

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE January 10, 1939

TO Secretary Morgenthau
 FROM Mr. Hase *HA*
 Subject: Wheat export sales and other market data from the Federal Surplus Commodities Corporation.

Dec. 26: The fact that there is not much export business in Canadian wheat at the moment prevents any strong advance in the Winnipeg market. This should change after the first of the year when much better demand for Canadian wheat is indicated.

We have mentioned previously that about 40,000,000 bushels of the present new wheat crop in Argentina was unfit for anything but feed due to being heavily frost damaged. Recent reports indicate that this figure is an underestimate.

Jan. 2: Export business in wheat was very small with selling limited to a few scattered lots of Manitoba wheat to the Continent and a small amount of United States wheat in store in Antwerp.

Large export sales of flour were reported yesterday. It is expected that sales overnight will also be large, as this will be the last day on subsidy sales except to the Philippines.

It was reported that a ship loaded with 400,000 bushels of Canadian wheat destined for England had been sunk late last week.

Jan. 3: Sales of export flour yesterday were not as large as expected. This was the last day on which subsidies will be paid except for sales to the Philippines. Sales of flour for export this week were reported at over 400,000 barrels.

Jan. 4: After the market closed an announcement was made that the British Government would requisition all English and Continental ships for the duration of the war. It is hard to say what effect this order will have on

Secretary Morgenthau - 2

the grain markets, although some traders believed it might result in larger clearances from Argentina.

Argentine reports that the cereal import committee of England has not bought any wheat since November 10. Belgium has been buying some Argentine wheat in spite of high ocean freight costs.

Jan. 5: Foreign export demand for Canadian wheat has been dull recently, but it is thought that shipping conditions have been improved by requisition of ships to the United Kingdom and reduced war insurance rates. Sales of Canadian wheat for export are estimated at around 300,000 bushels.

There are many inquiries for flour, but mills are unable to accept offers because they cannot get shipping space for the next four months.

A cargo of United States corn was sold for shipment from Baltimore to the United Kingdom.

Jan. 6: Scandinavia was reported to have bought about 250,000 bushels of Canadian wheat, and a few small lots were also sold to other countries.

Reports from Australia indicate that wheat yields exceed expectations. The crop is now placed at 183,000,000 bushels compared with 154,426,000 a year ago.

Broomhall now estimates the wheat surpluses of exporting countries at 1,016,000,000 bushels compared with 832,000,000 bushels a year ago.

January 10, 1940

My dear Mr. President:

Carrying out your suggestion of Monday, I saw Chairman Doughton, of the Ways and Means Committee, and Chairman Taylor, of the Appropriations Committee, today. Mr. Bell accompanied me.

I informed these two gentlemen that you would like them to select some Democrat to introduce a bill in connection with Finland; what this bill should do, you left entirely to the decision of the Congress.

They both pressed me very hard to indicate to them how much money you would like to see loaned by Congress and I said that you had no program. They wanted to know, if they did pass a bill for Finland, whether that would meet with your approval and I said it would be pleasing to you to have them do something.

Chairman Doughton and Chairman Taylor said they would immediately get in touch with the House leadership and try to formulate a program. Chairman Doughton indicated that he might want to consult with you before he introduced a bill.

Faithfully yours,

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TREASURY DEPARTMENT

WASHINGTON

January 10, 1940.

Conference in the Office of Chairman Taylor
of the Appropriations Committee regarding the
action to be taken by Congress on a loan to Finland.

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Those present were Chairman Taylor, Appropriations Committee; Chairman Doughton, Ways and Means Committee; Secretary Morgenthau of the Treasury; Mr. Sheild, Clerk of the Appropriations Committee; and Mr. Bell of the Treasury.

The Secretary explained that he had been asked by the President to see Chairman Taylor and Chairman Doughton and advise them that in view of the number of bills which had been introduced in Congress for the benefit of the Government of Finland, the President thought it was only fair to let them know that he had no program to submit. The Secretary said further that the President feels that Congress should determine the program it desires to enact for the benefit of Finland and that a bill embodying this program should be introduced by a Democrat and considered by the appropriate committees.

These gentlemen pressed the Secretary for some indication as to the President's attitude on this matter and whether the President had any particular sum in mind.

The Secretary said that he was quite certain the President did not have any sum in mind but wanted to leave that entirely in the hands of the Congress.

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He was then asked if he thought the President would approve a bill if Congress passed one embodying what, in its judgment, it thought should be done for Finland. The Secretary said he thought the President would approve such a bill.

Chairman Doughton said he thought they should get in touch with Congressional leaders and discuss the matter with them and ascertain the kind of a program that should be put forward. It was thought that after this discussion some one might go and talk the matter over with the President. The Secretary said he could see no objection to this procedure.

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THE INCOME CERTIFICATE PLAN

January 10, 1940.
10:30 a.m.

Present: Mr. Blanford
Mr. Copeland
Mr. Blough
Mr. Young
Mr. Delano
Mr. Currie
Mr. Davis
Mr. Ecker-Racz
Mr. Garfield
Mr. Eccles
Mr. Bell

H.M.Jr: Blough, I haven't had a chance to talk to you. I don't know what these experts have been doing.

Blough: Did you see my note?

H.M.Jr: No, I haven't seen anything.

Blough: We got together two times, once on the day of the last meeting and the Friday before Christmas. Mr. Smith at that time had not appointed anyone to serve and Mr. Blaisdell, Mr. Garfield of the Federal Reserve Board and Mr. Ecker-Racz and myself discussed the question at some length and then agreed to do some thinking about it and perhaps write up some notes on it and meet again. We met yesterday afternoon and there didn't seem to be any particular disagreement among the technical people. We didn't find a general desire to join in any statement of points agreed on, but I think I can safely report that there was no substantial disagreement of any kind with respect to the technical aspects of the question. We prepared another memorandum which we submitted to the other parties in the discussions. We have revised that and have it here today, if you need it for discussion.

H.M.Jr: Well, I would just like to say - talking for myself, before I hear the memorandum - that I am going to send something to the President. Before I get into an argument with anybody, I just want to say that I have got to send him a memorandum on the certificate plan. I hope that we can send in a joint memorandum but if we can't, I have got to send him something. I wanted to say that before I hung myself in disagreement.

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I have got to send him something in view of the statement that Mr. Wallace has made and I am not going to answer him publicly but I am going to send it to the President and the President can do anything he wants with it. At least I am on record.

So, Blough, would you read the latest memorandum?

Eccles: In that connection, on the parts that we could get together on, it would seem to me that a joint report should be sent over there to the extent that we agree on certain points and then also point out to the President the points that we might not agree on.

H.M.Jr: Fine. Before we got into a disagreement, I wanted to say that I have got to send something.

Eccles: I had assumed from the beginning that the only purpose of this committee working on this was for the purpose of making a report.

H.M.Jr: I don't know where I got the impression, maybe it was from the last meeting, that some people felt we shouldn't make any report.

Eccles: I have never had that feeling.

H.M.Jr: Then we are all together? Is it agreeable to you if Blough reads this?

Blough: I doubt whether the whole report needs to be read. It is a good deal of a re-hash, but I might pass out copies and then verbally pick out the high spots.

Now, what we endeavored to do here was to try to simplify and clarify the problem by setting out what seemed to be the issues involved in the plan from the viewpoint of the Fiscal and Monetary Commission. We have divided it into two parts, first the considerations in support of the certificate plan and those considerations which are indicated on page one seemed to be these, first - I mean, these are the arguments that are presented in favor.

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"(1) More agricultural aids are necessary, particularly for cotton and wheat farmers;

"(2) The aids should be adopted as a permanent policy which will not have to be scrutinized annually by Congress;

"(3) Only the income certificate plan has the essential characteristics for achieving this result."

Those seemed to be the strongest points which the Department of Agriculture made and which they think sufficient to support the plan.

Now, with respect to the first point, that more agricultural aids are necessary, particularly for the cotton and wheat farmers, we didn't feel in our discussions that we were in a position really to give the type of factual or analytical background to supply a real answer to that question, since it goes to the very heart of the agricultural program. We did think, however, that there were certain questions which ought to be raised in the minds of the committee, which do have an important bearing on the answer to whether more agricultural aids are needed and those are questions that are listed on page two.

"(a) Does 'parity price' measure the kind of parity which it is in the public interest to provide agricultural producers at government and public expense?"

In other words, this whole parity price concept and the parity income concept back of this are based on certain types of calculations and certain assumptions which are by no means universally accepted by economists and others who have studied the problem and before we go into more agricultural aids, perhaps that is something which needs some thought and consideration.

"(b) Should agricultural subsidies go to the agricultural group as such, that is, should the subsidies go to all farmers producing a given crop, including corporations, without regard to need for family income?"

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If our farm program is in the nature of a relief program, should that relief go to needy farmers or should the relief go to all farmers? Under the present program the greater part of the relief and this parity program relief or subsidy would go to all farmers and in proportion to their incomes rather than more to the more needy farmers.

Here is another question which we may want to raise with respect to increasing the agricultural benefits.

"(c) Does the present distribution of parity payments and that proposed under the income certificate plan give an adequate share of assistance to tenants, sharecroppers, farm laborers and small farm units?"

Some criticism has been raised and we don't present any factual data because I for one don't have any adequate data, but some point has been raised that the aid goes, the parity payments go too largely to landlords. The Department of Agriculture, I think, does not believe that is true.

"(d) In view of the benefits of all kinds paid them by government, are the agricultural groups in greater relative need for further aid to achieve 'parity' than such industries as railroads and coal mining, or such groups as the unemployed?"

There are questions which go to the very heart of whether there needs to be further payments to agriculture.

"(2) The second point that parity payments should be adopted as a permanent policy which will not have to be reconsidered and reviewed by each succeeding session of Congress, conflicts with another consideration indicated below, namely, that sound budgetary practice requires expenditures to be scrutinized periodically.

"The democratic process assumes that Congressional determination represents the nearest possible approach to the expression of the public will. This is recognized in certain parts of the Department of Agriculture's memorandum. In respect to the parity

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payments, however, a contrary position appears to be taken, namely, that while the present Congress represents the public will, succeeding Congresses may not represent it."

That may be a little exaggerated in view of their position, but they seem to have a good deal more faith about what they could secure from the present Congress than what they might be able to secure from future Congresses. It might be well to read another paragraph or two.

"Although there is thus an apparent anomaly, those taking this position hold that agricultural aids should be adopted as a permanent policy outside the budget, because other economic and industrial groups have protective legislation of various kinds which need not be reconsidered at each session of Congress. The tariff is the principal example mentioned."

Then there is a paragraph which seeks to say something about that question.

"Many agricultural commodities are protected by tariffs and, in recent years, even the tariff on wheat has been effective in raising the farm price. Aside from this consideration, however, the observation may be made that the tariff is either a policy or a disease. If it is a policy intended to achieve a certain result the measures should not be taken which would operate to nullify it. If instead the tariff is a disease, the cure would seem to be its elimination rather than to spread the disease by measures which in no respect reduce the economic loss caused by the tariff in misdirecting the use of the nation's productive resources. The tariff hits primarily consumers. This proposal would hit them again.

"The type of tax pressure afforded by the tariff is very different from the payment of governmental cash benefits financed from taxes. The distribution of burdens is different, the distribution of benefits is different, and the effect on internal competition and productive efficiency is different."

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Those are the economic points. I don't think we need, perhaps, to go into them unless there is some question.

"A line must be drawn somewhere between the incidental effects of governmental policy on the fortunes of people and the direct payments of money forcibly collected from the people. The latter is more susceptible to the dangers of misuse, and accordingly requires more careful scrutiny to achieve an allocation of governmental burdens and benefits in accordance with the public interest. Although similar scrutiny should no doubt be accorded to tariffs, the fact that it has not been given does not warrant extending the lack of scrutiny to direct governmental payments."

Then their third point is that the income certificate plan is the only plan that has the characteristics necessary to give larger and perhaps more - and more permanent parity payments. Our general thought there is that the income certificate plan probably would give larger and somewhat more permanent payments. It is not an open and shut case, however, because there is a possibility that the existence of these special taxes falling on the masses of the population would present a constant target for political action which might lead to a reaction against both a tax and the benefits.

"With reference to the above points raised in favor of the income certificate plan, the possibility must always be kept in mind that some other method may afford results sufficiently approximating those expected of the certificate plan but without its inherent disadvantages as to be on balance preferable."

Those, from studying the Department of Agriculture's memorandum, seem to be the considerations which they raised in favor of the plan and we don't consider that this is an adequate answer to those. Perhaps there is no answer to it. But we attempted, at any rate, to bring out into the open some of the questions involved here.

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H.M.Jr: Before you go further, may I ask you a question? At any place do you bring out this point, that this would only reach a group of three million people and that if we - a compensating fact?

Blough: That is the next part.

H.M.Jr: You do bring that out?

Blough: Yes.

H.M.Jr: And then also the question that if you put this tax on cotton, it might increase rayon and so forth?

Blough: Yes, that is in here. That comes out in the next part. In other words, we have been trying now to give the arguments or considerations in favor of the income certificate plan and now turn to the fiscal considerations against the certificate plan.

H.M.Jr: You have got these things that I have mentioned?

Blough: Yes, two of them.

"The fiscal considerations against the income certificate plan as a method of financing agricultural parity payments are mainly the following:

"(1) Any plan for the payment of agricultural benefits would be less subject to abuse and would be more likely to promote the public interest over the long run if the tax collections and benefits were included in the budget and handled in the same manner as other taxes and appropriations.

"(2) The processing taxes constitute so highly regressive a method of financing benefits as to be less desirable than other sources of revenue.

"(3) Even if processing taxes were to be used for financing benefits, the income certificate tax would be inferior to the type of processing taxes which were in operation from 1933 to 1936."

Now, with regard to the first point I think there is fairly general agreement among fiscal people. That is the paragraph - this is on page 7.

"The adoption of the income certificate plan would make it more difficult to determine the amount of actual public expenditures and the actual tax burden of the various groups of taxpayers. Only by the inclusion of all public expenditures in the budget and by the submission of all public expenditures to periodic executive and legislative review can there be any assurance that the proper allocation of public funds among the many public uses is approximated. Furthermore, the elimination of such an important item as this from the budget would limit the effective use of fiscal policy as an instrument of economic control."

That last point is intended to relate to the use of the budget, surpluses and deficits as measures of control, and by placing this completely outside of the budget you drop any possibility of using it for that purpose.

"In the memorandum submitted by the Department of Agriculture, the view is expressed that '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.'"

We go on to point out that the certificate plan is very largely a fiscal problem or a fiscal plan, that the taxes are collected and revenues are distributed by an agency of government, that it is not materially different from the old processing tax plan, that the actual operations to be conducted, although by a special revolving fund, yet you would have substantially the same characteristics that you have now and have had previously.

The last paragraph on page 8.

"In the Department of Agriculture's memorandum the view is expressed that 'under existing circumstances,'

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an increase in direct governmental payments is 'neither practical nor desirable.' It is urged that since Congress is not likely to continue to make direct appropriations for the benefit of a particular group, an indirect subsidy should be provided; that such an indirect subsidy is already being provided industry. In addition to what has already been said on this point, it should be noted that the pursuit of the proposed policy would logically involve the granting of indirect subsidies to numerous additional groups."

You could hardly stop logically with agriculture.

Now, the second point regards the merits of the processing taxes and since they put so much stress on this, I am wondering if it might be desirable to read that several pages completely.

"In regard to the second point bearing upon the merits of processing taxes, it should be noted that the certificate plan would place the burden of parity payments on the consumers of the products affected. Underlying this method of financing is the assumption that the existence of low agricultural prices bestows an unfair advantage on consumers, and that such an advantage might properly be recaptured for the benefit of agricultural producers. It presupposes that the rewards accorded by the market place to the producers of certain commodities are not just and require supplementation to raise them to some specified but variable levels.

"Although it may be agreed that 'the farmer is entitled to a fair price,' that does not dispose of the question as to what is the fair price. Even defining it as a price which will give the producer a fair income leaves undetermined the essential question of what is fair. Furthermore, a price that will give a fair income to the producer is not necessarily a fair price to the consumer. The consumer ought not be required to pay more than the price resulting under a sound organization of agriculture. A sound organization of agriculture giving fair returns to those engaged in farming would almost certainly afford lower prices to consumers than 'parity' as now

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computed. To impose on the consumers through a processing tax the burden of giving the farmer a fair price - whatever that may be found to be - may thus result in serious unfairness to consumers.

"Such concepts as parity price and parity income cannot be accepted without reservation. While Congress has on several occasions endorsed parity income and parity price as a legislative objective, these endorsements have been qualified. The 1933 Agricultural Adjustment Act, for example, instructed the Secretary of Agriculture to assist farmers to obtain parity prices and parity incomes 'insofar as practicable' at the same time that it instructed him to assist 'consumers to obtain an adequate and steady supply of such commodities at fair prices.' Actual parity payments to the farmers are to be made only when, as, and if, and to the extent that, appropriations are made for that purpose. Even if the present concept of parity price and income be accepted, the fiscal methods of providing them are subject to further consideration. The question immediately at hand is whether a tax on the consumer of certain agricultural commodities is the desirable method of financing parity payments to the growers of these commodities.

"The certificate plan would impose a tax on certain necessities. It would tax the consumption of wheat, cotton and rice. Experience with the processing taxes under the Agricultural Adjustment Act of 1933, invalidated in 1936, indicates that the burden of taxes on these commodities would fall, in large part, on consumers. Inasmuch as the consumer expenditures for the products of these agricultural commodities account for a much greater proportion of the total expenditures of individuals and families with small incomes than of the total expenditures of those with larger incomes, the burden of the tax would be regressive. It would bear more heavily on those with small incomes than on those with larger incomes.

"The tax would be unusually regressive for it would be imposed on physical units of an agricultural commodity, without regard to the price of the product consumed. Unlike a sales tax

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which is imposed on the basis of price, the certificate tax would be imposed on the basis of weight or volume. Low income consumers purchasing low-priced cotton articles would pay a higher tax with each dollar spent than higher income consumers purchasing high-priced cotton articles.

"It may be that in some cases processors would find it necessary and practical to transfer some of the tax burden from their low-priced to their high-priced products. Under the invalidated processing taxes cigarettes, for instance, appear to have borne more than their share of the tobacco taxes. This type of adjustment, however, is very uncertain and cannot be predicted as a likely occurrence in the case of other products.

"The rate of taxation contemplated by the proposed certificate plan would be far heavier than the rates which in the past usually have been applied to necessities in the United States. The general sales taxes imposed by states in no instance exceed 3 percent of the amount of the transaction, and moreover, in many cases, exempt farm products from taxation.

"The rate of the tax under the proposed certificate plan would be equal to the difference between estimated parity prices and the average farm prices of the particular agricultural commodities affected. In some instances, the rates of these taxes would be even higher than those imposed under the invalidated processing taxes. Even on the basis of United States average farm prices prevailing on December 15, 1939, the difference between parity prices and farm prices amounts to 30.8 cents per bushel of wheat, 6.2 cents per pound of cotton and 31.8 cents per bushel of rough rice. A 6-cent tax on 10-cent cotton, for instance, would be equal to 60 percent of the farmers' selling price. The imposition of indirect taxes of this magnitude, superimposed on an already regressive Federal-state-local tax system, would severely affect the already limited purchasing power of the low-income families.

"The effects of the certificate plan would be especially burdensome to those who, just like

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wheat, cotton and rice farmers, are receiving less than 'parity' incomes. There are large numbers of other persons on farms and in the cities who have incomes and standards of living as low as the growers of wheat, cotton and rice. The whole body of the unemployed and the under-employed laborers in all industries have less than 'parity' incomes and would be subjected to a heavy burden on account of the tax.

"In the Department of Agriculture it is recognized that the certificate plan would constitute, in effect, a tax on consumption. It has been maintained, however, that the regressive effects of the tax would be offset by the 'progressive' effects of the expenditures and that the net result would be 'progressive.' Underlying this position is the assumption that the plan would benefit a low-income farm group largely at the expense of a higher-income non-farm group."

We don't like the words "regressive" and "progressive" in this instance. We would much prefer a "redistribution downward" instead of the word "progressive" and a "redistribution upward" instead of the word "regressive", because I think that is what we really have in mind. When they say "progressive", they mean that there is a redistribution of income from the higher-income groups and when they say "regressive" they mean that there is a redistribution of income from lower-income groups to higher, but we are using their terminology.

"At the outset, it should be noted that this distinction between farm and non-farm population is not wholly relevant to the issue. The certificate plan has been designed for the benefit of wheat, cotton and rice (and possibly some tobacco) growers only. It probably cannot be employed successfully, and it is not proposed, for the benefit of the growers of the many other farm commodities. In consequence, the plan does not propose to benefit the entire farm population at the expense of the entire non-farm population. It proposes, rather, to benefit wheat, cotton and rice growers as distinct from all other farm groups as well as all the non-farm groups.

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"There are at present in the United States approximately 7 million farm families. About 3 million of these are engaged, to a small or large extent, in the growing of wheat, cotton and rice. Thus, even if all wheat, cotton and rice growers cooperated in the AAA production and soil conservation programs and were eligible for parity payments, the certificate plan would benefit not more than 3 million farm families, at the expense of another group consisting of 4 million farm families, more than 22 million non-farm families, and several million single individuals.

"Moreover, the plan, if adopted, may not be of much help to some wheat and cotton growers. That likelihood is indicated by the fact that a portion of the wheat and cotton growers produce these commodities in such small quantities that the benefits they would receive from their share of the certificates, if they complied with the farm program, would be offset largely by their share of the tax burden as purchasers of wheat, cotton and rice products.

"The certificate plan is said to have 'progressive' effects because the average income of the farm population which would be benefited is lower than the average income of the non-farm population which would be taxed. However, a comparison between farm and non-farm population on the basis of per capita incomes is subject to misinterpretation. The incomes of the two groups are not comparable. A dollar of income in a rural area is something entirely different from a dollar of income in an industrial area. Its purchasing power is different because the cost of living generally is lower in rural than in urban areas. For those on farms, food, housing and clothing, three important elements in the budget of the low-income groups, require a smaller expenditure than for those in the cities.

"In comparing the income of the farm and the non-farm population it is emphasized that a larger proportion of the farm population falls in the low-income group than is the case in the non-farm population. It is pointed out, for instance, that a considerably larger percentage of the families

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on cotton farms have low annual incomes than is the case with an industrial population. Such use of percentages, however, does not bring out some of the important aspects of the low-income problem. The percentages relate to entirely different magnitudes. The adoption of the certificate plan would result in the taxation of at least 5 million non-relief families with incomes of less than \$780, for the benefit of wheat, cotton and rice growers, only part of whom have such low incomes. In addition, there were 4,500,000 relief families, of whom 600,000 were farm families. In other words, it is not evident that the net effect of the plan would be a distribution of income from higher to low income groups.

"Moreover, we are here dealing with families whose incomes range from minus quantities upward. Therefore, even if, on the average, the families taxed had a higher income than those which received the benefits, the families taxed would still include a number whose incomes would be lower than the incomes of many receiving the benefits. In other words, despite the fact that on the average farm families have lower incomes than urban families, the plan would tax some consumers with little or no income for the benefit of some farmers with relatively larger incomes. To this extent the effect of the plan would be the converse of 'progressiveness.'

"Finally, it should be noted that, aside from limitations on maximum payments to individual farmers, the benefits under the certificate plan would be distributed among farmers approximately in proportion to the present distribution of incomes. Wheat, cotton and rice growers would benefit in proportion to their normal production. Therefore, in general, farmers with large farms, producing large amounts of wheat, cotton or rice would receive more money from the plan than small farmers producing smaller amounts.

"These considerations indicate that (1) the cost of the plan would be distributed inversely to tax-paying ability, (2) the benefits of the plan for

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these commodities would be apportioned roughly according to the present distribution of incomes among the growers, and (3) some purchasing power would be transferred from low income families to higher income families.

"At all events, even if it could be agreed that the certificate plan tax on consumers for the benefit of producers might have 'progressive' effects, it would still be true that the degree of such 'progressiveness' would be less than could be achieved under practically any other method of taxation."

The third point is that the certificate plan imposing the processing tax, even if we wanted a processing tax, gives it a less integrated and less wrought up way than if it were a processing tax in the budget itself.

"A processing tax can be administered readily by the regular tax-collecting agency of the government. It can be more carefully integrated in technical details (with respect to definitions of tax base, and exemptions, deductions and refunding provisions) than is the case with the certificate plan.

"The effective application of processing taxes requires the imposition of compensatory taxes. Floor stock taxes are a case in point. Under the invalidated processing taxes provision was made for compensatory floor stock taxes on any article that on the date the processing tax became effective was held for sale or other disposition.

"Such compensatory taxes are essential to prevent undue profiteering. The need for such taxes is especially present when rate changes are likely to occur from time to time. Moreover, in those instances where on occasions reductions in tax rates are likely, provision should also be made for refunds on floor stocks. In the absence of such provisions, processors and distributors are exposed to heavy losses merely because of a change in the tax rate.

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"Under the processing tax, the Secretary of Agriculture was instructed to ascertain whether 'the payment of the processing tax upon any basic agricultural commodity is causing or will cause to the processors thereof disadvantages in competition with competing commodities by reason of excessive shifts in consumption between such commodities or products thereof.' If he so found, he was to proclaim a tax at a rate 'necessary to prevent such disadvantages in competition' on the first domestic processing of the competing commodity. The need for this type of compensatory levy is particularly important in a commodity, such as cotton, for which important competitive substitutes are available, such as paper, jute and rayon. This problem may be more serious in the case of the industrial uses of cotton.

"Conceivably, a certificate plan of the type proposed could be supplemented by compensatory taxes within the internal revenue system. Whether such compensatory taxes are in fact contemplated by the proponents of the plan has not yet been indicated. It would appear that the imposition and administration of compensatory taxes as well as the disposition of the revenues raised would be less cumbersome as an integral part of processing taxes than as adjuncts of the certificate plan. To these should be added the previously discussed considerations: that if processing taxes were employed they would be included in the budget, that they would be less hidden from the public, and that they are more likely to be currently scrutinized than the taxes inherent in the certificate plan."

Now, we don't pretend to have covered all the points. Many in the original memorandum are not in here, but those seem to be the ones most at issue.

H.M.Jr: I congratulate you gentlemen on doing a beautiful job.

Blough: Now, I don't mean to assume that the technical people from the other departments approve of everything that is in here and I hope if they don't approve of things they will have an opportunity to express their disapproval.

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B.W.Jr: How would you like to proceed, Mr. Eccles?

Eccles: Well, we have a statement here that is more or less tentative. I asked Mr. Davis a day or two ago if he wouldn't come in and advise with reference to this question, as he had had so much experience in the agricultural field.

The thought that we had in mind wasn't to go into the question as exhaustively as your staff has here, into all of the technical, economic and tax implications. We had approached the thing rather from the thought of making some kind of a statement to the President and knowing that he liked these short memoranda and that he - and possibly direct or definite recommendations or alternatives, we had not thought so much of getting into all of the various economic and technical arguments which may be back of our conclusions. I think this memorandum here is an excellent study and it brings out some very good points.

Of course, when you get into the field of economics in taxation, you can go on indefinitely and build up volumes in discussing the various aspects and will never come to agreements or conclusions.

Now, as I say, we have here somewhat of a brief, a tentative statement, that is by no means, I would say, a final conclusion. It is five pages. If you would care to have it done, I think that this may state rather briefly the present results of our consideration of this question.

B.W.Jr: Will you read it?

Eccles: Would you like us to do that? I would like you to read this, Chester. Will you do that?

Davis: I want, in order to avoid a false impression, to disclaim authorship and give Mr. Garfield the primary responsibility for it.

"Already a great advance has been made toward price and income parity for farmers but these goals have not yet been attained. In 1940, when

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parity income would be $9 \frac{3}{4}$ billion dollars or more, income from farm marketings may be about 8 billion and Government payments to farmers, including 225 million of parity payments already appropriated, may be close to $3 \frac{1}{4}$ billion, making a total of $8 \frac{3}{4}$ billion. This would be short of income parity by a billion or more. If parity payments are dropped, the difference in 1941 would be larger, unless market developments were favorable to farmers. It is our position that an approach to parity of incomes for farmers is both equitable and economically desirable.

"Appropriations and certificate plan

"If parity payments are to be maintained or increased, should they be made out of the general funds, that is, out of general taxation, or out of special taxes allotted through the certificate plan? Appropriations from the general funds presumably would come to some extent from income and other taxes based on ability to pay. The cost under the certificate plan would fall mostly on consumers of products made from cotton, wheat, and rice, in accordance with the poundage of these materials in products bought. A large portion of the cost would be paid by people with low incomes. It is exceedingly difficult to compare the incomes of farm and nonfarm groups to determine whether those receiving the payments (in relatively large amounts each) are worse off than those who would make the payments (in relatively small amounts each, the tax being spread over a large number of people). But it is clear from the point of view of income distribution and also from the point of view of putting idle funds to work that making payments out of the general funds of the Treasury would be better than making them out of the proposed consumer taxes.

"There is, moreover, a fundamental objection to making, in effect, such large appropriations without the annual review accorded those for practically all other purposes; in this connection it should be noted that the amount of taxes under the certificate plan would automatically increase

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if prices received declined relative to prices paid (and vice versa).

"Another important argument for appropriations from the general funds rather than the special taxes proposed is that farmers really can not afford to lose more of their markets. Domestic cotton consumption would probably be curtailed as a result of a 5 cent tax - a study of the effects of the processing tax by the Bureau of Agricultural Economics would suggest a loss of perhaps half a million bales annually. This total might be reduced by distribution of cotton goods through extension of the Food Stamp Plan but in many particular cases competitive materials certainly would be given a great advantage by an increase of perhaps one-third in the cost of the highest grades of cotton and two-thirds for the lowest grades. A decrease in consumption would lower production and have an unfavorable effect on producers, particularly farm laborers, who in any event would be benefited only indirectly. The effect of the tax on consumption might be lessened if the certificate plan were revised to bear less heavily on the low-value uses of cotton, and more heavily on high-value products where the cost of the raw material is small relative to the price of the finished goods (lawn, lace, and broadcloth fabrics, for example, as against mattresses or overalls).

"If the certificate plan is adopted, demand for protection from competing domestic materials would probably take form similar to the compensating taxes under the A.A.A., which were very troublesome, and extended almost endlessly. Cotton manufacturers and growers asked for compensatory taxes on silk, rayon, and paper; wheat millers and growers for taxes on corn, rye, and the imported starches. Devices of this sort would run counter to the efforts of various agencies to eliminate restraints on domestic trade. They would not be involved if funds were appropriated direct from the Treasury.

"The principal argument advanced for the certificate plan is that this year and every other

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year it will provide larger payments than can be obtained any other way and make possible the continuation of effective measures to control production and supplies in the interest of consumers as well as of producers. Consumers, it is urged, would probably not begrudge the producer his parity price. Also, once the certificate plan was adopted, funds would be made available automatically each year; how this would work out actually is uncertain - relating payments to specific taxes might make them a target in an election year even if incomes are higher than in other recent years.

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"It is understood that the suggestion of the certificate plan has been made partly to meet a demand for a system of fixed or guaranteed parity prices on the domestically-consumed portion of staple crops. The certificate plan would be preferable to a system of fixed prices since while the effect on the consumer would be approximately the same the certificate plan would channel the benefit to cooperating producers, thus supporting the broad adjustment and ever-normal granary program.

"Summary

"To summarize, it is our judgment that efforts to establish a better relationship between the income of farmers and of others should continue, particularly if it can be done in a way that would contribute to the effectiveness of the broader farm program. Our first preference is for appropriations financed by taxes derived in accordance with ability to pay. Our next choice would be a combination of appropriations and the certificate plan, with appropriations sufficient to reduce materially the amount of the taxes under the certificate plan and sufficient to provide payments for some other groups not covered by the certificate program. If, however, the choice is between discontinuance of parity payments and possible consequent dislocation of the farm program on the one hand, and the certificate

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plan on the other, or between a system of fixed or guaranteed prices and the certificate plan, then the certificate plan, with certain revisions, would be favored.

"In thinking about revision the following questions might be considered.

"(1) How can substitution of other materials, notably for cotton, be prevented? Even if new outlets are gained by extension of the Food Stamp Plan it would be unfortunate for cotton growers to lose markets narrowly held with current price relationships.

"(2) What provision can be made for integrating the certificate program with the parity payment program in 1940; and subsequently for continuing parity payments to corn producers, who are now receiving 50 to 60 million dollars a year of such payments?

"(3) If many other nonmilitary appropriations are actually decreased this year, should parity payments to cotton, wheat, and rice growers be increased as much as would be necessary to bring the income of these groups all the way to parity? (The amount to be collected for these groups under the plan as outlined would be around 400 or 500 million dollars as compared with average parity payments to them of about 150 million dollars on the past two crops.)"

Eccles: Thank you. We would be glad to furnish some copies of this if you would like to have them.

H.M.Jr: Yes.

Eccles: It seems to me that we are together; that this proposal is not burdened on consumption; that it is more regressive than progressive; that it is not related at all to ability to pay; secondly, that as I understand your position here, it is undesirable to have an operation of this sort outside of the budget. It isn't subject to annual consideration and review. It seems to me that we also agree that this proposal of theirs does not cover the entire field of agriculture but only a portion of it and that it might, and

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likely would, result in a reduction of the consumption, particularly in the field of cotton and the bringing in of substitutes.

Now, we go beyond the point that you do, I think, and that is to the extent of not just throwing this program out, because of these factors that both you have mentioned and we have mentioned here, but we recognize what we consider the alternative, that we have recognized some alternative should be provided.

Mr. Davis is in touch with the farm leaders, I think more than anyone else connected with our organization, and I think he agrees with Secretary Wallace in feeling that there is a great danger in attempting to get a guarantee of prices and of course it has been the objective of nearly all forms of organizations unless they could get some alternative. The need of exercising that control over the agricultural production is, I think, pretty well recognized by everyone and this would tie into the soil conservation - not the farm certificate plan, but some parity payment plan would tie into the conservation program and would strengthen the production control, so that we got around to the point where as a practical matter the farmer, we feel, is entitled to some consideration. That isn't just these two types of farmers, cotton and wheat and rice. Corn is a big factor in this and has been taken care of in the past but is not covered under the certificate plan and we would favor, as a first choice, some benefit, not necessarily a parity payment. I recognize there are factors that have been brought out here that might not warrant any such appropriation or taxes as to give parity payment, but we feel there should be some appropriations made available for some payment recognizing the parity principle and that as a first choice.

As a second choice, and I will say it as not a close second, as far as I am concerned, that possibly a modified certificate plan to cover certain articles and supplemented with a tax program to take care of corn and some other products. In other words, if you are going to

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have - if it is necessary to have a taxation of this sort, it ought to be just as small as possible. If you are going to have it at all, we would like to see it reduced to the very minimum and as much of the taxes come out of the general revenues, either through some new taxes to be levied or - we don't go into that aspect at all.

It would seem, Mr. Secretary, that we are in agreement on the first two items. As to whether or not you want to go beyond that, you haven't indicated in your memorandum at all whether you want to recognize any alternative program. We have been down to the point of recognizing that there should be alternatives and you haven't, so we are in agreement as far as we have gone. Wouldn't you say that was apparent, Chester?

Davis: Well, with certain reservations. I would like to comment at an appropriate time on the memorandum Dr. Blough read there.

Eccles: What I meant was in reference to the two general memoranda.

Davis: I don't think there is any question.

Eccles: We are against this principle of taxation and that it should not be - any form of benefit should not be outside of the budget so that it has the benefit of the annual review and we have gone to the point of suggesting some alternatives. I would like Mr. Davis to comment.

Davis: I have one or two thoughts, Mr. Secretary, on hearing the Treasury's memorandum. In one sense it seemed to me that in the broader picture and its relation to farm legislation it is not fully realistic. That is, there will be a program which is aimed to increase and support farm prices, no matter what administration may be in power, continuing down through the years, in my judgment. I believe that same thing is true of all the countries that have a capitalistic or price economy. I think those programs are in effect and they will be in effect there as well as here.

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From the agricultural standpoint, therefore, the question becomes one of what is the most satisfactory form for this support to take. The effect on the consumer of any effective plan to increase or support farm prices at a level above which they otherwise would hold is substantially the same as the effect of the certificate plan, as has been pointed out in the Treasury's memorandum. That is, the effect of any successful program would be the same as this program, the incident of tax would be identical in both cases.

The certificate plan has certain advantages over other alternative plans to increase and support farm prices that might be suggested and it also has some disadvantages, as your memorandum points out.

Now, as to the question of parity as a standard, the fact is, of course, that it is the principle underlying the objectives set forth in the present law, whether it is the correct standard or not, that does happen to be the standard laid down for the guidance of the Secretary of Agriculture at the present time.

H.M.Jr: Seventy-five percent?

Davis: No, that was only in the appropriation item of 225 million, Mr. Secretary.

H.M.Jr: Well, Mr. Wallace told me last Friday at Cabinet that he considered it 75 percent.

Davis: Seventy-five percent only applies to the distribution of 225 million dollars appropriated on June 30, 1939. It was written in as a rider to the amendment to the Agricultural Appropriation Bill at that time and is not in the main Agricultural Adjustment Act. That is my interpretation.

H.M.Jr: If you don't mind, you are getting way beyond anything that I want to take a position on. All I want to take - I don't want to get into a discussion of whether agriculture should or should not have parity.

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- Davis: I think your memorandum has done so, Mr. Secretary.
- Blough: I raised that as one of the questions.
- Davis: And I addressed my remarks to that, because....
- H.M.Jr: Well, if we are going to use this - if you don't mind, I will interrupt you. I just want to say where I stand and maybe it will save time. I very definitely don't want to get into a discussion of whether agriculture should or should not have parity payments. All I would like to - my own advice to the President is, is a certificate plan good or bad as a method.
- Davis: I would not have addressed myself to that if your memorandum had not done so, Mr. Secretary.
- H.M.Jr: Go ahead, will you?
- Davis: I have completed.
- H.M.Jr: No, I am sorry.
- Davis: That is all right, I have said all I wished to say. That is quite all right. I hope I haven't taken too much time.
- H.M.Jr: I just meant I wasn't going to go along with my own staff beyond whether the certificate plan was good or bad.
- Davis: I understood your endorsement of this as indicating you were, and I was raising that point of view.
- H.M.Jr: I think you are right.
- Davis: That was the only point of my discussion.
- H.M.Jr: I think you are right. Talking just for the Treasury, I don't want to go beyond the tax field, that is all. I don't want to get into an agricultural program.
- Eccles: In other words, you don't want to in any way propose any alternative, because I don't - I feel a little different in that I don't want to point

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out all the objections to the certificate plan, of which there are many, and then say that against it, unless I suggest alternatives, because if there are no alternatives, if it is a question of nothing or the certificate plan, a modified certificate plan, we would say, then I would be for a modified certificate plan as against not considering giving any further consideration to the farm problem. I think if that is the case, we will open up some other very undesirable developments or features such as an attempt to fix prices, guarantee prices, so that I - I started to say in the beginning, I agree with you, as far as you go, but I would just go one step further and say that I am only for some modified certificate plan in case it is that or nothing. I think there are other alternatives that are very much better for the economy as a whole.

H.M.Jr: Well, let me ask Mr. Delano - he has been very patient with all of us - how he feels about this.

Delano: Mr. Secretary, I am very much impressed with both these papers. I don't know that I have any - I know I haven't any right to commit our group to a decision on this thing. In fact, I am only authorized to attend this meeting as an observer. I asked one of the brilliant lawyers in the employ of the government what the duties of an observer were and he told me that an observer could make observations. That is all I know, and I know that I don't know the answers to these questions.

Personally, I think that while I see the position of the Treasury, that if it sees a plan suggested that is going to affect the Treasury in a bad way, they have a right to condemn that plan, but as citizens of the United States, I think we are all interested in trying to help solve this solution of this problem.

I am old enough to remember the time when the farmers represented 75 percent of the population. They allowed the tariff fellows to put it all over them so that they had to pay more for everything that they bought and sell in a wide open market without any protection. Now, the farmers are only 25 percent of the population and they

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certainly are going to hell in a hack unless there is a guardian, that is my personal opinion.

Now, my colleagues might not agree with that. As I say, I haven't any right to more than make an observation.

H.M.Jr: I am surprised that you let a couple of lawyers hobble you.

Delano: I only asked one. If I had asked two, I wouldn't know where I was.

I think every argument that has been made against this certificate plan could be made with even greater force about the tariff and I am impressed with the point, is the tariff a necessity or is it a disease? Two wrongs don't make a right. Just because we have got the tariff doesn't mean that we ought to have the same kind of a wrong to help the farmer. Yet we all know that we are laced up with this tariff and have been for 125 years and we are not going to get rid of it. Even efforts at ameliorating the conditions don't go very far, but I don't know any economist that has ever figured out how much more the tariff is costing the people of the United States. It is one of those delightfully indirect methods of effecting business that - when I was in - I went to the Near East in '26 and I saw steel rails sold on the dock for \$17 a ton when they were selling them in this country for \$45 at the mill. Part of that is due to tariff, part of it is due to selling stock for whatever they can get for it.

H.M.Jr: Would you be willing to do this, if we don't get any further along than where we are (speaking to Mr. Currie), let each of these four agencies prepare a memorandum. I will try to keep ours down to two or three pages. Then we will give it to you and you can summarize it for the President. If we are in agreement, you can say the four agencies agree on this but from there on they are not in agreement. We will have the supporting memorandum but I will summarize it

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and we will simply take the position, does the Treasury think the certificate plan is good or bad, and we will say we think it is bad and why. We won't go beyond that. But if each person will give you a summation of this, and then you take it and just make a factual summary for the President and you can say that we are in agreement on this and on this we are not.

Currie: I will be glad to do it, Mr. Secretary.

H.M.Jr: Don't you think that is the best way?

Eccles: I think that is an excellent way to get at it.

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

Currie: I will be very glad to.

H.M.Jr: I would like to make this suggestion, that as much as possible of this should be sent to the Chairman of the Ways and Means Committee of the House and Senate. If he wants to, he can just forward this stuff to them, but I think it would be unfortunate after all this work has been done if these two committees don't get the benefit of it and they can decide what they want.

(Mr. Currie left the conference)

H.M.Jr: He had to go and I just thought - I mean, there is an awful lot of feeling on this thing and I am thinking this would be fair to everybody, wouldn't it?

Eccles: It is entirely fair to me. I don't see how anybody could object to that. There has been, of course, a good deal of publicity and I feel somewhat like you do, that because of one side of the thing being presented publicly I have said absolutely nothing on it and I know you have said nothing. I would hope that what is given to the President with the supporting data would go to the people in Congress that are considering this so that all sides of the question can be given the free discussion and the widest publicity, because I am put in a position and I think you

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are too, and I don't like it very well, of being against the farm interests, against doing something for the farmer, when as a matter of fact I am opposed to this method, this processing tax, as being another consumer tax where we already have excessive consumer taxes, and I don't object to being put in a position of being opposed to this but having it interpreted as being against the farmer and failing to recognize the farm problem and the farm interest is not a very satisfactory light to be put in.

H.M.Jr: Is this all right with the budget, to do it this way?

Elanford: Mr. Secretary, I haven't entered into the discussion because my immersion in the subject has been rather recent and Harold Smith has represented us at our two previous meetings. Unfortunately, he couldn't be here today. I think I should point out that the subject is currently before the Bureau, independent of its participation in this committee, in the form of a report, proposed report by the Secretary of Agriculture on a pending bill and we have the task of determining whether or not that is in accord with the policy and to that end all of this material - and I hope I may have a copy of the other memoranda - is very helpful, and we are proceeding with what material we can get to move into the subject on the basis of clearing it with the President.

I think the consideration of it will inevitably move some realities, that this particular budget omits a couple of hundred million dollars of parity appropriation, although it does include, I think, 170 million dollars of expenditures for previous parity appropriation, and we must face some of that picture of present statutory intent and the possibilities of demands that the parity picture be met and of course in that consideration I believe the Bureau will be very much impressed with some points made in this memorandum with respect to a decentralization of our fiscal control. I think that is a disturbing prospect from the viewpoint of programming the federal taxes and expenditures, but

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I am inclined to think that we are going to be faced with the suggestion of an alternative, other ways possibly of meeting the Congressional intent.

- H.M.Jr: Well, I have got Phil Young sort of acting as secretary of the group. If you will send it to him, he will forward the memoranda immediately to Mr. Currie and we will be glad to - I will see that he furnishes each man with a copy of everything that goes to Currie, whatever goes to Currie.
- Eccles: That is, he would furnish other members of the group....
- H.M.Jr: Everybody else.
- Eccles:a copy of everybody else's memorandum as well as furnishing it to Currie?
- H.M.Jr: That is right.
- Eccles: This is the only one we have. Of course, you understand that it isn't final by any means. It is purely a tentative memorandum. In the light of the discussion this morning, I think there may be some modifications made and maybe even a change in approach and certainly a memorandum to go to the White House would have to be shorter than this memorandum.
- H.M.Jr: Today is Wednesday. If they could get this to Mr. Young by Friday, we could get it to Mr. Currie the same day and maybe he could get it to the President on Monday.
- Eccles: Let's fix Monday as a deadline, anyway.
- H.M.Jr: Friday is the deadline.
- Eccles: I guess we have done enough preliminary work that we could do it by Friday.
- Blanford: We have sort of a special status on this subject, I think.

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- Davis: Marriner asked if I thought we could get it done, and I thought surely we could.
- H.M.Jr: We can. Let's try it and you have got to ride herd on these boys (speaking to Mr. Young).
- Eccles: Do you say we have special status on this plan?
- Blanford: I think we have a peculiar status on this particular subject due to the fact that the whole thing may be before the Bureau of the Budget.
- Bell: It is before you now in that form, isn't it? It seems to me what you say ought to be coordinated with what Currie is going to say on this whole program.
- Blanford: What we get together would be on the basis of clearing it with the President. It might be an analysis of the material.
- H.M.Jr: Well, that would be all the more reason to get it to you sooner.
- Thank you all very much.

January 10, 1940

Current and parity incomes for farmers

Already a great advance has been made toward price and income parity for farmers but these goals have not yet been attained. In 1940, when parity income would be $9 \frac{3}{4}$ billion dollars or more, income from farm marketings may be about 8 billion and Government payments to farmers, including 225 million of parity payments already appropriated, may be close to $\frac{3}{4}$ billion, making a total of $8 \frac{3}{4}$ billion. This would be short of income parity by a billion or more. If parity payments are dropped, the difference in 1941 would be larger, unless market developments were favorable to farmers. It is our position that an approach to parity of incomes for farmers is both equitable and economically desirable.

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If parity payments are to be maintained or increased, should they be made out of the general funds, that is, out of general taxation, or out of special taxes allotted through the certificate plan? Appropriations from the general funds presumably would come to some extent from income and other taxes based on ability to pay. The cost under the certificate plan would fall mostly on consumers of products made from cotton, wheat, and rice, in accordance with the poundage of these

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materials in products bought. A large portion of the cost would be paid by people with low incomes. It is exceedingly difficult to compare the incomes of farm and nonfarm groups to determine whether those receiving the payments (in relatively large amounts each) are worse off than those who would make the payments (in relatively small amounts each, the tax being spread over a large number of people). But it is clear from the point of view of income distribution and also from the point of view of putting idle funds to work that making payments out of the general funds of the Treasury would be better than making them out of the proposed consumer taxes.

There is, moreover, a fundamental objection to making, in effect, such large appropriations without the annual review accorded those for practically all other purposes; in this connection it should be noted that the amount of taxes under the certificate plan would automatically increase if prices received declined relative to prices paid (and vice versa).

Another important argument for appropriations from the general funds rather than the special taxes proposed is that farmers really can not afford to lose more of their markets. Domestic cotton consumption would probably be curtailed as a result of a 6 cent tax--a study of the effects of the processing tax by the Bureau of Agricultural Economics would suggest a loss of perhaps half a million bales annually. This total

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might be reduced by distribution of cotton goods through extension of the Food Stamp Plan but in many particular cases competitive materials certainly would be given a great advantage by an increase of perhaps one-third in the cost of the highest grades of cotton and two-thirds for the lowest grades. A decrease in consumption would lower production and have an unfavorable effect on producers, particularly farm laborers, who in any event would be benefited only indirectly. The effect of the tax on consumption might be lessened if the certificate plan were revised to bear less heavily on the low-value uses of cotton, and more heavily on high-value products where the cost of the raw material is small relative to the price of the finished goods (lawn, lace, and broadcloth fabrics, for example, as against mattresses or overalls).

If the certificate plan is adopted, demand for protection from competing domestic materials would probably take form similar to the compensating taxes under the A.A.A., which were very troublesome, and extended almost endlessly. Cotton manufacturers and growers asked for compensatory taxes on silk, rayon, and paper; wheat millers and growers for taxes on corn, rye, and the imported starches. Devices of this sort would run counter to the efforts of various agencies to eliminate restraints on domestic trade. They would not be involved if funds were appropriated direct from the Treasury.

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The principal argument advanced for the certificate plan is that this year and every other year it will provide larger payments than can be obtained any other way and make possible the continuation of effective measures to control production and supplies in the interest of consumers as well as of producers. Consumers, it is urged, would probably not begrudge the producer his parity price. Also, once the certificate plan was adopted, funds would be made available automatically each year; how this would work out actually is uncertain--relating payments to specific taxes might make them a target in an election year even if incomes are higher than in other recent years.

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Summary

To summarize, it is our judgment that efforts to establish a better relationship between the income of farmers and of others should continue, particularly if it can be done in a way that would contribute to the effectiveness of the broader farm program. Our first preference is for appropriations financed by taxes derived in accordance with ability to pay. Our next choice would be a combination of appropriations and the certificate plan, with appropriations sufficient to reduce materially the amount of the taxes under the certificate plan and sufficient to provide payments for some other groups not covered by the certificate program. If, however, the choice is between discontinuance of parity payments and possible consequent dislocation of the farm program on the one hand, and the certificate plan on the other, or between a system of fixed or guaranteed prices and the certificate plan, then the certificate plan, with certain revisions, would be favored.

In thinking about revision the following questions might be considered.

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(2) What provision can be made for integrating the certificate program with the parity payment program in 1940; and subsequently for continuing parity payments to corn producers, who are now receiving 50 to 60 million dollars a year of such payments?

(3) If many other nonmilitary appropriations are actually decreased this year, should parity payments to cotton, wheat, and rice growers be increased as much as would be necessary to bring the income of these groups all the way to parity?

(The amount to be collected for these groups under the plan as outlined would be around 400 or 500 million dollars as compared with average parity payments to them of about 150 million dollars on the past two crops.)

January 10, 1940

General Watson called me at a quarter of five to say that whoever he sent up to Buffalo to see the Curtiss-Wright had just returned and said that they were perfectly willing to give the French 25 of the P-40's that they had on order for the Army, but that the French were insisting on having a plane that had four machine guns instead of two and a different kind of voltage.

I happened to step out of my office and ran into Purvis and Bloch-Laine and gave them this message and they both agreed that of course the French would take the United States Army model and if I did not hear from them again, they would consider the thing settled.

January 10, 1940.
9:12 a.m.

H.M.Jr: Hello.
Captain Collins: Good morning, Mr. Secretary.
H.M.Jr: Hello Collins.
C: Yes, sir.
H.M.Jr: Collins, the Finnish Minister made a statement to me last night, I'd like you to check. He said that they had on order - about to place on order with the Remington Arms for fifty million rounds of ammunition.
C: Yes, sir.
H.M.Jr: At a cost of a little over two million dollars, and he got instructions from his Government to cancel it because he didn't have the money to pay for it. What I want to know is, did he - was there such an order with Remington Arms or not.
C: Well I know this, they have in there for clearance some rifle ammunition and I think that was cleared to them.
H.M.Jr: Yes. Well take - take a look at it, see?
C: Yes, sir, I will.
H.M.Jr: Now the other thing, last night, Gordon Rentschler called me up and you know he has one brother who is in the machine tool business.
C: Yes, sir, Fred.
H.M.Jr: Yes, and another brother who's with Pratt & Whitney.
C: Yes, sir.
H.M.Jr: And he said - Ward is that his name?
C: Ward.
H.M.Jr: Ward of Pratt & Whitney.
C: He's President of Pratt & Whitney.
H.M.Jr: Was spending the evening with him last night and he said that he's getting him to see whether

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he can't help solve this thing, that he knew all about Sloan and he said he might be able to help Beaufort, Pratt & Whitney on getting him to use sub-contractors and also with -

C: Packard?

H.M.Jr: No, with the machine tool people, see?

C: Yes, sir.

H.M.Jr: So I told him that I was very much in the background on this thing but he asked could he see me, so he may be down Saturday or Sunday.

C: Yes, sir.

H.M.Jr: And if he is I'll have you sit in.

C: I'd like to.

H.M.Jr: But I've worked with Rentschler before. He's a driving power.

C: Yes I know that, but he's driving for the National City, isn't he?

H.M.Jr: Oh sure.

C: All the time.

H.M.Jr: Oh sure. That's right.

C: I know - I know his brother awfully well.

H.M.Jr: Yes, but -

C: Fred, the one you know that put Pratt & Whitney together.

H.M.Jr: Yes. Somebody is going to have to crack this thing.

C: Oh I think so. Well I think maybe we'll get a crack on it Thursday.

H.M.Jr: Well then he knew all about that too, and so I want to know what he's doing and I think the best way is to let him tell me.

C: That's right.

H.M.Jr: Now Mr. Purvis is coming in at three.

C: Yes, sir.

H.M.Jr: I'd like you here.

C: I'll be there.

H.M.Jr: But he's into this thing up to his neck and the interesting thing was he said "If you're going to do something", he said, "I'm about to come to the conclusion the only thing to do is for the Armies and Navies to give up part of their production. "

C: How?

H.M.Jr: What?

C: Well that's all right then. That would indicate some other conclusion that you reach.

H.M.Jr: Yes.

C: Certainly. I think that's the answer.

H.M.Jr: But he said - I said, "What about this machine tool business". He said, "I think we can do something about that", and so I again told him, please not to - if he's coming down, not to tell anybody.

C: Yes, sir.

H.M.Jr: But we'll see.

C: All right sir.

H.M.Jr: But evidently there are a lot of people - and so I put it this way, I said, "I can't believe that American industry is going to let this challenge go by the Board."

C: That touched him in a light spot too.

H.M.Jr: What?

C: That touched him in the right spot.

H.M.Jr: And I said here's the challenge, it looks to me, I said, "I'm very blue about it, it looks to me as though American industry is just going to fall down".

He said, "Don't say that", he said, "We're just getting started".

G: (laughs) Well that was very satisfactory, Mr. Secretary.

H.M.Jr: Sure. Oh all of these fellows are working for their own pocketbook.

G: Oh, of course, can't - I don't understand it, but when you're in the final analysis I'd had said, now he had a grand story also without as a matter of fact. Concerning Packard.

H.M.Jr: Yes.

G: I'd like to know how much money he has in there.

H.M.Jr: Who?

G: Rentschler.

H.M.Jr: Rentschler?

G: Gordon, yes.

H.M.Jr: Personally you mean?

G: No, I mean through his bank.

H.M.Jr: Oh!

G: And as a matter of fact Ward told me that this man, who was running around here with our friends on the subject of Packard, very definitely told him that it was an idea of his own, that it hadn't been acted upon by their Board, as a matter of fact, only one of the officers of the Company knew of it, said to go through with it would require the construction of additional plans.

H.M.Jr: I don't know the Packard story, what's that?

G: Well this man was over in New York.

H.M.Jr: What man?

G: A man named Pratt, as I remember it, and he was

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- frankly while Ward's impression was that he was free lancing there. He was just trying to sell an idea, and Ward gets the story second hand from a man that, and I'd say second hand, I presume it came through Rentschler, that they might be in a position to do something. Well the story is this, that they can't do anything at all with the present plan, not even the four walls are going to help it. It will be an additional plant built immediately adjacent to the existing plant and they wanted to probably try to get a license.

H.M.Jr: I see.

C: To build somebody else's motors. Well of course that's one thing that Gordon Rentschler would never go for in the world.

H.M.Jr: No.

C: Because they're not - this thing is going to be bad enough as it is when the show's over and they're certainly not going to have those people there cutting their throats in competition with themselves.

H.M.Jr: No.

C: And that that wouldn't do us any good if we're going to go into a deal of that sort you might as well put the plant right in Hartford.

H.M.Jr: Yes, we,, let's see what happens and what happens on your meeting tomorrow.

C: Yes, sir.

H.M.Jr: O.K.

C: Oh that, look sir, on that meeting tomorrow I'm on the same basis as before.

H.M.Jr: What's that?

C: Just Mr. Collins himself, with these people, or do you think I should have the others in. I'm afraid I might frighten my boy friends from the North if I bring anybody else into that.

H.M.Jr: Well -

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C: At this stage, and they're still on an informal basis.

H.M.Jr: Well I - you'll have to play your own hunch on that.

C: All right I'll do that sir, I won't bother you with it.

H.M.Jr: Right.

C: All right sir.

H.M.Jr: Thank you.

C: Goodbye.

January 10, 1940.
11:55 a.m.

H.M.Jr: Hello.

Operator: Captain Collins. Go ahead.

H.M.Jr: Hello.

Captain Collins: Mr. Secretary.

H.M.Jr: Talking.

C: I checked back - the fifty million - he was wrong - the fifty million rounds the contract is all ready for signature, has been approved, arrangements made and went to New York last night.

H.M.Jr: Yes.

C: The ten million was Remington however, is open to discussion.

H.M.Jr: Oh!

C: There's some hitch.

H.M.Jr: The fifty million rounds. Of what was that?

C: That was, that part - that seven point six two, rifle ammunition.

H.M.Jr: Where were they buying that?

C: Winchester.

H.M.Jr: That went through.

C: Yes, sir.

H.M.Jr: Now what's the one that didn't go through?

C: The ten million Remington.

H.M.Jr: I see. Was that on account of the money?

C: No they don't know. They said it - from what I got, it was not a case of that, it was a case of the terms.

H.M.Jr: I see.

C: Now I don't think it was the lack of funds, I think it was probably the price.

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H.M.Jr: Right.
C: Holding it up.
H.M.Jr: Thank you.
C: You're entirely welcome sir.

Present: Mr. Bell Mr. Cotton
Mr. Gaston
Mr. Foley
Mr. Sullivan
Mr. Haas
Mr. Thompson
Mr. Harris
Mr. Cochran
Mr. Schwarz
Mr. White
Mrs. Klotz

H.M.Jr: Harry, you are interested in China. I don't want this to go out of the room. It is a very interesting map. If anybody else is interested, look at it in the room here.

Today is going to be Finland day. Here is the situation. I don't want it talked outside of the room. The President asked Dan - asked me, rather, to see Congressman Doughton and Ed Taylor, Chairman of the Committee on Appropriations to find out what they are going to do on the Hill and let them make up their own minds. It is kind of a vague instruction. I understand that they are waiting on the Hill to get a word, so Dan and I are going to try to have lunch today - we are seeing Doughton. We haven't been able to reach Ed Taylor yet and I am convinced a hundred percent the thing that is holding the thing up is the State Department, that they don't want anything to go through the Ways and Means other than trade treaties and unless the President calls me off, I think the plan is going to originate on the Hill and we will give them a good draft. It is, I think, a straight fifty million dollar loan and then cancel what they owe us. I don't mind saying I don't know whether it is neutral or unneutral, but I don't know where we could spend fifty million dollars to better advantage than to give it to the Finns to fight our battle to keep these fellows from getting to the Atlantic, because once they get to the Atlantic, God help England and then we are in the soup. Then he talked about your

two Navies and your hundred million dollar battleships and the Finns will get through to the Atlantic - I am checking up whether he told me the truth or not last night. If the Finns had an order with Remington Arms for ammunition for fifty million rounds, a little over two million dollars, and he hasn't even got two million dollars to pay it.

White: Who is the he?

H.M.Jr: The Finnish Minister.

White: They have got money here.

H.M.Jr: Where?

White: They did have it with the Federal Reserve Bank.

H.M.Jr: I am checking with the Remington Arms. Your Export-Import loan was let out by a half million dollars.

Cotton: There has been a delay, apparently, on the Finns giving a guarantee.

H.M.Jr: Will you go to town on that end? Find out.

Cotton: All right.

H.M.Jr: Find out whether the trouble is with the Finns or with us.

Cotton: They have been slow in giving the guarantee, is all.

H.M.Jr: What kind of a guarantee and all the rest of it, let's find out, will you?

Cotton: All right.

H.M.Jr: Anybody disagree with me?

White: I don't fully disagree with you, but I would like to modify it.

Gaston: You didn't say damn yet.

White: I take it that was a request you asked, wasn't it? I think that it certainly ought to be

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accompanied by a loan to China for several reasons. I think there ought to be two together. If you pick on that, it raises a host of questions, it seems to me, that are difficult to answer, whereas if you put it together with somewhat similar loans to China, why it puts the thing on a very different basis.

H.M.Jr: Well, unfortunately the Chinese Ambassador has no sex appeal.

White: I didn't know you were susceptible to that sort of thing.

H.M.Jr: Well, the Congress is, that is the thing.

White: It seems to me that you might --

H.M.Jr: Harry, I said exactly what you are saying at Cabinet and got sat on, exactly what you are saying and I got sat on. I raised the question, why not do something for China, and the President of the United States answered, "You are quite right but if you try to put that on you will kill the loan to Finland." I raised it last Friday. I raised exactly the same thing and I got sat on, just the way you are now only gentler.

Cotton: Will the loan be in the discretion of the President or will it be done by Congress?

H.M.Jr: I don't know.

Dan, answer that.

Cotton: I merely asked that because it would seem they would want the French and the British to kick in.

Bell: I don't get the point.

Cotton: One would hope that it would be left somewhat to the discretion of the Executive, it seems to me, so that he could see what France and Great Britian were doing and wouldn't want to go out on a limb if they were going to let Finland down.

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- Bell: I had in mind drafting a Bill authorizing the Secretary of the Treasury, with the approval of the President, to loan them this money and cancel the obligations we hold under the present agreement and appropriating money at the same time. I don't think you ought to wait for an appropriation if you are going to do something.
- Sullivan: Is the cancellation going to be in the same Act that would authorize the new loan?
- Bell: Yes.
- Cochran: It wouldn't refund the past payments, just cancel future payments.
- Bell: Yes.
- Sullivan: I think you would avoid some question if you didn't cancel the other loan.
- (Mr. Schwarz enters the conference.)
- H.M.Jr: Come here, Papa. How is the Mrs.?
- Schwarz: Fine.
- H.M.Jr: They tell me that when you are a father, you get cigars (handing cigars to Mr. Schwarz).
- Schwarz: I have got some less expensive ones coming for the rest of these men.
- H.M.Jr: Very well. We are on the Finnish loan. This is all going to originate on the Hill, you know.
- White: Is the State Department merely not supporting this because they want their other matter first or do they have other reasons?
- H.M.Jr: In State Department language, knowing that I was lunching with the President, they called the President just before I was there and they said, "We have to test the sentiment of the country," and I just put two and two together, saying that this has to go through Ways and Means, that they don't want anything to go

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through Ways and Means that in any way might hold up the Trade Treaty.

- White: I feel a little bit like this is a hot potato if the State Department isn't with you on it and whether you specifically handle it --
- H.M.Jr: That is O.K. It is all right. It is going to all originate on the Hill and the President is going to know every minute what I am doing. If I don't do it, Harry, goodbye Finland, goodbye Sweden, goodbye Norway. Somebody has got to do it now. A good friend of mine was on the Hill yesterday. They are all ready to go. They just want some indication from down town where they stand, and they can't find out.
- White: Well, I still remain a little bit skeptical about your being the instrumentality of that unless this is in cooperation --
- H.M.Jr: I am just giving the machinery, that is all. The President asked me to do this. He asked me to see Doughton and Taylor.
- Sullivan: What is the necessity of cancelling the old obligation in this same Act?
- Bell: Encouragement, gesture.
- H.M.Jr: You have got to do something, John, on this thing because the President announced publicly that the last interest payment would be held in suspense. How are you going to write something to handle it? My thought was instead of trying to write something to handle it, instead of making it sixty million dollars, cancel the eight or nine they owe us and lend them fifty million dollars of fresh money.
- Now, I will let you know, Dan. Does somebody else want to ask about drafting this Bill, what kind of a Bill?
- Cotton: Are you going to limit what they can do with the money?

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Bell: You might say "Under such terms and conditions as the Secretary deems advisable." Just don't get any more surplus crops involved.

Gaston: Yes, that is what I was afraid of.

Gaston: Why not just no strings at all.

H.M.Jr: Well, Dan knows - and I pleaded for - I don't know where the Government could spend fifty million dollars to better advantage right now. I will let you know, Dan.

Herbert?

Gaston: You asked us this morning for a report on the John Bright Hill case. Mr. Foley has a report as to the gentleman's legal qualifications. I think Ed had probably better give it to you. I have nothing else.

H.M.Jr: Ed, go to it.

Foley: He is not much of a lawyer. He went to Harvard Law School in February, 1919, and he busted out in August, 1919. He failed four out of five courses and never went back. He was admitted to practice down in North Carolina. He at one time was a candidate for the United States District Attorneyship in that District down there. The whole bar apparently was against him.

H.M.Jr: Put it in writing and I will send it over to the President.

Gaston: They all say he is a nice fellow, but no lawyer.

Foley: He managed Reynolds' campaign down there last year.

H.M.Jr: Whatever it is, put it in writing.

Foley: I have got a memorandum, but I don't think it is in the form that you want it.

H.M.Jr: Fix it up with an accompanying letter for me to sign to the President, will you please, and return the stuff on that that I gave to Herbert, but between the two of you, let's

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get it out and signed today, will you?

Gaston: Yes.

Foley: Yes.

H.M.Jr: Anything else, Herbert?

Gaston: Nothing else.

H.M.Jr: On that memorandum that comes from Cochran to you and Cochran to Bell, have you got a safe where you can put it?

Gaston: I have. I just got the first one this morning but I will put it in the safe.

H.M.Jr: Have you, Bell?

Bell: I returned mine to Mr. Cochran.

H.M.Jr: Why don't you return them to Mr. Cochran?

Gaston: I will do that.

H.M.Jr: And you (Cochran) number them, will you, to help these people remember?

Cochran: All right.

H.M.Jr: Come on, Giannini.

Foley: I would like to talk to you some time today about the fee for the lawyer.

H.M.Jr: Oh, you and the Comptroller and Danny Bell settle it. You and the Comptroller and Danny Bell settle it. What else?

Foley: Settle the fee for the examiner also?

H.M.Jr: Yes, you three fellows settle it.

Foley: All right. I think it might not be a bad idea for us to have a talk with Leo Crowley, because I think that Leo can stop this talk about switching from a national bank to a State bank if he wants to. They would have to form a new corporation out there, get a charter from the State of California, then turn the assets of the national bank over

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to the State bank and make application to the Federal Reserve for membership. If the Board grants that membership, they automatically become entitled to insurance. But I don't think that the Federal would dare admit them. If Leo made some pronouncement that he was going ahead with a hearing to determine whether or not that insurance should be suspended --

- H.M.Jr: You (Bell) can take that under advisement, you and Foley and the Comptroller.
- Bell: I think a conference is in order, too, to see whether or not we are going ahead on this order to show cause immediately.
- H.M.Jr: Dan is raring to go.
- Bell: I think this whole thing is a bluff. I don't see how he can expect to jump the two hurdles he has got to jump after he gets out of the national system, particularly in view of the statements that Leo Crowley has made at the last three conferences.
- Foley: I would like to see Leo do something more than just make statements. I think if he will, he will head this thing off.
- Bell: The letters were delivered to the directors yesterday. I want to advise the Counsel that they were delivered. There is a wire in this morning giving about the same information as given to you last night over the telephone. That is the latest development.
- H.M.Jr: Have you heard whether Jerome was successful?
- Bell: No, Delano thought he would call Marriner and ask him what they had done.
- H.M.Jr: O.K.?
- Foley: O.K.
- H.M.Jr: Mr. Sullivan.
- Sullivan: Any time you wish to discuss those Angostura Bitters, I am ready.
- H.M.Jr: Take care of it for me. Was that from Birge Kinne?

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- Sullivan: I was given the letter and you said you would want to discuss it --
- H.M.Jr: No, just handle it. Birge Kinne works for this thing and he is a nice boy, perfectly honest, but evidently Angostura Bitters is either in the papers as an advertiser or something, so whatever the ethical thing is, do it, or don't do it.
- Sullivan: Do you want a letter prepared?
- H.M.Jr: You handle it for me.
- Gaston: There are several documents that were attached that came over my desk.
- H.M.Jr: Has he got a just complaint?
- Sullivan: No, sir. So far as the Bureau is concerned, they haven't. Certain representations were made to them by the Interior Department.
- Gaston: They were absolutely misled by Ickes' crowd. They promised them immunity from taxation, that they could use non-tax paid alcohol if they moved their plant down there and our people told them as soon as it was put up to them that they could not.
- Foley: I think we ought to make some kind of an equitable adjustment. I don't think we ought to make this tax retroactive.
- Sullivan: We have never tried to.
- H.M.Jr: Will you three fellows handle it? He is a perfectly nice fellow, but over enthusiastic. All right? I am going to forget about it.
- Anything else? Now, while I am looking in that direction, who is following - can inform me of what is going on up on the Hill with Pat Harrison's committee, Mr. Bell's appointment, and Mr. Sullivan's appointment. Who is following that on the Hill? Who is following that?
- Thompson: I understood that Mr. Sullivan was to go up there today. Did you get an invitation to come up today?

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Sullivan: No, I did not.

Thompson: Maybe I am mistaken.

Klotz: I knew that they just asked for a biographical sketch.

H.M.Jr: What is the usual procedure? Larry Bernard?

Foley: Yes, he can go around and see Pat Harrison and find out what Pat wants.

H.M.Jr: Will you do that immediately?

Foley: Yes.

H.M.Jr: Is that crosswise with you?

Thompson: No.

H.M.Jr: Will you tell him, please, to sit on their doorstep until these boys are through and if you need any help, let me know.

Foley: All right.

Bell: I take it you will know some time after the meeting.

H.M.Jr: Well, let Larry sit on the doorstep. That takes care of that, doesn't it?

Klotz: Yes.

H.M.Jr: Merle?

Cochran: Randolph Burgess telephoned me two days ago, wanted to know if I would see John Rivera if he came down today. Rivera is an American who has been a representative in Spain for several years for the National City Bank. I don't think he wants anything, but I will give you a memorandum if there is anything interesting.

H.M.Jr: I don't want to see him. Anything else?

Cochran: Just the question of these memos. Should I get them back from the officers to whom I send them?

H.M.Jr: I think so. I don't like them floating around.

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Cochran: Sterling was very strong yesterday, 3.97. The rubber price has gone up and this morning it is reported that tin has gone up four thousandths a ton so that may strengthen sterling even more.

H.M.Jr: Chick?

Schwarz: I would like to inquire how capitalism is getting on, if I might.

H.M.Jr: Prospering.

Harry, in connection with that talk, will you take this please? Just keep it.

You (Schwarz) ought to do nothing, if you don't mind.

Will you be in at 10:15 on Friday on that thing?

White: Yes.

H.M.Jr: Chick?

Schwarz: That is all.

H.M.Jr: Will you (Cotton) see that Jones' and Welles' appointment for 10:00 o'clock Saturday is confirmed? Mr. Traphagen will be here. I don't understand, are they also going to have the Colombia?

Cotton: There was some talk about it.

H.M.Jr: Will you check on that?

White: That was the understanding.

H.M.Jr: I don't think they ought to be here at the same time.

(Insert telephone conversation with Jerome Frank.)

January 10, 1940.
9:55 a.m.

H.M.Jr: Hello.
Jerome
Frank: Hello Henry, Jerome.

H.M.Jr: How were the cocktails last night?

F: I couldn't make it. I worked here without stopping until half past seven.

H.M.Jr: Oh!

F: And then on reflection it seemed to me that it would be unwise for me to do it for this reason.

H.M.Jr: Yes.

F: Supposing Marriner went back and told them that the SEC was butting in on Federal Reserve.

H.M.Jr: Yes.

F: As he might do.

H.M.Jr: Yes.

F: If our -

H.M.Jr: My God you haven't put on spats have you, and carrying a cane?

F: (laughs) No, but I'm just worrying, you know, with all - if your suspicions are half justified that story might go right back to Giannini.

H.M.Jr: Oh!

F: And then they'd say, well here's the SEC trying to not mind its own business. Now if we get into a meeting again somewhere I can talk up but I don't think I ought to go and seek him out.

H.M.Jr: Well your judgement is best on that.

F: I think I'd better not.

H.M.Jr: O.K. We've heard nothing today, so far.

F: No. If you want me -

H.M.Jr: Yes.

F: If you want - if you go to the President, if you go to the President, if you want me to go along and say me too, I'll be delighted to.

H.M.Jr: Well no, I think if I go to see him I think I'll have to go alone.

F: O. K.

H.M.Jr: All right.

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H.M.Jr: Jerome decided that it was better that he should go and see Eccles, but he is willing to come to another meeting to say whatever he has to say, but he is afraid the Federal Reserve might say that the S.E.C. was butting in on their business. Well, we have made the fight alone so far. It is all right, it is a good fight.

Foley: It is some fun.

Klotz: Who all is coming in on Saturday morning, who is arranging that?

H.M.Jr: Cotton.

Klotz: Jones, Welles, and Traphagen?

H.M.Jr: Yes.

Cotton: Do you want the Colombians a little later?

H.M.Jr: I invited Mr. Traphagen to be here at 10:00. I think we ought to talk with Mr. Traphagen and if they want Mr. - Colombia, let them come in at 10:30. I am going to leave it to you to handle, please.

George?

Haas: I have nothing this morning.

H.M.Jr: I feel fine today. I see what that beef did for me last night.

Harry?

White: There is something that needs to be looked into here with regard to exports to Russia. I told you that we got a report stating that there was a large shipment and included in that shipment was almost a million dollars worth of molybdenum. Now, we likewise got a report Basil turned over to us which he got from the Assistant Collector in which he gives an itemized list of what was on the ship and on that list there is no molybdenum but there is an item which, judging from the amounts involved, I think is the same thing, and that is called tin and we don't export that amount of tin in the first place. Now, either there has been an error or deliberate entry in the manifest for some purpose I can't

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understand, so that if we had been following that we would have thought that tin was going out but instead of that we got the export declarations and found molybdenum.

H.M.Jr: Is there any law broken?

White: I inquired about that this morning and they didn't know and they are going to find out today and let me know whether there is a greater penalty in one case or the other, but in view of the steps you have taken with respect to molybdenum, I didn't know whether that had any bearing on the entry.

H.M.Jr: It could be that the molybdenum was for a 1939 contract which had not been completed.

White: Then why did they call it tin in two places?

H.M.Jr: I don't know.

White: Supposing I get together with Basil and we run this thing down.

H.M.Jr: I wish you would.

Harris: I am checking all exports to Russia. What you say is quite right.

H.M.Jr: Harry gave me a memorandum saying from December 19th to January 1 there had been no exports to Russia. I showed that to the President and now suddenly there is four or five million dollars in one day.

White: Moreover, that ship left on the 28th, according to their figures, in the export declaration and we have gone by that but from now on we are going to try to go by the ships. I think it was unnecessarily delayed. It may have been specially delayed.

H.M.Jr: The ship was delayed?

White: No, the information.

H.M.Jr: Basil, would you --

White: That is all.

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H. M. Jr: Everybody else feels good this morning?
Dan?

Bell: I have nothing.

Thompson: I have a few examples looked up of comparisons of costs.

H. M. Jr: It is much cheaper?

Thompson: It is. On a three minute message the teletype is about a third of the cost of a regular telephone call and half the cost of a telegram.

H. M. Jr: To Seattle it is four dollars and sixty-eight cents by telegraph and teletype is two twenty and you get instant delivery. Why can't you circularize that?

Thompson: Yes.

H. M. Jr: We have got a teletype machine upstairs on the third floor. Once in a while - I saved seventeen thousand dollars on taking out a telephone line for the Coast Guard to New York and taking one out here, the two together, and then we are putting in a teletype and I wondered how much that would save over telegrams and of course on the question of delivery, for instance, this thing of yours comes in night letter. On that basis, when we have this machine upstairs, practically all the Treasury offices have the teletype and it gives you instantaneous delivery. I think we ought to circularize that.

Thompson: I will do that.

H. M. Jr: That is done once in a while to save a little money. We are in the foothills of New England. That is where I live.

Sullivan: We are trying to get a special resolution through for a deficiency on refunds. If we can do that, we will save about eighty-nine thousand and you can add that to seventeen.

H. M. Jr: No, you add that.
Now, you will watch these boys, won't you?

Foley: Yes.

January 10, 1940.
9:40 a.m.

Operator: Go ahead.

H.M.Jr: Hello.

Ed
Taylor: Good morning Mr. Secretary.

H.M.Jr: How are you?

T: Nicely thank you. First rate. How's Mr. Secretary?

H.M.Jr: I'm fine, never better.

T: Well bully, that's fine.

H.M.Jr: Mr. Taylor, the President asked me to confer with you and Bob Doughton.

T: Yes.

H.M.Jr: In regard to this loan to Finland that Congress seems to be considering.

T: Yes.

H.M.Jr: I called up Bob Doughton, asked whether we couldn't get together at lunch time, and he said he'd like to but he thought that I'd better come up on the Hill, so I said I'd come any place that would be convenient for you two gentlemen, see?

T: Well that's very nice of you indeed.

H.M.Jr: And he was trying to get the Speaker's room so we could meet privately.

T: Yes.

H.M.Jr: Now would it be convenient for you today?

T: Well I - I think so. We have the first meeting of our general committee this morning.

H.M.Jr: Yes.

T: To consider the President's emergency bill for national defence 271 million, and then you know they have a vote beginning right after twelve o'clock on that meeting.

H.M.Jr: Yes.

T: On that meeting.

H.M.Jr: Yes.

T: We have a busy time here. I think we could get together but then probably, maybe it would be better sometime in the afternoon and then not try to figure on the lunch because I'm afraid we'd be interrupted, that is I -

H.M.Jr: Well -

T: I don't know whether or not my committee is going to get through before twelve o'clock.

H.M.Jr: Well I'll do it any time that you are willing -

T: I'll call Mr. Doughton as soon as I can get loose from that committee and as soon as we learn about that vote and when we have some time and I'll be very glad to have a conference with you about it.

H.M.Jr: Dan Bell will be with me.

T: Well that's all right, yes indeed.

H.M.Jr: Because he's -

T: Well I'll be glad to have a conference with you about the matter because I've thought pretty seriously about that thing and I'd be glad to have some conferences and some suggestions from others.

H.M.Jr: Well what we want is more suggestions from you people.

T: Well.

H.M.Jr: And we just want to be helpful.

T: All right. Thank you ever so much. Well I'll call you back again.

H.M.Jr: Thank you.

T: When I can fix a definite time.

H.M.Jr: Thank you.

T: Thank you, goodbye.

January 10, 1940.
10:20 a.m.

H.M.Jr: Hello Bob?
Robert
Doughton: Hello Henry.

H.M.Jr: Yes.

D: Well your Speaker's dining room is already engaged. Why not just come up after you get your lunch and let us meet back there in our office, just omit the lunch part and let Taylor and I meet with you and General Bell back there in my office and if anything - if an emergency call come why I could run out.

H.M.Jr: Well - all right.

D: How would that suit you?

H.M.Jr: That's all right. What time -

D: Well -

H.M.Jr: Have you talked to Taylor?

D: I haven't. Have you?

H.M.Jr: Yes, he seems to think that I ought to wait maybe until the session was over and come up later this afternoon.

D: Well I don't know how long it might run. Anytime this afternoon that suits you I'll try to see you.

H.M.Jr: Well I could be up there - I could be up there at two-fifteen if that would be all right.

D: Let me call him and call you back.

H.M.Jr: And I could be there at two-fifteen at any place you say.

D: Well the Ways and Means Committee Room on the capital would be most convenient, it's right by the door you know.

H.M.Jr: I know.

D: Well I'll tell him and unless we call you back we'll expect you there at two-fifteen.

H.M.Jr: Well do I understand, if I don't hear from you again
I should be at the Ways and Means Room in the
Capital at two-fifteen.

D: Correct.

H.M.Jr: Righto.

D: Oh thank you.

H.M.Jr: Thank you.

January 10, 1940

Current and parity incomes for farmers

Already a great advance has been made toward price and income parity for farmers but these goals have not yet been attained. In 1940, when parity income would be 9 3/4 billion dollars or more, income from farm marketings may be about 8 billion and Government payments to farmers, including 225 million of parity payments already appropriated, may be close to 3/4 billion, making a total of 8 3/4 billion. This would be short of income parity by a billion or more. If parity payments are dropped, the difference in 1941 would be larger, unless market developments were favorable to farmers. It is our position that an approach to parity of incomes for farmers is both equitable and economically desirable.

Appropriations and certificate plan

If parity payments are to be maintained or increased, should they be made out of the general funds, that is, out of general taxation, or out of special taxes allotted through the certificate plan? Appropriations from the general funds presumably would come to some extent from income and other taxes based on ability to pay. The cost under the certificate plan would fall mostly on consumers of products made from cotton, wheat, and rice, in accordance with the poundage of these

- 2 -

materials in products bought. A large portion of the cost would be paid by people with low incomes. It is exceedingly difficult to compare the incomes of farm and nonfarm groups to determine whether those receiving the payments (in relatively large amounts each) are worse off than those who would make the payments (in relatively small amounts each, the tax being spread over a large number of people). But it is clear from the point of view of income distribution and also from the point of view of putting idle funds to work that making payments out of the general funds of the Treasury would be better than making them out of the proposed consumer taxes.

There is, moreover, a fundamental objection to making, in effect, such large appropriations without the annual review accorded those for practically all other purposes; in this connection it should be noted that the amount of taxes under the certificate plan would automatically increase if prices received declined relative to prices paid (and vice versa).

Another important argument for appropriations from the general funds rather than the special taxes proposed is that farmers really can not afford to lose more of their markets. Domestic cotton consumption would probably be curtailed as a result of a 6 cent tax--a study of the effects of the processing tax by the Bureau of Agricultural Economics would suggest a loss of perhaps half a million bales annually. This total

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might be reduced by distribution of cotton goods through extension of the Food Stamp Plan but in many particular cases competitive materials certainly would be given a great advantage by an increase of perhaps one-third in the cost of the highest grades of cotton and two-thirds for the lowest grades. A decrease in consumption would lower production and have an unfavorable effect on producers, particularly farm laborers, who in any event would be benefited only indirectly. The effect of the tax on consumption might be lessened if the certificate plan were revised to bear less heavily on the low-value uses of cotton, and more heavily on high-value products where the cost of the raw material is small relative to the price of the finished goods (lawn, lace, and broadcloth fabrics, for example, as against mattresses or overalls).

If the certificate plan is adopted, demand for protection from competing domestic materials would probably take form similar to the compensating taxes under the A.A.A., which were very troublesome, and extended almost endlessly. Cotton manufacturers and growers asked for compensatory taxes on silk, rayon, and paper; wheat millers and growers for taxes on corn, rye, and the imported starches. Devices of this sort would run counter to the efforts of various agencies to eliminate restraints on domestic trade. They would not be involved if funds were appropriated direct from the Treasury.

The principal argument advanced for the certificate plan is that this year and every other year it will provide larger payments than can be obtained any other way and make possible the continuation of effective measures to control production and supplies in the interest of consumers as well as of producers. Consumers, it is urged, would probably not begrudge the producer his parity price. Also, once the certificate plan was adopted, funds would be made available automatically each year; how this would work out actually is uncertain--relating payments to specific taxes might make them a target in an election year even if incomes are higher than in other recent years.

Fixed price plans and certificate plan

It is understood that the suggestion of the certificate plan has been made partly to meet a demand for a system of fixed or guaranteed parity prices on the domestically-consumed portion of staple crops. The certificate plan would be preferable to a system of fixed prices since while the effect on the consumer would be approximately the same the certificate plan would channel the benefit to cooperating producers, thus supporting the broad adjustment and ever-normal granary program.

Summary

To summarize, it is our judgment that efforts to establish a better relationship between the income of farmers and of others should continue, particularly if it can be done in a way that would contribute to the effectiveness of the broader farm program. Our first preference is for appropriations financed by taxes derived in accordance with ability to pay. Our next choice would be a combination of appropriations and the certificate plan, with appropriations sufficient to reduce materially the amount of the taxes under the certificate plan and sufficient to provide payments for some other groups not covered by the certificate program. If, however, the choice is between discontinuance of parity payments and possible consequent dislocation of the farm program on the one hand, and the certificate plan on the other, or between a system of fixed or guaranteed prices and the certificate plan, then the certificate plan, with certain revisions, would be favored.

In thinking about revision the following questions might be considered.

(1) How can substitution of other materials, notably for cotton, be prevented? Even if new outlets are gained by extension of the Food Stamp Plan it would be unfortunate for cotton growers to lose markets narrowly held with current price relationships.

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(2) What provision can be made for integrating the certificate program with the parity payment program in 1940; and subsequently for continuing parity payments to corn producers, who are now receiving 50 to 60 million dollars a year of such payments?

(3) If many other nonmilitary appropriations are actually decreased this year, should parity payments to cotton, wheat, and rice growers be increased as much as would be necessary to bring the income of these groups all the way to parity? (The amount to be collected for these groups under the plan as outlined would be around 400 or 500 million dollars as compared with average parity payments to them of about 150 million dollars on the past two crops.)

January 10, 1940. 282
9:05 a.m.

H.M.Jr: Hello.
Robert Doughton: All right.
H.M.Jr: Bob?
D: All right.
H.M.Jr: How are you?
D: All right Henry. How are you?
H.M.Jr: Oh, top of the morning.
D: How's that?
H.M.Jr: I feel fine.
D: That's good.
H.M.Jr: Bob, the President suggested that I see you and Ed Taylor of Colorado and talk about this loan to Finland.
D: About which?
H.M.Jr: Loan to Finland.
D: Loan to Finland, yes.
H.M.Jr: Now do you suppose that you and Ed Taylor could have lunch with Danny Bell and me today?
D: Danny Bell and you.
H.M.Jr: Yes, and Ed Taylor.
D: Why I don't know of any reason why I couldn't now, Mr. Secretary. I couldn't speak for Brother Taylor.
H.M.Jr: Well I'll call him up.
D: Yes, where would you want to have it.
H.M.Jr: Well we have pretty good food right in the Treasury, if you'd come down here.
D: Yes. Well the House meets and we've got this - this anti-lynching bill's up you know.
H.M.Jr: What time?

- D: They begin to read that - I understand they've got an hour and something more general debate and then they leave it under the five minute rule and I can find out a little further about when I might be needed on the floor of the House. I'd have to call Sam Rayburn when he gets in. I wouldn't want to be absent on ^{the}
- H.M.Jr: Well, if there's any place. I'll come up there with pleasure.
- D: Well that might be better. You talk with Taylor. He'll have the same interest on being on the floor that I will probably.
- H.M.Jr: Yes.
- D: I'll get and talk with - in touch with Sam and you can call me back and if you don't - if I don't call you before you call me back, you call me.
- H.M.Jr: Well -
- D: If I find out anything from Sam, I'll call you, if you don't call me before.
- H.M.Jr: Right, and I'll call -
- D: And any arrangement that you make with Ed I'll try to fall in with.
- H.M.Jr: Well then I'll tell you - I'll call up Ed Taylor.
Yes.
- H.M.Jr: And maybe the two of you put your heads together and you tell - wherever you want me I'll come.
- D: Well that'll be all right. I'll be all right. It might be better up here than down there, but -
- H.M.Jr: Well I'd be glad to come up there if you tell -
- D: See what he says, you know that's a right important matter.
- H.M.Jr: Well why not let's settle it now. Is there any place I can treat for lunch up there?

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- D: Well it's not a very - not much privacy up here unless we could get the Speaker's - I guess we could get served in the Speaker's dining room.
- H.M.Jr: Well could we do that?
- D: Unless he has some appointment of his own, some arrangement of his own I'm satisfied we'd get some privacy and have it served in there.
- H.M.Jr: Well could you - would you mind asking him?
- D: I'll find out and phone you back, yes.
- H.M.Jr: All right, and I'll call up Ed Taylor.
- D: All right thank you.
- H.M.Jr: Thank you.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE January 10, 1940

TO Secretary Morgenthau

FROM Mr. Cochran

CONFIDENTIAL

Although the foreign exchange market appeared much quieter than yesterday, nevertheless, the volume of sterling transactions was £190,000 greater than yesterday's volume. A quieter tone in the market in the face of an increased volume of transactions was due to the fact that banks had both buying and selling orders for sterling and, as these orders were married, the transactions never appeared in the market.

The opening sterling rate was 3.95-3/4 and, after touching 3.96 early in the morning, it eased slightly. Shortly after noon, sterling receded to 3.95-1/8 and fluctuated in a narrow range for the remainder of the day to close at 3.95-1/8.

Sales of spot sterling by the four reporting banks totaled £666,000 from the following sources:

By commercial concerns.....	£ 354,000
By foreign banks (Europe and South America).....	£ 312,000
Total....	£ 666,000

Purchases of spot sterling amounted to £598,000, as indicated below:

By commercial concerns.....	£ 483,000
By foreign banks (Europe and Far East).....	£ 115,000
Total....	£ 598,000

The following reporting banks sold cotton bills totaling £52,000 to the British Control on the basis of the official rate of 4.02-1/2:

£ 33,000 by the National City Bank
17,000 by the Guaranty Trust Co.
2,000 by the Chase National Bank
<u>£ 52,000 Total</u>

The rates for the Cuban and Mexican pesos were quoted at 10-5/8% discount and .1672, respectively.

The other important currencies closed as follows:

French francs	.0224-1/8
Guilders	.5332
Swiss francs	.2243
Belgas	.1683
Canadian dollars	11-15/16 % discount

We purchased gold valued at \$1,125,000 from the earmarked account of the Bank of Mexico.

The Federal Reserve Bank reported to us a shipment of gold valued at \$2,600,000 from South Africa, shipped by the South African Reserve Bank. This shipment will be earmarked at the Federal for account of the Netherlands Bank.

On the report of January 3, 1940 received from the Federal Reserve Bank of New York, giving the foreign exchange position of banks and bankers in its district, the total position of all currencies was short the equivalent of \$20,098,000, an increase of \$3,153,000 in the short position. The net changes in positions are as follows:

COUNTRY	SHORT POSITION	SHORT POSITION	INCREASE IN
	DEC. 27, 1939	JAN. 3, 1940	SHORT POSITION
England	\$ 6,408,000	\$ 8,217,000	\$ 1,809,000
Europe	7,322,000	8,680,000	1,358,000
Canada	93,000	4,000	89,000 (Decrease)
Latin America	231,000	249,000	18,000
Far East	2,859,000	—)
Japan *	—	2,455,000) 101,000
Other Asia	—	505,000)
All others	32,000	12,000 (Long)	44,000 (Decrease)
Total	\$ 16,945,000	\$ 20,098,000	\$ 3,153,000

* Includes Korea and Manchuria

We received a report from the Federal Reserve Bank of New York showing deposits for the account of "Asia" as reported by the New York agencies of Japanese banks on January 3. Such deposits totaled \$34,290,000, of which \$26,832,000 were placed with the Yokohama Specie Bank in New York. Of the amount on deposit with the Yokohama, \$24,724,000 were listed under China and represent the deposits of the Yokohama Specie Bank's branches in that part of China occupied by the Japanese, particularly Shanghai. As compared with the total deposits on December 27, the balances on January 3 were lower by approximately \$32,000,000. All of this reduction was in deposits with the Yokohama Specie Bank. The overdraft on the books of that Bank for account of its head office in Japan was reduced by about \$32,000,000 to \$69,285,000. Recently there have been large imports of gold from Japan and in all probability, part of the reduction in the overdraft was effected by using the dollars received from the sale of the gold.

The London spot and forward prices for silver were fixed at 22d and 21-15/16d, respectively, both up 1/8d. The U. S. equivalents were 39.15¢ and 38.75¢. Handy and Harman's price for foreign silver was unchanged at 34-3/4¢. The Treasury's price was also unchanged at 35¢.

We made five purchases of silver totaling 500,000 ounces under the Silver Purchase Act. Of this amount, 200,000 ounces represented a sale from inventory by one of the refining companies and the remaining 300,000 ounces was new production silver from foreign countries purchased for forward delivery.

B. W. S.
CONFIDENTIAL

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE January 10, 1940.

TO Secretary Morgenthau

FROM Mr. Cochran

Upon the request made two days ago by Mr. Randolph Burgess by telephone, I today received Mr. John Rivera, representative in Spain of the National City Bank whom I have known several years, and Mr. William Lancaster of the law firm of Sherman and Sterling.

Mr. Rivera told me that when he was recently departing from Madrid the Spanish Minister of Finance told him that he would be very appreciative of anything that the National City Bank could do to obtain financial assistance in the United States for Spain. Mr. Rivera spoke in terms of from \$100,000,000 to \$200,000,000, for a period as long as 15 years.

Mr. Rivera was considerably more optimistic about getting help in the United States for the rebuilding and restocking of Spain than was Mr. Lancaster. The latter was more of the opinion that credits of the type of those given by the Export-Import Bank were more likely to be considered favorably now than any bigger proposition, particularly involving long term funds. I told my visitors that I knew the Spanish Ambassador was already in touch with the Export-Import Bank, and, as they were aware, Spain had through this medium received a credit for cotton last year.

The two gentlemen have an appointment to see the Spanish Ambassador this afternoon. This past summer, Mr. Lancaster had some discussion with Under Secretary of State Welles with respect to financial help for Spain. I saw no way in which the Stabilization Fund could possibly be of assistance and expressed the opinion that the Export-Import Bank was the proper agency to approach. When Mr. Rivera mentioned the possibility of Congressional action on a big loan in favor of Finland, Mr. Lancaster pointed out that there was certainly not a sentiment in the United States favorable to Franco Spain in any sense comparable to that for Finland, on defense against Russia.



Economic Position of France
— After 4 Months of War

Division of Monetary Research
U. S. Treasury Department
(January 1940)

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE JANUARY 10, 1940

TO: Secretary Morgenthau
FROM: Mr. White
Subject: French Economic Report

There is appended a report on the economic position of France after four months of war which was prepared by Mr. Gass and Mr. Wheeler of this division. I believe it to be a very competent job and worth your perusal.

The following are its main conclusions:

1. The war is substantially lowering the consumption level of the French people. The real value -- not the money value -- of the French national income will be at least 20 percent less during 1940 than it was in 1938 and 1939. Furthermore, an increasing percentage of the national income will be absorbed by war costs.
2. Government expenditures during the first three months of the war exceeded the full year's tax revenues. Government expenditures for 1940 are estimated at 330 billion francs (about \$7½ billion) which is substantially greater than the whole national income was in 1938. Expenditures for war account for 75 percent of the national Government's total expenditures.
3. The national Government debt increased about 100 billion francs in 1939, bringing the outstanding debt to 650 billion or 2 1/2 times the national income. (If our debt were on a comparable basis our national debt would be \$175 billion!) It is estimated that the deficit for 1940 will be about 250 billion francs.
4. France appears to be on the eve of an inflation similar to that of 1914-18. Output has fallen and will probably remain below pre-war levels. Government expenditures are now on a scale in excess of the money value of the 1938 national income. Before the outbreak of war prices already showed a strong upward trend. It is unlikely, in view of the composition of the French Government and the previous record in comparable situations, that the Government will adopt and carry out measures of taxation, rationing, and price control sufficiently rigorous to prevent a major inflation.

5. The French tax system falls very heavily on low income groups. In 1937 over 60 percent of the budgetary revenues were raised by consumption taxes. The heaviest tax imposed since the outbreak of war is the 100 percent tax on wages earned for work between forty and forty-five hours a week and the 33 1/3 percent tax on wages for work over forty-five hours a week. The general national defense tax of 2 percent on all incomes has been raised to 5 percent. Tobacco and match prices (both State monopolies) have been raised about a quarter. All profits in national defense industries above 10 percent are to revert to the State.
6. French foreign exchange resources are less than one-third those of England. France has between \$4 billion and \$5 billion of foreign exchange resources, of which about \$3 billion are in gold and \$1/2 billion in other assets in the United States. Most of her other foreign investments are in her own Empire. As war is prolonged and intensified, France will become increasingly dependent on Great Britain for economic assistance.
7. The immediate impact of war on the French economy was paralyzing. Five million men -- two-fifths of all the gainfully employed males -- were withdrawn from their normal occupations by mobilization; several million non-combatants were evacuated; there was a crisis in transport. Exports for September and October fell to perhaps half the peace-time level, imports probably falling proportionately. Since then several hundred thousand men have been released to work in industry and on farms although apparently they are not demobilized.
8. Government controls over labor, foreign trade and exchange, and certain supplies have been established. The Ministry of Labor is now the key agency in the determination of wages, hours, and working conditions. The Bank of France is administering exchange control, which is gradually being tightened up. Exports and imports are being carried on under a licensing system. Special agencies have been created to ration supplies of industrial raw materials and prepare for any rationing of foodstuffs. The first steps have been taken towards a general system of government supervision of prices.
9. French agriculture will not be able to supply the nation's essential war-time requirements of foodstuffs and agricultural raw materials. While France is a great agricultural country, even in peace time her foreign trade deficits

Division of Monetary
Research

- 3 -

were due solely to an excess of agricultural imports. She imports not only rubber and vegetable fibres but also staple foodstuffs. French agriculture will be crippled by an acute labor shortage, lack of essential tools and supplies, and inadequate transport facilities. French agriculture in 1914-18 could not meet the nation's essential needs, and there has been so little mechanization since then that the loss of labor will be just as damaging.

The measures adopted by the French government will not restrict consumption within the limits of domestic supplies. The Government does not appear to have any comprehensive food plan, having so far adopted only minor rationing measures. It is hoping to curtail consumption indirectly by controlling wages, but because of the increased demands of the army, it will be hard to get along without increased food imports.

10. French industrial and armament output will be considerably higher in this war than it was in 1914-18. The Maginot line protects the French heavy industrial centers of the North and East. The rapid industrialization of France in 1919-30 has increased her industrial and armament capacity, and while her capital equipment probably depreciated in the Thirties, it is still far above 1913.

11. The dominant political bloc in France today is conservative, nationalist, and anti-republican. The Radical Socialist Party has joined forces with the parties of the Center and Right, and France in the first months of war was in the process of acquiring the complexion of a conservative middle-class dictatorship.

THE ECONOMIC POSITION OF FRANCE

U. S. Treasury Department
Division of Monetary Research

Prepared by: Mr. Gass and Mr. Wheeler

December 15, 1939

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Summary of Conclusions

1. The war will lower the national income of France by at least one-fifth.

The real value of output will probably not reach pre-war levels during the period of hostilities. (In 1914-1918 the decline from the 1913 level was perhaps forty percent.) Even M. Reynaud, who is nothing if not optimistic, has conceded (September 10) that, in spite of all efforts, French production will inevitably and materially decrease.

The army has already claimed the best part of the male labor force. Work has been disorganized by evacuation and may be further crippled by attacks from the air. Industrial raw materials will be hard to get. Shortage of materials and transport and disruption of normal trade will make it difficult to maintain exports. Agricultural yields and the area planted will both decline. The real value of the national income must therefore fall. In this respect, France is, at present, in a quite different position from the United Kingdom.

The part of the national income available for consumption and productive investment will, of course, decline even more drastically, because an increasing percentage of output will be made up of munitions. The living standards of the French people will therefore decline severely.

2. The industrial and armament output of France during the present war will probably be greatly higher, both absolutely and relatively, than during the war of 1914-1918.

The fortifications built in the post-war years seem likely to prevent occupation of the French heavy industry centers of the north and east such as took place in August and September 1914.

Rapid industrialization took place between 1919 and 1930. The industrial progress of France during those years was probably greater than that of any other western European nation.

However, the industrial gains of the 1920's were, in large part, dissipated during the 1930's. While Germany and the United Kingdom both, after 1932, experienced an expansion in which production and investment passed all previous records, French capital equipment probably depreciated somewhat and output remained stagnant at a level not far above 1913.

Very little has been done during "the Reynaud recovery" to catch up with the industrial and armament output of Germany and the United Kingdom.

3. French agriculture will be unable to supply the nation's essential war-time requirements of foodstuffs and agricultural raw materials.

France is a great agricultural country. Yet even in time of peace she has had persistent foreign trade deficits due solely to her excess of agricultural imports. She is a net importer not only of rubber and vegetable fibres but also staple foodstuffs.

French agriculture will be crippled by an acute labor shortage, lack of essential tools, equipment and supplies, and inadequate transport. Departmental committees have been set up to overcome these obstacles and some special government assistance is being given for the purchase of farm equipment, but these measures will not suffice to maintain output.

In 1914-1918, French agriculture was unable to supply the essential needs of the nation. Yields declined severely even in the uninvaded areas. France had to import large quantities of foodstuffs from abroad. Few basic changes have taken place since those years. There has been little mechanization, and the loss of labor will therefore be quite as damaging as formerly. France will have to import a substantial part of her food supply.

4. The French Government has not yet adopted a rigorous and comprehensive system of consumption controls.

The measures so far adopted will not restrict food consumption within the limits of domestic supplies. A few minor measures of rationing, such as official meatless days, have been adopted. Rationing will probably be extended to other commodities from time to time. But the French government does not appear to have any comprehensive food plan. At

present, M. Reynaud places all the emphasis on the control of wages as the effective instrument for the limitation of consumption. This indirect method of restriction will not enable France to get along without considerably increased food imports. Men in the army consume more of staple foodstuffs than they do in civilian life.

The consumption of industrial products will, no doubt, fall; there will be little production of consumers' durable goods and considerable undermaintenance of residential housing. But the picture will not be a simple one. In the last war, the industries which showed the greatest expansion were confectionery, perfume and fine lingerie.

5. Central government expenditures for 1940 are estimated at 330 billion francs; during 2½ months from September 1 to November 11, expenditures were 78.5 billion francs -- more than a full year's tax revenue.

Expenditure during 1940 is tentatively estimated at about 330 billion francs. The regular budget includes expenditures of 79.3 billion francs, and the special war budget will be 249 billion francs.

Actual expenditures may, of course, differ greatly from those now projected. The principal variables are the character of hostilities, the movement of prices, and the availability of foreign exchange.

6. The expenditures of the central government alone are currently at a rate greatly above the past money value of the national income.

The best estimate of individual income payments showed a total of 243 billion francs in 1930 (when the real value of the national income was at its maximum). It totalled 242 billion francs in 1937 and 267 billion francs in 1938, but these latter francs were greatly depreciated in real value.

Government expenditures during the last quarter of 1939 and those projected for 1940 are at a rate considerably in excess of the past money value of total income payments to individuals. This is a repetition of the experience of 1914-1918. In 1913 the French national income was estimated at 35 billion francs. The French Government accumulated internal debt at the rate of about 50 billion francs a year during the four years of the war. In 1918 prices were between three and four times as high as they had been at the outbreak of war.

7. French taxes bear most heavily on the poor; these taxes can hardly be expanded to provide any substantial part of war expenditures.

French tax revenues in 1939 will certainly be less than 70 billion francs and probably less than 65 billion. (The final figures will not be available yet for some time.) The revenue system, which made such a sorry record from 1914 to 1918, has never been reconstructed to bring receipts into line even with ordinary expenditures.

For the greater part of the last twenty years, the first concerns of French governments have been to avoid direct taxes, to strike property and the higher income groups lightly, and to derive as large a part of the public revenues as possible from indirect taxes bearing on consumption.

French taxes bear most heavily on the poor. In 1937 over 60 percent of budgetary State revenues were raised by consumption taxes. These taxes can hardly be expanded to pay for any substantial part of war expenditures.

The only really heavy new tax which has been imposed since the outbreak of war is the 100 percent tax on wages earned for work between forty and forty-five hours a week and the 33-1/3 percent tax on wages earned for work over forty-five hours a week. The general national defense tax of 2 percent on all incomes was raised to 5 percent and, in the case of some non-mobilized men between the ages of 18 and 49, to 15 percent. Tobacco and match prices (both State monopolies) were raised about one quarter. It has been announced that profits in national defense industries will be severely restricted, all profits over 10 percent to revert to the State.

8. The French public debt increased by at least 100 billion francs during 1939, reaching about 650 billion francs at the end of the year; France may have to borrow 1,000 billion francs more if the war continues for several years.

At the end of 1938 the French public debt (including the debt of the national railroads and the Departments and Communes but not the Colonies) was about 546 billion francs. By the end of 1939 it will probably pass 650 billions.

All of the 1940 special war budget is to be met out of borrowing; this amounts to roughly 250 billion francs. Even the regular budget of 79.3 billion francs is only nominally

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balanced. Finance Minister Reynaud has hinted that France may borrow 1,000 billion francs during the present war.

9. There is at present good reason to believe that France is about to undergo an inflationary experience comparable to that of the war of 1914-1918.

Output has contracted and will probably remain, for the duration of the war, greatly below the pre-war level. Present and projected government expenditures are at a rate considerably in excess of the past money value of the national income. Already before the outbreak of war all French general price indices showed a strong and persistent upward trend. The record of the present French governing bloc suggests that such measures of severe taxation, rationing and price control as are necessary to prevent a major inflation will probably not be carried out. Some restraining influence will, however, be exercised by the United Kingdom.

10. French foreign exchange resources at the outbreak of war in September 1939 were probably considerably less than five billion dollars.

France had about three billion dollars worth of gold. She had securities, balances and direct investments to a total value of \$520 million in the United States. It seems unlikely that her other salable foreign investments would bring much more than a billion dollars at the present time. Therefore five billion dollars seems a high estimate of French foreign exchange resources.

The bulk of French foreign investments are apparently within her own empire, especially in North Africa and Indo-China. Some rubber plantations in Indo-China and some French properties in Belgium and Switzerland may be salable. Very little of her North African holdings could be sold, except at sacrifice prices, especially so long as there is a possibility of hostilities spreading to the Mediterranean.

11. France will become increasingly dependent on the British Empire as the strain of war becomes more severe. French dependence on the United States will be determined by American policy.

France lacks the resources and the organization to carry on equal warfare against so formidable an enemy as Germany. She will therefore become steadily more dependent on the vastly greater resources of the British Empire, and this

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dependence will become particularly great if the war grows more active and the German blows more powerful. Allied economic cooperation has already, in the agreement of September 4, reached a point which it only approximated during the last war after three years of hostilities.

France is now dependent on the United States to sell her munitions not procurable in other countries. She made a direct request for credits from the United States within five days of the outbreak of war. It may reasonably be expected that, should the war prove to be long and hard-fought, French requests for American credits will become steadily more frequent and insistent.

12. The immediate effect of mobilization on the economic life of France was paralyzing.

Five million men (constituting about two-fifths of all males gainfully employed) were withdrawn from their normal peace-time occupations. Several million non-combatants were evacuated from specially vulnerable areas. An official return of October 2 said that over two and a half million people had been evacuated from Paris. Strasbourg became a ghost city.

The transfer of the railroads to military control and the special demands of mobilization brought about a crisis in transport. Exports fell during September and October to perhaps half of their peace-time level. Imports may have fallen as much. Tax revenues in September were only 50 percent of budgetary estimates, and even in October they were still about 10 percent below the trend of the first eight months of the year. The government had to order the Bank of France to extend special credit facilities to mobilized debtors. Payments of rent were temporarily in complete confusion, pending authorized war-time readjustments of up to 75 percent. A cumbersome procedure of application delayed payments of war-time assistance to the dependents of mobilized men.

13. The French government has taken the first steps toward the assumption of control over the national economy.

Authoritarian government control over wages, hours and labor organization was established in the first days after the outbreak of war. The Ministry of Labor has replaced the trade unions and the trade associations as the key agency in the determination of wages and working conditions.

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Foreign trade and international capital transactions have gradually been subjected to government regulation. The Direction du Commerce Extérieur licenses all imports and exports. The Bank of France administers exchange control.

Special agencies have been created to ration supplies of industrial raw materials and to prepare for any rationing of foodstuffs. These agencies are represented on the inter-allied committees for economic cooperation.

The first steps have been taken towards a general system of price supervision.

14. When the Radical Socialist Party left the Popular Front in 1938 to join forces with the parties of the Center and Right, it accepted the leadership of a bloc which is dominantly conservative, nationalist and anti-republican. The outbreak of war has enabled that bloc to extend and consolidate its position. In the first months of war, France was acquiring the complexion of a conservative, middle-class dictatorship.

War Economy

A. The First Three Months of War Economy

1.

The immediate effect of mobilization on the economic life of France was paralyzing. The conscription of five million men and the evacuation of several million non-combatants from vulnerable areas brought about a severe decline of production and a crisis in transport.

The French military authorities expected an immediate violent attack in the West. They consequently insisted on mobilizing as many men as possible, and they have subsequently shown the greatest reluctance to release conscripted men even for the most urgent economic activities. Our information indicates that no men have been released from active stations at the front, but some releases of executive personnel, technicians and skilled workers have taken place from reserves stationed in interior districts.

Even in September men were released from military duty to gather the sugar beet crop. In October some men classed as industrial specialists were allowed to return to their peace-time employments. On October 27, the government decided to demobilize the 1910 class (consisting of men aged forty-nine), those men over forty-three who have three children, and those over forty-five who have two children. On December 2, it was announced that fathers of four children or more would be demobilized beginning December 15 and that eventually all fathers of two or more children would be released. On December 4, Sir John Simon said that France had three and a half million men under arms. We do not know how many additional mobilized men are serving in public and private munitions and in other strategic occupations.

Meanwhile, non-combatants were being evacuated en masse from specially vulnerable areas. On October 2, an official return was issued showing that over two and a half million people had been evacuated from Paris alone. We do not know how many more have been evacuated from the frontier districts. But there is evidence that evacuation from the most vulnerable

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areas in the East has been fairly thoroughgoing. Strasbourg is apparently quite deserted. Special government assistance has been provided for needy evacuated persons. 1/

This mass mobilization and evacuation severely differentiates the economic position of France from that of the United Kingdom. The slogan "business as usual" is particularly hollow in France because there is nobody to conduct normal business. It can be forecast with considerable assurance that French production will not again reach pre-war levels during the period of hostilities. Even M. Reynaud, who is nothing if not optimistic, has conceded (September 10th) that, in spite of all efforts, French production will inevitably and materially decrease. The decrease will begin to approximate that of the last war should there be a considerable loss of life, should industry be disorganized by bombardment from the air, or should the Germans succeed in disorganizing oceanic shipping.

The superior "flexibility" of the French "free economy" over the German totalitarian system, which has been proclaimed by many Liberal economists, manifested itself principally in that France mobilized a considerable number of unemployed men (as well as a larger number of employed), while all those mobilized in Germany had previously been engaged in productive labor or in preparing the equipment with which Germany would wage war. M. Reynaud however prided himself (in a speech of September 10th) that, in the economic sphere, the French Liberal economy had "fresh troops" -- fresh from unemployment. In the first three months of war France was developing replicas of most of the economic controls which had been functioning in Germany for some years. She too was becoming an organized war economy. 2/

2.

The outbreak of war was the signal for the establishment of government control over wages, hours and labor organization.

A decree 3/ was issued on September 1, which permitted an increase in the weekly hours of work from forty to forty-five without any increase in pay. This decree may be regarded as

1/ Journal Officiel, October 11, 1939, pp. 12, 236.

2/ French industrial capacity for the waging of a long war is discussed in greater detail below, in Chapter II.

3/ Journal Officiel, September 6, 1939, pp. 11, 158-9.

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the first dividend declaration of the bloc which achieved definitive victory over the Popular Front in November 1938 — a dividend declaration equal to 12 percent of the wage bill. However, a month later (October 4), probably as a result of popular outcry, it proved necessary to withdraw this dividend and to provide that the wages which would normally be paid to working men for hours of work between forty and forty-five be paid instead into the national Treasury. 1/ It was further provided, in the original decree, that for all hours worked over forty-five, payment should be at the rate of two-thirds the existing wage rate; the remaining one-third was to be retained by the employer and paid by him into the national Treasury.

A general sixty-hour week was established in industry by decree of September 1 (several weeks before the same step was taken in Germany). The same decree provided further that, for periods not to exceed twelve weeks, a seventy-two hour week would be permitted in industries working for national defense or for the public service. Women and children were allowed to work up to ten hours a day.

The provisions for arbitration and conciliation in earlier collective wage contracts have been declared void. By decree of November 16, 1939, it was provided that, in industries important for national defense, the government would fix wages and working conditions directly. In other industries arbitration would be permitted under the supervision of the Ministry of Labor.

A whole batch of decrees has been issued to combat labor "insubordination". For instance, a decree of November 19 provides:

"Individuals dangerous for national defense or the security of the State may be transferred from their place of residence to a center that the War and Interior Ministries select. These persons can be requisitioned for national defense work, and, if they refuse to work or if they leave the center where they are established and return to their former residence, they are liable to 5-year prison terms. This ruling is effective as long as France is under martial law."

The government has indicated its intention to take severe measures against any labor opposition and to convert the French

1/ Journal Officiel, October 4, 1939, pp. 11,198.

labor unions into a docile Labor Front. In view of the anti-Labor and anti-Republican character of the larger part of the bloc which supports the Daladier Administration, there is every reason to believe that these decrees will be applied with the greatest severity. 1/

Foreign trade and international capital transactions have gradually been subjected to government regulation.

Already on August 29th a decree was issued prohibiting exports of hides and skins, wool, silk, cotton and linen, cereals, sugar, petroleum, rubber, many chemicals, surgical and scientific instruments, radios, trucks, etc.

A decree of September 1 provided that: "Imports into France and Algeria of all foreign merchandise, except gold in any form, under any customs regime whatsoever, is prohibited." All imports are regarded, in principle, as exceptions to this general prohibition. These "exceptions" are granted by the Direction du Commerce Extérieur and the responsible ministries and import groups which have been authorized to assist it. No importation may take place without the issuance of a certificate by the Exchange Office stating that the delivery of foreign currency has been authorized or that foreign currency is not required.

Exports also require prior authorization from the Direction du Commerce Extérieur, and, in particular, they are subject to the presentation of an agreement signed by the exporter to cede to the Exchange Office all foreign exchange received from the sale of the exported merchandise.

Despite repeated, emphatic denials (throughout August and as late as September 4th) by responsible French officials that their government had any intention of imposing extraordinary controls over international capital transactions, complete exchange control was established by decree dated September 9th. 2/ That decree provided that: "The export of capital under any form whatever is prohibited, unless authorized by the Minister of Finance." Only the Bank of France and its authorized agents were permitted henceforth to engage in foreign exchange transactions.

A further decree 3/ provided that all French persons and corporations (and certain foreign corporations) must submit a

1/ The background of these decisions is discussed in greater detail below, in Chapter VI.

2/ Journal Officiel, September 10, 1939, p. 11,266 ff.

3/ Journal Officiel, September 17, 1939, p. 11,535

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declaration of their foreign holdings as of October 15, 1939. The decree promised that this declaration of foreign holdings would not be used to attempt to recover or punish past tax evasion. By basing the required declaration on a date a month forward, it provided opportunity for the repatriation or for the concealment of foreign holdings. The date on which this declaration of foreign holdings is to be based was postponed (on October 9) to November 15 and then (on November 15) to December 31, 1939.

Special agencies have been set up to ration supplies of industrial raw materials and to prepare for any necessary rationing of foodstuffs. On September 1 there was established a special war food service under a Secrétaire General du Ravitaillement General. On November 1 provision was made for the establishment of groups in each Department of France to facilitate the supply of foodstuffs to the population in the event of local shortages, difficulties of transport, etc.; these groups are evidently inactive pending the appearance of an emergency situation. A decree was issued on November 23 requiring the declaration of all stocks of animal and vegetable oils and fats, and some steps — hardly going beyond moral suasion — have been taken to reduce the consumption of beef and veal. On the other hand, the rationing of industrial raw materials is evidently more complete. The system of import licenses is an important instrument of this rationing. Since November 6 there has been a special rationing system for iron ore, lead, zinc, antimony, manganese, tungsten and other iron alloys. Special boards — including representatives both of the government and the trade associations — are being created to control the rationing of all important materials.

The first steps have been taken towards a general system of price supervision. In the interest of encouraging wheat planting, the price of hard wheat was fixed on September 1 at the generous level of 207.5 francs a quintal $\frac{1}{2}$ for September 1939, rising progressively each month to 226 francs for August 1940. On September 4 the price control committee issued a warning, couched in the usual French rhetoric, that "abnormal" price increases would be repressed. On September 16 the Journal Officiel published a decree prohibiting all unauthorized price increases over the level prevailing on September 1. With this decree the French government nominally adopted the system of the German Freistopverordnung of

$\frac{1}{2}$ A quintal equals approximately 3.67 U. S. bushels.

October 17, 1936. It remains highly dubious that the French administration will be able to achieve a degree of price stability comparable to the German. There have already been a large number of approved price increases. Further ones are announced in the Journal Officiel every week. But the publication of price indices has been prohibited, and we have no other reliable information on the general movement of prices.

3.

France has been struggling ever since the war of 1914-1918 to meet a heavy burden first of reconstruction and then of rearmament with an antiquated tax system and an inefficient tax administration. For the greater part of these years, the first concerns of French governments have been to avoid direct taxes, to strike property and the higher income groups lightly, and to derive as large a part of the public revenues as possible from indirect taxes bearing on consumption. Under this regime, the French public debt has increased almost continuously, and France has had a lush flowering of customs, excise, stamp and sales taxes. ^{1/} A fundamental reconstruction of the French tax system has ceased, even nominally, to be on the order of the day since the fall of the second Blum government (April 9, 1938).

The present French government evidently intends to pay for its internal war expenditures, largely by borrowing, supplemented by some additional taxes especially on wages and consumption. The only really heavy new tax which has been imposed since the outbreak of war is the 100 percent tax on wages earned between forty and forty-five hours a week and the 33-1/3 percent tax on wages earned for work over forty-five hours a week. The general national defense tax of 2 percent on all incomes first levied in May 1939 was increased (by decree of November 17) to 5 percent. Tobacco prices (a State monopoly) have been raised about one quarter. It was announced that profits in national defense industries would be severely restricted, all profits over 10 percent to revert to the State.

These additional taxes will cover only a small part of additional war expenditures. It must be recalled that a appropriations for defense during 1939 have totaled about 186 billion francs or perhaps two-thirds of the national income. About 31.9 billion was appropriated for defense in the ordinary budget. About 72.6 billion has been appropriated in various special budgets. Some 81.2 billion has been appropriated under the law of December 31, 1938, chargeable to 1940 and later budgets. Expenditures have been less than appropriations, but we do not know exactly how much less.

^{1/} A more detailed account of French public finances is given below in ~~Chapter 24~~. *section D.*

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Next year's ordinary budget includes expenditures of 79.3 billion francs and the war budget is estimated at about 249 billion francs. Of this 249 billion, some 106 billion is tentatively allocated to the Air Ministry, about 87 billion to Armament, about 37 billion to War, about 15 billion to Navy and small amounts to other ministries.

Even without war there would have been an increase of at least forty-billion francs in the French public debt during 1939. Since the outbreak of war the public debt has been rising at least twice as fast as during peace. "Borrowing" is currently largely a euphemism for money creation by the Bank of France and the other banks who are buying large amounts of armament bonds. It seems quite clear that it will be impossible to preserve the stability of the French general price level during a long war without imposing the severest income and inheritance taxes combined with a capital levy. The present French government may very likely prefer inflation combined with fervent declamation against "the enemies of the Republic".

Our best information indicates that French tax revenues in September were 50 percent under budgetary estimates. Yields during October were about 10 percent under the trend of the first seven months of this year. We have no information yet on yields during November.

New subscriptions to armament bonds totaled 1.6 billion francs in the first week of war. But since then the first patriotic flush has subsided. Our best sources say merely that bond subscriptions are currently running materially above the one hundred million francs a day which they were averaging before the outbreak of war.

Professor Rist has estimated that the daily cost of the war to the French government is perhaps seven hundred million or eight hundred million francs, but he was not at all confident that this figure was accurate. Other official sources say only that the cost is enormous. (Total budgetary revenues of the State for the first seven months of 1939 were only 32.4 billion francs.) Total central government expenditures for the seventy-odd days from September 1 to November 11 were 78.5 billion francs. This is more than a full year's tax revenues and nearer one-third than one-fourth of the French national income.

From the outbreak of war to November 30, the government received advances of 10.0 billion francs from the Bank of France. The other banks are apparently subscribing liberally to government bonds. As long as the expansion of their investments in

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governments proceed uniformly, no bank need lose cash, and the process can go on indefinitely. When such sophisticated methods of money creation are available, there need be no great reliance on "the printing presses".

Since the end of January 1939 note circulation has increased from 109.3 billion francs on January 26 to 149.4 billion francs on November 30. We have no up-to-date figures on the increase in total demand deposits, but that is a less important deficiency in the case of France than it would be in other large countries because French business relies relatively more on notes and less on checks. Measured by the increase in note circulation, the supply of money has probably increased more in France than in any other major European country. Most of the increase has taken place since the week before the outbreak of war.

The weighted index of wholesale prices compiled by the Statistique Generale rose from an average of 411 in 1936 to 581 in 1937 and 653 in 1938. It stood at 674 in August 1939 compared to 649 in August 1938. No price indices have been published since the outbreak of the war. The French government has announced its intention to repress all "abnormal" price increases. However, in view of the lack of controls comparable to those of Germany, the contraction of output brought about by mobilization, and the considerable reliance on money creation to finance war expenditures, the prospects for the stability of the French general price level are not bright. Prophecy is hazardous, but it seems not unlikely that an inflationary experience comparable to that of the last war is about to be repeated in France.

4.

The experience of the first three months of war suggests that France will have to restrict her imports from countries outside the sterling and franc areas very carefully. 1/

At the outbreak of war France had about three and a half billion dollars of gold, dollar balances and American investments. She had perhaps a billion dollars more of salable assets in other neutral countries and in such parts of her empire as might attract foreign buyers. It was not clear how much of the foreign holdings of her nationals she would be able and willing to take over for

1/ A more extended analysis of French capacity to pay for imports during a long war is given in Section E below.

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public purposes. Repatriation of capital after the outbreak of war, while very impressive in francs, amounted to very little in dollars. (For instance, the French were very proud that their exchange equalization fund gained a billion francs of gold in September, but this was only about twenty-three million dollars.)

Exports declined drastically after the outbreak of war. It is impossible to assess the precise magnitude of the decline because the French have discontinued the publication of foreign trade statistics, and we have only very incomplete information from other sources.

The few figures we have are of slight interest. They deal only with September and October and have very little prediction value. The crisis of the first weeks of mobilization, when it was expected that a violent attack might have to be met at any moment, can hardly be projected for the duration of the war. Only the figures which appear after the beginning of 1940 will begin to show the permanent character of war commerce.

French exports to the United States were only \$3,851,000 in September 1939 compared to \$5,395,000 in September 1938. October was even lower with \$2,094,000 compared to \$5,953,000 in the preceding October. This was a reversal of the trend of the first eight months of 1939 in which the value of French exports to the United States was \$43,909,000 compared to \$31,896,000 in the same period of 1938.

French exports to Switzerland declined even more severely. September 1939 exports were valued at 7,092,000 Swiss francs compared to 20,951,000 in September 1938. October exports were 11,710,000 compared with 23,745,000 in October 1938. This also was a reversal of the trend of the first eight months in which the Swiss bought 192,174,000 Swiss francs of French goods compared to 137,638,000 in the same period of 1938.

French exports to the Netherlands in September were only 3,138,000 Dutch florins compared to 5,069,000 florins in September 1938. This again was a reversal of the trend of the first eight months in which the Netherlands imported 57,278,000 florins of French goods compared with 41,259,000 florins in the same months of 1938.

French exports to Canada declined in September to 653,000 dollars compared to 709,000 dollars in September 1938, and this, too, was a reversal of the trend of the first eight months in which Canada bought \$4,114,000 of goods from France compared with \$3,608,000 in the same period of 1938.

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Data on French exports to her two greatest customers, Great Britain and Belgium, are not yet available for the period since the outbreak of war.

French imports, except from the United States, may have declined as much since the outbreak of war as her exports. Swiss sales to France which were valued at 10,794,000 Swiss francs for the two months September-October 1938 were only 3,409,000 Swiss francs during September-October 1939. Canadian sales to France were \$1,664,000 in September-October 1938 and only \$615,000 in September-October 1939. Netherlands exports to France were 4,579,000 Dutch florins in September 1938 and only 2,322,000 in September 1939. Even United States exports to France were only slightly larger in September-October 1939 than in the same period 1938, being \$24,687,000 in the latter year compared with \$23,556,000 in the earlier one.

From September 1 to November 29, French sales of gold to the United States amounted to \$90,027,000. At the same time French dollar balances in the United States were reduced by \$40,479,000. On the other hand, there were net French purchases in the United States of \$2,500,000 of domestic securities and \$13,400,000 of foreign securities.

The French government has said that it is quite unable to make any estimate, even in round figures, of its probable war purchases in the United States during the first six months or first year of war. France has arranged already for the purchase of some forty million dollars of copper in the United States. In November France received authorizations for the import of \$95 million worth of airplanes, parts, and engines from this country. In the coming year airplane purchases may amount to several hundred million dollars. Machine tools, cotton and petroleum will probably be prominent among the things the French buy from the United States.

Negotiations for allied economic cooperation have particularly emphasized that every effort must be made, in view of the stringent exchange situation, to buy as much as possible within the sterling area. Meetings took place during November to set up committees for the coordination of allied foreign purchases. They also included negotiations with regard to the French desire to maintain her sales to the United Kingdom, which consist largely of luxury goods whose importation into the United Kingdom was forbidden at the outbreak of war. On December 4, a financial agreement was signed involving an almost complete pooling of allied exchange resources.

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However, at the end of the first three months of war, Anglo-French economic collaboration was only getting started. Such collaboration may be expected to acquire increasing importance as war-time organization is perfected and as the long strain of war brings out the greatly superior economic resources of the British Empire as opposed to the French. 1/

At the end of the last war, France had sold and lost by default and repudiation almost six billion dollars of foreign investments, and she had acquired about seven and one-half billion dollars of debts to the United States and the United Kingdom. Today she has over a billion dollars more of gold than she had in 1914, but the value of her foreign investments is substantially less than it was twenty-five years ago. It will be impossible for France during the present war to finance, from her own resources, such a volume of imports as she received during 1914-1920 as a result of the assistance of the United States and the United Kingdom. Exchange to pay for imports comparable to those of the last war can come only from commercial and governmental loans by the United States and from renewed dependence on the United Kingdom. France will undoubtedly make every effort to get credits in the United States. A request for such credits was made within five days after the beginning of hostilities.

France may not be urgently in need of foreign credits (and she may not become greatly indebted to the United Kingdom) for a period considerably beyond the end of 1940 if the war continues a relatively static course on the land frontiers, with a resulting low consumption of war materials. However, should land and air hostilities become active, it is quite likely that the consumption of war materials will be greatly in excess of any previous experience. Even today French military tactics and French purchases must be adjusted to the fact that there is no guaranty that credits will be available should her own resources become exhausted.

5.

In contrast to the United Kingdom — where the outbreak of war was accompanied by the maintenance of vigorous opposition criticism, the assumption of the burden of war costs largely by

1/ A brief sketch of allied economic cooperation during the war of 1914-1918 and some further details on present arrangements are given below in section E.

the middle and upper income groups, and the participation of the organized Labour movement in the management of war industry —, in France criticism has largely been silenced by censorship and military trials; parliament has given up all effective control over the executive and has ceased even to be a platform for continuous minority criticism, war costs bear especially heavily on the poor, and every effort is being made to destroy the independent labor movement. 1/

We have already indicated above that the heaviest French war taxes are on wages and consumption.

It is necessary to differentiate sharply the position of the opposition parties in Britain and France. In Britain the consistency of the foreign policy of the Labour Party, the weakness of the Chamberlain government, the presence of strong socialist parties in several Dominions, the necessity of playing up to democratic sentiment in the United States, and several other factors — which lie deep in the social and intellectual composition of Britain, but which are hard to describe in a few words —, ruled out any policy of "cracking down" on labor and muzzling all independent opposition. In France such inhibitions have counted for much less.

Even the most casual reading of the current British and French press reveals the most striking contrasts. The English press is critical, well informed — stern in its realization of obstacles to be met and losses to be suffered. The French press is entirely uninformative. A journal like "L'Europe Nouvelle", which in the immediate post-war years had a high reputation for informed judgment, now abounds in absurd underestimates of the strength of Germany and unrestrained exaggeration of the power of France. The French newspaper press predicts "starvation and revolution" in Germany within six months.

Less adequate provision is apparently being made for the families of mobilized men in France than in Britain or even Germany.

1/ The background of this trend is described in greater detail in section F below.

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By decree 1/ dated September 1, 1939, it was provided that needy families of mobilized men would be paid 12 francs a day in the Department of the Seine, 8 francs in communes of more than 5,000 inhabitants, and 7 francs in other communes. For each child under 16 years of age there would be granted a further allowance of 5.5 francs in the Seine Department and 4.5 francs in all other Departments. Reductions of rent up to 75 percent of the prevailing level were to be negotiated between landlord and tenant, in case of need.

In accordance with this decree, the wife of a mobilized soldier with four children living in Paris would receive 238 francs a week (about \$5.25 at current exchange rates) and some rent adjustment. A woman in similar circumstances in London would receive £2 (about 353 francs at current exchange rates) and up to £2 additional as an allowance for living in a specially expensive area, as well as a guarantee against eviction for non-payment of rent and a guarantee against being forced to return any articles bought before the outbreak of war on the installment plan.

Information is not at hand for a precise comparison with Germany, but we do know that the Germany government has declared its intention to provide the families of mobilized men with 85 percent of their normal peace-time wages, and this is certainly far better than is being done in France.

The participation of labor in war-time administration in France approximates that of Germany rather than that of the United Kingdom. Labor was not consulted on any of the decree legislation, and all but the most strongly placed opposers (e.g. M. Blum) were silenced by mobilization, military discipline, and military trials. Parliamentary criticism has been smothered. Communist Deputies have been imprisoned in violation of their parliamentary immunity. The French trade unions today have little independent bargaining power while the British ones are as strong as ever. The Russo-German pact threw confusion into the ranks of the French Communist Party (which on the first ballot of the general election had a larger popular support than the party of M. Daladier). The decree of September 26 dissolving the Communist Party and a mass of other legislation which followed it 2/ have been used to silence, for the time, practically all vigorous defenders of the claims of the French working classes. Scores of elected municipal councils

1/ Journal Officiel, September 8, 1939, p. 11,199.

2/ See especially Journal Officiel, September 27, 1939, pp. 11,770-1 on the dissolution of elected local government bodies.

have been dissolved and their members replaced by supporters of the political and social policy of the Right-Center. 1/

In the first three months of the war, France was taking on the aspect of a conservative middle class dictatorship. We do not believe it possible at present to predict how long this trend will continue. We would warn against any systematic under-estimation of the strength of the republican and equalitarian tradition in France, but we wish also to emphasize the reality of the social struggle which is going on there under the thin slogan of "National Union".

Should a conservative middle class dictatorship emerge in France from the present war, it seems quite unlikely that this dictatorship will be, as the French would say, "a fascism". 2/ It will be something much more indigenous. The French middle classes are not going to give themselves over to a leader on the Germany or Italian model, and they will undoubtedly preserve something of the traditional republican symbolism. Rather than a new armed group of partisans taking over the power of the State, we look for a reaffirmation of the strength of the traditional French ruling classes. The dictatorship of M. Daladier will no doubt — both in its forms and in its content — resemble that of M. Thiers or M. Clemenceau more than that of Hitler or Mussolini.

1/ See Journal Officiel, October 20, 1939, pp. 12,490-2 for the dissolution, in a single day, of 25 municipal councils in the Department of Gard and several others in Seine-et-Marne and the Pyrennees.

2/ We expect to prepare an independent paper on this matter at a later date. The essential insight is already present in Elie Halevy, L'Ere des Tyrannies, (1938), especially p. 223.

Industry and Munitions

B. Industrial and Armament Capacity

1.

The industrial and armament output of France during the present war may reasonably be expected to be greatly higher, both absolutely and relatively, than during the war of 1914-1918. This improved prospect is due, in the first instance, to the fortifications built in the post-war years, which seem likely to prevent any such occupation of the French heavy industry centers of the north and east as took place in August and September 1914.

After the advance in the West was stabilized at the Aisne in the middle of September 1914, warfare on French soil was stationary for over three and a half years. ^{1/} From Compiègne to Belfort the ebb and flow of advance never reached ten miles. For industrial purposes, the line which marks the extent of invasion may be taken to start at Nieuport in Belgium, pass through Ypres and enter France to the east of Armentières, then south to the west of Lille and east of Arras. From there it bent in a wide semi-circle through Albert, west of Lassigny and north of Soissons, and Reims, passing north and east of Verdun. Then it bent sharply south of St. Mihiel and Pont-a-Mousson, following approximately the frontier of Alsace-Lorraine as far as the east of St. Die and thereafter due south to the Swiss frontier. Ten departments were included more or less in the invaded area: Nord, Pas-de-Calais, Somme, Oise, Aisne, Marne, Meuse, Meurthe-et-Moselle, Vosges and Ardennes.

The completely invaded area was only 6 percent of the total French territory, but it was (aside from the Seine area) perhaps the richest section of France. It had 10 percent of the population of the country and 14 percent of her industrial workers.

^{1/} C. R. M. F. Gruttwell, A History of The Great War 1914-1918, Oxford (1934), map 10, p. 110. Arthur Fontaine, L'Industrie Française Pendant La Guerre, New Haven (1925), map pp. 8-9.

But even the figure of 14 percent greatly underestimates the importance of this area to France's war economy. The invaded area was par excellence the zone of heavy industry. Before the outbreak of war, this region had had 52.7 percent of France's metallurgical workers, 60.6 percent of her iron and steel workers, 41.8 percent of her miners, 29.4 percent of her textile workers, and was heavily represented in almost every other branch of manufacturing industry. The ten invaded departments had 41 percent of the total steam power of France. The area invaded or under fire had formerly produced 74 percent of France's coal, 76.5 percent of the coke, 81 percent of the pig iron, 63 percent of the steel, 94 percent of the copper, 76 percent of the zinc, 81 percent of the wool, 93 percent of the linen, 44 percent of the chemicals, 76 percent of the sugar, 59 percent of the industrial alcohol, 80 percent of the window glass, 50 percent of the bottles, and appreciable parts of the output of many other commodities. It was precisely the industries which were most important for the waging of war which were located in the invaded provinces. For the duration of the war of 1914-1918, these industries were added, in large part, to the industrial and armament capacity of Germany, crippling France and greatly increasing her dependence on imports.

Without possessing any special military knowledge or competence, it is our opinion that France is not likely to be deprived of these heavy industry areas early during the present war. Some part of them may be disabled from the air, but the occupation of these areas is impossible without the conquest of Belgium and the reduction of the French fortifications. These things seem unlikely to occur in the near future. Possessing these areas, France will be more able than in 1914-1918 to produce her own munitions. She will be less dependent on imports.

Together with these old centers of heavy industry, now protected by fortifications, may be considered the additional industrial capacity of the departments of Moselle (Lorraine), Bas-Rhin and Haut-Rhin (Alsace) re-annexed under the Treaty of Versailles. ^{1/} These departments added only 2.74 percent to the territory of France, but they made a great addition to her heavy industry capacity. In 1936 the whole of France produced 46.1 million tons of coal; of this total, 5.5 million tons were mined in the department of Moselle alone. In the same year France produced 6.2 million tons of pig iron, of which 2.3 million tons were produced in Moselle. She had an output of 6.7 million tons of steel, of which 2.2 million tons came from Moselle. Moselle

^{1/} Henri Leufenberger in *Revue d'Economie Politique*, Janvier-Fevrier 1939 and *Annuaire Statistique 1937*, section 3B.

also contains almost all the potash and petroleum of France. Alsace makes her contribution especially in the textile industries, having (in 1936) 16.7 percent of the cotton spindles of France, 17.3 percent of the cotton weaving machines, 11.9 percent of the wool spindles and 7.7 percent of the wool weaving machines.

The value of the product of these frontier regions protected by the new fortifications and re-annexed under the Treaty of Versailles, over a period of four war years, may reasonably be estimated at a sum greatly in excess of the capital value of French gold stocks and foreign investments added together.

2.

The second great cause of the improved industrial and armament capacity of France today, in comparison with 1914, is the rapid industrialization which she accomplished between 1919 and 1930. The industrial progress of France during those years was probably greater than that of any other western European nation 1/

The gainfully employed population of France numbered 21.6 million at the census of 1931. This was an increase of only .9 million over 1906. (It will be recalled that France's male population between the ages of fifteen and fifty decreased by 11 percent between 1911 and 1921.) The numbers engaged in industry, however, increased much more rapidly. From 34.9 percent of all gainfully employed in 1906 they passed to 39.1 percent of all gainfully employed in 1931, or an increase of over 12 percent. The number of persons employed in transport increased by 290,000 (or 64 percent), in mining by 150,000 (or 56 percent) and in manufacturing industry by 1,030,000 (or 26 percent).

In 1906 there were only 97,000 establishments in France employing machine power. In 1926 there were 125,000 such establishments and in 1931 there were 175,000. The amount of machine power used increased between 1906 and 1931, in mining from 243,000 kilowatts to 1,510,000 kilowatts, in the chemical industries from 148,000 to 555,000, in metallurgy from 221,000 to 1,814,000. reckoned in horsepower, and averaged over all industry, horsepower per worker passed from .90 in 1906 to 1.78 in 1926 and 2.41 in 1931.

1/ R. Wagenfuhr, Entwicklungstendenzen der deutschen und internationalen Industrieproduktion 1860 bis 1932, Hamburg (1933), C. Gide et W. Oualid, Le Bilan De La Guerre Pour La France, New Haven (1931), W. F. Ogburn and W. Jaffe, The Economic Development of Post-War France, New York (1929), and the special January-February 1939 number of the Revue D'Economie Politique.

Coal

France has very meager coal resources compared to those of Germany, Britain or the United States. Though the expansion of her coal industry during the 1920's was remarkable, she was still not a great coal producer.

France's total reserves were estimated in 1913 at eighteen billion tons, compared with one hundred ninety billion tons in Great Britain, four hundred twenty billion in Germany and three thousand eight hundred billion in the United States. French coal is generally poor or inaccessible. Her greatest field, in the Nord and the Pas de Calais, is only the tail-end of the more accessible Belgian coal measures. The other important French coal-bearing states are on the upper Loire, west of Lyons, especially between St. Etienne and Roanne, but this field is so small that it would hardly merit mention in any other country. While France produced an average of forty million tons of coal in the years 1911-1913, Germany was producing one hundred ninety-three million tons (including lignite equivalents), Great Britain two hundred seventy-eight million tons, and the United States four hundred eighty-four million tons. During these years, France had average annual net imports of 20.9 million tons of coal.

The French delegation went to the peace conference determined to improve the position of their country with regard to coal supplies. Coal production in France had been drastically reduced during hostilities by the German occupation of the Nord and part of the Pas de Calais as well as by the general labor shortage and disorganization of war industry. French production of coal had been 40.8 million tons in 1913 but only 19.5 million in 1915 and 26.3 million in 1918. France had been absolutely dependent during 1914-1918 on coal imports from the United Kingdom, which were a heavy drain on her foreign exchange resources and had first claim on severely rationed shipping facilities.

France insisted at the peace conference that she must have the Saar basin (with coal reserves as great as those of all France), and Clemenceau clung to this demand so tenaciously that President Wilson threatened to withdraw from Paris if he did not moderate his attitude. ^{1/} Finally a compromise was reached whereby France was given ownership of the coal mines, the Saar territory was placed under League administration, and its permanent political status was left to be determined by plebiscite in 1935. The coal mines

^{1/} R. S. Baker, Woodrow Wilson and World Settlement, N. Y. (1922) vol. II, pp. 18-19, 23 ff.

of Moselle passed to France. Germany undertook to deliver to France seven million tons of coal per year for ten years, and Germany was obliged to guarantee France, for a period not exceeding ten years, further shipments of coal equal to the difference between the pre-war production of the Nord and the Pas de Calais and their production during the post-war decade. ^{1/}

The recovery of production in the devastated areas was rapid and complete. By 1925 the Nord and the Pas de Calais were producing more coal than ever before. The mines were also more efficiently equipped than formerly. There was a wider use of pneumatic drills and of mechanical cutting instruments; new types of steam boilers had replaced the old more rapidly than would have been provided for by normal depreciation, and electric power was much more widely used.

The output of coal (excluding the Saar) rose from 25.3 million tons in 1920 to 48.1 million tons in 1925 and 55.1 million tons in 1930. Net imports of coal, however, continued to increase. In 1920 such imports totaled 32.0 million, and in 1930 they were 33.4 million. Total French consumption of coal therefore, after having decreased from 64.8 million tons in 1913 to 56.8 million in 1920, now increased to 86.4 million tons in 1930. Both in production and consumption of coal, the French rate of increase from 1913 to 1930 was greatly in excess of that of Germany or Great Britain.

Nevertheless, it was impossible to overcome unfavorable natural conditions. The average daily output of coal per person employed in 1930 was only 696 kilograms in France compared to 1,098 kilograms in Great Britain, 1,352 kilograms in the Ruhr and 1,369 kilograms in Polish Upper Silesia.

French coals are particularly ill adapted for the production of coke, and the price of coke has consequently always been comparatively high in France. In 1913 France produced only 4.0 million tons of coke; in 1930 she produced 9.2 million tons. Somewhat less than half of her domestically-produced coke was, however, produced from imported coal (principally German), and she imported a further 1.6 million tons of finished coke.

^{1/} Treaty of Versailles, Part VIII, Annex 5, paragraph 2.

Iron and steel

The French iron and steel industry expanded more rapidly in the 1920's than that of Britain, Germany or the United States. In 1930 France was second among the countries of the world in the production of iron ore, third in the production of pig iron and third in the production of crude steel. 1/

In 1913 France produced twenty-two million metric tons of iron ore. The invasion, however, deprived her of the great Nancy and Briey basins. Her production consequently fell in 1915 to 620,000 tons. During the best year of the war, 1917, she produced only 2,035,000 tons, or less than 10 percent of the 1913 output.

The peace not only restored the Nancy and Briey mines but also added the more accessible ores of the Metz-Thionville field. In 1920 production of iron ore reached fourteen million tons; in 1935 it was up to thirty-six million and in 1929 attained fifty-five million tons. It was calculated in 1928 that French production of iron ore was at the rate of 1,200 kilograms per capita, while the production of the United States was only 575 kilograms per capita, Great Britain only 256 kilograms, and Germany only 98 kilograms.

After the war of 1914-1918, the iron and steel plants which had been destroyed were reconstructed and others were modernized. Most of the plants, especially in the East, were constructed as integrated establishments including both blast furnaces and rolling mills, and usually producing a considerable number of by-products as well as iron and steel. Before the war, the daily capacity of blast furnaces usually varied between two hundred and three hundred tons; by 1929 furnaces of three hundred tons had become typical and some existed of three hundred fifty to four hundred ton capacity.

In 1913 France produced 5.2 million tons of pig iron. The German section of Lorraine produced 3.7 million. But in 1915 French production of pig iron had fallen as a result of the invasion, to 584,000 tons, and even in 1917 it only reached 1.4 million tons.

Within her new frontiers, France produced 3.3 million tons of pig iron in 1920, about 8.5 million in 1925, and 10.4 million in 1929. She was the largest European producer of pig iron.

1/ F. Benham, The Iron and Steel Industry of Germany, France, Belgium, Luxembourg, and The Saar, London and Cambridge Economic Service, (October 1934). Statistical Yearbook of the League of Nations 1938-9, Geneva (1939).

She was also one of the largest producers of steel. French steel production was 4.7 million tons in 1913, only 1.1 million tons in 1915, and -- even within her new frontiers -- only 2.7 million tons in 1920. However, steel production was already 7.5 million tons in 1925 and reached 9.7 million tons in 1929. It was still greatly below the production of Germany (16.0 million tons) and slightly below that of the United Kingdom, but the French rate of increase had been much the most rapid.

The East -- including Ardennes, Haute-Marne, Moselle and Meurthe-et-Moselle -- is the great iron and steel area. It produces 95 percent of the iron ore, four-fifths of the pig iron and two-thirds of the steel. Its location is determined by the Lorraine iron ore field; nearly all its fuel comes from elsewhere. (Transport costs are very heavy in the French iron and steel industry). The North produces primarily finished products, and the Centre primarily forged pieces and special steels. We shall have something to say about the Centre below, in connection with armament output.

Chemicals

The war of 1914-1918 stimulated the expansion of the French chemical industry, and the reannexation of the potassium deposits of Alsace added further to her resources. In 1913 France produced 1,200,000 tons of sulphuric acid; in 1925 she produced 1,850,000 tons -- coming second only after the United States. She was the greatest European producer of natural phosphates and of super-phosphates of lime. She became a heavy net exporter of synthetic dyes and of other chemical products. The number of persons employed in the chemical industry increased by 64 percent between the censuses of 1906 and 1931.

Automobiles

In the 1920's France became the greatest European producer of automobiles. From 40,000 in 1920, her production increased to 177,000 in 1925 and 254,000 in 1929. Her production was slightly higher than that of Great Britain and almost three times as great as that of Germany.

Industrial production

The most comprehensive index we have of French industrial production (1913 = 100) shows a rise from fifty-seven in 1919 to one hundred forty in 1930. This index weights the capital goods industries far too heavily and hence accentuates the actual fluctuations in French industrial production. ^{1/} When due allowance is made for the imperfection of the index, the actual rise in industrial production over the 1913 base is probably nearer 20 percent than 40 percent. Nevertheless this is a remarkable achievement, particularly when we consider the destructiveness of the war and the necessity of spending about one hundred billion francs from the national Treasury for the restoration of the devastated areas.

A German scholar, Rolf Wagenfuhr, has calculated that French industrial production increased from 48 percent of the German in 1913 to 67 percent of the German in 1928-9. The precision of these figures is specious, but they do illustrate a broad truth. Both Germany and France increased their industrial production during the 1920's more rapidly than did the United Kingdom, and France was going ahead faster than Germany.

3.

The industrial gains of the 1920's were, in large part, dissipated during the 1930's. While Germany ^{2/} and the United Kingdom ^{3/} both, after 1932, experienced an expansion in which production and investment passed all previous records, French capital equipment probably depreciated somewhat and output remained stagnant at a level not far above 1913.

In view of the primitive condition of French statistical information, it is quite impossible to give anything but an impressionistic estimate of French capital investment during the 1930's. In our opinion, taking the economy as a whole, there was no net investment, except (if this be considered investment) in

- ^{1/} J. Dessirier, Indices mensuels de la Production industrielle en France, in Bulletin de la S. G. F., October 1924, pp. 73-109 and April 1926, pp. 297-332.
- ^{2/} A thumbnail sketch of the economic development of Germany since 1933 is given in our memorandum of November 6, 1939 on The Economic Position of Germany.
- ^{3/} The best general survey is still Colin Clark, National Income and Outlay, London (1937).

armament equipment. On the contrary, it is our impression that, since production was always considerably below capacity, there was a large volume of undermaintenance and that the capacity of French industry in 1939 was therefore probably somewhat less than in 1929. This judgment coincides broadly with that of M. Marc Aucuy ^{1/} and is consistent with the statistical evidence used by M. A. Sauvy and Mm. O. Mangin. ^{2/}

Even the new French index of industrial production is not designed so as to make possible a sure division between investment goods and consumption goods. Several of the groups used in computing the index cover both categories. Still it is possible, by taking our courage in both hands, to arrive at a rough approximation of the reality. We include mines, quarries, chemical industries, metallurgy, metal working, building materials and construction in the investment category and put food, paper, rubber, textiles, leather, electric power, glass and moving pictures in the consumption goods category. This procedure (on a base 1928 = 100) yields an index of ninety-six for consumption goods and seventy-nine for investment goods, in the bad year 1938. Considering further that those groups which we have classed as consumption contain a considerable number of investment items, there is reason to suspect that production of industrial consumption goods hardly declined at all during the depression in France. On the other hand, the index of the production of investment goods certainly understates the decline in productive investment because it makes no allowance for the greatly increased importance of armament output in recent years. Ideally we should have three indices: Consumption, investment and armament.

In any case, the record of 1938 makes dismal enough reading in comparison with 1928, 1929 or 1930, and 1938 was as good a year in France as 1932, 1934, 1935 or 1936. The annual index of industrial production stood at eighty-five in 1938 compared with one hundred in 1928, one hundred eight in 1929, and one hundred eight in 1930. Industrial production was therefore more than 20 percent below that of 1929 and 1930. Two of the French statisticians best acquainted with these matters, M. A. Sauvy and M. B. Rivet, have calculated that French industrial production was no greater in 1938 than in 1913. This would mean that French industrial output in 1938 was very roughly a third that of Germany.

^{1/} Revue d'Economie Politique, Janvier-Fevrier (1939) p. 181 ff.
^{2/} Bulletin de la S. G. F., Avril-Juin 1939, pp. 523-4.

Whereas French coal output was 53.8 million metric tons in 1929, it was only 46.5 million tons in 1938; meanwhile German (including Saar at both dates) output had risen from 177.0 million tons to 186.2 million tons (excluding lignite). French output of iron ore (in iron content) was about 18.0 million tons in 1929, but only 10.1 million tons in 1938, meanwhile Germany had increased her output from 2.1 million tons to 3.1 million tons. French production of steel fell from 9.7 million tons to 6.2 million tons between the same dates, while German (including Saar at both dates) production of steel rose from 18.2 million tons to 23.2 million tons. French production of cement fell from 5.8 million tons to 4.3 million tons (in 1937, last year available), while German production rose from 7.2 million to 12.6 million. France's production of aluminum increased from 29.1 thousand tons to 45.3 thousand, while German production increased from 33.3 thousand to 160.0 thousand. France lost to Germany her preeminence in the production of sulphuric acid. She was passed by Italy in the production of superphosphates of lime. She fell from first to third place in Europe in the production of automobiles, her output in 1938 being only half that of Britain and two-third that of Germany. Almost every other French industry in which international comparisons are possible showed the same kind of decline.

It would require a broader political and economic canvas than is possible here to justify an attempt at an explanation of the general stagnation and retrogression of the French economy in the 1930's. However, it is impossible to refrain from a word on the explanation of French stagnation which is most popular among French economists. ^{1/} This is, quite simply, that — especially in 1936-7, the years of the Popular Front — French labor "refused to work". Insofar as this phrase can be given precise meaning, it is flatly contradicted by all the available statistical information. The index of industrial output per hour worked advanced more rapidly in France during 1936 and 1937 than in any other country for which data is available. ^{2/} These were the years of the great strikes and of the gradual introduction of the 40-hour week. The French

^{1/} A more sophisticated form of the same thesis is defended even by so able an economist as J. E. Meade, see World Economic Survey 1938-9, Geneva (1939), pp. 26ff.

^{2/} World Production and Prices 1938/39, Geneva (1939), p. 34.

index of industrial output per hour worked rose from an average of one hundred nine in 1935 to an average of one hundred seventeen in 1936 and an average of one hundred thirty-three in 1937. Output per man rose from ninety-nine in 1935 to one hundred five in 1936 and then subsided slightly to one hundred four in 1937. There is no evidence in these figures of any decline in "the will to work". --There was, of course, a temporary increase during 1936-7 in the political power of some groups who were determined to alter the distribution of the French national income as well as to change the control of the French economy, but even intelligent journalists need not confuse these things with a decline in "the will to work".

4.

Very little has been done during "the Reynaud recovery" to catch up with the industrial and armament output of Germany and the United Kingdom.

The index of man hours worked in French establishments employing more than one hundred persons stood at only 70.6 (on a base 1930 = 100) in July 1939, the last month for which figures have been published. 1/ Activity was particularly low in the consumption goods industries as far as they can be isolated. All the published sources 2/, as well as our consular reports, indicate that activity was really high only in those firms which had armament orders. Armament expenditures were increased especially rapidly after the German occupation of Prague in March, and France consequently was beginning to feel a real armament boom, but this did not suffice to bring about full use of capacity.

Industrial production reached a peak of 91.9 in June (on a base 1929 = 100). The average for the first six months of the year was 87. This mediocre showing is all the more significant since the French monthly index of industrial production is heavily weighted with precisely those industries -- mining, chemicals, metal working, etc. -- which might be expected to boom during a vigorous armaments campaign.

The seasonally adjusted index of carloadings (on a base 1938 = 100) stood at 64.9 in the week ending August 26th. The average for the first eight months of this year has been 68.

1/ Bulletin de la S. G. F., September 1939, p. 9.

2/ See, for instance, L'Activite Economique, 31 Juillet 1939, pp.117-118.

This compares with an index number of seventy-three for the mediocre year 1937.

French production of coal was only 3.9 million metric tons in July; her average monthly coal output for the first seven months of 1939 was 4.2 million tons compared to 4.5 million in 1928. Her production of iron ore during the first seven months of 1939 was about 30 percent below that of the same period in 1928. Her production of pig iron was 23 percent below 1928, and her production of steel was 16 percent below 1928. -- The other major indices tell substantially the same story: even in the field of heavy industry, the expansion in armament output did not replace the decline in output for other purposes.

On the other hand, the recovery of confidence on the part of French investors that people of their own fundamental social and economic outlook were again in control of French policy did produce a steady inflow of capital. Since November 1, 1938, France has gained about five hundred fifty million dollars of gold. This influx of capital contributed to an easing of interest rates and thereby facilitated public borrowing. However, there was no consistent rise in stock exchange prices. The S. G. P. index of stock prices, which had averaged two hundred nine in 1938, moved up to two hundred forty in May 1939 but then subsided to two hundred twenty-nine in June and two hundred nineteen at the end of August.

The depreciation of the franc which had taken place in 1938, together with the recovery from the recession in the United States and the continuance of expansion in other countries, brought about some expansion of French exports, but this expansion was of little importance in the total perspective of the ground which France had lost in the 1930's. 1/

5.

Our limited information suggests that French armament output is not adequate to the demands of a long and hard-fought war.

As we have shown above, France is short of coal, and she has not kept pace in recent years with the expansion and renovation of heavy industry in other industrial countries.

1/ Something more is said of this matter in ~~Section~~ Section below.

A large part of French armament capacity is still located in the Centre region. This location is largely irrational from the point of view of supplies and involves the industry in heavy transport costs which can only be justified by considerations of security. The industry of the Centre had its origin in the pre-coke period of iron production. Its demands on rail transportation are particularly burdensome during war when transport facilities tend to become the most limiting bottleneck and the most vulnerable industrial target for enemy air attack.

Contrary to popular impression, the French armament industry is still based primarily on private production. ^{1/} The production of heavy and specialized war materials has hitherto been conducted on a dispersed, small-scale basis. The firms producing these heavy materials have operated under quasi-monopoly conditions. Orders received from the State or from foreign sources have been divided up among the various firms according to their plant capacity. There has been little development of central plant fabrication. Production in series has not been possible, and even rigorous interchangeability of parts has not been achieved.

Most of the armament industry is subject to State control under the law of August 11, 1936 only in the form of government licensing. Twelve factories or groups of factories have been taken over by the State -- ten by the War Department and two by the Navy. Although some of the establishments taken over were large, the relative importance of private and State production of armaments was not greatly changed by the small number of expropriations. The total number of workers in these nationalized plants was only about ten thousand, scarcely one-tenth of the workers in France who were engaged in armament manufacture in April 1939. The plants taken over are mostly for cartridge, charging shells, trench digging machines, small automatic arms and small artillery equipment. One plant for tank assembly has also been nationalized.

The weakness of the French armament industry is perhaps most clearly revealed in the airplane branch. Here the form of private enterprise has been retained. Most of the production of parts takes place in private factories situated all over the country. Six national companies for airplane assembly have been formed. In these the State holds the majority of the stock. These companies have invested about fifty million dollars in productive plant. (This amount is quite small even by comparison with French orders

^{1/} Paul Reuter, La Nationalisation des usines de guerre, in Revue D'Economie Politique, March-April 1939.

for airplanes which were made in the United States during the first three months of war.) These assembly plants were said to be almost ready to begin large scale production in April 1939. Up to the outbreak of war, however, the planes which should have resulted from this large scale production were not yet available. The French Air Ministry said month after month that the new output would be appearing at any time now. On November 30, 1939, Air Minister Guy La Chambre said again that the new equipment was now ready.

Airplane output is, of course, of crucial importance in the strategic plans of the French General Staff. General Armengaud, writing in L'Air for July 1, 1939, has argued that the difficulties of a land offensive against Germany would be so overwhelming as to make such an attempt impractical. General Armengaud contended that the only feasible plan for France would be to assume a defensive position on land and undertake an offensive in the air. Senator Laurent-Eynac, a former minister, (L'Air, April 20, 1939), writes that even a force of two thousand front line planes would require a monthly production of one thousand two hundred during a period of active hostilities, taking a conservative replacement figure of 60 percent per month. This figure was more than ten times the French monthly production at that time, according to Laurent-Eynac. The Senator complained that the need for industrial mobilization to achieve the necessary output figure had not been recognized by the French government. In the issue of July 1, 1939, Senator Laurent-Eynac wrote "...our monthly rate which inexplicably had rested for long months below the level of 100, tends now to mount as a result of the program of re-equipment along modern lines at last finished, and for which nearly 2 billion francs have been spent". Minister Guy La Chambre spoke on November 30 of the same two billion francs.

Such conservative figures as these indicate how utterly fantastic are the estimates of French air strength and French capacity for the production of air craft now appearing in the press. The French airplane industry is still working on a level very far below France's requirements. The American press reports that France has ordered over one thousand five hundred airplanes in the United States in recent months. These orders include all types of pursuit planes and bombers. There have been further orders estimated by the press at over seventy million dollars for airplane engines and propellers. French funds have been supplied to several American airplane companies for plant expansion.

In addition to these airplane purchases, France has been ordering a considerable range of other military supplies in the United States, from trucks to sub-machine guns. We have no exact information on the extent of these orders. A complete inventory of their contents would probably reveal fairly well the extent of present French dependence, on imports for armament supplies. The extent of that dependence would, of course, be greatly increased should land warfare enter a more active stage or should enemy air attack succeed in disabling any considerable part of French industrial or transport equipment. It would be very rash to assume that French imports of munitions will remain stable at approximately the present level for the duration of the war.

Agriculture and Food

C. Agriculture and Food Supply

Although France is essentially an agricultural country, French agriculture will not be able under war conditions to supply all national requirements of foods or industrial raw materials of agricultural origin. Even in peace time, France and the French empire were net importers of agricultural products. Under war conditions output will decline severely. The French government does not plan any measures capable of preventing such a decline. France will rely on the British Dominions, South America, and to some extent the United States to make good her agricultural deficits.

1.

Agriculture is the basic industry of France. In 1931, at the time of the last census, 36 percent of France's gainfully employed were engaged in agriculture, forestry, and fishing, compared with 35 percent in industry and mining. About 48 percent of the population is rural and essentially dependent upon agriculture. France has only seven cities of more than 200,000 population compared with twenty-eight cities of 200,000 or more in the old Reich.

France's natural endowments are favorable to agriculture. Her climate is excellent and her soils generally fertile. The great diversity of soils and climates permits a great variety of crops, ranging from Alpine to sub-tropical. The agricultural producers of France are generally hard working and resourceful. The smallness of holdings has retarded the advance of agricultural technique, yet the practical achievement of French agriculture is impressive; on an area one-fourteenth as large as that of the United States, France produces most of the essential foodstuffs for a population one-third as great as that of the United States.

The most productive areas of France are on the Northern plain and in the river valleys. Most of the wheat, oats, and barley is produced in the northwestern half of the country. France is one of the world's greatest producers of wheat, which forms the staple foodstuff of the nation. Potatoes are produced everywhere, but mostly in the northern and central parts; corn in a limited area near the Spanish border, sugar beets in the north, and wine in the river valleys and along the Mediterranean.

Livestock is widely produced, but principal concentration is in the North and Center. Livestock accounts for about one-fourth of the cash farm income.

Wheat is still the most important crop of France, ranking even in bad years ahead of wine and livestock as a cash crop. The area planted to wheat averages about 25 percent of the total cultivated area. However, in recent years wheat cultivation has lost much ground to livestock production.

The average area planted to cereals during the past ten years has been six million acres smaller than the average of the ten years before 1914, while the area in permanent meadows and forage crops has during the same period increased by about five million acres. Whereas livestock quickly made good the losses of the war years, wheat culture never again has reached the pre-war level. The lands retired from wheat have been turned to pasture. This shift is a result of persistent price differentials in favor of animal food products compared with vegetables as well as chronic labor shortage in the rural districts. In recent years there has appeared a further tendency towards concentration on dairy products.

The volume of food imports has been restricted since 1928 by the imposition of high tariffs and quotas. By means of such restrictions, major agricultural imports were reduced from 2,340,000 tons in 1928 to 996,000 tons in 1936. During the same period livestock imports were reduced from 100,000 head to 30,000 head.

Nevertheless, even in time of peace France is still a considerable net importer of agricultural products. For the past sixty years, with the exception of 1924-1927, France has had a passive balance of trade caused solely by an excess of agricultural imports over agricultural exports. ^{1/} By contrast, France is normally a net exporter of manufactured goods. France has

^{1/} Journal Officiel, Année Administrative, February 14, 1939

considerable agricultural deficits not only of raw products but also of foodstuffs. Fruits, coffee, cereals, sugar, cheese, oilseeds, and fish are the principal foods imported. But the most important agricultural deficit is in vegetable fibres. In 1937 France imported over two billion francs worth of raw cotton, and in addition hemp, flax, jute, and sisal to the value of six hundred million francs. Most of these raw materials had to be imported from outside the French empire. France imported about sixty thousand tons of rubber in 1937.

2.

French agriculture is carried on mostly on the family pattern. There is little specialization except in the wine districts. The French livestock industry, the aggregate output of which is of great importance, is based almost entirely on farmyard culture. Breeds and types are not standardized, and stock raising methods are generally backward.

The typical French farmer is an independent small holder. About 60 percent of the farms were in 1929 operated by owners, about 30 percent by tenants, and about 10 percent by share croppers.

Most French farms are small:

Classification of Agricultural Holdings in 1929 ^{1/}

Size	Number	Percent	Area in acres	Average acres
0 to 2.5 A	1,014,731	25.3	1,812,270	1.8
2.5 to 25.0 A	1,863,867	47.1	23,890,710	12.9
25 to 125.0 A	973,520	24.6	56,094,425	58
125 to 250.0 A	81,844	2.1	15,317,200	187
Over 250 A	32,468	0.8	18,398,692	567
Total	3,966,430	100.0	115,513,297	

Michael remarks ^{2/} that, considering the two classes of small and very small holdings together, it is safe to infer that, on the average, 85 percent of the land holdings representing 30 percent of the cultivated area exclusive of woods and forests, and averaging

^{1/} A considerable number of the holdings of less than 2.5 acres probably should not be classed as agricultural.

^{2/} Louis Michael: Agricultural Survey of Europe: France, U.S. Department of Agriculture. Technical Bulletin No. 37, page 35.

only 5.4 acres, could not furnish sufficient field crops per holding to furnish food for an average family of five adults and the feed for the farm animals maintained, except on a standard of living far below that of the United States. Probably this class of farms did not as a whole produce a net marketable surplus. Farmers in this predominant class could maintain themselves only by working on other holdings for wages.

On the other side, 30 percent of the land of France is owned by less than 3 percent of the proprietors. In part these great holdings are estates that have survived all the vicissitudes of French history since 1789. In the Northwest in particular the old noble families have succeeded to a considerable extent in preserving their lands and political influence against all the political tides. Other of the great holdings have been acquired by successful industrialists and financiers. Thus M. Guy de Wendel is on the Committee of the powerful association Agriculteurs de France. M. de Wendel's name is not unknown in another capacity. Also on the Committee are M. le Marquis de Vogus, a leading ironmaster and financier, the Comtes de Bucci, de Felcourt, de Warren, d'Olliamson, and many others of the same quality.

Largely as a result of the social structure of French agriculture, in which dwarf holdings occupy so large a place, and because of the splintering of holdings the technical level lags behind that of the most advanced European countries. French per acre yields are only moderately high except in the case of wine. Not only do French yields fall far behind those of Denmark, Holland, and Belgium, but they are considerably below the yields obtained in Germany on poorer soil and under worse climatic conditions. Furthermore, grain yields have scarcely improved over pre-war yield. To be sure, low yields are not by any means a proof of inefficient farm methods. But in view of France's superior natural endowments, and the intensive use of labor in almost all branches of French agriculture, the mediocre yields obtained suggest serious faults of organization.

The most obvious of these faults is undercapitalization. Too little machinery and too little fertilizer are used compared with labor — unless, indeed, a value of little more than zero is imputed to labor. The implicit evaluation of labor at or near zero, which is characteristic of all countries where the family system of agriculture prevails, is especially characteristic of France.

Since 1930, especially, machinery and buildings have been allowed to deteriorate. In 1930, there were about thirty-five thousand

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skilled workers employed in the agricultural implement industry in France; by 1936 the number had shrunk to fifteen thousand. The 1930 sales of the agricultural implement industry were valued at two thousand million francs; in 1934, at six hundred million francs. French agriculture was even in 1930 seriously lacking in all types of horse-and power-drawn implements. In the years after 1930, when this deficiency might have been made good, the French agricultural implement industry was standing idle. ^{1/} It is now too late to make good the inadequacies of French farm equipment. At the time of the last Census in 1931, less than one-third of French holdings were equipped with improved steel plows. Only one-third had horse-drawn mowing machines; evidently a large part of the French hay crop is still cut by hand with scythes. One-fifth of the farms had horse-drawn automatic hay rakes. Combines of course cannot be used to advantage on the small and scattered French grain fields; but even reaper-binders were possessed by only 10 percent of the holdings. France has fewer tractors per cultivated acre than Italy.

3.

The outbreak of war in 1914 found French agriculture ill prepared to supply the essential needs of the country under war conditions. Nor was it possible to remedy the weaknesses of the industry during the course of the war. On the contrary, total production and unitary yields fell heavily and continued at a low level throughout the war period.

Few revolutionary changes have occurred in the technique or organization of French farming since 1914. The problems remain essentially the same — how to maintain output with a decimated labor supply and a backward technique. The measures of preparation have been much the same in both periods: that is to say, practically none at all.

How serious the drain on labor power may be can be estimated from the experience of the war of 1914-1918. M. Auge-Lariba has calculated that from first to last 3,700,000 men employed in agriculture were mobilized during the years 1914-18. ^{2/} Thus of the 5,237,000 men previously employed in agriculture, only about a million and a half remained in 1918, and these, of course, tended to be the less capable. The principal burden of carrying

^{1/} Neil Hunter, Peasantry and Crisis in France, London, 1938.

^{2/} L'Agriculture Pendant la Guerre, New Haven, 1925.

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on the farm work under these difficult conditions fell on the women, of whom there were about three and one-fourth millions engaged in agriculture.

Not only was the best part of the farm labor force withdrawn from productive work, but a large part of the stock of draft horses was requisitioned for the army. Furthermore, draft oxen were requisitioned for slaughter. The army took most of the wagons, trucks, and autos, and for the remaining machines gasoline was virtually unprocurable.

To add to the confusion, most farm supplies were placed in Class D of railway priorities, and as most stations had the greatest difficulties in finding cars for Class A traffic, essential farm supplies were subject to indefinite delays in transit. The railways were exempt by decree from liability for damages due to delay and mishandling of farm supplies.

Consumption of all kinds of chemical fertilizers practically ceased. Application of potash salts and phosphates from basic slag fell to zero in 1915, and by 1918 the use of nitrate of soda and sulphate of ammonia had shrunk to a negligible figure. A small quantity of super-phosphates — the principal chemical fertilizer then as now — was used throughout the war, but the volume fell from 2,000 thousand metric tons in 1913 to 500 thousand metric tons in 1915.

The cumulative effect of all these was disastrous for French agriculture. Not only did France lose by enemy occupation of considerable part of her most fertile lands — that may be of little significance in estimating probable developments in the present war — but output in the free areas also declined heavily through abandonment of fields to fallow and poor yields on the remaining cultivated lands. Thus, taking the average per acre yields of 1904-1913 as 100, yields per acre for the war years were as follows:

	<u>1914</u>	<u>1915</u>	<u>1916</u>	<u>1917</u>	<u>1918</u>
Wheat	94	82	81	64	102
Rye	97	84	90	78	97
Potatoes	92	79	78	87	62
Sugar beets	114	62	100	106	70
Wine	120	41	72	76	91

France, during the war years, consumed her stock of farm animals. The figures below show the relative position:

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Numbers of the principal kinds of livestock in France

	<u>1913</u>	<u>1919</u>	<u>1937</u>	<u>1938</u>
Horses	3,222,000	2,250,000	2,742,000	2,692,000
Cattle	14,787,000	12,250,000	15,805,000	15,621,000
Sheep	16,131,000	9,061,000	9,994,000	9,872,000
Hogs	7,035,000	3,980,000	7,117,000	7,126,000

This table fails to reveal the relative increase in importance of the livestock industry. The rapid increase in the cattle and hog population after the low of 1919 was in the face of a general flight from the land and a decline in cereal production. Furthermore, the average weight of cattle and hogs has increased by from 6 to 10 percent, so that actual meat production has increased more than cattle and hog production. Mutton has never formed more than a negligible part of French meat consumption.

4.

Nothing has been done since 1930 to build up a reserve of fertility, or even to insure the maintenance of the fertility of the French soil. The use of animal manures has probably not fallen off since 1930, but the use of chemical fertilizers has declined. France has never made as extensive use of chemical fertilizers as Germany. Since 1930, while German consumption of all kinds of fertilizers has been increasing at a rapid rate, French consumption has remained low. Consumption of super-phosphate, the principal chemical fertilizer used in France, fell by a third from 1931 to 1936. Less superphosphate was used in France in 1937 than in the years before the World War. Nitrogen fertilizers have never been intensively used in France; in 1932, the capacity of the French nitrate industry was about 1,600,000 tons, while actual output was 361,000 tons.

It will be impossible to maintain the output of chemical fertilizers under war conditions. Neither the raw materials, nor the labor, nor the transport facilities will be spared for what will be regarded as a secondary need.

Thus it appears that not only has French agriculture lost the best part of its labor force, but the women, boys, and old men who are left will have to make the best of inadequate and worn-out tools and implements, inadequate fertilizers and other supplies, and inadequate mechanical and animal power. Nor would it be correct

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to regard the women of rural France as a labor reserve. Peace-time crops were already in considerable part the fruit of long and heavy labor of French farm women. It is therefore no reflection on the courage and energy of these women to conclude that they will not be able to prevent a great decline in agricultural production in the course of a long war.

5.

The French government can confidently be expected to treat the problems of agriculture as secondary or to ignore them. Statements from high official sources bearing on France's agricultural position show a carefree optimism which must be due to insufficient consideration of the problem. Official plans are still in the stage of inventory of resources and estimates of needs, and even the latter estimates will no doubt be made in an offhand manner. The French government persists in its view that relatively long term forecasts and plans of all sort are impossible and superfluous.

Preference will be given to industry in allocating labor, raw materials, machinery and transport facilities. The measures of control so far undertaken do not suggest that the French government plans any of the drastic measures which would be necessary to the maintenance of agricultural production in war time. 1/ Very little appears to have been done thus far towards actual assumption of Government control over French agriculture although such control is authorized under decrees of April 21, 1939. The same decrees provide for a special service of the Ministry of Agriculture called the General War Provisioning Service. Various services are to be set up, various plans may be made for agricultural mobilization. In each of France's ninety Departments, a committee for agriculture production in war time is set up (September 9, 1939) under the presidency of the Prefect. It will advise farmers to adjust output in line with National food requirements, and "facilitate" measures providing for the requisite agricultural labor, draft animals, fertilizer, seed, and fodder. Government subsidies up to a maximum of 20 percent are to be provided for the purchase of tractors and up to 30 percent for the repair of old ones. 2/

This setup is not very impressive even on paper. Its effective operation would depend entirely on national government action, as

1/ Foreign Agriculture, U. S. Department of Agriculture, November 1939, page 507.

2/ Journal Officiel, October 18, 1939, p. 12,448.

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these problems would defy local solutions. The local committees could obviously do very little to insure supplies of fertilizers, labor, draft animals, or transport.

Agriculture in France is, of course, subject to the general controls of export and import licensing. The Minister of Agriculture is authorized by a decree of September 1, 1939 to fix prices. In fixing prices, the Minister is authorized to ask the advice of the Consulting Committee, made up of representatives of the employers and employees of commercial, industrial, and agricultural enterprises, and of the various government departments, as well as the National Committee for Price Supervision.

Only wheat has been brought under more effective control; since the establishment of the Office du Blé in 1936, prices and marketing have been under national control. The activities of the Office du Blé prevented a continued decline in the area sown to wheat after 1936. As has been indicated in Chapter I above, wheat prices have been fixed at over \$1.25 a bushel.

If French wheat yields per acre fall as heavily as they did in the last war, say by 20 percent, France will fall about 1,700,000 tons short of supplying her normal peace-time needs. If French potato yields fall as heavily as in 1914-1918, France will fall short by 4,000,000 tons of supplying her normal potato consumption.

It is not possible to measure declines in livestock yields in this way. In 1914-1918, France was pressed into consuming her livestock capital, (as shown by the table above), as well as increasing her imports. This can be expected once more.

Sugar production, which does not normally cover France's requirements, will no doubt fall as it did in 1914-1918.

Inevitably, then, France will find her agricultural deficit greatly increased by the war. To the usual deficits of vegetable fibres and rubber, which may themselves be increased somewhat, will be added large new deficits in foodstuffs -- grains, potatoes, fruits, sugar, cheese, and fish. The deficits in coffee and various minor foodstuffs will remain as large as ever.

To meet these deficits the French government has several choices open to it. It can import, as long as the Allies have partial control of the seas, and as long as foreign exchange is procurable; it can introduce rationing; or it can reduce consumption indirectly by allowing price rises to work an automatic

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restriction on consumption by the lower income groups. The last method is the one most in harmony with the past record and the outlook of the present French government. If this restriction is insufficient, the French government will attempt first to buy foodstuffs from the British Empire and from Argentina and Uruguay. It will be very reluctant to allow any dollar exchange to be spent on American agricultural products. Of course, liberal dollar credits would change this situation.

Public Finance

D. The Financing of Internal Expenditures

Central government expenditures in France are currently at a rate in excess of the past money value of the national income. Projected expenditures for the year 1940 are about 330 billion francs. French national income paid out has been most reliably estimated at under 270 billion francs for the year 1938; there is every reason to believe that this is the highest money value ever attained.

The French financial system made a dismal record during the war of 1914-1918. During those years, no part of war expenditures was paid out of taxation. All special expenditures due to the war were paid for out of borrowing. Prices rose to between three and four times the level of 1913.

During twenty years of peace, the French public debt has increased almost continuously. As M. Qualid has shown ^{1/}, French State tax revenues in recent years have run slightly less than two-thirds of State expenditures. In 1936, revenues were 63 percent of expenditures, and M. Qualid (in January 1939) estimated that similar figures would result in 1939. At the end of the year 1939 the French debt will be about 650 billion francs (including the debt of the national railroads and of the Departments and Communes, but not the Colonies). Finance Minister Reynaud has hinted of further borrowings of 1,000 billion francs during the present war.

Over half of French national tax receipts are derived from customs, excise, stamp and sales taxes. Income and property taxes are not severely progressive.

The social composition and intellectual caliber of the present French governing bloc leads us to believe that such measures of heavy taxation, rationing and price control as are necessary to prevent a major inflation will probably not be carried out in France. Already before the outbreak of war all French general price indices showed a strong and persistent upward trend. The prospects for the stability of the French general price level during a long war are certainly not bright.

^{1/} Revue d'Economie Politique, January 1939, page 482.

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On the contrary, there is at present every reason to believe that France is about to undergo an inflationary experience comparable to that of the war of 1914-1918.

These indications do not, however, amount to proof. Our forecasts must not be confused with descriptions of fact. Great Britain may exercise a restraining influence on French financial policy. Large credits from the United States would ease the strain. It is even possible that French price controls will prove effective and that the French government will subject its supporters to heavy progressive taxes. However, at present, it does not seem likely that these forces will be exerted with sufficient strength to prevent a serious inflation.

1.

Taxes

The outbreak of the war in 1914 found France with a wholly inadequate tax system. The wealthier classes had succeeded in defeating every attempt to reconstruct the tax structure along progressive lines. 1/ The elaborate system of indirect taxes and the weak and antiquated direct taxes had not produced enough revenue even for the needs of peace. Nor did the resistance to the imposition of income taxes cease with the outbreak of war; on the contrary, the enemies of the income tax argued that it was intolerable that a man's private affairs should be subject to inquisition while he faced the enemy at the front. In fact, no fundamental reconstruction of the French tax system took place during the war.

As a result of the opposition of the wealthy and the incompetence and corruption of the administration, the real value of French tax receipts not only did not rise to meet war needs, but actually declined during the war. 2/ No part of the war costs were met out of tax receipts. Most of the real internal burden of the war was borne by the class of small investors in the securities of the French government, the value of which was largely destroyed by inflation.

The French national income was estimated at 35 billion francs in 1913, but the French government borrowed internally

1/ R. H. Raig: Public Finances of Post-war France, New York, 1929.

2/ See Jaze and Truchy, op. cit., part II.

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an average of about 50 billion francs a year during 1914-1918, in spite of a drastic decline in production. At the end of 1918 the index of retail prices stood at 261 and that of wholesale prices at 362 (bases 1913 = 100).

The financial traditions of France have shown a remarkable tenacity. There is an ominous parallel between the position of French finances in 1914 and the position today. The tradition of economic illiteracy has been preserved intact. Corrupt financial practices are probably more widely current than in the administration of any other major power. The wealthy classes have still succeeded in evading, in one way or another, the payment of income taxes even remotely comparable to the British ones. The backbone of French State revenues still consists of indirect taxes -- taxes bearing most heavily on the poorest classes in the community. The table inserted at the end of this chapter makes this point clear.

It should be observed, however, that this inserted table of budgetary receipts does not add up to the total of Public Revenue. This table does not contain the revenues of the Autonomous Amortization Office, which are raised largely by indirect taxes. It does contain, however, the net results of the budget operations of a series of satellite institutions. It does not show the revenues of the State railways, of the Posts, Telephone, and Telegraph, or the receipts of local governments. If these absent receipts were accounted for fully and on a gross basis, the regressive character of the State revenues would be further emphasized.

The following table which we have borrowed from L. Trotabas ^{1/} indicates how lightly the French income tax bears even on the declared income of the wealthiest classes.

^{1/} Les Finances Publiques et les Impots de la France, Paris 1937, page 157.

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Figures published by the Administration of Finances
in 1935 = income for 1933, taxed in 1934

Categories of Income Taxed	Number of Taxpayers	Total Income (in francs)	Total Taxes paid (in francs)
1 million and over	349	735,976,000	222,273,600
From 500,000 fr. to 1,000,000	1,223	817,691,100	182,969,900
From 200,000 fr. to 500,000	8,299	2,479,879,500	329,451,700
From 100,000 fr. to 200,000	24,416	3,493,222,900	260,099,600
From 50,000 fr. to 100,000	82,799	6,182,158,000	221,450,800
From 40,000 fr. to 50,000	58,883	3,020,397,900	61,857,900
From 30,000 fr. to 40,000	124,409	5,081,333,600	73,002,800
From 20,000 fr. to 30,000	320,173	9,583,526,600	78,348,100
From 10,000 fr. to 20,000	1,299,857	22,264,732,400	68,270,100

Unfortunately, these figures are not as recent as might be desired. However, they are the most recent ones available, and as tax schedules have not been changed substantially since 1934, the table remains of considerable interest.

The striking fact is that the total of taxes paid on all the income received by the group with incomes of a million francs or more was only about 30 percent of their declared income. It should also be observed that the groups below the 50,000 franc level made only a negligible percentage contribution. The group with incomes of 40,000 to 50,000 francs (at that time roughly equivalent to \$2,700 to \$3,500) paid a total of only about 2 percent of their income as general income tax.

In spite of the immense popularity of the slogan "Faire Payer Les Riches!" in the 1936 election, in spite of the specific clauses in the program of the People's Front calling for progressive income taxes, the percentage contributed by direct taxes in 1937 was still only about 37. The rich in France do not want to pay, and by one method or another they are still succeeding in avoiding payment.

2.

Public Debt

The French national debt has increased almost continuously since 1914. The latest full figures which we have are for January 1939, as shown below:

The Public Debt of France

(In millions of francs)

	: January 1, : January 1,	
	: 1938 : 1939	
<u>Internal Debt:</u>		
Perpetual	50,037 50,000	
Amortizable (long-term)	228,255 231,750	
Medium and short-term	35,992 34,000	
Floating	48,698 67,150	
External	3,739 3,500	
Bank of France advances to Treasury	35,104 30,627	
Railroad (30,000,000,000 francs included above. Not including Treasury advances in 1938)	84,796 84,000	
Departments and Communes	32,978 33,950	
Posts, telegraphs and telephone	10,137 9,500	
National Agricultural Credit Fund	2,034 1,900	
Total	531,770 546,377	

Source: Office of the American Commercial Attache, Paris,
February 10, 1939.

Since January 1, 1939, the debt has been increasing at a very rapid rate. Net borrowing of 40 billion francs during 1939 was forecast in the middle of the year. At that time, our representatives in Paris said that this was a minimum estimate. Total State expenditures from September 1 to November 11 alone were 78.5 billion francs, or more than a full year's tax revenue (and approached 30 percent of the French national income). At this rate, expenditures from September 1 to December 31 will be about 130 billion francs.

Budgetary revenues in September were 50 percent under estimates. October showed a decided improvement, but revenues for the last four months of the year together will be considerably under budgetary estimates, perhaps by as much as one-third. Therefore, the French national debt will increase this year by at least 100 billion francs and probably by considerably more. M. Reynaud has spoken of new public borrowing of 1,000 billion francs for war purposes. He has projected expenditures of 250 billion francs for national defense in 1940; all of this is to be met out of borrowing.

Professor Rist has estimated war costs tentatively at 700 million to 800 million francs a day. We do not know exactly how new subscriptions to armament bonds are running currently. If we assume, however, that they are taking place at a rate twice the 100 million francs a day, which they were averaging at the outbreak of war, they would still be only between one-third and one-fourth of estimated current war costs. If the financial program of the French government is to succeed, armament bonds subscriptions must rise rapidly, and they probably will. Subscriptions will come both from individuals and from private banks. Bank subscriptions will, no doubt, result in an all-round inflation of demand deposits. Insofar as subscriptions are insufficient, it will be necessary to resort to advances from the Bank of France and the printing of notes.

From the outbreak of war up to November 30, the Government has received advances of 10 billion francs from the Bank of France. It is uncertain whether these advances will increase very rapidly during the course of hostilities. It is quite likely that the French government will, in fact, be paying for most of its expenditures with government bonds. In that case reliance on advances from the bank need not be very considerable.

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3.

Prices

The French government (and M. Reynaud in particular) has an unjustified confidence in the effectiveness of wage controls in keeping down any price rises. Since civilian consumption expenditures will be a decreasing percentage of the national income in any case, greater importance attaches to the volume of war expenditures and the prices at which they come. Price controls and the careful adjustment of government demand to available resources are absolutely necessary. Once prices have been pushed up by such a volume of government orders as are projected in the 1940 budgets, it will be very difficult to resist pressure for higher wages also.

It seems likely that the political groups which have greatest influence in France today will resist effective price controls as they have resisted effective progressive taxation. French price controls were a total failure in the war of 1914-1918, as Pierre Pinot has shown in his study of the control of food supplies. ^{1/} We have no confidence that they will be more successful this time. But dogmatic prophecy is foolish. We shall simply have to watch and see.

^{1/} P. Pinot, Le Controle Du Ravitaillement, New Haven, 1925.

French Budgetary Receipts

(In millions of francs)

	1930	1934	1936	1937
Taxes on Consumption and Turnover				
Customs	4,785	5,312	6,524	6,378
Turnover	8,240	6,151	6,115	5,301
Monopolies (matches, tobacco)	415	252	241	535
Duties on Colonial foodstuffs, salt, wine, sugar, etc.	8,300	7,088	6,128	5,280
Stamp and registry	4,882	3,242	2,846	2,771
Sumptuary taxes (autos, theatres, etc.)	1,542	527	271	251
Diverse	616	586	3,368	?
Total taxes on consumption and turnover	28,780	23,158	25,493	20,516
Taxes on Income and Property				
General Income tax	9,948	5,908	5,706	7,551
Gift and Inheritance taxes	884	1,869	a/	a/
Tax on income from securities	3,640	2,868	3,060	3,061
Stamp tax on stock market transactions	2,428	2,238	2,093	2,004
Total direct taxes	16,900	12,883	10,859	12,616
Total state revenues	45,680	36,041	36,352	33,132
Percentage derived from direct taxes	38%	36%	30%	37%

a/ Included in above.

Imports

E. Imports and Foreign Exchange

We are quite unable to strike a meaningful balance in terms of which it would be possible to say that France's capacity for the financing of necessary imports is "adequate" or "inadequate". Too much depends on the character and outcome of hostilities on land, on sea, and in the air.

We find it equally impossible to say that France's capacity to finance necessary imports is greater or less today than in 1914. On the one hand, as we have suggested above, her dependence on industrial imports will be considerably less than in 1914, because of her new fortifications for the defence of the frontier regions of heavy industry and because of the industrialization which she achieved in the 1920's. Her Colonies are much more capable of furnishing supplies than in 1914. She has over one billion dollars more gold than she had in 1914. She will receive earlier and more complete economic assistance from Great Britain.

On the other hand, she has perhaps as much as four billion dollars less of foreign investments today than she had in 1914. The credit resources of the United States are, at present, closed to her. ^{1/} She is slightly more dependent on imports for her food supplies. And she does not seem likely to have the assistance which was rendered in the war of 1914-1918 by the participation on the side of the Allies of Russia, Japan, Italy, and ultimately the United States.

What seems certain is that France will have to husband her foreign exchange very carefully. We expect her to become steadily more dependent on the vastly greater resources of the British Empire. She is already dependent on the United States to sell her munitions not procurable in other countries. It may reasonably be expected that, should the war prove to be long and hard-fought, French requests for American credits will become steadily more frequent and insistent.

^{1/} It may be recalled that France accumulated a debt of four billion dollars (value at time of funding) to the Government of the United States, apart from commercial debts.

1.

During the war of 1914-1918, France had an enormous excess of imports. ^{1/} In 1913 her excess of imports was 1.5 billion francs, and in 1914 it remained stable at 1.5 billion francs; but in 1915 the excess of imports was 8.1 billion francs and it mounted to 21.5 billion francs in 1917. For the years 1914-1918, the excess of imports totaled sixty-two billion francs, and this sum cannot be written off lightly as due to a fall in the value of the franc. On the contrary, the exchange value of the franc was reasonably stable during 1914-1918. The old par was 5.18 francs to the dollar, and even in December 1918 the franc was quoted at 5.45. The excess of imports for the years 1914-1918 therefore amounted to about twelve billion old gold dollars.

The same facts can be approached from the point of view of tonnage. France is regularly an importer of heavy raw materials (coal, petroleum, etc.) and an exporter of light fabricated products. In 1910 the weight of her imports (in tons) was 2.1 times the weight of her exports, and in 1913 the weight of her imports was 2.0 times the weight of her exports. But in 1915 this index had mounted to 8.1, in 1916 it was 10.8, in 1917 reached 11.6, and it was 7.9 in 1918. (By 1921 this index had gone back to 2.4, and by 1928 it had subsided to 1.2.)

It does not at present seem likely that an excess of imports comparable to that of the years 1915-1918 will appear early in the present war. Thus far France has retained her centers of heavy industry. The French government seems fully aware of the importance of maintaining exports. The war has not yet been wasteful of lives or material.

But there is a great danger in projecting the present state of military affairs far into the future. As yet warfare on land has been static in the West, and even in the air, hostilities have hardly gone beyond preliminary skirmishes. It is possible that the contending armies will not lightly risk great land offensives in which hundreds of thousands of casualties result in the capture of a few villages. This war may have no campaign like Joffre's of 1915, or the British opening on the Somme, Rivelle in the spring of 1917, or Passchendaele. But it is too soon to make any such judgment. It is quite probable that this war will involve losses of life and expenditure of material beyond any past experience. It is quite possible that bombing from the air will seriously disrupt industrial activity. The German army has proved itself in the past to be a

1/ *Annuaire Statistique*, 1922, pp. 92* and 93*.

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master of surprise, and there is no reason to believe that it will not again deal some crushing blows. In that case French industrial operations may be as seriously disrupted as in 1915 or 1916, and dependence on imports may pass all previous experience.

2.

During the war of 1914-1918, in addition to her deficit on imports, France had to meet special costs for shipping services. Again this appears to be a cost which will not be quite so heavy in the present war.

In 1914 French ships carried 17.3 percent of French imports and 35.8 percent of her exports. Shipping services yielded France a net annual credit of 250 to 350 million francs. Her merchant fleet was the fourth largest in the world, with a gross tonnage of about 2.3 millions (including all kinds of ships).

But during the war she lost about 1.1 million tons. ^{1/} She had to pay enormously high freight rates. Coal freights from England to France were six to seven times as high (in shillings) in 1918 as in 1914. Rates for the carrying of Canadian wheat to France were twenty-five times as high (in francs) as in 1914.

In 1939 France has about 3.0 million gross tons of merchant ships. Her fleet is seventh in size. Her net credit on shipping account in 1938 was estimated at 2.5 billion francs (which is roughly the same, in dollars, as in 1914). She does not seem likely to lose as heavily from submarine attack as in the last war.

On the other hand, the withdrawal of American ships from the North Atlantic trade will evidently mean some additional burden on French capacity. Should the German air and mine "blockade" prove effective, this withdrawal of American ships may much more than compensate for the increase in French tonnage.

^{1/} C. Gide et W. Qualid, Le Bilan De La Guerre Pour La France, New Haven (1931) p. 280. Perhaps the best-rounded brief study of the whole question is H. Steubel, Die Frachtraumproblem in Weltkreise, in Vierteljahrshefte Zur Wirtschaftsforschung, April 1939.

3.

France has more gold today than she had in 1914, but it is difficult to say exactly how much more.

On July 30, 1914 the Bank of France had nearly 4,150 million francs of gold; ^{1/} this was worth almost exactly 800 million old gold dollars. During the course of the war, the Bank of France recovered about 2,400 million francs of gold from the public; this was worth an additional 460 million old gold dollars. There is no way of knowing how much more gold was held by the French public and might have been recovered had the government gone beyond appeals to patriotism.

If we disregard the difference between old and new dollars, we may say that the gold held and recovered by the Bank of France in the war of 1914-1918 was about \$1.7 billion dollars less than France had at the outbreak of war in 1939. On the other hand, if we attempt to get at the physical quantity of gold by reducing new gold dollars to old gold equivalents, we find that the French gold stock of about \$3.0 billion on the outbreak of war in 1939 was only roughly \$.9 billion more than French holdings in 1914, and, if we go further and make an allowance for holdings not recovered from the public in 1914-1918, the difference in the size of French gold stocks at the two dates is further narrowed.

During the war of 1914-1918, the Bank of France sold or pledged about 3,022 million francs (about \$580 million) of gold, principally to the Bank of England. During this war, there will be no transfers of gold to the United Kingdom, but there will no doubt be much larger shipments to the United States.

^{1/} G. Jeze and H. Truchy, The War Finance of France, New Haven, (1927), p. 297.

4.

French foreign investments at the outbreak of war in 1939 were considerably less than in 1914. It seems not extravagant to estimate the difference in nominal value at \$4 billion, but French foreign investments did not prove of any great value to France in 1914-1918, and it is yet to be seen what they will be worth in this war.

French foreign investments in 1914 were estimated at between 40 and 50 billion francs (i.e., between 7.7 and 9.7 billion old gold dollars). ^{1/} They proved to be of little value. About a fourth consisted of Russian securities and a considerable further part of Italian securities, which quickly lost their value after the outbreak of war. Only between three and three and a half billion francs of foreign securities were actually sold during the war. Perhaps 20 billion francs more were simply lost through default or repudiation.

Staley has estimated French long-term foreign investments at \$8.6 billion in 1914 and \$3.5 billion in 1929.

There is no figure worth dignifying by the name of an "estimate" of French foreign investments in 1939. Rist and Schwob have guessed that, at the end of 1937, French foreign assets were worth 80 to 130 billion Poincare francs (which would be \$5.3 billion to \$8.6 billion, at the present gold content of the dollar.) Between the end of 1937 and the outbreak of war there was a repatriation of \$500 million to \$600 million of French balances. This would leave French foreign holdings at the outbreak of war at between \$4.7 billion and \$8.0 billion. In our opinion, the lower of these figures is a generous estimate even of peace-time value.

Total French holdings of United States dollar balances, securities and direct investments were only about \$580 million at the outbreak of war. It is extremely unlikely that French holdings in Canada add up to another \$10 million. Our experts on Latin America say that no estimate worth quoting exists on the value of French assets in Latin America. We do not know the value of French investments in Belgium, Switzerland, Holland, Spain or the United Kingdom.

^{1/} Gide et Quaid, op. cit., p. 91 ff., Leonard Rist et Philippe Schwob, Balance des Paiements, in Revue d'Economie Politique, January - February 1939, and the estimates brought together by E. Staley, War and the Private Investor, New York (1935), pp. 523 ff.

It is likely that, even making allowance for some valuable properties in such countries as Belgium, Spain and Switzerland, fully three-fifths of French foreign assets are within her own empire, especially in Algeria, Tunis, Indo-China and Morocco. It is claimed that France has invested twenty-five billion francs during the last fifty years in French Indo-China. 1/ These francs were of very different values. We have no knowledge of the present value of these investments, except that they include large rubber plantations which might be salable assets. French Indo-China has over twenty-three million people, and consequently it may be quite reasonably believed that French investments there are of considerable value, but we have no real knowledge of the matter. The same judgment applies to Algeria, Tunis and Morocco, but in these latter cases French investments are probably not salable except at sacrifice prices so long as there is a possibility of the war spreading to the Mediterranean. Frankel has estimated 2/ that between 1870 and 1936 about £70 million was invested in French Equatorial Africa, French West Africa, Togo and Cameroons; we have no idea what these investments are worth now, and they are certainly not salable during war time.

All together we do not believe that France's foreign investments are likely to prove a major source of foreign exchange during the present war. Certainly it would be naive optimism to add an estimate like that of Rist and Schwob into any balance sheet of French foreign exchange assets.

5.

France's colonies will be of much greater assistance to her during the present war than during 1914-1918. 3/

In 1909-1913 the French colonial empire (including Algeria) supplied 11 percent of French imports and took 13 percent of French exports. In 1937-1938 the French colonial empire supplied 26 percent of French imports and took 28 percent of French exports. In short, French trade with her own colonies has more than doubled its relative importance during the last twenty-five years.

1/ Foreign Policy Reports, November 15, 1939, p. 212.

2/ S. H. Frankel, Capital Investment In Africa, London (1938), table 28 and pp. 331-354 and 414-416.

3/ See especially the excellent sketch by Henri Hauser, the distinguished historian and imperialist, Colonies et Metropole, in Revue d'Economie Politique, January-February 1939, and also G. Hardy, La Politique Coloniale..., 1937.

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In 1938 Algeria was first in the total value of her trade with France (surpassing even the United Kingdom), Tunis was eighth and Indo-China was ninth. Algeria supplies France especially with wines, cereals and fruits. Tunis sells her wines, cereals, phosphates and lead. Eastern Africa also provides cereals, fruits and about half France's imports of cacao. Indo-China sells her cereals, rice, rubber and petroleum.

During the war of 1914-1918, the share of French imports which came from her colonies did not increase, except in the case of Algeria. In the interval, however, a great deal of time and thought has gone into the development of imperial ties. As long as normal communication is maintained in the Mediterranean and adequate shipping facilities are available to carry imports from the Far East, the share of French imports supplied by her colonies will probably increase.

6.

France will receive earlier and more complete financial assistance from Great Britain during the present war than she did during 1914-1918. On the other hand, the Allies do not seem likely to procure support comparable to that which was rendered them during the last war by Japan, Russia, Italy and the United States.

Allied economic cooperation was a slow growth during the war of 1914-1918. ^{1/} A Commission Internationale de Ravitaillement was created on August 15, 1914 to exchange information on army supplies, and Italy was admitted to the Commission in September 1915. The Commission's authority was gradually extended to the making of joint purchases of army supplies, wheat and sugar. In May 1916 England agreed to supply France with coal at fixed prices. Allied gold stocks were pooled to support the exchange, and the United Kingdom agreed to lend some shipping assistance. At the end of November 1916, an Interallied Wheat Executive was set up, and in December Great Britain agreed to send France more coal, to assist her with railway rolling stock, and to cooperate further in oceanic shipping. In August 1917 a Meat and Fats Executive was organized for joint purchase of these foods.

^{1/} An excellent short account is in S. S. Clough, France: A History of National Economics, (1939) pp. 283 (F. W. Clementel, who conducted the negotiations on the French side, has written a rambling book, La France Et La Politique Economique Inter-alliee, New Haven (1930).

Finally, in November 1917, more than three years after the outbreak of war, came the real pooling of allied economic power under the War Purchase and Finance Council and the Allied Maritime Transport Council. Close economic cooperation survived until December 1919 when the United States and Britain refused to supply France with foodstuffs and coal out of a common pool.

In this war, allied economic cooperation is starting at a point which it only approximated last time after three years of hostilities. By an agreement dated December 4th, France and Great Britain have decided to make exchanges of francs and sterling at fixed rates for the duration of the war and six months thereafter. Any exchange acquired, by either party, beyond £50 million or 9 billion francs is to be held in the form of 3 percent Treasury notes, on which payment may not be demanded until three years after the duration of the war. All foreign borrowing is to be done in collaboration, and any assistance granted to allied or guaranteed States is to be borne 60 percent by the United Kingdom and 40 percent by France. Special arrangements are made for "blockade" purchases and for the joint sale of foreign assets. Cooperation, on the financial level, could hardly be more complete without a direct amalgamation of internal tax and borrowing receipts.

Nevertheless, it is doubtful whether this more complete cooperation can compensate for the absence of Russia, Italy, Japan and the United States from the Allied ranks. Each of those powers, and especially Russia and the United States, made an important contribution to the defeat of the Central Powers in 1914-1918. The importance of the credit facilities of the United States in the last war can hardly be overestimated. It is true that the United States is also rendering assistance to France in the present war by converting gold into dollars and by shipping supplies not available from other sources, but — should the war prove long and hard fought — France will no doubt turn ever more insistently to the United States for credits. If France does not receive credits from the United States, she will hardly be able to avoid exclusive dependence on the British Empire.

Social Trends

F. Social Trends

When the Radical Socialist Party left the Popular Front in 1938 to join forces with the parties of the Center and Right, it accepted the leadership of a bloc which is dominantly conservative, nationalist and anti-republican.

1.

The Conservatives

French conservatism is not that of the old school tie or even a Princeton education. It is something much more self-conscious and intellectual. From Maistre to Maurras, French conservatism has carried on a tireless intellectual warfare against the rationalist, equalitarian and democratic tradition of France. 1/

Against the alleged anarchistic doctrines of the Revolution, French conservatism calls for a return to a social order in which authority, hierarchy, and order will be duly recognized. Against the judgments of individual reason, it appeals to historic tradition. The Conservatives represent themselves as the proponents of the Stoic life of self-abnegation in public service; they uphold the authority of the State and society against the disruptive influences of selfish particular interests. 2/ They stand for the essential and permanent interests of the nation and the unity of the nation above class struggle.

- 1/ The best account of the early stages of this warfare is still the great book of Henry Michel, L'Idée De L'Etat: Essai Critique Des Théories Sociales Et Politiques En France Depuis La Révolution, Paris 1898. The period up to 1918 is dealt with adequately in a book by the present dictator of German historical studies, Walter Frank, Nationalismus und Demokratie im Frankreich der dritten Republik 1871-1918, Hamburg (1933).
- 2/ Daniel Halévy, La République des Comites, Paris (1934), p.40ff, 187ff., Andre Tardieu, La Révolution A Refaire, Paris (1936 -).

In France this is universally understood. When the Daladier government was formed, all France knew that it leaned on the men of Franco, the bloc whose press rarely misses a chance to praise Mussolini, the men of the Rhine frontier.

But the parties of the Right have not been so sectarian in their methods as their intransigent doctrine might lead one to expect. In spite of their unbending hostility to all the principles of the Revolution, they have never hesitated to make use of men raised in the Revolutionary tradition. This flexibility is fully in line with their theoretical empiricism. The die-hard Royalist Action Francaise became the strongest supporter of Clemenceau in 1917.

The French parties of the Right have demonstrated on many occasions, and recently, their willingness to assist in the overthrow of the Republic. 1/ But as long as it is impractical to get rid of democratic forms, they turn their energies to making the Republic manageable. For this it is necessary to destroy the independent labor unions, to eliminate working class political parties, to discredit parliament, and to suppress all independent criticism. The war, together with the disintegration of the Popular Front, has been seized upon by the parties of the Right as an opportunity for settling scores with the democratic and socialist forces in France. Already they have gone a considerable way towards the establishment of a dictatorship of the Right Center.

2.

French democracy

The most formidable barrier to the establishment of a Right-Center dictatorship is the strength of the democratic and egalitarian tradition in France. This tradition has been maintained since the Revolution in spite of all efforts of conservative and authoritarian governments to destroy it. The egalitarian mood has permeated the whole of French social relationships and has left a deep impress on the political institutions of France. The French are a democratic people in the sense that the Americans are democratic, and the English undemocratic. They are suspicious of and rebellious against duly constituted authority. They do not respect their betters. French high society is exclusive and secretive; it has

1/ Fernand Fonteny, La Cagoule Contre La France, Paris (1938). See also the comments of an intelligent royalist on the political temper of good society in France during the civil war in Spain, in Georges Bernanos, Les Grands Cimetières Sous La Lune, Paris (1938), especially pp. 23, 48, 58, 70, 104, and 117.

no popular following. A magazine such as The Tatler, which recounts the comings and goings of the high-born for the benefit of the lowly of Britain, would be unthinkable in France. A noble name is a severe handicap in French politics.

The strength of the democratic idea in France is reflected in the strong position of the Deputy, and the power of the Deputy in turn is reflected in the fact that France normally has a Parliamentary Government. The great Committees of the Chamber are in a position to formulate policy, to supervise and intervene in administration. It is not for a mere French cabinet to dissolve the Chamber which has been deputized by the Sovereign people of France.

The power of the democratic tradition in France is further shown by the failure of its aristocratic elements to adapt themselves to the public side of Republican politics. The atmosphere of campaigns is oppressive to them. The Right in France is always lacking in leaders who have close contacts with and a following among the common people. Popular leaders who can see their way clear to collaborating with the Right wing parties are assured of a profitable and honorable career. This helps to explain the constant defection of the leaders of the Left parties. Indeed the history of the Third Republic could be written in terms of the movement from Left to Right of the professional political personnel. Clemenceau, Millerand, Briand, and Leval are only a few conspicuous names on a roll which includes hundreds.

In the beginning of 1939 there were three great parties in France which claimed, with some plausibility, to be the inheritors of the ideals of the Great Revolution. These were the Radicals, the Socialists and the Communists.

3.

The Radicals

The Radical and Radical Socialist Party is a political alliance of peasants and provincial bourgeoisie. It has little strength in industrial districts or in Paris. It is above all the party of the little people (*des petits gens*), of provincial lawyers, middling peasants, small business men, and state functionaries. ^{1/} Although

^{1/} Robert de Jouvenel, La Republique Des Camarades, Paris (1913) and D. Halevy, La Republique Des Comites, Paris (1934). The latter is an especially devastating little pamphlet.

the party was not founded before the establishment of the Third Republic, its mythology descends from the time of the struggle against the Second Empire. Radicalism in those days was taken as the equivalent of Jacobinism. At that time the party was anti-clerical, republican, nationalist, equalitarian and socialist in the Proudhonian sense.

The Radicals have not succeeded entirely in adapting their program to the requirements of post-war politics. Anti-clericalism, which was formerly their stock in trade, is now largely a dead issue. They have suffered severely from electoral competition with the socialists and more recently with the communists. They have found themselves obliged, in the face of this competition, to adopt programs much to the left of the real views of the leaders of the party. Thus they have been placed in the cruel position of depending on socialist, C.G.T., and even communist votes in electoral campaigns, but on conservative votes in the Chamber of Deputies. The equivocal and opportunist policies pursued by the party have weakened its prestige. In the French universities, in recent years, any young man connected with the Radicals has been regarded as a simple careerist. In 1932 the party campaigned on a Leftish program with socialist support; the results of the election were regarded as a decisive victory for the Left. Yet the Radicals soon had pushed aside the program on which they had gone to the country. ^{1/}

The Radical-supported governments from 1932 to 1936 will be remembered for their sabotage of the League, their deflationary economic policies, their taint of financial corruption, and their complacency towards the Fascist leagues.

It was clear in 1935 that the Radicals were faced with a major defeat at the polls in the 1936 elections. They saved themselves only by entering the Popular Front and subscribing to the specific commitments of the program of the People's Front. Once the 1936 elections were past however, the leaders of the Radical party returned to a more conservative line of policy. In 1935 and in 1939, the Radicals have formed part of a governing bloc whose policies had been repudiated by the French electorate and by the Radical party itself in 1932 and 1936, respectively.

What is the thread of consistency which runs through post-war Radical policy, giving coherence to what seems on the surface a vacillating and inconsistent record? It can hardly be the thread

^{1/} Georges Gautier, *L'Experience Radicale-Socialiste, 1932-34*, Paris (1934) page 17, and passim.

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of economic and political doctrine. The party has failed to reach a common agreement on the alphabet of political or economic theory. M. Gaetan Pirou has, in twenty scant pages ^{1/}, given courteous treatment to all of Radical doctrine from the days of M. Leon Bourgeois' "Social quasi-contract" to the "economie dirigee" of M. Pierre Cot.

The real political capital of the Radicals consists of their ability to provide a popular basis for conservative government. The party is the historic spokesman for the interests, or better, the aspirations, of the peasantry, the small shopkeepers, the small rentiers, the ambitious professional men of rural France. The party has given these people a political unit differentiated from proletarian socialism. At the same time it has maintained the egalitarian tradition of 1789; it has defended (at least verbally) the interests of provincial France against the encroachment of the great industrial and financial trusts, against the pretensions of the Church and the social monopoly of the noble families. It has kept open the channels of political advancement to the little people of the provinces. It has given the peasantry a voice in the political life of France which it never had fifty or sixty years ago. The party therefore has considerable historical capital assets. The Radical leaders have been able to command votes, decisive votes. The leaders of industry and finance have needed those votes and the popular support which the Radical leaders were in a position to deliver to them. But it has been increasingly difficult for the Radical leaders to reconcile the interests and aspirations of their electoral clientele with the requirements of parliamentary cooperation with the Right parties. Here is the root cause of the chameleon tendencies of the Radical party.

4.

The Socialists

The Socialist party (S.F.I.O.) is, according to its official program, Marxist, working class, and international. In fact, however, one can search in vain through the works of the socialist leaders for any trace of Marxist doctrine.

^{1/} Gaetan Pirou, Les Doctrines Economiques en France, Paris, 1934.

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Rousseau, Kant, Saint-Simon and Proudhon are the fathers of the S.F.I.O. The French Socialists are in the great tradition of the Revolution. This can be seen in small matters as well as in great.

If the S.F.I.O. is not Marxist, it is in considerable degree a working class party. It has defended the interests of the working class with vigor; a large part of its numerical strength comes from the working class. But in recent years, the Socialists have lost ground among the industrial working class to the Communists. In all the area of the Seine, the greatest industrial district of France, the Socialists have saved from Communist encroachment only a handful of seats. They have kept their influence in the mining towns of the Nord, but in general their strength is concentrated in the Republican strongholds of the Southwest. When Blum was driven out of his Pâleville constituency by the Communist candidate, he found a safe seat in the city of Marbonne, a center of the wine trade and an agricultural market town. School teachers, doctors, artisans, working business men, peasants, state employees -- these, more than industrial workers, make up the backbone of the S.F.I.O.

The S.F.I.O. has stood for the defense and extension of democratic processes under the Republic; for the extension of state enterprise and public control of business; for the development of the social services; for the organization of world peace. The Socialists have generally cooperated with the Radicals on the second ballot, but they refused, until 1936, to enter any Radical cabinet. However, the Radicals could usually depend upon their votes in the Chamber.

5.

The Communists

The Communist Party first became a political force of the first order of importance in 1935. Previous to that time it had not succeeded in extending its influence beyond a sector of the industrial

working class and a handful of writers and professional people. It had not worked out a program capable of influencing the peasants. Among the urban workers its influence was limited by its quarrel with the Socialists and with the C.G.T. The Communists insist that they have aimed consistently since 1920 at creating a united working class movement capable of attracting allies from the middle class and from the peasants. ^{1/} However, their calls for labor unity could not be taken very seriously, as they were based in general on the idea of the "United front from below". That is, the rank and file of the Socialist and other democratic groups were to be drawn into the Communist sphere of influence, while the Communists continued to attack and discredit the Socialist leaders. Naturally, the Socialist leaders did not care to cooperate on this basis. ^{2/} They preferred cooperation with the Radical party, which, if it was not too scrupulous about observing its agreements, at any rate did not attempt to disrupt the Socialist party organization. In truth, there was no real basis of cooperation between the Communists and the other parties of the Left before 1933. After that year, the forms of cooperation had to be painfully and slowly worked out, in view of the confirmed hatreds and jealousies which had long characterized the relations of the Left parties.

In spite of all difficulties, the Communist party succeeded in 1936 in establishing itself for the first time as being in the direct line of French revolutionary tradition. Under the program of the People's Front, the Communists gained tremendously in influence among the working class, and they also succeeded in penetrating rural France to a degree alarming to the Conservative parties. ^{3/}

6.

The Popular Front

The Popular Front in France was formed in reaction against the developing international Fascist movement. It drew its strength from widespread popular feeling that the Right was conspiring to overthrow the parliamentary system, from popular anger at government toleration of the Fascist leagues, and from bitterness against the economic policies of Leval's Radical-Conservative coalition.

^{1/} Maurice Thorez, France Today and the People's Front, Paris (1936).
^{2/} Leon Blum, Les Communistes et Nous, Paris (1935).
^{3/} Neil Hunter, op. cit. p. 254.

The program of the Popular Front (first published in January 1936) called for the following policies: 1/

1. Dissolution of the Fascist leagues. Suppression of political corruption. The repression of slander and blackmail. Publicity for the financial accounts of the press.
2. Collective security within the framework of the League. Sanctions against aggressors.
3. Recognition of the right of labor organization. Restoration of purchasing power by the adoption of an expansionist economic policy. Reduction of the working week with no reduction in pay. Old age pensions. Unemployment relief.
4. Raising of agricultural prices. Establishment of an Office du Ble. Strengthening of agricultural co-operatives. Sale of agricultural supplies to farmers at cost.
5. Reform of the Bank of France. Reorganization of the tax system on a progressive basis. Measures against tax evasion. Control over the export of capital.

The program of the People's Front was expanded and given color before the elections and afterwards by the development of a great campaign of slogans, posters, and articles. It was the Communist party which achieved the most sensational success in this war of slogans, with its main battle cry — "pour Une France Libre, Forte, Heureuse", with its brilliant slogan "Contre Les Gens de Coblenz". The battle cries of the People's Front evoked all the latent, Revolutionary myths of France, from the days of '89 to those of '48 and up to the present: Les Deux Cent Familles, Le Mur d'Argent, Les Marchands du Canon — these slogans were loaded with meaning and they caught on everywhere in France.

The elections of April-May, 1936 were, according to French standards, a landslide for the Left, specifically for the far Left. At the same time the tenacity of Conservative influence was demonstrated once more. Throughout the greatest part of the Northwest the People's Front failed to make any inroads on the conservative strongholds. The distribution of votes in 1932 and 1936 was

1/ See A. Werth, Which Way France? New York (1937) p. 233.

as follows: ^{1/}

	1936	1932
Right	2,254,000	2,262,000
Centre	1,938,000	2,225,000
Radicals	1,461,000	1,805,000
Small Left Groups	518,000	511,000
Socialists.	1,922,000	1,931,000 ^{2/}
Dissident Communists	95,000	85,000
Communists	1,503,000	794,000

It will be noticed that the Right succeeded in maintaining its electoral strength almost unimpaired. The Center and the Radicals were the great losers and the Communists the great gainers, but the decline in the Radical vote is undoubtedly very much smaller than would have been the case if they had gone to the country without the support of the People's Front.

Because of the varying concentration of popular votes, the distribution of seats does not reflect closely the total popular vote. Thus the Radicals got 40,000 fewer votes than the Communists but the Radicals won 116 seats, compared with the Communists' 72.

In spite of the electoral victory of the Popular Front and the sweeping success of its supporters in the great strikes of 1936, its strength was hollow almost from the beginning. Neither on domestic nor on foreign policy was there any real agreement among its constituent parties. The Blum government broke the unity of the Popular Front on its attitude towards the civil war and fascist intervention in Spain. The Radical Socialists would not agree to progressive taxation, control over the export of capital or a large program of public investment. By the beginning of 1937, the Popular Front was at a complete stalemate. Its dissolution was only a question of time and circumstance.

From July 30, 1936, when Italian military planes were forced down in Algeria, the French Government had positive proof of Italian military support for the rebellion in Spain. Yet it affirmed its intention of preventing any export of war materials to the Spanish Republic and did so even before addressing an appeal to the fascist governments. The German and Italian Governments

^{1/} A. Werth, *op. cit.*, p. 274.

^{2/} This includes votes cast for candidates who later became Dissident Socialists.

evidently concluded, and quite rightly, that the foreign policy of the Popular Front did not need to be taken seriously. If Blum was ready to retreat on the Spanish issue where his legal and strategic position was so strong, there was no reason to be afraid of the French government in other quarters where strategic factors were unfavorable to France, where the legal position could be confused and where the political issues were less clear-cut.

The result of the abandonment of the foreign policy of the People's Front was disastrous. The unity of the movement was broken at the bottom. The rank and file of the Socialist Party ceased to attend the meetings and demonstrations of the People's Front, because the Spanish question was certain to be raised there and the Spanish question was a subject of painful humiliation to the entire Socialist Party. The Socialists were embittered by the Communists' attacks on their position on the Spanish question. They felt that the Communists were taking an unfair advantage in posing as the only true friends of Spain in France. They felt that it was easy for the Communists who, after all, did not have the responsibility of office, to be militant in their support of Spain. The Communists, for their part, resented the boycott by the Socialist Party of all the demonstrations organized in support of the Spanish Republic.

The hatred and jealousy which had characterized the relationships of the Socialist and Communist parties since 1920, which had never been completely overcome by the common action of the People's Front, appeared again more violent than ever. The great journal of the Communists, L'Humanite, attacked the foreign policy of the Blum Government daily. Le Populaire, the chief Socialist newspaper, replied by offering its columns to critics of the whole People's Front movement and particularly of the Communist Party.

On economic policy, it was the Radicals who reduced the program of the Popular Front to complete impotence. The Radicals controlled the Senate (because of the enormous over-representation of rural communes in senatorial elections), and the Senate would hear nothing of progressive taxation or control over the export of capital. Without these two measures the economic policy of the Popular Front was reduced to an empty shell.

Having disorganized and disheartened its followers on the Spanish question, and lacking any constructive economic policy, the Popular Front gradually dissolved into its constituent parts.

The Radical Socialists joined forces again with the Center and Right. For this combination the only possible economic policy was one which left control of the economy to the captains of industry and finance, while government undertook to protect them from any loss of confidence which might result from popular pressure for security and a redistribution of income.

7.

The return of the Right to power

Certain groups on the extreme Right has been preparing for a military coup before the complete dissolution of the Popular Front. In the fall of 1937, their military preparations were discovered quite by accident. A system of heavily armed private arsenals was found to exist in Paris. The equipment of these arsenals, as well as their location, suggested that they were not intended simply for the limited objective of blackmailing Parliament by means of organized riots, like that of February 6, 1934.

It was not long before the political basis of the plot was revealed, at least in part. The arsenals had been built by the Secret Committee for Revolutionary Action, of which General Duseigneur, Commandant of the great Chartres air base, was the head. The C.S.A.R. proved to be an instrument of the Two Hundred Families. Duke Pozzo di Borgo, a leading Fascist and friend of Tardieu, was prominent in the Committee. M. Eugene Deloncle, a leading engineer of the Penhoet shipyards and W. Moreau de la Meuse, banker and industrialist, were among the first implicated. But subsequent evidence made it clear that the supporters of the C.S.A.R. were even more powerful and

more respected than these. The trial of the C.S.A.R. led straight to the Etoile bombings and the Etoile bombings had been carried out by the engineering department of the Michelin Rubber Works, under the direction of M. C. J. Gignoux, head of the General Confederation of French Production (the French counterpart of our National Association of Manufacturers).

Through the whole period when the Left wing papers were carrying headlines on the Plot Against the Republic, the chief Center newspaper, Le Temps, carried only a subdued note on an inside page under the rubric "The Affair of the Keeping of Arms".

It should be noted that almost all of the vast amounts of equipment which had been assembled in these arsenals was of German and Italian origin. It is not possible to believe that this material parted from these countries without the active cooperation of German and Italian officials. It is equally difficult to believe that it could have been assembled in France without the connivance of highly placed officials.

Immediately after the discoveries, M. Marx Dormoy, a Socialist who was at that time Minister of the Interior, issued a strongly worded statement in which he said that the plot was clearly a serious attempt against the Republic. ^{1/} Those guilty would be hunted down and ruthlessly punished, he said.

In fact, however, the prosecution of the affair soon began to lag. Important discoveries continued to be made, it is true, but they were mostly made by accident or by snooping journalists of the Left wing papers. The Surete soon appeared to have lost interest in the case. Members of the C.S.A.R. confessed to having organized the murder of Carlo and Nello Rosselli, leaders of the Anti-Fascist Italian exiles, but in spite of this confession, in spite of the clearly established fact that the C.S.A.R. had engaged in assassinations, bombings, in the sale of French military secrets to the Fascist Axis, and large scale military preparations against the Republican regime, the prosecution of the C.S.A.R. was quietly dropped. As far as we know the affair has never got beyond the Instruction. The treatment of the C.S.A.R. makes the most glaring contrast with the ruthless prosecution to which militant anti-Fascist exiles have been subjected in France. (Today Spanish refugees in France receive treatment which can only be compared with that accorded political prisoners in Fascist countries.)

^{1/} Fontenay, op. cit., page 25.

Especially since November 1938, the forces of the Center and Right have been steadily increasing their authority in France. Their power has become almost unchallenged since the outbreak of war and the disintegration of the French Communist Party. "Communism" is being used as an excuse to strike at every opposition movement, and it is a very effective excuse because it can be clothed in the rhetoric of putting down national treason. The Socialists, at present, have very little real strength; they are not strong enough even to force a discussion of France's war aims, and certainly they cannot defend the French trade unions as the Labour Party is doing in the United Kingdom.

Nevertheless it would be unwise to project a picture of complete social calm in France for the duration of the war. The French people constantly surprises casual observers by its resurgently critical attitude towards all government and especially towards any gratuitous display of authority. War-time administration, however, seems likely to be effectively dictatorial. It is further possible that a permanent Right wing dictatorship will emerge from the present war in France. On the other hand, it would be folly to be confident about any early and easy elimination of French democratic and egalitarian traditions. Those who expect a long and hard-fought war to bring out nothing but the spirit of "national union" in France are due for some great surprises.

Treasury Department
Division of Tax Research

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Date.....1/11/40.....1938

To: Miss Chauncey

On Jan. 10 at the 10:30 A M conference- Mr. Blough handed the Secretary the original of the attachment. You may want this copy for your information.

Please note that after the conference a change was made on page 10 - line 12 - we made a change from "The 1933 Agricultural" -- to: The 1938 Agricultural.
THIS CHANGE DOES NOT APPEAR ON THE SECRETARY'S ORIGINAL TYPED COPY.

This correction is a minor one, because the same wording appears both in the 1933 and 1938 law.

CGHumphries

MR. BLOUGH

January 10, 1940.

ISSUES RELATING TO THE INCOME CERTIFICATE PLAN FOR AGRICULTURE

The choice of a policy with respect to the income certificate plan for agriculture involves the consideration of a number of issues. It is the purpose of this memorandum to clarify certain of these issues and to present some facts bearing on them.

I. CONSIDERATIONS IN SUPPORT OF THE CERTIFICATE PLAN

The considerations advanced in support of the income certificate plan fall into three parts:

- (1) More agricultural aids are necessary, particularly for cotton and wheat farmers;
- (2) The aids should be adopted as a permanent policy which will not have to be scrutinized annually by Congress;
- (3) Only the income certificate plan has the essential characteristics for achieving this result.

(1) With respect to the point that more agricultural aids are necessary, an intelligent evaluation would require a lengthy factual and analytical discussion beyond the scope of this memorandum. The matter is an extremely important one, however, since adoption of the

income certificate plan would not only reaffirm the desirability of the present agricultural program, but would enlarge that program and seek to make it more permanent. Accordingly, certain questions may properly be raised. Some of these are:

- (a) Does "parity price" measure the kind of parity which it is in the public interest to provide agricultural producers at government and public expense?
- (b) Should agricultural subsidies go to the agricultural group as such, that is, should the subsidies go to all farmers producing a given crop, including corporations, without regard to need for family income?
- (c) Does the present distribution of parity payments and that proposed under the income certificate plan give an adequate share of assistance to tenants, sharecroppers, farm laborers and small farm units?
- (d) In view of the benefits of all kinds paid them by government, are the agricultural

groups in greater relative need for further aid to achieve "parity" than such industries as railroads and coal mining, or such groups as the unemployed?

(2) The second point, that parity payments should be adopted as a permanent policy which will not have to be reconsidered and reviewed by each succeeding session of Congress, conflicts with another consideration indicated below, namely, that sound budgetary practice requires expenditures to be scrutinized periodically.

The democratic process assumes that Congressional determination represents the nearest possible approach to the expression of the public will. This is recognized in certain parts of the Department of Agriculture's memorandum. In respect to the parity payments, however, a contrary position appears to be taken, namely, that while the present Congress represents the public will, succeeding Congresses may not represent it.

Although there is thus an apparent anomaly, those taking this position hold that agricultural aids should be adopted as a permanent policy outside the budget, because other economic and industrial groups have protective legislation of various kinds which need not be

reconsidered at each session of Congress. The tariff is the principal example mentioned.

Many agricultural commodities are protected by tariffs and, in recent years, even the tariff on wheat has been effective in raising the farm price. Aside from this consideration, however, the observation may be made that the tariff is either a policy or a disease. If it is a policy intended to achieve a certain result the measures should not be taken which would operate to nullify it. If instead the tariff is a disease, the cure would seem to be its elimination rather than to spread the disease by measures which in no respect reduce the economic loss caused by the tariff in misdirecting the use of the nation's productive resources. The tariff hits primarily consumers. This proposal would hit them again.

The type of tax pressure afforded by the tariff is very different from the payment of governmental cash benefits financed from taxes. The distribution of burdens is different, the distribution of benefits is different, and the effect on internal competition and productive efficiency is different.

A line must be drawn somewhere between the incidental effects of governmental policy on the fortunes of people and the direct payments of money forcibly collected from

the people. The latter is more susceptible to the dangers of misuse, and accordingly requires more careful scrutiny to achieve an allocation of governmental burdens and benefits in accordance with the public interest. Although similar scrutiny should no doubt be accorded to tariffs, the fact that it has not been given does not warrant extending the lack of scrutiny to direct governmental payments.

(3) The third point raised in favor of the income certificate plan is that only that plan has the essential characteristics necessary to achieve larger and more permanent parity payments. It is probably true that agricultural aids would be larger and more permanent with than without the income certificate plan. However, there is also the possibility that the existence of these special taxes falling on the masses of the population would present a constant target for political action which might lead to a reaction against both the tax and the benefits.

With reference to the above points raised in favor of the income certificate plan, the possibility must always be kept in mind that some other method may afford results sufficiently approximating those expected of the certificate plan but without its inherent disadvantages as to be on balance preferable.

II. FISCAL CONSIDERATIONS AGAINST THE CERTIFICATE PLAN

The fiscal considerations against the income certificate plan as a method of financing agricultural parity payments are mainly the following:

(1) Any plan for the payment of agricultural benefits would be less subject to abuse and would be more likely to promote the public interest over the long run if the tax collections and benefits were included in the budget and handled in the same manner as other taxes and appropriations.

(2) The processing taxes constitute so highly regressive a method of financing benefits as to be less desirable than other sources of revenue.

(3) Even if processing taxes were to be used for financing benefits, the income certificate tax would be inferior to the type of processing taxes which were in operation from 1933 to 1936.

(1) There is need for a better general comprehension rather than a concealment or confusion of the detailed receipts and expenditures of the Federal Government.

The adoption of the income certificate plan would make it more difficult to determine the amount of actual public expenditures and the actual tax burden of the various groups of taxpayers. Only by the inclusion of all public expenditures in the budget and by the submission of all public expenditures to periodic executive and legislative review can there be any assurance that the proper allocation of public funds among the many public uses is approximated. Furthermore, the elimination of such an important item as this from the budget would limit the effective use of fiscal policy as an instrument of economic control.

In the memorandum submitted by the Department of Agriculture the view is expressed that "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."

In point of fact, however, the certificate plan involves many aspects of fiscal policy. Under its provisions taxes would be collected and revenues would be distributed by an agency of the government. The operation of the plan would not differ materially from the processing taxes and benefit payments provided under the Agricultural Adjustment Act of 1933. The fact that in this instance

some of the actual operations would be conducted by a special revolving fund and not the general fund does not alter the fact that the fiscal aspects of agricultural benefit payments are substantially similar to those of other governmental services or expenditures.

Furthermore, the parity payments provided the producers of the 3 or 4 commodities covered by the certificate plan would not differ significantly (excepting perhaps in amounts) from the parity payments which are now provided through the budget and from the general fund to the growers of agricultural commodities and would no doubt be continued for the commodities not covered by the plan.

In the Department of Agriculture's memorandum the view is expressed that "under existing circumstances," an increase in direct governmental payments "is neither practical nor desirable." It is urged that since Congress is not likely to continue to make direct appropriations for the benefit of a particular group, an indirect subsidy should be provided; that such indirect subsidy is already being provided industry. In addition to what has already been said on this point, it should be noted that the pursuit of the proposed policy would logically involve the granting of indirect subsidies to numerous additional groups.

In the interest of fiscal planning and sound fiscal management parity payments to farmers should be made within the budget.

(2) In regard to the second point bearing upon the merits of processing taxes, it should be noted that the certificate plan would place the burden of parity payments on the consumers of the products affected. Underlying this method of financing is the assumption that the existence of low agricultural prices bestows an unfair advantage on consumers, and that such an advantage might properly be recaptured for the benefit of agricultural producers. It presupposes that the rewards accorded by the market place to the producers of certain commodities are not just and require supplementation to raise them to some specified but variable levels.

Although it may be agreed that "the farmer is entitled to a fair price," that does not dispose of the question as to what is the fair price. Even defining it as a price which will give the producer a fair income leaves undetermined the essential question of what is fair. Furthermore, a price that will give a fair income to the producer is not necessarily a fair price to the consumer. The consumer ought not be required to pay more than the price resulting under a sound organization

of agriculture. A sound organization of agriculture giving fair returns to those engaged in farming would almost certainly afford lower prices to consumers than "parity" as now computed. To impose on the consumers through a processing tax the burden of giving the farmer a fair price -- whatever that may be found to be -- may thus result in serious unfairness to consumers.

Such concepts as parity price and parity income cannot be accepted without reservation. While Congress has on several occasions endorsed parity income and parity price as a legislative objective, these endorsements have been qualified. The 1938 Agricultural Adjustment Act, for example, instructed the Secretary of Agriculture to assist farmers to obtain parity prices and parity incomes "insofar as practicable" at the same time that it instructed him to assist "consumers to obtain an adequate and steady supply of such commodities at fair prices." Actual parity payments to the farmers are to be made only when, as, and if, and to the extent that, appropriations are made for that purpose. Even if the present concept of parity price and income be accepted, the fiscal methods of providing them are subject to further consideration. The question immediately at hand is whether a tax on the consumer of certain agricultural

commodities is the desirable method of financing parity payments to the growers of these commodities.

The certificate plan would impose a tax on certain necessities. It would tax the consumption of wheat, cotton and rice. Experience with the processing taxes under the Agricultural Adjustment Act of 1933, invalidated in 1936, indicates that the burden of taxes on these commodities would fall, in large part, on consumers. Inasmuch as the consumer expenditures for the products of these agricultural commodities account for a much greater proportion of the total expenditures of individuals and families with small incomes than of the total expenditures of those with larger incomes, the burden of the tax would be regressive. It would bear more heavily on those with small incomes than on those with larger incomes.

The tax would be unusually regressive for it would be imposed on physical units of an agricultural commodity, without regard to the price of the product consumed. Unlike a sales tax which is imposed on the basis of price, the certificate tax would be imposed on the basis of weight or volume. Low income consumers purchasing low-priced cotton articles would pay a higher tax with each dollar spent than higher income consumers purchasing high-priced cotton articles.

It may be that in some cases processors would find it necessary and practical to transfer some of the tax burden from their low-priced to their high-priced products. Under the invalidated processing taxes cigarettes, for instance, appear to have borne more than their share of the tobacco taxes. This type of adjustment, however, is very uncertain and cannot be predicted as a likely occurrence in the case of other products.

The rate of taxation contemplated by the proposed certificate plan would be far heavier than the rates which in the past usually have been applied to necessities in the United States. The general sales taxes imposed by states in no instance exceed 3 percent of the amount of the transaction, and moreover, in many cases, exempt farm products from taxation.

The rate of the tax under the proposed certificate plan would be equal to the difference between estimated parity prices and the average farm prices of the particular agricultural commodities affected. In some instances, the rates of these taxes would be even higher than those imposed under the invalidated processing taxes. Even on the basis of United States average farm prices prevailing on December 15, 1939, the difference between parity prices

and farm prices amounts to 30.8 cents per bushel of wheat, 6.2 cents per pound of cotton and 31.8 cents per bushel of rough rice. A 6-cent tax on 10-cent cotton, for instance, would be equal to 60 percent of the farmers' selling price. The imposition of indirect taxes of this magnitude, superimposed on an already regressive Federal-state-local tax system, would severely affect the already limited purchasing power of the low-income families.

The effects of the certificate plan would be especially burdensome to those who, just like wheat, cotton and rice farmers, are receiving less than "parity" incomes. There are large numbers of other persons on farms and in the cities who have incomes and standards of living as low as the growers of wheat, cotton and rice. The whole body of the unemployed and the under-employed laborers in all industries have less than "parity" incomes and would be subjected to a heavy burden on account of the tax.

In the Department of Agriculture it is recognized that the certificate plan would constitute, in effect, a tax on consumption. It has been maintained, however, that the regressive effects of the tax would be offset by the "progressive" effects of the expenditures and that

the net result would be "progressive." Underlying this position is the assumption that the plan would benefit a low-income farm group largely at the expense of a higher-income non-farm group.

At the outset, it should be noted that this distinction between farm and non-farm population is not wholly relevant to the issue. The certificate plan has been designed for the benefit of wheat, cotton and rice (and possibly some tobacco) growers only. It probably cannot be employed successfully, and it is not proposed, for the benefit of the growers of the many other farm commodities. In consequence, the plan does not propose to benefit the entire farm population at the expense of the entire non-farm population. It proposes, rather, to benefit wheat, cotton and rice growers as distinct from all other farm groups as well as all the non-farm groups.

There are at present in the United States approximately 7 million farm families. About 3 million of these are engaged, to a small or large extent, in the growing of wheat, cotton and rice. Thus, even if all wheat, cotton and rice growers cooperated in the AAA production and soil conservation programs and were eligible for parity payments, the certificate plan would benefit not more than 3 million farm families, at the expense of another group consisting

of 4 million farm families, more than 22 million non-farm families, and several million single individuals.

Moreover, the plan, if adopted, may not be of much help to some wheat and cotton growers. That likelihood is indicated by the fact that a portion of the wheat and cotton growers produce these commodities in such small quantities that the benefits they would receive from their share of the certificates, if they complied with the farm program, would be offset largely by their share of the tax burden as purchasers of wheat, cotton and rice products.

The certificate plan is said to have "progressive" effects because the average income of the farm population which would be benefited is lower than the average income of the non-farm population which would be taxed. However, a comparison between farm and non-farm population on the basis of per capita incomes is subject to misinterpretation. The incomes of the two groups are not comparable. A dollar of income in a rural area is something entirely different from a dollar of income in an industrial area. Its purchasing power is different because the cost of living generally is lower in rural than in urban areas. For those on farms, food, housing and clothing, three important elements in the budget of the low-income groups, require a smaller expenditure than for those in the cities.

In comparing the income of the farm and the non-farm population it is emphasized that a larger proportion of the farm population falls in the low-income group than is the case in the non-farm population. It is pointed out, for instance, that a considerably larger percentage of the families on cotton farms have low annual incomes than is the case with an industrial population. Such use of percentages, however, does not bring out some of the important aspects of the low-income problem. The percentages relate to entirely different magnitudes. The adoption of the certificate plan would result in the taxation of at least 5 million non-relief families with incomes of less than \$780, for the benefit of wheat, cotton and rice growers, only part of whom have such low

incomes. In addition, there were 4,500,000 relief families, of whom 600,000 were farm families. ^{1/} In other words, it is not evident that the net effect of the plan would be a distribution of income from higher to low income groups.

Moreover, we are here dealing with families whose incomes range from minus quantities upward. Therefore, even if, on the average, the families taxed had a higher income than those which received the benefits, the families taxed would still include a number whose incomes would be lower than the incomes of many receiving the benefits.

1/ In 1935-36, one-third of American families are estimated to have had incomes of less than \$780. No information is available on the income distribution among wheat, cotton and rice farmers specifically. However, in that year, 37.6 percent of all non-relief farm families were estimated to have had annual incomes under \$780. For all non-relief families, the corresponding proportion was only 23.5 percent. However, in actual numbers, over 6 million non-relief families had incomes less than \$780. Non-relief farm families accounted for a little over 2 million of the six. However, families of wage earners also accounted for over 2 million. Even if the percentage of wheat, cotton and rice growers falling in this low income group were much larger than that reported for all farm families, the adoption of the certificate plan would result in the taxation of at least 5 million non-relief families with incomes of less than \$780, for the benefit of wheat, cotton and rice growers, only part of whom have such low incomes. In addition, there were 4,500,000 relief families, of whom 600,000 were farm families. In other words, it is not evident that the net effect of the plan would be a distribution of income from higher to low income groups.

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In other words, despite the fact that on the average farm families have lower incomes than urban families, the plan would tax some consumers with little or no income for the benefit of some farmers with relatively larger incomes. To this extent the effect of the plan would be the converse of "progressiveness."

Finally, it should be noted that, aside from limitations on maximum payments to individual farmers, the benefits under the certificate plan would be distributed among farmers approximately in proportion to the present distribution of incomes. Wheat, cotton and rice growers would benefit in proportion to their normal production. Therefore, in general, farmers with large farms, producing large amounts of wheat, cotton or rice would receive more money from the plan than small farmers producing smaller amounts.

These considerations indicate that (1) the cost of the plan would be distributed inversely to tax-paying ability, (2) the benefits of the plan for these commodities would be apportioned roughly according to the present distribution of incomes among the growers, and (3) some purchasing power would be transferred from low income families to higher income families.

At all events, even if it could be agreed that the certificate plan tax on consumers for the benefit of producers might have "progressive" effects, it would still be true that the degree of such "progressiveness" would be less than could be achieved under practically any other method of taxation.

(3) The third consideration against the certificate plan is that even in the event that it is deemed desirable to finance parity payments from taxes falling largely on the consumers of the commodities concerned, processing taxes of the type employed from 1933 to 1936 would be preferable administratively to the certificate plan taxes.

A processing tax can be administered readily by the regular tax-collecting agency of the government. It can be more carefully integrated in technical details (with respect to definitions of tax base, and exemptions, deductions and refunding provisions) than is the case with the certificate plan.

The effective application of processing taxes requires the imposition of compensatory taxes. Floor stock taxes are a case in point. Under the invalidated processing taxes provision was made for compensatory floor stock taxes on any article that on the date the processing tax became effective was held for sale or other disposition.

Such compensatory taxes are essential to prevent undue profiteering. The need for such taxes is especially present when rate changes are likely to occur from time to time. Moreover, in those instances where on occasions reductions in tax rates are likely, provision should also be made for refunds on floor stocks. In the absence of such provisions, processors and distributors are exposed to heavy losses merely because of a change in the tax rate.

Under the processing tax, the Secretary of Agriculture was instructed to ascertain whether "the payment of the processing tax upon any basic agricultural commodity is causing or will cause to the processors thereof disadvantages in competition with competing commodities by reason of excessive shifts in consumption between such commodities or products thereof." If he so found, he was to proclaim a tax at a rate "necessary to prevent such disadvantages in competition" on the first domestic processing of the competing commodity. The need for this type of compensatory levy is particularly important in a commodity, such as cotton, for which important competitive substitutes are available, such as paper, jute and rayon. This problem may be more serious in the case of the industrial uses of cotton.

Conceivably, a certificate plan of the type proposed could be supplemented by compensatory taxes within the internal revenue system. Whether such compensatory taxes are in fact contemplated by the proponents of the plan has not yet been indicated. It would appear that the imposition and administration of compensatory taxes as well as the disposition of the revenues raised would be less cumbersome as an integral part of processing taxes than as adjuncts of the certificate plan. To these should be added the previously discussed considerations: that if processing taxes were employed they would be included in the budget, that they would be less hidden from the public, and that they are more likely to be currently scrutinized than the taxes inherent in the certificate plan.

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JAN 10 1940

Dear Mr. Currie:

Reference is made to your letter of December 27, 1939 in which you request that I advise you whether the Secretary of the Treasury possesses authority to sell the Treasury's holdings of shares in Federal Savings and Loan Associations and whether the Home Owners' Loan Corporation has authority to purchase such shares from the Treasury.

It is assumed that you are referring to full paid income shares of Federal Savings and Loan Associations of which the Treasury Department holds approximately \$40,000,000. You are advised that the Treasury Department is of the opinion that the Secretary of the Treasury is not authorized to sell the full paid income shares of Federal Savings and Loan Associations held by the Treasury (except that the shares may be repurchased by the issuing associations as authorized by law), and that the Home Owners' Loan Corporation is not authorized to purchase such shares from the Secretary of the Treasury.

Very truly yours,

Edward W. Clarke
Acting Secretary of the Treasury.

Mr. Lauchlin Currie,
Administrative Assistant
to the President,
The White House.

DJS:es typed 12.29.39

D.J.S. not [unclear] HE E. W. CLARKE [unclear] [unclear] [unclear]