were removed from coverage under this Act by the Railroad Unemployment Insurance Act which became effective July 1, 1939.

Receipts from the Carriers Taxing Act of 1937 are estimated to rise to $135 millions as compared with anticipated receipts of $124 millions in the fiscal year 1940 and receipts of $109 millions in the fiscal year 1939. The increase of $11 millions over fiscal year 1940 receipts is largely the result of the advance in the rate of tax from 2 3/4 percent on both employees and employers on liabilities prior to January 1, 1940, to 3 percent on both employees and employers on liabilities in the fiscal year 1941.

Railroad Unemployment Insurance Act. Receipts under the Railroad Unemployment Insurance Act are estimated at $7 millions, an increase of $2 millions over fiscal year 1940 estimated receipts of $5 millions. The major part of this gain results from the fact that estimated receipts in the fiscal year 1941 will include a full year's tax liabilities whereas estimated receipts in the fiscal year 1940 will include only nine months' tax liabilities.

Customs. The customs estimate for fiscal year 1941 is $273 millions. This represents a decrease of $10 millions from the estimated customs receipts of $283 millions in fiscal year 1940. Customs in fiscal year 1941 appear unlikely to be enlarged by the extraordinary receipts which marked a brief interval in fiscal year 1940, immediately following the outbreak of the European war.

Actual receipts in the fiscal year [illegible] and January [illegible] Budget estimates of receipts
in the fiscal years [illegible] and [illegible]

General and special accounts (on the basis of the daily Treasury statement (unrevised))	Actual [illegible] 1/	Estimated [illegible]	Increase or decrease [illegible] over [illegible]	Percent increase or decrease [illegible] over [illegible]	Estimated [illegible]	Increase or decrease [illegible] over [illegible]	Percent increase or decrease [illegible] over [illegible]	Increase or decrease [illegible] over [illegible]	Percent increase or decrease [illegible] over [illegible]
1. General revenues:									
(1) Income taxes	$ [illegible]	$ [illegible]	$ - [illegible]	- [illegible]	$ [illegible]	$ + [illegible]	+ [illegible]	$ + [illegible]	+ [illegible]
(2) Tax on output manufacture	[illegible]	[illegible]	- [illegible]	- [illegible]	[illegible]	- [illegible]	- [illegible]	- [illegible]	- [illegible]
(3) Miscellaneous internal revenues:									
Capital stock tax	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
Estate tax	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	- [illegible]	- [illegible]	- [illegible]	- [illegible]
[illegible] tax	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	-	-
Alcoholic beverage taxes	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
Tobacco taxes	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
Beer taxes	[illegible]	[illegible]	- [illegible]	- [illegible]	[illegible]	- [illegible]	- [illegible]	- [illegible]	- [illegible]
Manufacturers' excise taxes	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
Miscellaneous taxes	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
Total miscellaneous internal revenue (collection basis)	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
Adjustment to daily Treasury statement basis	- [illegible]	—	+ [illegible]	—	—	+ [illegible]	—	—	—
Total miscellaneous internal revenue (daily Treasury statement basis)	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
(4) Employment taxes:									
Taxes on employment by other than carriers:									
Federal Insurance Contributions Act 2/	[illegible] 2/	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
Federal Unemployment Tax Act 2/	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	- [illegible]	- [illegible]	- [illegible]	- [illegible]
Total	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
Taxes on carriers and their employees (Chap. 9, Subchap. B, of the Internal Revenue Code)	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
Total employment taxes	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
Total internal revenue	[illegible]	[illegible]	- [illegible]	- [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
2. National Unemployment Insurance Act	—	[illegible]	+ [illegible]	—	[illegible]	[illegible]	—	+ [illegible]	+ [illegible]
3. Tariffs	[illegible]	[illegible]	- [illegible]	- [illegible]	[illegible]	- [illegible]	- [illegible]	- [illegible]	- [illegible]
4. Miscellaneous revenues and receipts	[illegible]	[illegible]	+ [illegible]	+ [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]
Total receipts, general and special accounts	[illegible]	[illegible]	- [illegible]	- [illegible]	[illegible]	+ [illegible]	+ [illegible]	+ [illegible]	+ [illegible]

[illegible] 11, [illegible].

Source: Department, Division of Research and Statistics.

Details of miscellaneous internal revenues on collection basis with details adjusted to basis of daily Treasury statement (unrevised). Details of employment taxes on basis of daily Treasury statement (unrevised).

1/ Actual receipts in fiscal year [illegible] are the amounts heretofore classified as received under Title VIII of the Social Security Act.
Actual receipts in fiscal year [illegible] are the amounts heretofore classified as received under Title II of the Social Security Act. Estimated receipts in fiscal years [illegible] and [illegible] include receipts from the tax originally
levied by Title II of the Social Security Act on carriers with respect to employment prior to July 1, [illegible].

2/ Includes nonrecurring receipts of $[illegible] tabulated as "Unclassified".

[illegible]

General and special accounts (On the basis of the daily Treasury statement (accounts))	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
General revenues:									
(1) Income taxes									
Individual, current	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Corporation, current	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total income taxes (collection basis)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Adjustment to daily Treasury statement basis	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total income taxes (daily Treasury statement basis)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
(2) Tax on unjust enrichment	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
(3) Miscellaneous internal revenue:									
Capital stock tax	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Estate tax	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Gift tax	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Alcoholic beverage taxes:									
Distilled spirits (imports) (excise tax)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Distilled spirits (domestic) (excise tax) 2/	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Imported malt liquors 2/	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Wines, brandy and fruit juices (excise tax)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Rectification tax 2/	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Floor taxes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Container stamps	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Special taxes to connection with liquor connections	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
All other	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total alcoholic beverage taxes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Tobacco taxes:									
Cigars (large) 2/	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Cigarettes (small) 2/	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Snuff	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Tobacco (chewing and smoking)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Cigarette paper and tubes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
All other 2/	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total tobacco taxes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Mine taxes:									
Taxes of association, land transfers, and sales of [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Mine transfers	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Silver bullion sales or transfers	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Playing cards	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Revenue tax on value of product (excess profits)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total mine taxes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Manufacturers' excise taxes:									
Lubricating oils	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Gasoline	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Electrical energy	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Tires and inner tubes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Toilet preparations, etc.	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Automobile trucks	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Passenger automobiles and ambulances	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Parts and accessories for automobiles	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Radio sets, phonograph records, etc.	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Mechanical refrigerators	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Firearms, shells, pistols and revolvers	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
All other and repealed taxes not included above 2/	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total manufacturers' excise taxes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Miscellaneous taxes:									
Telephone, telegraph, radio and cable facilities, leased wires, etc.	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Transportation of oil by pipe line	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Taxes of safe deposit boxes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Admissions to theaters, concerts, cabarets, etc.	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Club dues and initiation fees	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Transportation, etc., tickets special taxes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Cotton and other vegetable oils (excise) 2/	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Miscellaneous coal tax	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Sugar tax	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
All other, including repealed taxes 2/	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total miscellaneous taxes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total miscellaneous internal revenue (collection basis)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Adjustment to daily Treasury statement basis	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total miscellaneous internal revenue (daily Treasury statement basis)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
(4) Employment taxes									
Taxes on employment by other than carriers:									
Federal Insurance Contributions Act 5/	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Federal Unemployment Tax Act 5/	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Taxes on carriers and their employees (Sec. 5, Subtitle B of the Internal Revenue Code)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total employment taxes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total internal revenue	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
4. Railroad Unemployment Insurance Act	—	[illegible]	[illegible]	—	[illegible]	[illegible]	—	[illegible]	[illegible]
5. Customs	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
6. Miscellaneous revenue and receipts	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total receipts, general and special accounts	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

[illegible]

Treasury Department, Division of Research and Statistics.

[illegible]

1/ Details of income taxes and miscellaneous internal revenue on collection basis [illegible] adjusted to basis of daily Treasury statement (accounts). Details of estimated taxes on basis of daily Treasury statement (accounts).
Collections for credit to trust funds are not included.
Includes for fiscal years [illegible] and [illegible] the taxes reported in the Bureau list of [illegible] as "[illegible]" and "[illegible]".
Excess, excise exhibit). For fiscal year [illegible], all repealed taxes are included under "[illegible]".
Includes the processing tax on [illegible] reported in the Bureau list of [illegible].
Actual receipts in fiscal year [illegible] are the excess [illegible] classified as [illegible] under [illegible] of the Social Security Act.
Actual receipts in fiscal year [illegible] are the excess [illegible] classified as [illegible] under [illegible] of the Social Security Act. Estimate respects to fiscal years [illegible] and [illegible] include taxes [illegible] for the [illegible].
Levied by Title II of the Social Security Act on employees with respect to employment [illegible] on or after January 1, [illegible].
2/ Includes excess-money receipts of [illegible] indicated as "[illegible]".

December 21, 1939

To: Mr. Hanes

177

From: Mr. Blough

RB

Pursuant to the request of the Secretary and in accordance with the conclusions reached at this morning's conference, there are described below six optional methods by which an annual additional revenue of $500 million could be raised under business conditions substantially approximating those forecast for the calendar year 1940:

1. Personal income surtax rates and estate and gift tax rates

Increase personal income surtax rates to raise $300 million. Increase estate and gift tax rates to raise $200 million. (This optional plan was presented to the Secretary in my memorandum of December 4.)

2. Personal income surtax rates

Increase personal income surtax rates to raise the entire amount of $500 million.

3. Personal income tax exemptions and surtax rates

Decrease personal exemptions for single persons from $1,000 to $800 and for married persons from $2,500 to $2,000. Increase personal income surtax rates so that the combination of decreased exemptions and increased rates will yield $500 million. (This is a variation of the "LaFollette Plan," and calls for much higher surtax rates since his plan would raise only about one-half the required amount.)

4. Personal income tax exemptions, normal rate and surtax rates

Reduce the personal exemptions for single persons from $1,000 to $800 and for married persons from $2,500 to $2,000. Increase the normal personal income tax rate. Increase the personal surtax rates so that the combination of increased rates and reduced exemptions will yield $500 million.

5. Personal and corporation income taxes

Reduce personal exemptions, increase normal and surtax rates on personal incomes, the combination to raise $400 million. Increase corporation rates to raise $100 million.

6. Personal income, liquor and gasoline taxes

Increase personal surtaxes to raise approximately $300 million (same schedule as for option 1 above). Increase the tax on beer from $5 to $7 per barrel and the tax on distilled spirits from $2.25 to $2.50 per gallon to raise approximately $100 million. Increase the gasoline tax by one-half cent to raise approximately $100 million.

Press at 3:00 P.M. last copy

Through diligent effort and most careful scrutiny of every proposed item of expenditure, material reductions have been made in the appropriations recommended for the operation of the government in the fiscal year 1941 with the exception of the one item of making added provision for the national defense. The deficit, even including the proposed expenditures for the enlarged national defense program, has been substantially reduced as compared to the estimated deficit for this fiscal year.

Faced with the necessity of putting our defenses in a sufficiently strong condition to safeguard us under present circumstances, any smaller appropriations for defense than are indicated in this message would not in my opinion be adequate. If we are to make the further progress that I believe should be made at this time in lessening the deficit we must seek additional revenue.

I am convinced that the situation fully justifies an extraordinary national effort. Therefore, I recommend that provision be made for financing the additions to the national defense in the present fiscal year and the fiscal year 1941 through special taxation. To cover the expenditures contemplated this special addition to our revenue structure should

yield approximately $500,000,000 on an annual basis, but the application of the tax should not extend beyond the period necessary to provide revenue sufficient to defray the cost of the additions to our defenses.

Since it is the function of Congress to determine how revenues should be raised I leave the choice of particular tax measures to its judgment. However, I believe I am expressing the sentiment of the country when I suggest that measures adopted for raising additional tax revenues should reflect two objectives. The first is that the taxes should come from the portion of the population which can best afford to pay them, with due regard to the taxes they now pay to the State, local and Federal governments. Care should be taken especially to design the taxes so that they will not fall on that portion of the population which can least afford to pay them. The second objective is that the taxes should have a minimum of disturbing effects on the further recovery and smooth working of the economy and accordingly should avoid as far as possible the discouragement of productive activity and employment.

Another matter concerning revenue which I should like to call to the attention of the Congress is the fact that parity payments for agriculture were added to the Executive

budget in both of the last two fiscal years in a total amount of $437,000,000 without any provision having been made for revenue to finance them. Therefore, I again urge, as I have in two previous years, that provision be made for new taxes to finance any new authorization for parity payments that may be made for the fiscal year 1941, and also that the Congress give consideration to making some provision for recouping through new taxes the amounts expended outside the budget for the fiscal years 1939 and 1940.

Enactment of the supplementary revenues here proposed will enable us to proceed with our program of making the substantial annual reductions in the deficit which the progress of recovery warrants. I should like to indicate to the country that there will be no interruption of that program. This can be accomplished if we resolve to finance the enlarged armament cost through a special national effort which will be put forth so long as the emergency exists.

ALTERNATIVE PARAGRAPH

In the fall of 1937 when the new agricultural program was under consideration in Congress, I strongly urged that if its cost should exceed the $500,000,000 already in the Budget to finance the Soil Conservation and Domestic Allotment Plan, additional revenues should be provided to finance the excess. The Agricultural Adjustment Act of 1938, approved by me on February 16, 1938, authorized parity payments, the cost of which was in addition to the Soil Conservation and Domestic Allotment program, but no revenue provision was made for financing these payments. When I signed this bill I said publicly that no parity payments ought to be made until Congress had provided the necessary revenues. While Congress has taken no steps to provide this additional revenue, it did appropriate in 1938 and again in 1939 a total of $437,000,000 for making parity payments. Congress has thus added to the aggregate deficit $437,000,000 for this purpose. If further appropriations are made for parity payments I strongly urge that revenue be provided for financing them. I think the Congress should also give serious consideration to providing added revenues to reimburse the Treasury for the amounts expended in parity payments in the last two fiscal years.

Through diligent effort and most careful scrutiny of every proposed item of expenditure, material reductions have been made in the appropriations recommended for the operation of the government in the fiscal year 1941 with the exception of the one item of making added provision for the national defense. The deficit, even including the proposed expenditures for the enlarged national defense program, has been substantially reduced as compared to the estimated deficit for this fiscal year.

Faced with the necessity of putting our defenses in a sufficiently strong condition to safeguard us under present circumstances, any smaller appropriations for defense than are indicated in this message would not in my opinion be adequate. If we are to make the further progress that I believe should be made at this time in lessening the deficit we must seek additional revenue.

I am convinced that the situation fully justifies an extraordinary national effort. Therefore, I recommend that provision be made for financing the additions to the national defense in the present fiscal year and the fiscal year 1941 through special taxation. To cover the expenditures contemplated this special addition to our revenue structure should

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yield approximately $500,000,000 on an annual basis, but the application of the tax should not extend beyond the period necessary to provide revenue sufficient to defray the cost of the additions to our defenses.

Since it is the function of Congress to determine how revenues should be raised I leave the choice of particular tax measures to its judgment. However, I believe I am expressing the sentiment of the country when I suggest that measures adopted for raising additional tax revenues should reflect two objectives. The first is that the taxes should come from the portion of the population which can best afford to pay them, with due regard to the taxes they now pay to the State, local and Federal governments. Care should be taken especially to design the taxes so that they will not fall on that portion of the population which can least afford to pay them. The second objective is that the taxes should have a minimum of disturbing effects on the further recovery and smooth working of the economy and accordingly should avoid as far as possible the discouragement of productive activity and employment.

Another matter concerning revenue which I should like to call to the attention of the Congress is the fact that parity payments for agriculture were added to the Executive

budget in both of the last two fiscal years in a total amount of $437,000,000 without any provision having been made for revenue to finance them. Therefore, I again urge, as I have in two previous years, that provision be made for new taxes to finance any new authorization for parity payments that may be made for the fiscal year 1941, and also that the Congress give consideration to making some provision for recouping through new taxes the amounts expended outside the budget for the fiscal years 1939 and 1940.

Enactment of the supplementary revenues here proposed will enable us to proceed with our program of making the substantial annual reductions in the deficit which the progress of recovery warrants. I should like to indicate to the country that there will be no interruption of that program. This can be accomplished if we resolve to finance the enlarged armament cost through a special national effort which will be put forth so long as the emergency exists.

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