

DIARY

Book 466

November 27 - 30, 1941

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November 27, 1941
9:12 a.m.

HMJr: Hello.

Operator: Mr. Forrestal.

HMJr: Hello.

James V. Forrestal: Henry, are you booked for the Army-Navy game?

HMJr: Am I booked for the Army-Navy game?

F: Uh huh.

HMJr: No. I don't even know when it's coming.

F: Well, that's coming - you can't be so indifferent to the Service as that, now, Henry.

HMJr: What's the matter?

F: It's coming Saturday.

HMJr: This Saturday?

F: Would you want to - would you like to go?

HMJr: Jim, I think we're going to the country, but I - our plans are to go to the country.

F: I see. Well, do you want to - you probably - do you want to check and let me know, if you and Mrs. Morgenthau would like to?

HMJr: Well.....

F: We're going up in the morning - Saturday morning by car.....

HMJr: Yeah. I will check, and I could let you know by early this afternoon.

F: That's all right.

HMJr: It's terribly nice of you to think of us.

F: Well, I haven't seen you in a hell of a while.

I thought it might be a chance to dicker.

HMJr: Yeah. Well, I would like to see you game or no game.

F: All right, Henry.

HMJr: Thank you. I'll let you know after lunch.

F: Okay.

November 27, 1941
9:30 a.m.

RE TAXES

Present: Mr. Kades
Mr. Blough
Mr. Paul
Mr. Sullivan
Mr. Groves
Mr. Tarleau
Mr. Buffington
Mr. Haas
Mr. Cann
Mr. Foley
Mr. White
Mrs. Klotz.

Blough: Here is one of your charts.

H.M.Jr: Do you want to stand and explain it? If the others don't see it, they can listen.

Blough: These are the same as I had the other day except for different companies. This one is General Motors--

H.M.Jr: Let me see it. I don't care whether they see it.

Blough: This one is General Motors, which is a big company. It has three hundred forty-seven

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million dollars worth of income. It had adjustments of eleven million dollars excess profits, credit of two hundred seventeen million, leaving excess profits income of a hundred and thirty million dollars. Its excess profits tax amounted to seventy-one million dollars.

H.M.Jr: They earned how much?

Blough: They earned three hundred forty-seven million dollars.

H.M.Jr: Whew!

Paul: What year was that, Roy?

Blough: This is 1940.

H.M.Jr: I am only working with '40. I don't want anything else but '40.

Blough: This is the return as filed by them in 1940.

H.M.Jr: Somebody in General Motors told a friend of mine the other day that they earned as much in the first six months as they had in all of last year.

Blough: That is a lot of money. Down here we have the computation of the normal tax showing sixty-six million dollars normal tax--

H.M.Jr: Did anybody leave the room just now to buy some General Motors?

White: We will buy the room and sell it short after we get through.

H.M.Jr: The point is, did anybody leave the room?
(Laughter)

Foley: It is too late now, Harry.

White: You saw the charts last night, didn't you?

Blough: So we have about a hundred and sixty-five million dollars worth of taxes altogether, a hundred and fifty-five million.

H.M.Jr: How much?

Blough: About a hundred and fifty-five million dollars worth of taxes.

H.M.Jr: How much did they have left over?

Blough: They had left over a hundred and ninety million dollars.

H.M.Jr: What is that proportion, about?

Blough: That proportion of three hundred forty-seven is about forty percent.

H.M.Jr: They had about sixty left over?

Blough: They had about sixty percent - a little less than sixty percent left over, between fifty and sixty percent.

White: What is their net value, is that there?

Blough: That is not on this chart. They didn't report that.

Paul: That is about a billion dollars.

Blough: We have some figures of our own. It must be at least that. They have been making around twenty-four percent or thirty percent on their invested capital.

Now here is a case of the United States Steel

Corporation where they are on invested capital basis, and they haven't made up to their invested capital credit. Their income begins here and goes over here. It is a hundred and twenty million dollars. Their excess profits credit is more than their income by fifty-seven million dollars, so that they are going to have an excess of credit to carry over to 1941 which they can use in 1941. They of course have no excess profits tax and merely have the normal and surtax on the regular income of the company, the hundred and twenty million.

- H.M.Jr: They pay nothing because they have a high capitalization?
- Blough: That is right. In relation to their low earnings, or low earnings in relation to capitalization, either way.
- H.M.Jr: I didn't know that was the situation on U. S. Steel.
- Foley: Are those figures, a hundred and twenty million and three hundred forty-seven million, net or gross?
- Blough: Those are net income figures.
- Foley: After all operating expenses?
- Blough: After all operating expenses as filed by the company.
- H.M.Jr: Give me that U. S. Steel again. That amazes me.
- Blough: U. S. Steel had a hundred and twenty million dollars. In addition to that it had certain adjustments over and beyond their normal tax income. A hundred and two million, I beg your

pardon, slight adjustments there. But their excess profit credit was a hundred and sixty-two million dollars, so that they had left over fifty-seven million dollars of excess profits credit. Next year that fifty-seven million will be carried forward as a credit against whatever income they make next year.

H.M. Jr: They carry it for one year?

Blough: Two years.

Sullivan: They have to make two hundred twelve million dollars. The hundred and sixty-five plus the sixty-seven, before they are subject to excess profits tax.

Paul: What was their excess profits credit?

Blough: A hundred and sixty-two million dollars.

Paul: And twelve times that approximately would be their invested capital, wouldn't it?

Blough: That is substantially correct, yes.

Paul: What would that be, then, a hundred and sixty-two times twelve?

Blough: A hundred and sixty-two times twelve would be about a billion nine.

H.M. Jr: Well, now, let me ask you this. It is amazing to me. You people might have all known this, but certainly it is an eye-opener to me. Could you do - if you haven't already started, I would very much like to see Bethlehem Steel.

Blough: We have asked for that.

Foley: That will be just like this one, won't it?

- Blough: It will look very much like this one.
- Paul: I would like to see one of the smaller steel companies like Inland Steel or Republic Steel or one of those.
- H.M.Jr: All right.
- Haas: One of the new ones that don't have obsolete stuff to put in the capitalization.
- H.M.Jr: Why not just run through the steel and see the difference between one industry? Why wouldn't that be a good angle?
- White: Of course, because the assumption that the U. S. Steel can have such a large capitalization necessary to do that business will be shown up when you take some of the other steel companies.
- H.M.Jr: Well, why not take National Steel and Inland Steel and Republic and then take a little one with a high specialty like Ludlow who makes only these special tool steels? Why not just stick to the steel and show the tremendous difference within one industry?
- Blough: What we might do is to have three or four charts made up on steel and then have for the rest of the companies the figures so we can say this company is just like this chart. Or would you like a chart for every one?
- H.M.Jr: I would like one for every one. There would only be about eight or ten. Don't you think so?
- White: Yes, and I think somebody ought to get started in George's shop at once to segregate the group of steel companies that you are picking out to see which of those are sufficiently

similar to justify the conclusion that the capitalization of the United States Steel does not represent an adequate basis for determining what their profits are. I mean, it would be hardly fair to compare United States Steel with some other corporation that is making high-grade specialties, but it certainly would be fair to compare them with several other steel companies that make the same type of product and which have a far higher proportion of earnings on the basis of their capital.

H.M.Jr: Well, Harry, there are ten or twelve steel companies and then let's take a look at it and we can all begin to analyze it, but just before I - I want to get to you - what were the net earnings of U. S. Steel?

Blough: U. S. Steel? A hundred and two million dollars.

H.M.Jr: And how much federal taxes did they pay?

Blough: They paid in federal taxes thirty-one million six hundred thousand.

H.M.Jr: Well, now, is it an accident that most of these are paying about a third?

Blough: The tax rate is thirty-one percent, which is the reason why it tends to be around a third.

Foley: That is without any excess profits?

Blough: That is without any excess profits.

H.M.Jr: But even these that we have seen, I haven't seen any with excess profits who have paid more than that.

Blough: General Motors paid more than a third.

H.M.Jr: Well, forty percent.

Blough: Something over forty percent.

H.M.Jr: Why do they keep telling me these companies are paying sixty percent?

Blough: We will get you two or three of the war babies in here. They are paying around sixty. They ought to be in tomorrow.

H.M.Jr: Don't you think, Paul, it would be a good idea to get a whole industry?

Paul: I do. I think we might get two or three industries, though.

H.M.Jr: I mean, they can't turn out--

Blough: Some, we can't turn out so many of these.

White: Mr. Secretary, some of us are accustomed to looking at figures rather than charts and if it doesn't stop them, what we would like is if somebody would do that with a great number of industries just in a column of figures and make as many charts as they can.

H.M.Jr: Talk to Roy about it.

Blough: Well, we will do that.

H.M.Jr: I think I would like to go through, because if we can show the difference within one industry and then after that we can take the airplane industry, if you want to, or the ship building. There are not so many ship building companies.

Blough: Not a great many large ones, no.

H.M.Jr: I would like to see the airplane industry.

Blough: We have quite a number of airplane ones.

H.M.Jr: Why not go through the airplane industry, planes and engines?

Blough: We have already asked for four or five or six of those.

H.M.Jr: Do that. I think that would be the most - I am simply astonished.

Blough: Do you want to look at another chart?

H.M.Jr: I would love to.

Blough: This is not an individual company. This is statistics for 1940.

Paul: Do you have the gross income?

Blough: I would have to check that up. Gross receipts or gross income.

Foley: Well, gross receipts.

H.M.Jr: Well, it certainly would be in the neighborhood of two million dollars. It certainly would be at least that, but I would have to check on it.

H.M.Jr: But we are going to run through the steel first.

Blough: Yes.

H.M.Jr: Is that all right with you, Paul?

Paul: Yes, indeed. I would like to see the charts on that and see the figures on several industries.

H.M.Jr: Well, you can talk to Roy. Go ahead.

*too try to handle
Returns - to Mr. Blough*

Blough:

We can just hang this somewhere. It isn't necessary to go through it in detail. Here we have the income brackets under five thousand dollars, five to twenty-five thousand, twenty-five to fifty and so on, and in this bank here we have the number of companies with excess profits taxes. These are the taxable companies. Practically none of them had less than five thousand dollars of income because they are exempt unless the net income is different from the excess profits tax due to capital gains and losses and dividends or something like that. By far the biggest number was in this five to twenty-five thousand dollar group and then there were nearly four thousand of those. Then they go on down until over five million dollars - we have a very small number of companies.

On the other hand, we have in this bank the net income in the pink, whatever that color is, and the taxable excess profits, the amount of excess profits subject to tax in the green for the different size companies also. The pink being of course natural because he is much bigger than the green.

And then at the bottom the income taxes and the excess profits taxes paid by these companies, the income taxes in the blue--

H.M.Jr:

I don't get it. Start all over again.

Blough:

It is too complicated, I will agree, but this chart has three banks. Number of returns, amount of income, amount of taxes. Number of returns by the size of the income of the company. Amount of income of those corporations. The corporations with fifty to a hundred thousand dollars of income had this much income and this much subject to the

excess profits tax.

H.M.Jr: What conclusion do you draw from that?

Blough: Well, it shows that as usual the largest number of companies are small, but that the big amount of income in excess profits tax are in a few big companies. You could cut off - you could cut a line right down here and cut out all companies with less than a hundred thousand dollars of income and you would eliminate three fourths or more of the companies subject to the tax, but you would still have a very great bulk of the income still subject to excess profits tax.

H.M.Jr: Does this show whether we get it or not?

Blough: This shows what we get.

White: That also is the best reflection of the concentration of industries in the United States. That is the best picture of the highness of industry because you notice those extremely few companies in the last two columns in the first bank get a high income in the bank below.

Paul: It also shows, does it not, that - in the middle chart the green is the amount of income subject to excess profits as I understand it and that is a very small proportion of the income of those companies in all examples.

Blough: That is correct on the average. These are taxable companies. These do not include companies which were not subject to excess profits tax and the great bulk of them were not.

White: Which would accentuate the tendencies in that chart.

Paul: Have you any figures showing what percentage of the companies are subject to excess profits tax?

Blough: There are here around twelve thousand five hundred returns out of five hundred thousand corporations, of which about two hundred thousand had an income. Most of them were eliminated because of their size.

Well, I have some other charts, but I think that is enough for today if I may suggest it.

H.M.Jr: All right. Roy, let me ask you this question. Is this impression that I have got right as far as we have gone? After all, let's for a minute just forget the inflation angle on the thing, see. Let's just talk revenue for a minute. If you were told that you had to get "X" billions of dollars additional revenue, where would you look for it?

Blough: That would depend on the size of "X", Mr. Secretary.

H.M.Jr: All right, five billion.

Blough: Five billion dollars?

H.M.Jr: Yes.

Blough: Well, I would know to begin with that I had to go for the bulk of that five billion dollars to the mass of the people, because I would know that that five billion dollars just wasn't left in the hands of a few hundred or a few thousand people at the top, so that I would have to go to the bulk of the people.

H.M.Jr: Let me ask you this way. I will have to lead you (Laughter) How many more billions can you get out of the corporations?

- Blough: How many more billions can you get out of the corporations?
- Paul: Could we go back a little further and ask what is the total corporate income? Let's start there.
- H.M.Jr: That is a good point.
- Blough: Let's see, I am not sure that I can tell you offhand. I think it is around thirteen billion dollars.
- Paul: Well, the excess profits tax net income under the last act was about five, wasn't it?
- Blough: Let's take this act. We expect about two billion three hundred million dollars of excess profits tax under this act.
- Paul: That is on an income of five billion, isn't it?
- Blough: That is on an - oh, you mean -- yes, it would be around five billion dollars, that is right, in that neighborhood, out of the thirteen billion.
- Paul: That is five billion out of the excess profits. Now, that seems a large proportion of twelve or thirteen billion total corporate profits.
- Blough: Well, thirteen billion is, but your total estimated corporate profits for normal tax and surtax purposes and your five billion would be about right for your excess profits estimate.
- Paul: So that out of the total corporate profits of the United States you have got a little over two billion or one, six.
- White: What is the five billion figure you are talking about?

Blough: That is the profit subject to excess profits tax.

White: But what you are getting is two billion three out of thirteen billion.

Blough: Out of excess profits, that is right.

H.M.Jr: You figure that the corporations in the calendar year '41 will earn how much? Don't be afraid, just rough.

Blough: It has been estimated at thirteen billion dollars, roughly.

H.M.Jr: Of that how much is the United States Government going to collect in taxes?

Blough: In surtaxes about three, and the two together about five.

Sullivan: Five billion three.

H.M.Jr: Five, what?

Blough: Around five billion dollars.

White: Where did you get that figure of thirteen billion for '41 income?

Blough: Nobody told me that figure, but I took the estimates and worked back from them and that is the estimate as of '41.

White: What were they in 1940? We already have some indication of the percentage of increase. Do you remember what they were in '40?

Blough: No, I don't recall.

H.M.Jr: Well, Harry, for my purposes whether it is thirteen or thirteen and a half --

White: No, I thought it was something like sixteen.

H.M.Jr: Well, again --

Blough: You see, intercorporate dividends are excluded here, eighty-five percent of intercorporate dividends.

White: I will check up on that.

H.M.Jr: How much do you think, Roy - make a guess for '42.

Blough: That it is going to be in '42?

H.M.Jr: Yes.

Blough: I would much rather George guessed. He has some basis to guess. I don't.

H.M.Jr: All right, George, give us a guess.

Haas: It is just wild.

H.M.Jr: All right, I love to see you go wild (laughter).

White: But not over your figures.

Haas: Sixteen.

Blough: That is what I would say. That was one of my wildest moments.

H.M.Jr: Well, why wouldn't it be reasonable if there was sixteen billion that we took ten of it?

Paul: Well, we interpolate one other question there.

H.M.Jr: Supposing we took ten of it?

Paul: Before we get to that question, Mr. Secretary, could we ask what the corporate profits were

in, say, 1939? I would like to see how much they brought up in relation to what we pay.

- White: I can quickly get those figures.
- Blough: We have them. I just don't have them with me.
- H.M.Jr: I am starting in with a trend of thought. We ought to get what the figures are, going back, say, four or five years, and an estimate next year, how much the Federal Government is taking each year, and the percentage, see, and then supposing we said, "Well, why shouldn't we take two thirds?" I talked about a hundred per cent. Supposing we talk about two thirds.
- Paul: Well, the more they have gone up on account of the defense effort, the more we are privileged to take.
- H.M.Jr: Well, if we took two thirds and sixteen was right, we would get the extra five billion right there.
- Paul: That is right.
- H.M.Jr: I had to answer myself.
- White: You don't have --
- H.M.Jr: Excuse me, just one minute, Harry. You don't have to go down and take it out of the working man's pocket. That is what I was trying to get at.
- White: If it were properly distributed among corporations, otherwise - and that is the assumption I take it, that is implicit in the very thing you are examining, because you could distribute that additional burden in such a way that you would seriously hurt business enterprise and so on.

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H.M.Jr: Well, following his chart there, you would only have to apply it to about five per cent of the corporations to get it.

White: That is right.

H.M.Jr: You could pick up another five billion and not taking it out of the working man's pocket.

White: That would still be a far cry from the English practice.

H.M.Jr: It would be a far cry from "Six per cent" Morgenthau, too.

Blough: No, you would get more money under that than you would under the "Six per cent" Morgenthau, if you left all under six per cent to the corporation. There isn't that much above six per cent.

H.M.Jr: You mean I couldn't get five billion on top of six if I left them six?

Blough: Well, I would say offhand that if you took six per cent across the board of the corporations of America, there wouldn't be five billion above that.

H.M.Jr: Wait a minute, if I took everything above six per cent net --

Blough: I seriously doubt whether you would get five billion dollars.

H.M.Jr: What I am asking for is ten, gross.

Blough: Well, I mean additional money.

White: Well, you are dealing there with facts we can easily check.

H.M.Jr: Well, I would like to explore that. I would like to explore if we wanted to take sixty-six and two thirds of the net earnings of all the corporations in America, how much would we get, that is proposal number one.

Proposal number two, that we left all the corporations six per cent net, how much would we get?

White: You see, one of the difficulties and that is the advantage of going through these charts, is that if you use a flat rate of that kind, you severely penalize a company like General Motors, which is very efficient, and you give an inversely proportional break to the United States Steel Company, which has an enormous capitalization, much of which is either in effect water, or inefficiency.

H.M.Jr: And the management has been grossly inefficient.

White: Well, it is probably that. They claim they have no water in it, but it is a combination.

H.M.Jr: No, I am talking about management.

White: So that there would have to be some kind of an allowance in some way made for that.

H.M.Jr: But Harry, no one has ever given me the figure on my formula. Supposing we took - supposing we took everything over and above six per cent. What would we get?

White: Well, they ought to be able to give you that.

Blough: Yes.

White: Assuming that business remains the same and you didn't interfere with business, initiative and so on, it is a simple computation.

- Blough: Those assumptions, of course, are a little --
- White: Of course.
- Paul: I am a little puzzled by one thought, why we are so afraid of penalizing corporate management when we don't hesitate to penalize individuals.
- White: Could you expand that?
- Paul: We put the surtaxes up in accordance with a person's income when he is an individual, irrespective of what --
- White: Irrespective of what education and ability he had to begin with.
- Paul: That is right, presumably on the general average that the more income, the better manager he is, but when we come to corporations, we get strangely tender hearted.
- White: We treat capital a little bit different than we do human ability. It is a curious phenomenon.
- H.M.Jr: Well, for me - of course it most likely is boring to you people, but it is the only way I can work. I have opened up another avenue of thought as far as I am concerned.
- White: This is going to the fundamentals. It is very significant.
- H.M.Jr: For me, I am opening up this stuff leaf by leaf.
- Groves: May I offer a suggestion to think about in connection with this heavier taxes on corporations?
- H.M.Jr: Please do.

Groves: It occurs to me that it might have a bad effect from the standpoint of inflation, at least it is something to be considered in two respects. One, that on Government contracts some of the tax comes back to the Federal Government because the bargain of the contract itself and the price of materials in the seller's market I think depend very considerably upon the corporation's cost in which they put some of these taxes. And the figures, I think, will indicate that as the tax expands the profit expands, and it keeps a jump ahead. Some of it is circular and comes back on the Government.

The other thing, particularly if the corporation tax is levied on a percentage basis, the corporation gets to have so little equity in its marginal dollar that it tends to get indifferent as to costs, and that is very favorable to an inflationary cycle, and they tend to give everybody what he wants and then add it to the bill, particularly if you are dealing with the Government, both of which tend to aggravate inflation. I don't know how serious they would be.

H.M.Jr: Well, let me ask you a question. Let's be specific on this thing. If I understand what you are talking about. I don't know whether you have read the Trammel report on the cost of the Army cantonments.

Groves: I haven't, sir.

H.M.Jr: Well, I don't know how many here have read it. It is not a very long report. It will take you maybe half an hour. Take that report. As I remember it, the cantonments - this was a year ago last summer, it was early - cost three hundred million dollars more than the estimates. Now, I don't know what form the contract was,

but it goes into what kind of a contract, whether it was a cost plus or whatever it was. It is all in this Trammel report, and apply this question that you are raising to that. Now, would it have helped or would it have hurt? I mean, they were grossly wasteful, you see, but did the question of taxation enter into the thing?

Groves: It would have been more wasteful if there had been higher taxes, is the question.

H.M.Jr: What you are getting to is this. I mean, you are a tax man, but you also have a broad conception. I just wonder that you are raising this question. Isn't it possibly - I mean, we have never done it, and the Bureau of the Budget hasn't done it, but that doesn't mean that I shouldn't. In all these talks, why shouldn't I raise - if we once made up our mind - the question of the way these Army and Navy contracts are working.

Groves: Very good. I think it is very important.

H.M.Jr: As a member of Senator Byrd's committee, I have a perfect right to raise that question. You and I can sit here and maybe miss a billion dollars or two, because we are fearful that the Army contractors are going to be wasteful, but after reading the Trammel report, my own feeling - I would like you to read it and come back at me just as hard as you want - please come back just as though we are in class, come back just as hard as you want, but my own feeling is that the tax thing plays a very small part in it. Now, I may be wrong in it, but just take that, see, and see that the gross waste - I mean, these Army Engineer people don't seem to have any - they have gone just hog-wild.

Sullivan: Excess profits wasn't written at the time most of those contracts were awarded.

H.M.Jr: All right, read the one in today's newspaper, the Trammel report.

White: That is further support.

H.M.Jr: Read that one they have done today. They are doing a swell job, but they make their reports and then nothing happens, and the Bureau of the Budget votes six or seven billion dollars to the Army at a time and they keep right on writing the same kind of contracts.

Sullivan: Jere Cooper --

White: There is a reason, Mr. Secretary, why you can demand that. Not only because you are a member of the Byrd committee, which I think is secondary, but because you are examining tax programs in which one of the important objections which is always raised is this very real objection which has been raised, that as you reduce the net income that accrues to the companies, they become more wasteful in their expenditures, that they increase wages more easily, spend more in advertising and so on, and isn't the answer to that not the inauguration of a tax program so much as the direction which you are suggesting, a more careful examination and more power over the contracts?

H.M.Jr: That is what I am saying. What I am saying is this. Professor Groves says, "Well now, wait a minute, Morgenthau, don't do this because of the tendency of making the contractor more wasteful." I say he is so wasteful now there is something the matter. There is something rotten in Denmark. Let's take a look at it. If we find they are being wasteful - here we are

trying to sell a billion and a half for the Government and we might be able to save five or ten billion dollars if the contracts were written right.

Sullivan: That is right. Ten per cent of your non-defense expenditures is almost nothing. Ten per cent of the other is a lot of money.

Foley: Have the property supervised.

Sullivan: Ten per cent of your non-defense expenditures is about six hundred million dollars, a drop in the bucket. Ten per cent of your defense contracts runs into some real money.

Groves: I was just going to say that there has been a lot of talk about saving on non-defense, and very little talk about saving in the defense part of the Budget. I suppose it is hard to gauge where the money is wasted there in definite quantitative terms, but it seems that some of the attention should be given it. I doubt if there is any country in the world that gets less for its military dollar than we do.

H.M.Jr: Here is a funny thing. I heard the President of the United States talk about the Assistant Secretary of the Navy Roosevelt and what he did and how he bought when he was Assistant Secretary, and that nobody drove a closer bargain and he keeps telling about this Charleston, West Virginia armor plate factory and what it did and how they were able - the Navy can take it over, at the end, grease it up and keep it there until they needed it. But none of the contracts are written that way today.

Sullivan: That is right.

H.M.Jr: We build a building for them and the company can say at the end, "Well, we would like to have it," or "We wouldn't." For instance, what kind

of care are they taking of our buildings which the taxpayers paid for, and all the rest of that stuff?

Sullivan: I think they are taking pretty good care of it, Mr. Secretary, because when the show is over you are going to find out that they are going to take those buildings over themselves and junk their old stuff.

H.M.Jr: Well, Groves, you have brought up a new line of thought, and I would like to have somebody, John, explore the question of contracts, I mean, somebody who - I should think in Internal Revenue could take a look at how these contracts are written. They must have begun to review them for '40 now, haven't they?

Who does that in Internal Revenue?

Cann: We are going to read some of them, Mr. Secretary, in the field, but we haven't had any report or any information which would allow us to formulate any opinion about that.

H.M.Jr: Could you speed that up a little bit?

Cann: Yes, sir.

H.M.Jr: Couldn't you concentrate on that?

Cann: We will look into that, yes, sir.

H.M.Jr: Well, how would it be if, for instance, we say we want a report on twelve steel companies? Why couldn't we get their government contracts and how they were written and have the whole picture on one group at a time?

Cann: I think we could.

H.M.Jr: I mean, if we are going to do twelve steel companies, why not look into their government contracts and the forms of them, you see, and the profits and then what they charged off. You have got their nineteen --

Cann: Well, that information would ordinarily be gone into as part of the regular investigation and might not be recorded, but I mean it would be examined.

H.M.Jr: Well, why not, if we are going to do the twelve, let's take a look at their government contracts and particularly as to how much they charge off to unusual - you know what I am after.

Cann: Yes, sir.

H.M.Jr: And in twelve steel companies you would get Army and Navy, too, wouldn't you?

Cann: Yes, sir.

H.M.Jr: And Shipping Board.

Cann: Yes, we would get the Shipping Board.

H.M.Jr: I wish you would do that. Get the names from Blough, which ones they are going to be. And can't you speed that up a little bit?

Cann: Yes, sir.

H.M.Jr: Couldn't I know maybe early next week, something?

Cann: Well now, that - I realize what you are after.

H.M.Jr: Well, look, you will just have to. How many men have you got who know how to examine a corporation income tax return?

Cann: We have enough to do that.

H.M.Jr: How many have you got?

Cann: Several thousand.

H.M.Jr: All right, put as many hundred on this as necessary. I don't care how many you put on. Put on a couple of hundred, if necessary.

Cann: Of course, we could get out a preliminary report to get the precise information you want.

H.M.Jr: But you have got to move fast. Put a couple of hundred men on it.

Cann: All right.

H.M.Jr: I don't care how many it takes but I am not going to sit around and - I mean, I always get this stuff about two years too late.

White: Doesn't that take only one aspect of the case that you are interested in, Mr. Secretary? They only go into their income. But aren't you also interested in the contract to see whether they are overpaid on various things? Do they have men who do that? Do you have men who are able to take the contract --

Cann: I would say our scope of investigation would go into the examination of --

White: Whether or not the price they paid for particular

commodities and so on is a fair price under those conditions and whether the labor costs and all the rest are reasonable, whether the advertising costs and all that --

Sullivan: I think Reiling, Herman Reiling of Ed's shop and Charlie Appel of Tim Mooney's shop can give you a pretty good picture of it.

Cann: Of course, so far it is an element of cost that enters in to the determination of profit and we examine it.

H.M.Jr: That is the answer to White.

White: What do you mean?

Cann: Well, we will examine it, of course, as to the purpose of verifying the amount spent. Now, as to --

White: Let me ask a specific question. Here is steel billed at thirty-two dollars a ton. The arithmetic is all right and you know they paid thirty-two dollars a ton.

Cann: That is as far as we go.

White: That is right. Do any of your men examine whether that is an inter-corporate arrangement, whether thirty-two dollars is a market price, whether they couldn't have bought it for sixteen --

Cann: If you are saying that, was there any indication of manipulation between affiliated companies, yes, we would be expected to go into that.

White: Or whether there was --

Cann: But as to whether that was too great a price or too little a price, that wouldn't be any concern of a revenue agent.

- White: That is why I think they might also have other procurement - there are so many angles --
- Cann: In other words, Mr. Secretary, if the United States Government elected to buy steel at thirty-two dollars and it should have paid only twenty-eight dollars, the revenue agent wouldn't be concerned in that.
- H.M. Jr: No, and from my end, if I could get what I want at the start, what White is talking about is something that is so broad that I would like to think about it, but certainly you could get a lot and I don't know how we could do it or where we would do it and so forth, but at least I am not putting it aside. I would like to think about it.
- Groves: Couldn't we get a little quantitative information as to how these government contracts are let, by bid or by individual choice, and how much those cost, and profit margins? I would be interested in knowing.
- White: You see, Mr. Secretary, I happen to know one case at the other end.
- H.M. Jr: Can you hold your thought a minute? Do you want to say something, John?
- Sullivan: Yes.
- H.M. Jr: Hold your thought a minute.
- Sullivan: We have the report of the Vinson Investigating Committee. It is just about ready for release. It may be out today or tomorrow. They had exactly the thing you are talking about. They had all kinds of men in the field, in the offices of these steel companies and ship building companies, investigating the contracts from the very point of view you are speaking of. I think

that might be a very good jumping off point and furnish you with excellent leads to pursue.

H.M.Jr: Well, let's give it all to Norman. I take it that is what he is here for. Kades, don't burst a blood vessel. (Laughter)

Kades: Mr. Secretary, you have a report on the cost of steel, made by the Procurement Division in 1939, a study of about five volumes. My suggestion is that Procurement be asked to bring that up to date. That would show the comparison between the cost in the five years preceding 1939 and now.

H.M.Jr: Chuck, write me a letter on that to Cliff Mack and I will sign it. Harry, you had one.

White: It is all on those lines. I happen to know somebody who sells some stuff to the government and I know they are selling it at tremendous profits. The percentage of profits would run ridiculous sums, a hundred and twenty-five to fifty percent. The degree of competition is mitigated by the fact that there are certain special characteristics of the thing, but you could examine that income statement and it is perfect. There is no attempt to defraud or to avoid, but if you once go behind that into what they are doing, that is where you will find a terrific waste, although I do think that also your study might reveal questions of depreciation and obsolescence and salaries and so on.

H.M.Jr: But Harry, my own guess is, I may be wrong, we will find so much when we take a look at this - now, I am not saying we shouldn't do it. I think we should do it, but I don't want to wait here until next May to get a report. But let's get started on the thing and if you (Cann) are the man to do it - that is what you are here for,

I take it. Is that right?

Sullivan: That is right.

H.M.Jr: So anybody that has any suggestions, turn them in. I am not saying, Harry, we shouldn't, but it is just --

White: It is a much larger task.

H.M.Jr: Well, I cabled to England and I find out what the Inter-Parliamentary Committee in England is doing. They have got a continuous committee sitting there. I want Groves to know about it. I heard they are doing a wonderful job in England on the cost of government, with a continuous committee sitting.

I cabled the Treasury man in London to let me know what this committee is doing on all costs so we had this in mind, but to come back to the original thing, what I was asking for is, I don't want to sidestep a corporate tax because I claim that is going to make a company that is already highly wasteful a little more wasteful. Does that fit in all right with you?

Groves: Yes.

H.M.Jr: I mean, I think we should do both.

Sullivan: I don't think Harold was trying to imply that we couldn't go any further. I think he was raising the point that there is a point beyond which you can't safely go. Wasn't that what you had in mind rather than that we couldn't go any further?

Groves: Well, I didn't mean to suggest any definite conclusion but merely that that be weighted in the problem, is all. I haven't made up my mind what we ought to do about the situation.

I merely raised the point that something should be considered.

H.M.Jr: Well now, what we have done this morning, we are going to have Cann go into this thing, and he is going to get the list and anybody that has any suggestions on how to get - the whole question of how much the thing has been padded will send it in to you, see.

Cann: All right, sir.

H.M.Jr: And you are going to get enough men on these ten or twelve steel companies, on their '40 returns, to see what they are doing. You can use a can opener on them. (Laughter) And I expect results.

Klotz: That was a good pun.

White: Was that intentional?

H.M.Jr: I didn't realize it until I said it.

Paul: Mr. Secretary, I think there is another --

H.M.Jr: The best ones are always the ones you don't realize.

Paul: I think there is another important aspect of Groves' point which has nothing to do with defense. I am always hearing it said that if the tax is too high, all incentive is gone, and this applies not only to defense but people become wasteful, say, in department stores and completely non-defense businesses. I am wondering if we could get at any data there to check the good faith of that statement, because it doesn't seem to me that people are going to become too terribly wasteful and do so much prestige advertising if the corporate rate is sixty percent.

H.M.Jr: Well, would you give --

Paul: I don't know how you get at that, but that is the argument that is going to be made all along the line.

Sullivan: I would like to bring a man here to do a study on increased corporate advertising. It is perfectly evident that there is a tremendous amount of money being squandered on advertising in ordinary periodicals, purely defense products. You can't pick up the Saturday Evening Post or Collier's or any of those popular magazines without seeing full page ads for Lockheed and Pratt and Whitney. Now, that money is being paid for a hundred cents on the dollar by the War Department and the Navy Department, and I think it ought to be stopped.

White: Absolutely.

Sullivan: I would like to start a study on that.

White: Isn't that the answer to what Groves and Randolph Paul are saying, that these wastes - and there are many of these - should merely encourage the taxpayer to find ways of eliminating them. It is easy to limit high salaries, limit the amounts of advertising to some figure, in which you block those avenues of waste; and there is just one further point I would like to add. You remember, Mr. Secretary, when you spoke of that six percent tax, one of the important reasons that you advanced in favor of its feasibility was this, that if you did tax everything above six percent, then you could be tough with the question of increasing wage rates and labor, and that is one of the avenues they claim is wasteful.

They say, "Oh, well, if a man only gets six

percent out of it, he doesn't care what he pays for labor," but at that point the government can step in and care because it comes out of its pocket.

H.M.Jr: We ought to care now.

Cann: Mr. Secretary, isn't it true that the Navy or the Army have their own trained representatives on the job at these particular spots also checking these costs?

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

Cann: I think they do.

H.M.Jr: It was my impression that they are simply there on production, as inspectors.

Foley: I think you are right about that. They don't have the same kind of inspectors that we had at PWA, where there was an audit of every cost, and where there was a disallowance of items that were exorbitant.

H.M.Jr: I never heard of it.

White: Anyway, so many of them joined the Electric Boat Company afterward that they are not --

H.M.Jr: It is the other way around, Harry. You get retired from the Navy and then join the Electric Boat Company.

White: So many of them have joined the Electric Boat Company lately that they are sympathetic.

H.M.Jr: In this investigation on advertising, just remember that if a man spends his money to advertise Defense Savings Bonds, that is exempt.

Foley: I think they ought to look at expense accounts in advertising too.

Paul: That is a good form of prestige advertising.

H.M.Jr: And when Bendix goes on the air for the Treasury Hour.

Sullivan: Well, there is a man in Chicago I have talked with quite a bit on this very thing, and I think I am going to, with your permission, write to him and ask him to come on here and let you have a talk with him and see if we want to take him on.

H.M.Jr: That is all right. Well, this for me has been a very profitable morning. If you could continue this conversation --

Sullivan: Do you want to see Ed and Joe O'Connell and myself and Harry White on that regulation now?

H.M.Jr: Not now. I have got press. I can see you men at 3:30.

Sullivan: Very well.

H.M.Jr: When do you want to see me again on this tax thing? When will you be ready? Sullivan and who?

Blough: We have a lot of stuff we haven't talked about yet.

H.M.Jr: Who is coming?

Sullivan: You asked Foley and O'Connell and this morning Harry White said he would like to be heard on it too.

H.M.Jr: On which thing?

Sullivan: The exempt corporations furnishing information on receipts and expenditures.

H.M.Jr: Harry is a hard man to keep out. (Laughter)

Foley: You ought to have Chuck Kades too, Mr. Secretary.

Sullivan: Yes, I think Chuck should be here.

H.M.Jr: They are a kind of team over there.

Paul: When can we talk about the plan we discussed after the last meeting, or have you talked about that?

H.M.Jr: We talked about it but we didn't get very far. Are you going to be here tomorrow?

Paul: I can't be tomorrow. I can be all next week but not tomorrow. That is why I wanted to see if we were going to have another meeting on it today.

Sullivan: Well, I think we had better because we are not in any position on that to bother the Secretary. I think after this meeting is over we all had better go down to my room and take our coats off and go to work on it.

H.M.Jr: Well, this meeting of Sullivan and Foley and all the rest of these fellows shouldn't take more than fifteen minutes, should it?

Sullivan: I shouldn't think so.

H.M.Jr: So if you tax boys want to come in after 3:30, I will be available. I will keep it open the rest of the afternoon. I will keep the rest of the afternoon open.

Sullivan: All right.

H.M.Jr: How is that?

Sullivan: I don't know that we will have any conclusions
for you.

H.M.Jr: But I will just hold it open.

Sullivan: All right.

Computation of tax liability on 1940 income
under present law

39

General Motors Corporation

Return filed on a consolidated basis, for the calendar year.

The income method is used in computing the excess profits tax.

Computation of excess profits tax

| | |
|--|---------------|
| 1. Net income | \$347,250,183 |
| 2. Adjustments in arriving at excess profits net income | - 11,172,044 |
| 3. Excess profits credit and specific exemption | 217,770,012 |
| 4. Adjusted excess profits | 118,308,127 |
| 5. Excess profits tax | 70,938,876 |
| 6. Balance of net income, after E.P.T., subject to normal tax and surtax | 276,311,307 |
| 7. Normal tax | 66,314,714 |
| 8. Surtax | 19,341,541 |
| 9. Total income and excess profits taxes | 156,595,131 |
| 10. Total income and excess profits taxes as a percent of net income | 45.1% |

Invested capital credit (Data not available)

Average earnings credit \$217,765,012

Business: Manufacture and sale of automobiles and parts, etc.

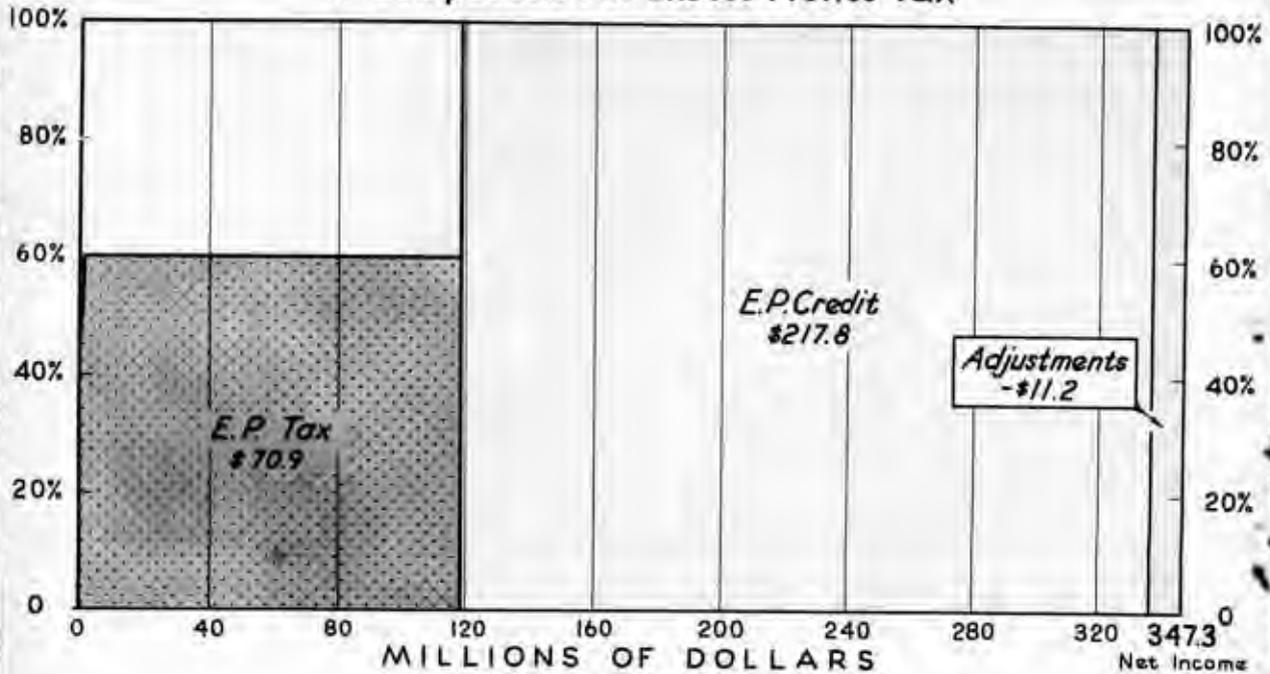
COMPUTATION OF TAX LIABILITY ON 1940 INCOME UNDER PRESENT LAW

GENERAL MOTORS CORP.

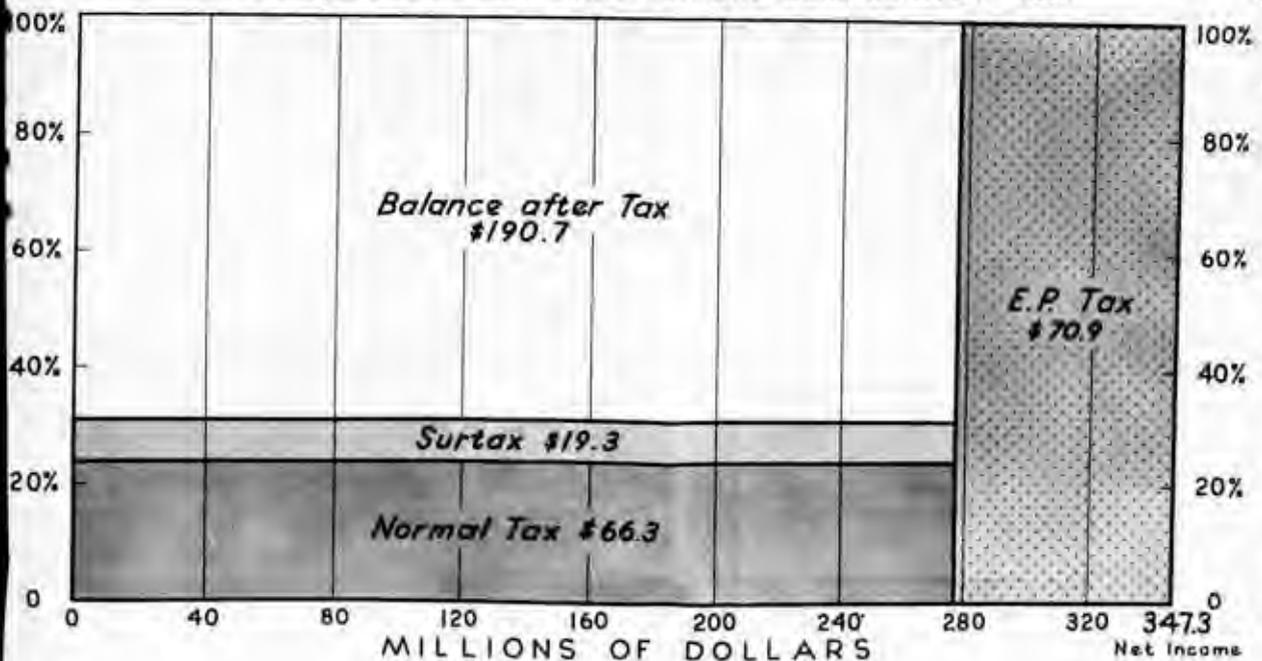
Income Method

Net Income \$347.3 mil. Adjusted Excess Profits \$118.3 mil.
E. P. Credit \$217.8 mil. Normal Tax Net Income \$276.3 mil.

I. Computation of Excess Profits Tax



II. Computation of Income Tax and Balance after Tax



Computation of tax liability on 1940 income
under present law

Glenn L. Martin Company

Return filed on an unconsolidated basis, for the calendar year.

The income (growth) method is used in computing the excess profits tax.

Computation of excess profits tax

| | |
|--|-------------|
| 1. Net income | \$8,355,138 |
| 2. Adjustments in arriving at excess profits net inc. | - 500 |
| 3. Excess profits credit and specific exemption | 5,473,400 |
| 4. Adjusted excess profits | 2,881,238 |
| 5. Excess profits tax | 1,682,743 |
| 6. Balance of net income, after E.P.T., subject to normal tax and surtax | 6,672,395 |
| 7. Normal tax | 1,601,375 |
| 8. Surtax | 466,818 |
| 9. Total income and excess profits taxes | 3,750,936 |
| 10. Total income & excess profits taxes as a percent of net income | 44.9% |

Invested capital credit (Data not supplied)

Average earnings credit \$5,468,400

Business: Aircraft and parts manufacturing

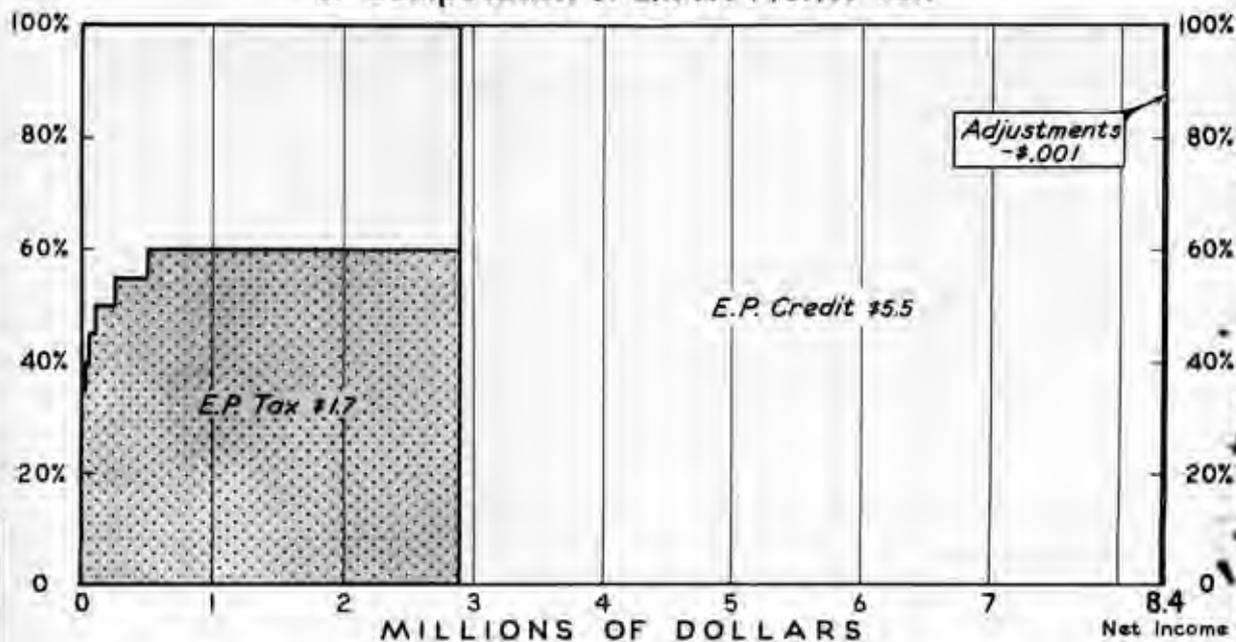
COMPUTATION OF TAX LIABILITY ON 1940 INCOME UNDER PRESENT LAW

GLEN L. MARTIN Co.

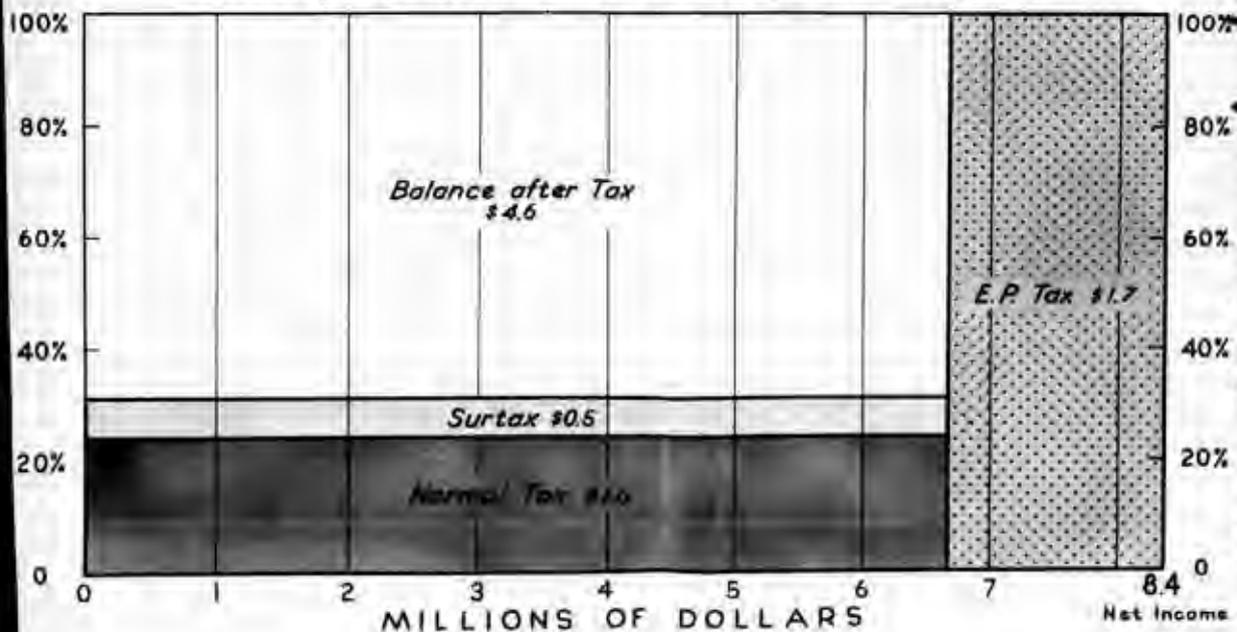
Income (Growth) Method

Net Income \$ 8.4 mil Adjusted Excess Profits \$ 2.9 mil.
E. P. Credit \$ 5.5 mil Normal Tax Net Income \$ 6.7 mil.

I. Computation of Excess Profits Tax



II. Computation of Income Tax and Balance after Tax



Computation of tax liability on 1940 income
under present law

Curtiss-Wright Corporation

Return filed on an unconsolidated basis, for calendar year.

The invested capital method is used in computing the excess profits tax.

Computation of excess profits tax

| | |
|--|---------------|
| 1. Net income | \$ 26,028,184 |
| 2. Adjustments in arriving at excess profits net inc. - | 369,117 |
| 3. Excess profits credit and specific exemption | 7,995,763 |
| 4. Adjusted excess profits | 17,668,304 |
| 5. Excess profits tax | 10,554,982 |
| 6. Balance of net income, after E.P.T., subject to normal tax and surtax | 15,473,202 |
| 7. Normal tax | 3,713,568 |
| 8. Surtax | 1,082,874 |
| 9. Total income and excess profits taxes | 15,351,425 |
| 10. Total income & excess profits taxes as a percent of net income | 59.0% |

Invested capital credit

| | |
|----------------------------|---------------|
| Amount of invested capital | \$113,439,465 |
| \$ 5,000,000 at 5% | 400,000 |
| 108,439,465 at 7% | 7,590,763 |
| Total credit | 7,990,763 |

Average earnings credit

2,472,258

Business: Manufacturers of aircraft.

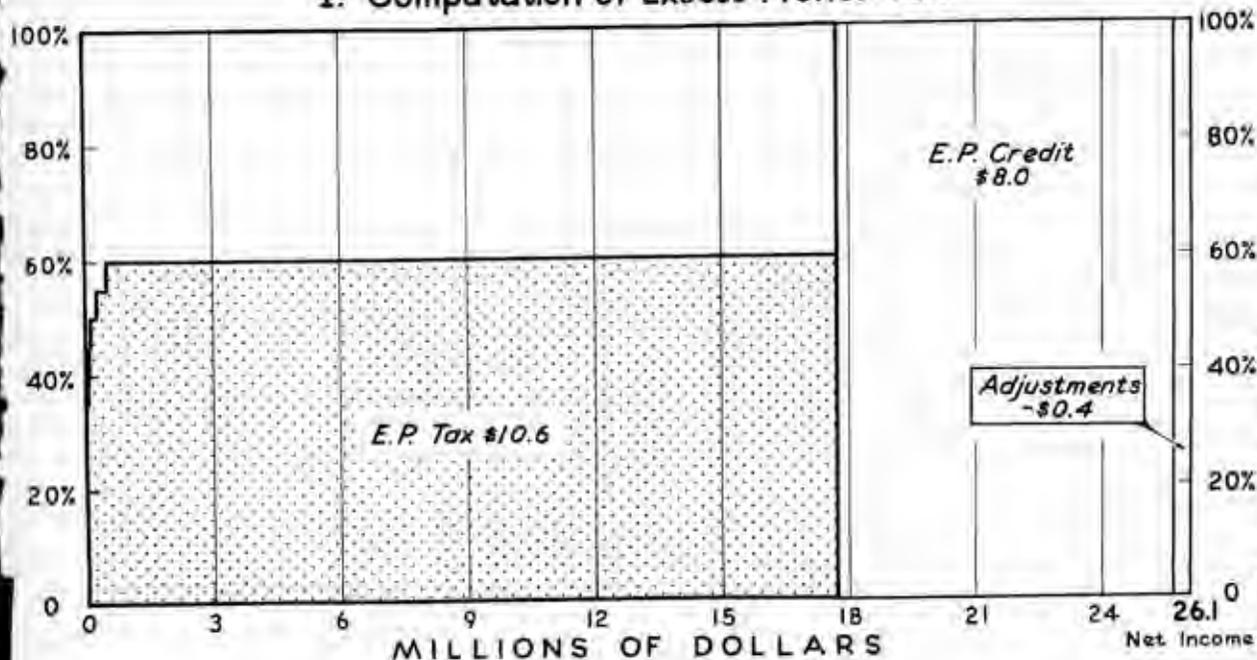
COMPUTATION OF TAX LIABILITY ON 1940 INCOME UNDER PRESENT LAW

CURTISS-WRIGHT CORP.

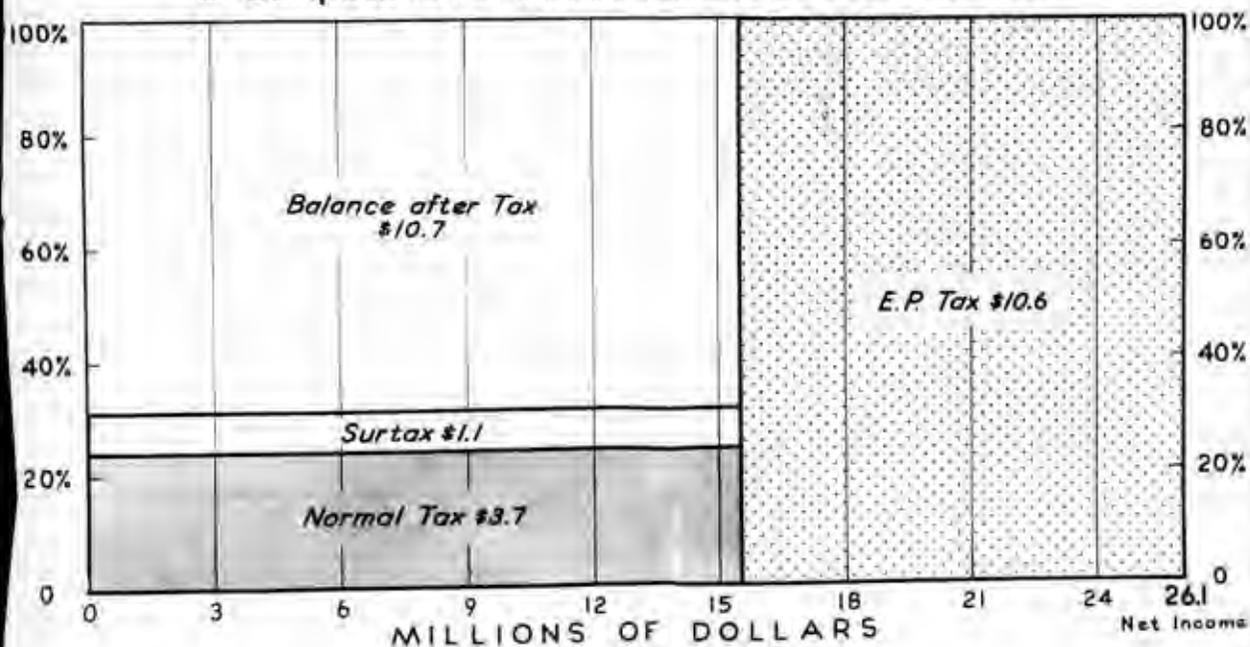
Invested Capital Method

Net Income \$26.1 mil. Adjusted Excess Profits \$17.7 mil.
E. P. Credit \$8.0 mil. Normal Tax Net Income \$15.5 mil.

I. Computation of Excess Profits Tax



II. Computation of Income Tax and Balance after Tax



Computation of tax liability on 1940 income
under present law

The Coca-Cola Company

Return filed on an unconsolidated basis, for the calendar year.

The income (growth) method is used in computing the excess profits tax.

Computation of excess profits tax

| | |
|--|--------------|
| 1. Net income | \$35,818,517 |
| 2. Adjustments in arriving at excess profits net inc. | - 256,558 |
| 3. Excess profits credit and specific exemption | 30,831,287 |
| 4. Adjusted excess profits | 4,730,672 |
| 5. Excess profits tax | 2,792,403 |
| 6. Balance of net income, after E.P.T., subject to normal tax and surtax | 33,026,114 |
| 7. Normal tax | 7,926,267 |
| 8. Surtax | 2,311,578 |
| 9. Total income and excess profits taxes | 13,030,248 |
| 10. Total income and excess profits taxes as a percent of net income | 36.4% |

Invested capital credit (Data not supplied.)

Average earnings credit

\$30,826,287

Business: Manufacture and sale of a soft-drink syrup under trade-mark "Coca-Cola."

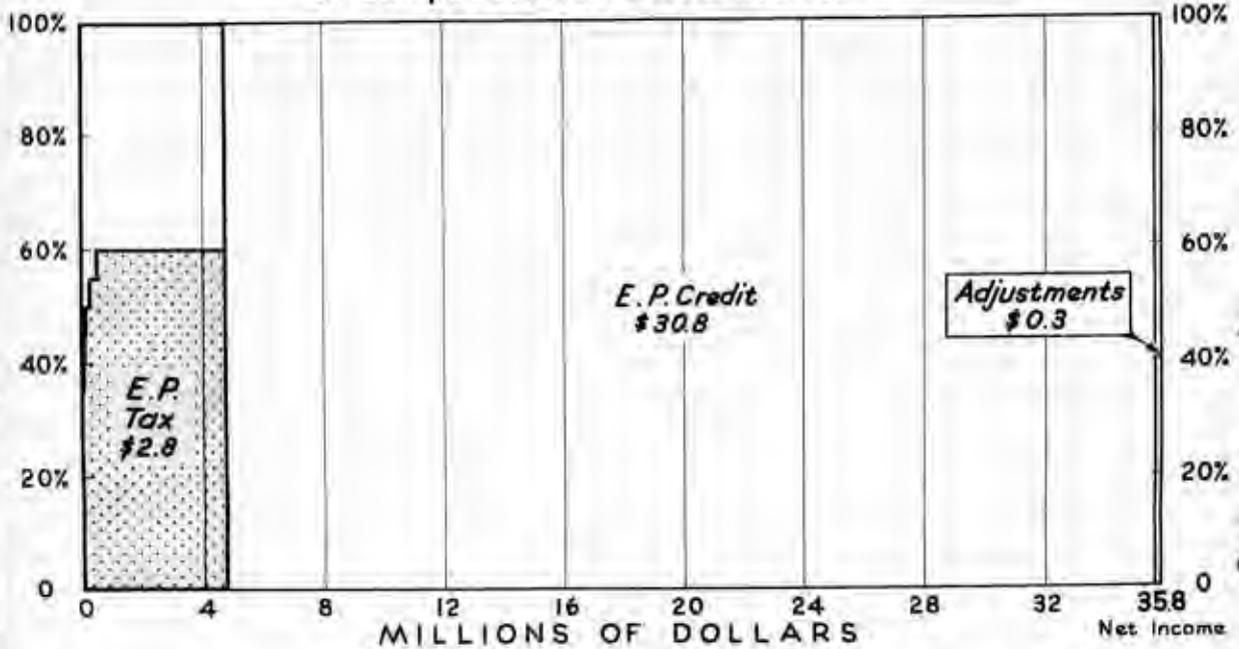
COMPUTATION OF TAX LIABILITY ON 1940 INCOME UNDER PRESENT LAW

COCA COLA CO.

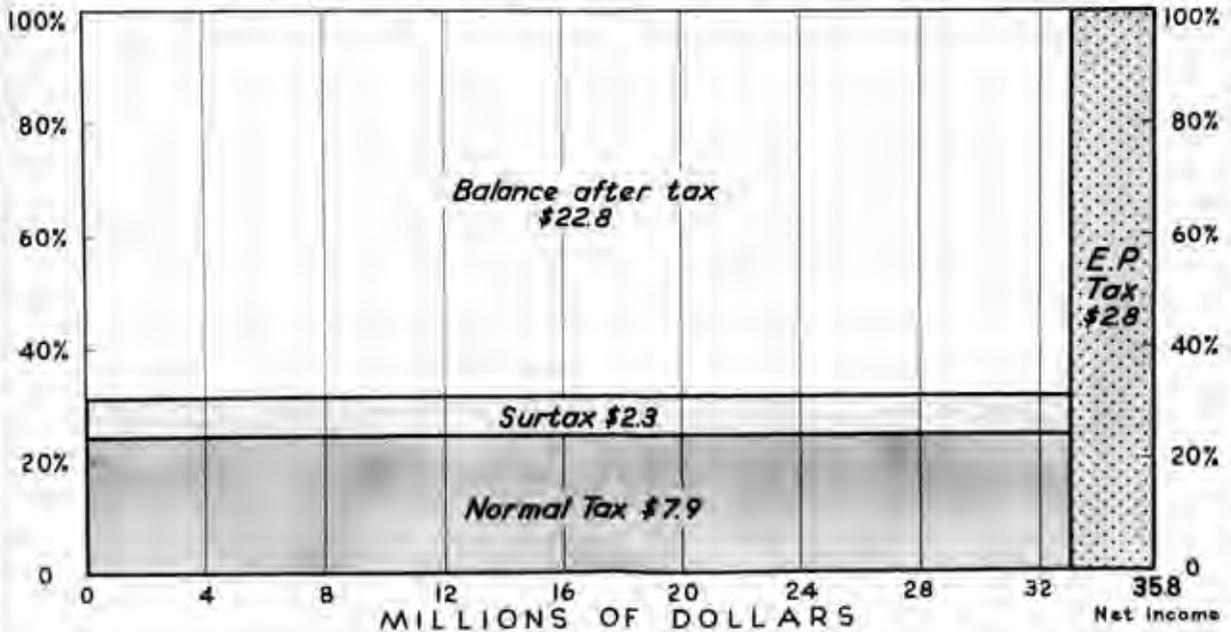
Income Method

Net Income \$35.8mil. Adjusted Excess Profits \$4.7mil.
E. P. Credit \$30.8mil. Normal Tax Net Income \$33.0mil.

I. Computation of Excess Profits Tax



II. Computation of Income Tax and Balance after Tax



Computation of tax liability on 1940 income
under present law

American Car and Foundry Company

Return filed on a consolidated basis, for period ended 4-30-41.

The invested capital method is used in computing the excess profits tax.

Computation of excess profits tax

| | |
|--|-------------|
| 1. Net income | \$6,983,751 |
| 2. Adjustments in arriving at excess profits net inc. | + 16,931 |
| 3. Excess profits credit and specific exemption | 6,612,535 |
| 4. Adjusted excess profits | 388,147 |
| 5. Excess profits tax | 192,481 |
| 6. Balance of net income, after E.P.T., subject to normal tax and surtax | 6,791,270 |
| 7. Normal tax | 1,629,905 |
| 8. Surtax | 475,139 |
| 9. Total income and excess profits tax | 2,297,525 |
| 10. Total income and excess profits taxes as a percent of net income | 32.9% |

Invested capital credit

| | |
|------------------------------|--------------|
| Amount of invested capital | \$93,679,072 |
| \$5,000,000 at 8% \$ 400,000 | |
| 88,679,072 at 7% 6,207,535 | |
| Total credit | 6,607,535 |

Average earnings credit (Data not supplied)

Business: Manufacturers of railway cars, supplies, etc.

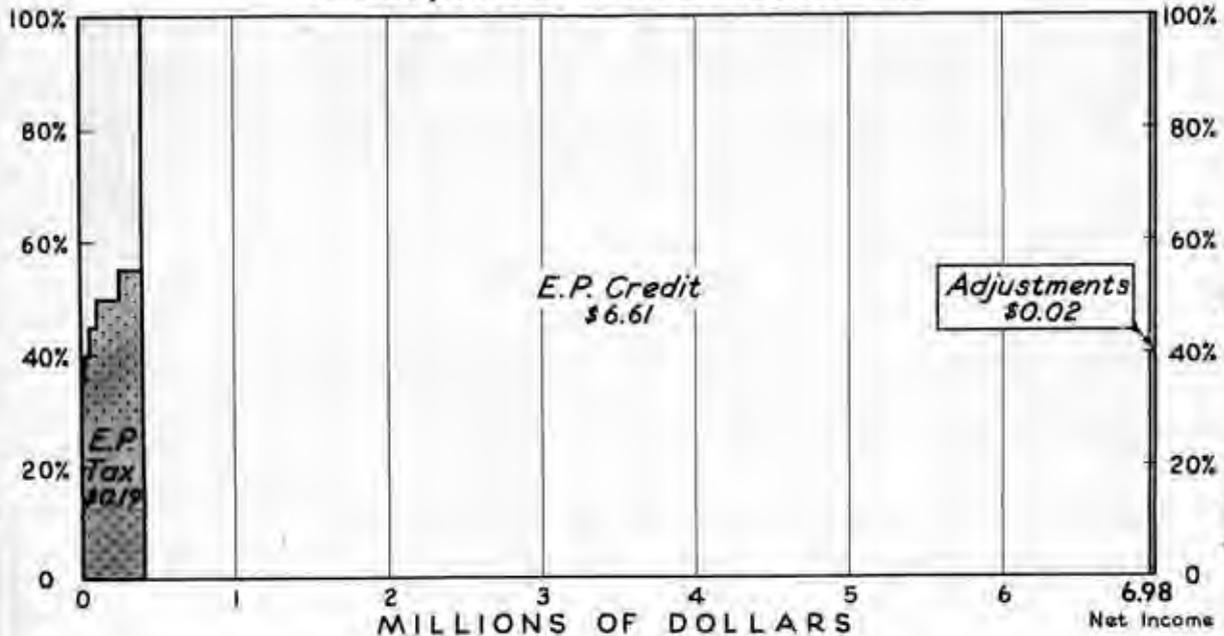
COMPUTATION OF TAX LIABILITY ON 1940 INCOME UNDER PRESENT LAW

AMERICAN CAR AND FOUNDRY

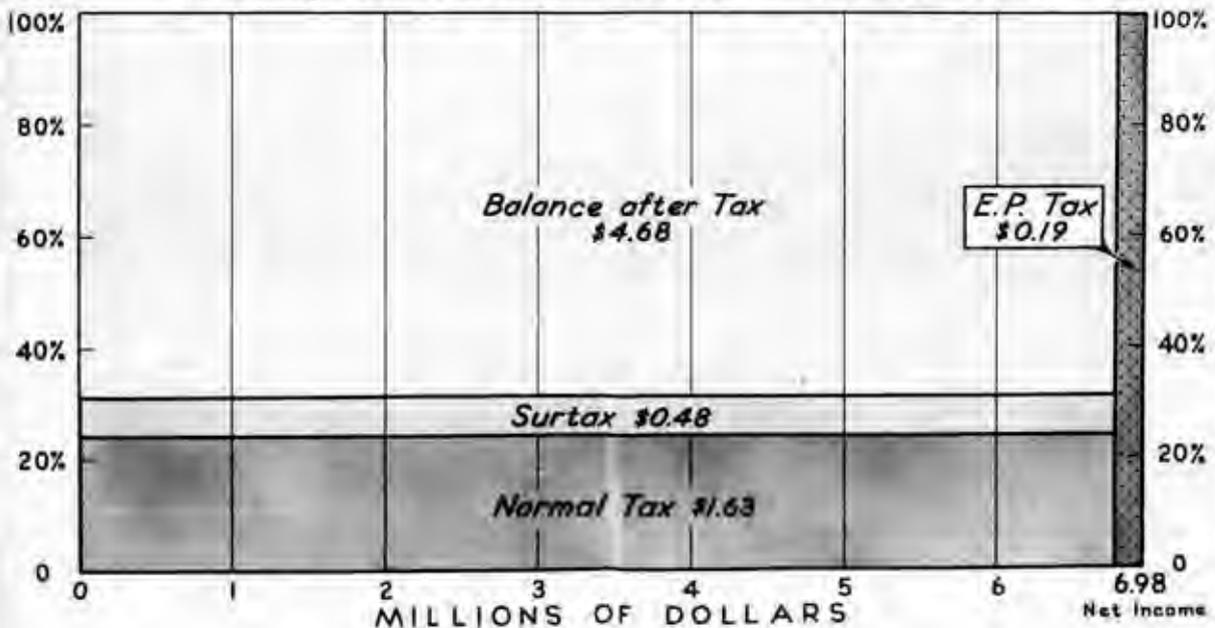
Invested Capital Method

Net Income \$6.98 mil. *Adjusted Excess Profits* \$0.39 mil.
E.P. Credit \$6.61 mil. *Normal Tax Net Income* \$6.79 mil.

I. Computation of Excess Profits Tax



II. Computation of Income Tax and Balance after Tax



Computation of tax liability on 1940 income
under present law

U. S. Steel Corporation

Returna filed on a consolidated basis, for the calendar year.

The invested capital method is used in computing the excess profits tax.

Computation of excess profits tax

| | |
|--|---------------|
| 1. Net income | \$102,049,526 |
| 2. Adjustments in arriving at excess profits net inc. | + 2,791,645 |
| 3. Excess profits credit and specific exemption | 162,154,284 |
| 4. Adjusted excess profits | - |
| 5. Excess profits tax | - |
| 6. Balance of net income, after E.P.T., subject to normal tax and surtax | 102,049,526 |
| 7. Normal tax | 24,491,886 |
| 8. Surtax | 7,143,217 |
| 9. Total income and excess profits taxes | 31,635,103 |
| 10. Total income & excess profits taxes as a percent of net income | 31% |

Invested capital credit

| | |
|---------------------------------|---------------|
| Amount of invested capital | 2,315,704,056 |
| \$500,000 at 8% \$ 400,000 | |
| 2,310,704,056 at 7% 161,749,284 | |
| Total credit | 162,149,284 |

Average earnings credit (Data not supplied)

Business: Holding corporation owning stocks and securities of various companies engaged in the manufacture of iron and steel products and the production and transportation of necessary raw materials

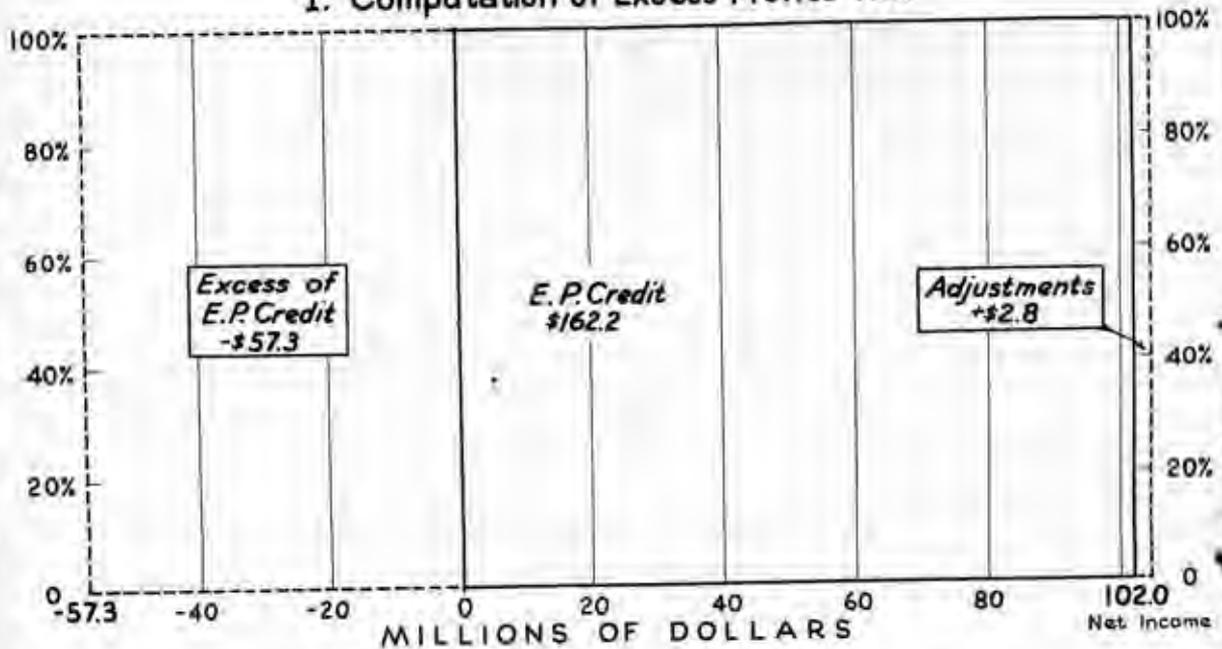
COMPUTATION OF TAX LIABILITY ON 1940 INCOME UNDER PRESENT LAW

U.S. STEEL CORP.

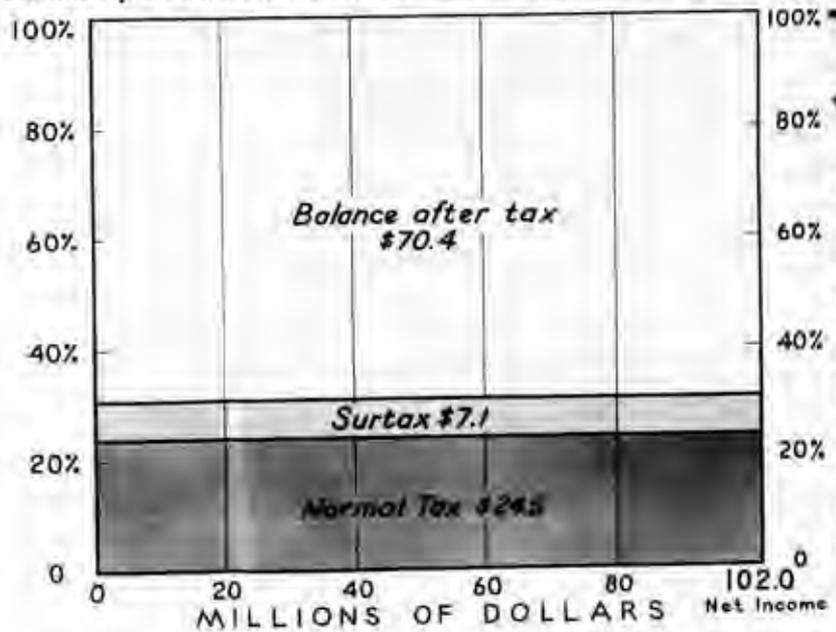
Invested Capital Method

Net Income \$102.0 mil. Adjusted Excess Profits -\$57.3 mil.
E. P. Credit \$162.2 mil. Normal Tax Net Income \$102.0 mil.

I. Computation of Excess Profits Tax



II. Computation of Income Tax and Balance after Tax



Computation of tax liability on 1940 income
under present law

51

Bethlehem Steel Corp.

Return filed on a consolidated basis, for the
calendar year.

The invested capital method is used in computing the
excess profits tax.

Computation of excess profits tax

| | |
|---|--------------------------|
| 1. Net income | \$ 63,246,906 |
| 2. Adjustments in arriving at excess profits net inc. * | 5,200,659 |
| 3. Excess profits credit and specific exemption | 42,273,328 |
| 4. Adjusted excess profits net income | 26,174,237 |
| 5. Excess profits tax | 15,462,981 ^{1/} |
| 6. Balance of net income, after E.P.T., subject to normal tax and surtax | 47,785,925 |
| 7. Normal tax | 11,468,142 |
| 8. Surtax | 3,344,625 |
| 9. Total income and excess profits taxes | 30,275,748 |
| 10. Total income & excess profits taxes as a percent of net income | 47.9% |

Invested capital credit

| | |
|------------------------------|----------------|
| Amount of invested capital | \$ 603,118,975 |
| \$ 5,000,000 at 8% 400,000 | |
| 598,118,975 at 7% 41,868,328 | |
| Total credit | 42,268,328 |

Average earnings credit 19,564,672

Business: Manufacturers of iron and steel products

^{1/} After allowing for payment of \$195,561 to U. S. Maritime Commission
as excessive profits.

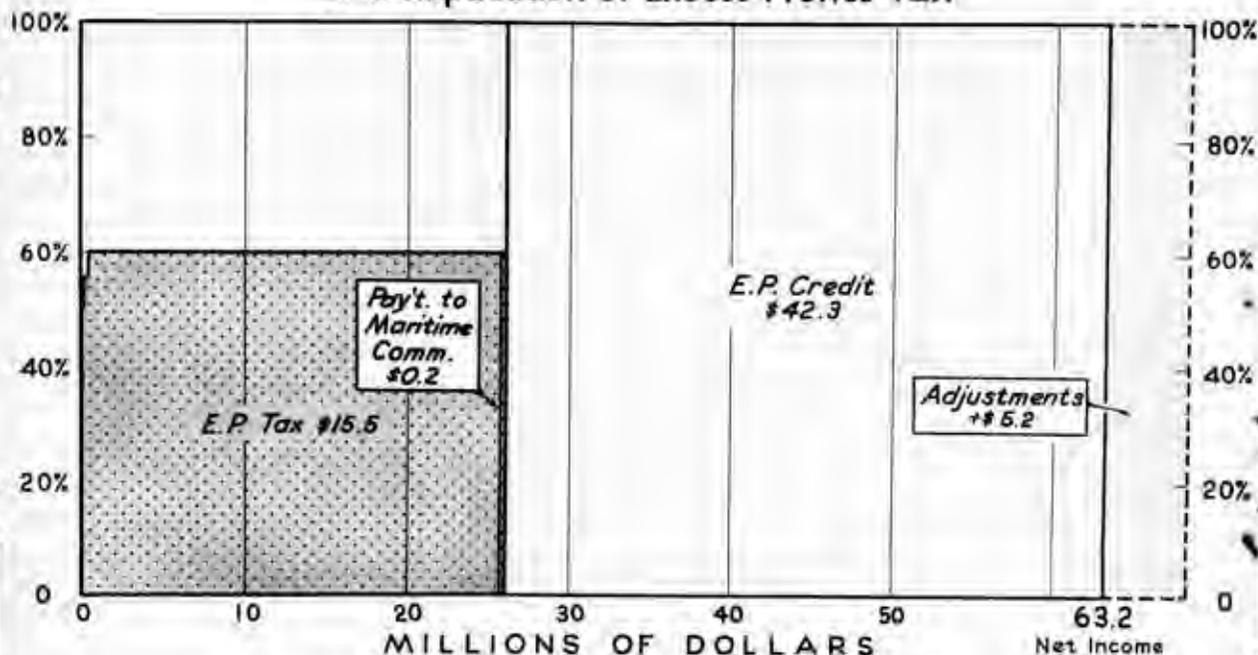
COMPUTATION OF TAX LIABILITY ON 1940 INCOME UNDER PRESENT LAW

BETHLEHEM STEEL CORP.

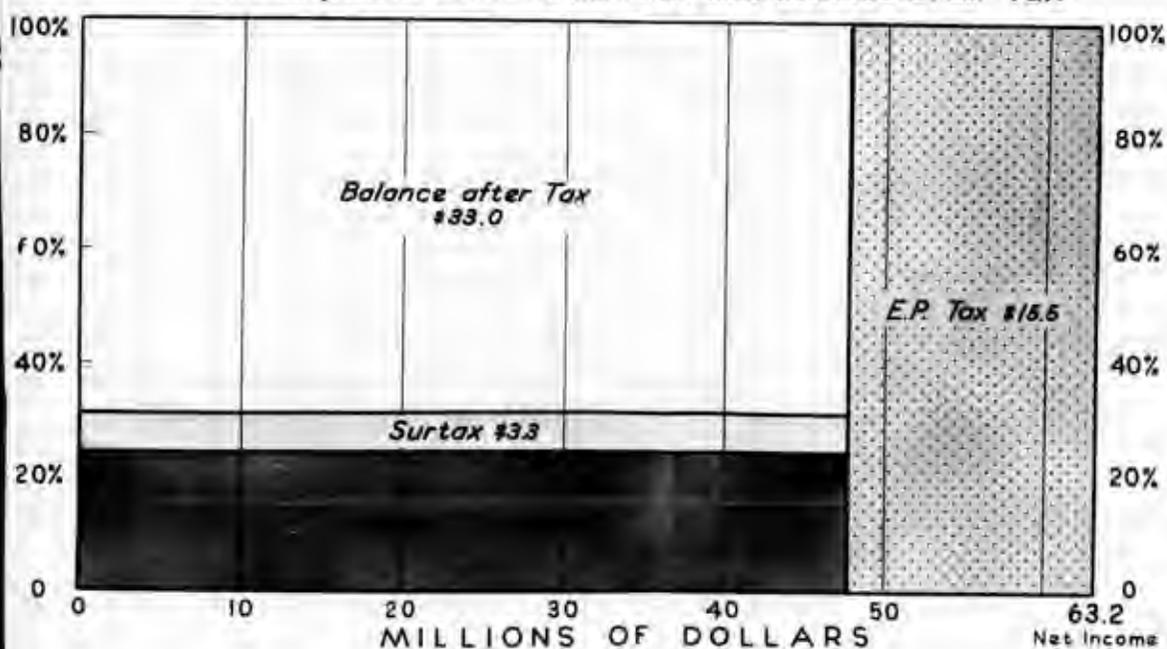
Invested Capital Method

Net Income \$632 mil Adjusted Excess Profits \$26.2 mil
E. P. Credit \$423 mil Normal Tax Net Income \$47.8 mil

I. Computation of Excess Profits Tax



II. Computation of Income Tax and Balance after Tax



November 27, 1941

MEMORANDUM FOR THE SECRETARY

Subject: Speeding up 1942 income tax collections.

This memorandum is intended briefly to outline a method of securing during 1942 additional tax collections which may be required for controlling inflation alternative to the supplementary 15 percent tax. The plan described below incorporates the withholding principle in our present tax structure. The essential idea of the plan is to withhold at the source in 1942 (the year in which taxes on 1941 incomes are payable) part of the tax on 1942 incomes. This will mean that in 1942 taxpayers would be paying (1) their 1941 taxes and (2) part of their 1942 taxes, thus increasing tax payments in 1942 and reducing purchasing power; but the additional payments in 1942 would be taxes on 1942 income and would not be a supplementary burden. In other words, these tax payments will be on account of tax liabilities already on the statute books, and will not reflect any additional imposition of tax liability.

There are two methods of accelerating tax collections, as follows:

1. The first is to collect the 1941 tax liabilities in 1942 in instalments under present law without change and, in addition, as soon after January 1 as practicable, to withhold at the source a tax of 10 percent (the basic combined normal and surtax bracket in the present law) from wages, salaries, bond interest and dividends. Simultaneously efforts would be made to induce the advance payment of as much of the rest of the tax as possible. In 1943 the withholding would continue and the balance of 1942 tax liabilities would be paid.

- 2 -

2. A second plan for accelerating income tax collections would be to collect the 1941 tax liabilities as early as possible in 1942, perhaps in six monthly installments, beginning February 15 and ending July 15. Beginning about July 1, the 10 percent first bracket rate would be withheld on salaries, wages, dividends and interest in the same manner as indicated in the first plan except that it might be found desirable to withhold at a higher rate than 10 percent in order to get a larger proportion of 1942 tax liabilities collected in 1942. The remaining 1942 tax would be collected in 1943.

Both of these methods involve an element of discrimination in that the recipients of wages, salaries, dividends and bond interest would be obliged to pay their taxes many months in advance of the recipients of other types of income and furthermore that the small taxpayer would be forced to pay a greater proportion of his taxes in advance than will the larger taxpayer. It may, therefore, be necessary to offer an inducement for early payment of that part of the tax liability which is not collected at the source. This may be done by offering a discount for early payment, perhaps at a level above that paid by the Government on its recent bond issue. A preferable alternative might be to impose an additional tax amounting to perhaps 5 percent of the income tax, such additional tax to be forgiven with regard to the withheld portion of the tax and also with regard to advance payments of the remaining tax.

The acceleration of tax collections has several advantages:

1. It constitutes a step in the direction of a system of current income tax collections. Once established, such a system would serve two important purposes.

(a) It would make the income tax a more flexible and a more sensitive instrument of public policy.

(b) It would better integrate the income tax with personal budgets.

2. The acceleration of tax collections would permit the postponement of tax rate increases while providing the higher collections which may be immediately required to dampen the inflationary process. Such a postponement may be desirable because it would furnish a longer period for studying the needs for further taxes, and also because of the hostility of the taxpayers to new, higher tax rates so soon after the recent revenue act.

3. The acceleration of tax collections would distribute the additional tax burden in accordance with the present progressive income tax, and, therefore, would probably be more equitable than any additional tax (including a flat 15 percent tax withheld at the source) that might be enacted.

4. Although this plan is simpler than adding a withholding tax, in that only one tax is imposed, it is flexible in that the withholding rates may be changed upward or downward when needed.

5. Politically, the speeding up of tax collections would probably be more acceptable than the imposition of a corresponding amount of additional taxes.

The acceleration of tax collections has several disadvantages:

1. In substance, it is merely a postponement and not a solution of the problem of legislation to withdraw more purchasing power from income recipients. It may leave a bigger tax problem for 1943 if conditions then demand a further drastic reduction in purchasing power.

2. The speeding up of tax collections, coming at a time when the recent substantial tax increases are beginning to be felt for the first time, would not obviate hardships or eliminate adverse public reaction to tax increases generally.

November 27, 1941

Tax on increases in income as a means of preventing
inflation

Several plans for taxing increases in income have been considered, among them the so-called "Paul plan".

The merits of a tax on increases in income depend, to a considerable extent, on the specific form of the tax. The following comments relate in the main to the general idea of such a tax.

A. Equity

1. Many income increases during the defense period are more or less windfalls to the individual which are not necessary in order to get him to do necessary work. The existence of such windfalls makes people who have not had increased incomes unwilling to have their standards of living cut through taxation as long as they see other persons who have received such windfalls paying no higher taxes on their incomes.

2. In general, however, a family which has been receiving a certain size income over a period of time is in at least as good a position to pay taxes on that income as a family which has been at a lower level of income and has just received an increase. Furthermore, there are many situations in which increases in income are necessary and desirable and should not be subject to tax, among them the following:

(a) Where the family has been on relief and the wage-earner has just gotten a job again.

(b) Where receiving the increased wage necessitates moving to a high-cost community, the increase in income may have been offset by increased living expenses.

(c) Where a person has recently graduated from high school or college or is just starting up in his profession, increases in income would be the normal expectation regardless of the defense effort. They may be accompanied by increased responsibilities such as marriage or the birth of children.

3. No way has been found of separating the cases where increases should be taxed and where increases should not be taxed. The existence of a great number of increases that should not be taxed would result in much inequity and hardship from a tax on increased income.

4. In general, the tax on increased incomes would fall on younger persons to the relative benefit and advantage of older persons. In view of the fact that the draft also hits younger persons, the imposition of the heavy tax on increased incomes may appear to concentrate the burden of the defense effort too much in the younger age groups.

B. Effectiveness in offsetting or preventing inflation

1. A revenue yield from the tax on increases in incomes would necessarily be smaller than such increases since otherwise the tax would have to be 100 percent of all increases. Actually, the rate would be much lower than 100 percent and the tax base would be greatly diminished by exempting the lower incomes where it appears the principal income increases are occurring. Accordingly, a tax on increases could not be expected to offset all the inflationary effects of increases in incomes.

2. If inflation became worse and incomes continued to increase, the yield from a tax on increased incomes would rise; thus the amount of the tax would, to some extent, be determined by the seriousness of the inflation.

3. Since the tax on increases in incomes could not be collected as a practical matter before the following year, the effects on inflation might come too late to be of any substantial use.

4. For these reasons, a tax on increases in income can not be viewed as a substitute for other anti-inflationary taxes. At best, it would be a supplement raising a minor proportion of the additional revenue.

C. Tax compliance and administration

1. A very simple tax on income increases would not be particularly difficult for the taxpayer and would not be an insuperable load added on to the present administrative burden

on the Bureau of Internal Revenue. A more equitable tax, however, might prove to be too complicated for the taxpayer to compute or for the Bureau to enforce. There is a limit beyond which a tax-administering agency cannot increase its effectiveness within a short period of time regardless of the amount of money available to it.

D. Anticipated political reaction

1. The tax on increased incomes seems popular because, not having been publicly proposed, we are hearing only from those who would be benefited by having such a tax instead of some other form. Once it was publicly proposed, however, the very substantial group which would be hurt by it would oppose it vigorously. Many very serious hardships would be revealed and much public sympathy would be developed for such cases. It should not be expected that such a tax would be politically more popular than any other form of tax raising the same amount of revenue.

November 27, 1941

MEMORANDUM FOR THE SECRETARY

Number of white-collar salaried persons

The most recent data on the number of white-collar salaried persons appear to be for 1935-1936. In that year, according to the National Resources Committee, there were almost 6 million white-collar salaried families, as follows:

| | |
|---------------------------------|-----------|
| Clerical families | 3,626,200 |
| Salaried business families. . . | 1,112,600 |
| Salaried professional families | 989,200 |
| Total | 5,728,000 |

More recent data are contained in the 1940 Census, but are not yet available, except for a few selected States.

For 1930, the Census enumerated about 10 million "clerks and kindred workers" and salaried "professional persons." The lower figure shown for 1935-36 does not imply a corresponding decline in the number of white-collar salaried persons during the five year interval; it is partly explained by differences in classification and the fact that the 1930 data are for persons while the 1935-36 data are for families.

Roy Blough

November 27, 1941
11:45 a.m.

RE FINANCING

Present: Mr. Haas
Mr. Morris
Mr. Murphy
Mr. Hadley
Mr. Bell
Mr. Schwarz

H.M.Jr: Well, go ahead George, what have you got for me?

Haas: Among other things, I don't know if you are interested in this at the moment or not; you asked for another memorandum on excess --

H.M.Jr: No, no, the financing; let's concentrate on that. I am oozing taxes.

Haas: Well, we are in a very preliminary stage on the thing. I can point out some of the issues.

H.M.Jr: Can't I settle how much money we want?

Haas: Well, I talked to Bell and he says a billion and a half.

H.M.Jr: How does he get that way?

Haas: It is the second question, that is, one or two issues.

(Mr. Bell entered the conference)

H.M.Jr: Come in, Professor. We can't operate without you.

Bell: I feel flattered.

H.M.Jr: Why do you want a billion and a half?

Bell: Well, I would like to go through until February without borrowing any more money.

H.M.Jr: Can you on that basis?

Bell: Except through Treasury bills. This program contemplates a hundred million dollars extra money in bills on the third and then dropping it to fifty million up to January 21, which completes the thirteen week cycle and then just rolling them over from there, we can consider at that time whether we want to increase that hundred and fifty to two hundred million.

H.M.Jr: Say it over again, please.

Bell: We get an extra hundred million on the third of December under the two hundred million program.

H.M.Jr: Yes.

Bell: On the tenth this program contemplates we drop it to a hundred and fifty.

H.M.Jr: Yes.

Bell: And go with a hundred and fifty until January 21, which completes the thirteen week cycle.

H.M.Jr: Yes.

Bell: And then we roll them over from there to the hundred and fifty or two hundred or whatever they might be, but we can consider at that time as to whether we want to increase that hundred and fifty million weekly offering to two hundred million, completing the thirteen week cycle on the two hundred million, which would make

two billion six outstanding. By borrowing a billion and a half in December, we can go out of December with two billion one hundred million and out of January with one billion and a quarter. That means we will have to borrow a million and a half dollars in February and then, as I told you yesterday, I would like to skip March because of the tax --

H.M.Jr: Well, you would go out of December with how much?

Bell: About two billion one.

H.M.Jr: Well, then, this doesn't have to be settled right now, but I would like to drop the bills down to a hundred million, you see, and not go out with so much and then pick them up in a month. But I am just throwing that out. I think to go out with two billion one is too much. I would like to start next week with a hundred million borrowing and then keep it a hundred until we need a little more money and we will go up to a hundred and fifty or two hundred. I don't care about this cycle business. I am not very good at cycles.

Bell: I don't think that is important.

H.M.Jr: But I think to go out with two billion one is too big; it is unnecessary, and I am just throwing it out to these gentlemen to drop it from two hundred to a hundred.

Bell: I think that will improve your rate immensely and have a psychological effect on the short term market. Even the fifty will. A hundred million, I think, will do that much better. We can do that - you probably ought to complete the cycle before February 18, when your first two hundred million dollars matures, because then you can't - you probably won't be in a position to add any from there on in.

H.M.Jr: That will be all right, but you could drop it to a hundred and leave it there until --

Bell: Well, in January you can pick it up, the first of January. That is all right. That might be a good thing.

- H.M.Jr: Well, nothing is settled. Of course, this is the first meeting, but I am throwing that out. When do we have to decide that, Monday?
- Bell: Well, I would like for you to decide it Monday. Of course Tuesday is your open market meeting. I think it would help the market if you would decide it. You threw out a hint today, I see.
- H.M.Jr: Well, they asked me about the bills.
- Bell: Did they?
- H.M.Jr: And I said we would let them know. Your friend Marriner Eccles goes up and makes a speech on taxes and neither John Sullivan nor I have yet seen a copy of it.
- Bell: Is that this New York crowd again?
- H.M.Jr: Yes.
- Bell: Is it off the record?
- Schwarz: This time they put it on the record, because it broke last time afterward.
- Bell: He learned his lesson last time, I guess. We are going out of November, Mr. Secretary, I think, if we get our tax note money, with a billion three, so that we are now in a position to drop those bills, as you suggested.
- H.M.Jr: Well, let's put - that is the only change to make right now.
- Bell: And we will go into December 15 with about eight hundred million dollars on that basis.
- H.M.Jr: December 15? That is plenty.

- 4 -

H.M.Jr: Well, nothing is settled. Of course, this is the first meeting, but I am throwing that out. When do we have to decide that, Monday?

Bell: Well, I would like for you to decide it Monday. Of course Tuesday is your open market meeting. I think it would help the market if you would decide it. You threw out a hint today, I see.

H.M.Jr: Well, they asked me about the bills.

Bell: Did they?

H.M.Jr: And I said we would let them know. Your friend Marriner Eccles goes up and makes a speech on taxes and neither John Sullivan nor I have yet seen a copy of it.

Bell: Is that this New York crowd again?

H.M.Jr: Yes.

Bell: Is it off the record?

Schwarz: This time they put it on the record, because it broke last time afterward.

Bell: He learned his lesson last time, I guess. We are going out of November, Mr. Secretary, I think, if we get our tax note money, with a billion three, so that we are now in a position to drop those bills, as you suggested.

H.M.Jr: Well, let's put - that is the only change to make right now.

Bell: And we will go into December 15 with about eight hundred million dollars on that basis.

H.M.Jr: December 15? That is plenty.

Bell: Yes. That is just before we get our new money and before we get taxes.

H.M.Jr: What do you think, Dave, about the bills.

Morris: I think we can drop them all right.

H.M.Jr: George?

Haas: I think it is smart.

H.M.Jr: Henry?

Murphy: If you can pick up the money fast enough so that you won't increase this financing, I think it is O.K. I am just having a little perturbation--

H.M.Jr: A little who?

Murphy: I am just a little disturbed that if the bills were dropped it would complicate the problem getting through to February because on bills you have to pick it up again slowly.

H.M.Jr: What do you think, Hadley?

Bell: I don't have any objection to reducing them.

H.M.Jr: We can take it up again tomorrow and we can take it up again Monday.

Bell: Tomorrow or Monday?

H.M.Jr: Well, the bill thing I would take up again - maybe tomorrow.

Bell: Would you like for me to discuss that any with the board and the bank?

H.M.Jr: I would like you to discuss it after you leave this room.

Bell: I see.

H.M.Jr: Just because they treat me shabbily is no reason why I should treat them shabbily.

Bell: Do you think Eccles is going to make a speech on taxes?

H.M.Jr: He did make a speech.

Schwarz: Tuesday night.

Bell: Oh, he did? That is over. I thought it was next week.

Schwarz: He made it.

H.M.Jr: He made it. I will find out. I told John to call him up.

Schwarz: I should have a copy by now.
(The Secretary held an unrecorded telephone conversation with Mr. Sullivan.)

H.M.Jr: Well, let him give Eccles hell before lunch, and you (Bell) can come along after lunch and say, "Well, now, look what a nice guy we are."

Bell: I will talk to Allan and Bob in New York about it.

H.M.Jr: Yes.
Well, then I think if everying is sound, all right, and you can check with me. Before I go home we might announce how much the cash is going to be, tonight for tomorrow morning's paper, you see. I would like to do that. The more advance notice we can give the market the better.

Bell: Yes, because apparently the market is drifting off a little just because of this contemplated financing, isn't it?

Hadley: Well, it is sort of wiggling.

H.M.Jr: One thing I would like you to do is, Dave Morris brought in a UP statement. I would like you to go into your room and get out a little written statement because they wrote the thing up wrong, what I said in my press conference, if you boys will take five minutes.

Bell: Not give out a formal statement but just let Chick tell the boys.

H.M.Jr: Yes, just so Chick will understand it.

Schwarz: Just make it easy.

H.M.Jr: Right. I haven't seen that book yet, Chick. They tell me you are one of the only three good men.

Schwarz: Our library is getting it. We accumulated it.

H.M.Jr: Somebody has written a book on it.

Schwarz: Delbert Clark, that runs the New York Times-Herald.

H.M.Jr: He has written a book on it. Press contact man.

Schwarz: He had some nice things to say about the Treasury generally, too.

H.M.Jr: He probably never has seen it.

Schwarz: He didn't have to submit the book to us.

H.M.Jr: Is that as far as we can go today?

Bell: I think so.

H.M.Jr: Has anybody got any bright ideas?

Bell: It is good progress.

H.M.Jr: Got any bright ideas, Dave?

Morris: No, because I think the first thing is to see the size of the issue, or the amount of money, to decide whether we are going to gun for one issue or two. It makes quite a difference.

Bell: That is right.

H.M.Jr: George, got any bright ideas?

Haas: No, sir, I have got one idea that I would throw out at this time. I think if we are going to have a long issue we should put a longer call period on it, maybe ten years. They will like you better twenty years from now, as you like the fellows that put the fifteen-year call on the Liberties.

Bell: He says he is going to leave you and I to worry about that.

H.M.Jr: Henry, got any bright ideas or long words that I could use?

Murphy: Well, I don't have any long words but I have some fine long call periods. I can support them with quite a number of short words.

H.M.Jr: That is the way you are going, long call period?

Murphy: That is where you are going. That is where I would like to see you go. I think there are some exceptionally good reasons for it.

H.M.Jr: Hadley, got any ideas?

Hadley: Well, I have a feeling toward reopening of outstanding issues.

H.M.Jr: You boys would have to put me down and strap me down and give me some ether before you could get me to take that. I would hate to tell you what Dan Bell said. I bet you he wouldn't offer to say it again.

Bell: Yes, I - that wasn't an offer. I just said we might want to consider it. I am a little scared of getting a lot of money out on the end.

H.M.Jr: So am I.

Bell: I have to - I realize, though, that the issuing of them at a high premium is a little dangerous.

H.M.Jr: So am I, Dan, but don't forget this, and you fellows ought to make a study on this, the fact that the insurance companies have dropped from three to two and a half may make a lot of difference.

Haas: We are getting some new figures on their cash. I called them up.

H.M.Jr: How much have you got?

Haas: Here it is graphically.

H.M.Jr: Read it to me, George.

Haas: We have got - at the end of August they were about one billion three and - is that what you have got here, Henry?

H.M.Jr: You had better let Henry read his own figures.

Haas: At the end of August they were one billion one

hundred twenty million. At the end of September, one billion one hundred thirty-nine. This figure I got over the telephone for the end of October is eight hundred fifteen. That reflects the figures.

- Bell: '67 - '72.
- H.M.Jr: Well, we might find out again --
- Bell: Reducing their rates would make our two and a half coupon more attractive to them.
- Hadley: On the other hand, they might not have to get as many bonds.
- Bell: As long as they have got the cash, they will --
- Haas: That is a very sharp reduction. It is unusually sharp.
- Murphy: It takes them back to about their lowest cash in two years.
- H.M.Jr: It depends on how fast we get this stuff out and dropping the bills. I would like to know what effect that has on excess reserves. Well, take a look at it.
- Haas: It wouldn't have any on it.
- Murphy: It would have no effect as such.
- H.M.Jr: I mean on the New York banks. I mean, dropping it - I mean, cutting it down from two hundred to one hundred, what effect will it have on the New York City banks, if any?
- Haas: It will affect the rate.
- Morris: Affect the rate, and that will affect what they put up for.

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Hadley: What you have got maturing is a hundred million, so it wouldn't change the amount that they are going to have to buy.

H.M.Jr: Well, look --

Bell: It would be that much more excess hanging there.

H.M.Jr: Sometime tell Fitz that the last thing I do before I go home is to see you gents.

Bell: Today?

H.M.Jr: Today. And then you get busy and if you go into your office now and write out a little statement to correct whatever this mistake was and we will give out the amount tonight. I would like to give out the amount tonight, a billion and a half, and I would also like it if you fellows could decide on the bill thing, if you are ready.

Bell: Yes, I think we can.

November 27, 1941
3:30 p.m.

RE TAX EXEMPT ORGANIZATIONS

Present: Mr. Graves
Mr. White
Mr. Foley
Mr. Kades
Mr. Sullivan
Mr. O'Connell
Mr. Odegard
Mr. Gaston

H.M.Jr: Well, who is the barrister and who is solicitor here?

Sullivan: We are all members of the same bar.

H.M.Jr: But there is a difference. Sit up here, Peter, where I can see you. I can't see you that far. Who is going to present the case for the plaintiff?

Foley: John.

H.M.Jr: All right, go ahead.

Sullivan: Well, as you know, for quite some time we have been working on a Treasury decision that would require all of those corporations that are exempt from the payment of income tax to furnish information as to their receipts and expenditures. As a matter of fact, I understand that this was on the Commissioner's desk last Friday when the discussion took place at the Cabinet, and it came over Saturday morning and we went over it. Herbert was in on that. I don't know whether you want him here now or not, but he was in on that discussion last Saturday

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morning. We made a few minor changes in it at that time. Now, under the regulation as it is now drawn, every tax-exempt organization except churches would be required within sixty days after the approval of this regulation to furnish us with statements of their purposes, not only the type of organization they have, but also their receipts and expenditures, and then each year thereafter they would have to give us their receipts and expenditures for the previous year.

We had understood that you thought that churches should be included in that, and it was the unanimous opinion of the group that churches should not be in the group.

(Mr. Gaston entered the conference).

H.M.Jr: Well, why not churches?

White: What group? This group does not include me, Mr. Secretary.

Sullivan: No, I understand you want churches in, because that will be the end of it.

H.M.Jr: End of what?

Sullivan: Harry is opposed to the whole regulation.

H.M.Jr: Well look, this is the way I feel. I think that this is a very momentous decision for somebody to take, if it is for me, and I don't see that if you are going to move on the front of saying that organizations, even though they are exempt from taxes, should make reports, then I don't see why every organization in the United States shouldn't make one to the United States Treasury.

Sullivan: Well, I think the attitude of the churches is going to be very hostile, because they will interpret this as the opening wedge of control by the State over the Church.

H.M.Jr: Well, it is the other way around. Why should any group of churches --

Foley: They don't look at it logically, Mr. Secretary. They will simply say that this is the first gun, and the next step is taxing them.

H.M.Jr: Well, let's get down to brass tacks, inside of this room. Let's get down to the Church of the Little Flower. Now, why shouldn't that organization make a report?

Sullivan: You mean Father Coughlin?

H.M.Jr: Yes.

Sullivan: He not only does, but pays taxes.

H.M.Jr: He does?

Sullivan: Yes.

Gaston: His radio station, you mean?

Sullivan: Sure.

Foley: The Church doesn't.

Odegard: He doesn't pay taxes on the Church of the Little Flower.

Sullivan: Not on the Church, no.

H.M.Jr: I said on the Church of the Little Flower.

White: It is one horse and one hare. The hare goes to the part that pays taxes.

- H.M.Jr: Let's just be impersonal as far as the Treasury is concerned. Let's take the Church of the Little Flower. I don't know how much you know about the thing.
- Sullivan: I don't know much about it.
- H.M.Jr: Well, I know quite a lot, and the money that they take in and the use that they make - if all of the moneys collected are used for church-like purposes, certainly I would be the last one in the world to want to do anything about it, but if by chance they should be used for improper purposes under the guise of a church, why shouldn't some agency know of it?
- Foley: Are you talking logically or politically?
- H.M.Jr: I am not talking politically because the way I feel is this. I think - I am using an extreme example. Now, as I understand it, what you are going to do is to ask the A. F. of L. and the C. I. O. and all the other unions to do it. Now, Foley could ask me, am I going to talk politically, am I going to talk logically. Well, I think from the standpoint of fairness - I don't know whether it is logical or not - that all of these organizations should through the United States Government make a report, and if that is done on a cooperative basis, and not a misuse of funds in the public interest, fine, but if they are - I mean, the argument for the union doing it is, I mean, here in the last ten years these unions have grown up until they have an organization of five million men and they can collect unknown millions and are accountable to nobody. I don't think under Democracy that is right.
- But the only way I can see that I could face the storm would be if I said, "No institution

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in the United States that collects money should be exempt from making a report."

Now, if I fall on that, if I fall on that, well then, at least I have fallen - I broke my neck on something that I believe in.

Foley: I wouldn't want to see you break your neck, though.

H.M.Jr: But I mean, the way I feel - and then I would like to hear some of the others - I can go anywhere and say, "Here are a group of organizations, whether they are religious or whether they are for labor unions or for educational purposes. Some of them collect millions and I believe that those organizations should file a financial report so that they can't be used to either undermine the Government or to do anything else. They are secret organizations. And under a Democracy - and that is why I want Peter to hear it. He will tell me if I am right or wrong. Under a Democracy we shouldn't have any secret organizations, not reporting. I would much rather trip and break my neck than to run around the stone wall. Now anybody else can talk.

Odegard: Could I ask what would be the purpose of the regulation? Is the purpose of the regulation to stop up leakages?

H.M.Jr: Well, you will have to ask them.

Foley: Well, that is the way it started, Peter. People came and said there were certain corporations enjoying tax exempt status that had extended their activities way beyond anything that was revealed to the Commissioner when they gained that tax exempt status; and once they got it, they never had to account for their income or their disbursements or their assets or their liabilities.

They never had to account for their activities in relation to the exemption that they enjoyed and there were a number of them that were using their fronts against the interests of the Government in these perilous times, that were making absolutely no contribution whatsoever to the Government, and were not being held accountable because the public wasn't given the information as to where their funds came from and how they were employing their funds. That is how the thing started and it started way back a year or more ago.

H.M.Jr: Can I go back of that?

Foley: Yes, sir.

H.M.Jr: Let me get the history right. Let me say the way I remember it. As I remember the thing, when I came in to the Treasury - and somebody can stop me when I am through and say I am wrong - I compared it - it may sound silly, but when I was Conservation Commissioner and Herbert Gaston was deputy, we went in there and we found that a great many people of undesirable character had been given a license to carry a gun and they were issued year after year and nobody ever looked at them. Some of them were most undesirable characters.

So I said, "From now on that license runs for

a year, and anybody that wants to carry a gun and get a license as a deputy game warden has to prove that he is worthy of it."

So I applied that same rule to this question of exemptions and I said, "From now on, once a year all of these so-called tax exempt societies have to prove that they are worthy but no longer, once they get the thing, will it run for five or ten years and nobody ever investigate them." I said these people have to prove that every year they are worthy of this particular status. That is the way I remember the thing starting, isn't that right?

Foley: Well, that goes back of my experience with it. I am telling you how --

H.M.Jr: But I am telling you when I first came in --

Foley: Yes, well, that goes beyond my time.

H.M.Jr: But that is the thing and I told the Commissioner that he must check these things and nobody from now on can have, so to speak, a charter, a tax exempt charter, and these people have to, at a regular interval - I think I said once a year - prove that they are worthy of this thing.

Now, this thing here, I understood this thing, this particular thing, had been brought to a head by Morris Ernst.

Sullivan: That is right.

Foley: Yes, that is what I am talking about. Morris Ernst started discussing it a year ago.

H.M.Jr: Morris Ernst had brought this thing to a head,

but I don't see, frankly, why this - I don't understand why this has been brought to a head if Helvering had carried out my orders, namely, that once a year every organization enjoying a tax exempt status had to prove that they were worthy of this particular status. If that was done once a year, why do you have to do this?

White: Mr. Secretary --

H.M.Jr: Just one second, Harry. What?

Foley: Well, this is to accomplish just what you said.

H.M.Jr: Oh. What I said was that the burden of proof must be on the group desiring a tax exempt charter, that they must prove that they are worthy of it.

Foley: They must make an annual showing that they are worthy to continue in that status. Well, that is what this would accomplish.

H.M.Jr: Four or five years ago I asked for it.

Gaston: The thing came up again, you will remember, in connection with the Mellon tax case. The Mellon educational and charitable trust. They were chartered as an institution which Mellon would contribute to and he furnished funds for the education of young men and then it was suddenly discovered that he had given to this educational and charitable trust ninety million dollars worth of paintings not envisaged in the original purpose at all and thereupon the charter was revoked.

Sullivan: This goes further than what you asked for, Mr. Secretary, because in addition to proving the character of the organization and the type of

work they are doing, they are obliged to file operating financial sheets to indicate the extent of it and in case of any person being paid a thousand dollars or giving a thousand dollars in any one year, that has to be itemized.

Kades:

Mr. Secretary, when I was in the Chief Counsel's office in 1938, we were informed that the policy of the Treasury toward tax exempt organizations had changed to the extent that the Secretary wanted a re-examination of tax exempt organizations. As a result of that, a questionnaire was sent to all organizations on our list. There are about twenty-six thousand of them. They filled out their questionnaire and the questionnaire was filed in the Bureau, but that is the extent to which the Bureau carried out instructions that you mentioned.

H.M.Jr:

My orders were never carried out.

(Mr. Graves entered the conference.)

Harold, help me out on my memory. Come up closer here. Were you with me when I told Internal Revenue that I wanted every tax exempt organization in the United States to prove that they were tax exempt and that that should be done, the burden of proof was on them and that should be done regularly?

Graves:

That is right.

H.M.Jr:

Well, what the hell happened?

Graves:

Well, they started in, I would say, about the summer of '37 - I am speaking now from memory, --

H.M.Jr:

I know.

Graves: ...to make a re-canvass of every exempt corporation case. I think that re-canvass was still in progress when I left the Bureau in 1939.

H.M.Jr: Well, Chuck Kades says it was done and then just filed and nothing ever happened.

Kades: Mr. Secretary, some of these returned questionnaires may have been examined, but there was no annual return requirement imposed. The Secretary said, Mr. Graves, that his instructions were that we were to get annual returns in the Bureau. It was my understanding that the questionnaire was to go out to re-examine these tax exempt organizations, and that such a questionnaire was sent out. Some of them probably were examined but no annual returns have been required.

Graves: I don't recall that there was any requirement for an annual return on this. I think he has correctly stated what they did down there.

H.M.Jr: My impression was that I said that these people, the burden of proof on them was once a year to prove that they were entitled to it.

Graves: That I don't remember.

H.M.Jr: But you went all through this, didn't you?

Graves: Well, that thing had been begun before you sent me down with the Bureau of Internal Revenue. It was in progress at the time --

H.M.Jr: But you are familiar with it.

Graves: Yes, I am.

Odegard: Did that apply to churches too at that time?

- Foley: The questionnaire?
- Kades: I think, Mr. Secretary, that this went only to charitable organizations.
- H.M.Jr: I don't think it applied to churches.
- Graves: Well, I think it went to religious associations that were owners of property that had income which might be involved in this question of taxability or non-taxability.
- Kades: That is right, but wherever the tax exempt status of the organization depended upon what it did with its money, then the questionnaire went out but I don't think the questionnaire went out to something which could be recognized as a church or as a labor union.
- Foley: Political organizations.
- Graves: My impression is that the questionnaire went out to all of the organizations or associations that were on record at the time in the Bureau of Internal Revenue as having been granted an exempt status.
- H.M.Jr: That is right.
- Graves: Some thirty odd thousand, according to my present recollection.
- H.M.Jr: Well, that would include churches.
- Graves: Any organization about which there has ever been any question raised.
- H.M.Jr: Ed, you went through that with me, the question of sending it to the Democratic and National Committees.
- Foley: Well, that came up in connection with the two percent clubs in Indiana.

- H.M.Jr: And we went through with it, didn't we?
- Graves: Well, I think the answer to that is this. Wherever any political organization had raised the question, or where we had raised a question --
- Foley: You are getting awfully bold, Mr. Secretary.
- H.M.Jr: Well, I am surprised. It doesn't sound like me.
- Graves: Wherever the question had been raised --
- H.M.Jr: It must have been just before a campaign. (Laughter) Well, Roosevelt is not running again. Go ahead, Harold.
- Graves: What I was saying was that wherever the question of the taxable status of a political organization had been raised and the club or organization granted a non-taxable status, that undoubtedly was re-canvassed along with all the --
- Kades: That is right. My recollection is similar to yours. I thought there were twenty-six or twenty-seven thousand, and you said about thirty-six.
- H.M.Jr: How did we do the political clubs in Indiana and not do the National Democratic and National Republican ones?
- Graves: Well, that was a special expedition. We ran into that organization as the result of our Indiana investigation.
- H.M.Jr: But we did do that?
- Graves: We did that.

- H.M.Jr: Did you get my message about another Indiana?
- Graves: Yes.
- H.M.Jr: Well, you (Odegard) ask him some questions.
- Odegard: Well, this political angle, I assume this would supplement, then, the Corrupt Practices Act, under which they are supposed to file returns as to their income, as far as political organizations. My feeling is, without knowing anything about it except what has been said here, that this thing - a general regulation of that kind, unless it is very delicately handled, is full of dynamite, particularly if it applied to organizations that are fearful of control, like churches and colleges and - if the feeling is going to be that Treasury is going to set itself up as a great censorship agency and it is going to pass upon the legitimacy of certain activities that are carried on --
- Foley: And any time you don't like what one organization is doing, then you immediately crack down on them.
- Odegard: It would seem to me possible to draw a regulation which would avoid that by setting up certain standards which would be beyond question, but unless that is done it seems to me that there is a lot of dynamite in it.
- H.M.Jr: Harry?
- White: Well, I made quite a speech before I came in here, and I don't want to get started or I am liable to repeat it. (Laughter)
- H.M.Jr: Are you afraid of meeting yourself coming home?
- Sullivan: It is very well worth hearing, and I am sure we would all be delighted to hear it the second time.

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White: The hell you would.

Foley: When he gets started, Mr. Secretary, you had better open the window so they can hear it across the street.

White: I think it would be a very, very grave error for you --

H.M.Jr: Come up closer, I can't see that far, Harry.

White: I thought maybe you could hear me. I think it would be a very grave error if an order of this character, irrespective of its merits, and I have no doubt about its merits, but irrespective of its merits, I think that this is a most inopportune time for an order of this character to be promulgated.

It will be interpreted, and correctly so, as having been designed to in some way or other hamstring unions, labor unions.

H.M.Jr: Hand or ham?

White:

Hamstring. The proximate cause, the immediate cause of the bringing forth of this order at this time, if my information is correct, was just that, that it was the desire to get at labor unions which prompted the investigation as to whether something can't be done about it and whether the Treasury can't do something about it. That is not the origin of it here in the Treasury. I mean, that is the proximate cause, the immediate cause of its coming forth, so that when labor unions feel strongly suspicious that this is going to be another crack by this Administration on them, they are not far from wrong because unless it is intended to use this as an instrument to weaken the bargaining power of labor, why is it coming at this particular moment, and it clearly is an instrument which can under improper guidance and improper control and unsympathetic control be used to stop any labor union in the course of a strike. You can always find ninety-nine different things wrong with any accounting procedure of any large organization, and you can stop their funds until such time as they make a reckoning.

Now, it is quite true that there are labor organizations and that there are possibly charitable organizations and that there are doubtless some churches here and there whose accounts could not stand a careful reckoning, but the bulk of institutions, I don't think, would fall in that category and it seems to me, as you said, that it should be simple enough to determine whether a labor union is a labor union, whether a church is a church, that sort of information might be possible to obtain through regulations, whether a charitable institution is a charitable institution, but when you push

that further and demand that labor organizations, among others, file a report of the sources of their income and their expenditures and where there are penalties implicit in it, then I think you are laying a groundwork for an attack against the finance of labor unions and that is exactly where the attack began in France. That is exactly where the attack began in Germany. The way to kill a labor union most quickly is to remove its power over finance. Proof of that is that was the reason why it was asked for, I think, at Cabinet.

As I understand it, Madam Perkins, the great Secretary of Labor, said the reason why labor unions strike--

H.M.Jr: Here! Here! (Laughter)

Well, Harry, I gather you are against it.

White: And how! At this particular time, irrespective of its merits maybe a year ago or more.

H.M.Jr: But for the moment you are against it?

Sullivan: I think Harry would agree with us that there is no point in publishing any kind of a regulation on the other organizations unless labor is included.

Foley: No, because you would get it just as bad from the people that are against the labor organizations because you left them out.

H.M.Jr: And you don't want to do the churches and not do the labor unions?

White: I feel that if you do the labor unions, you ought to do the churches, because I am sure if you do the churches you won't do it.

(Laughter) I was being honest before you found me out.

H.M. Jr: Thanks for the compliment.

Sullivan: Harry, assuming that we were to do everything except the churches, I mean assuming that we decided that we are wise to go ahead now on the labor unions, would you still think churches should be included?

White: Well, I don't feel that it is desirable for Government to go into the revenues and receipts of the churches to that extent. Sure, there are occasions where they are using their funds for subversive influences but we have got to take some of the bad because of the larger good. I think you can determine whether a church is a church without finding out where it gets its money and what it does with it, and I think that the dangers of the Government interfering within the internal frame of a church outweigh the advantages, though I should also like to see possibly some restrictions on the ability of the church to interfere with the affairs of government, but that is a horse from a different stable. (Laughter)

H.M. Jr: Herbert?

Gaston: Well, I have always thought our system with respect to these exempt organizations was very loose. The real problem is not with the regular labor organizations, not with the regular church organizations, not with the regular charitable organizations, it is on the fringes of all those groups. That is as true of the so-called religious organization as it is of the charitable organization, as it is of the labor organization, the racketeering organizations.

It may be that there is some other way to get at this problem in the way of policing these exempt organizations, looking at the fringes and seeing what ones are open to suspicion and going after them, if we have the authority to require reports when we want a report, when we are suspicious of an organization, but I am very much inclined to agree with Harry that this will now raise a terrific furore that would be very damaging.

White: And it goes out under the Secretary's signature, not under the President's.

H.M.Jr: What do you think, Joe?

O'Connell: Well, I first--

White: I think you are right (referring to note handed to him by the Secretary.)

H.M.Jr: O.K.

White: I weaken occasionally. The joke is on me.

O'Connell: I first learned about this move about a year ago when we were first drafting a T. D. that would carry this into effect. At that time I think I, as well as other people with whom I discussed it, was entirely in sympathy with the idea. I think it is perfectly legitimate on the merits, but I don't think you will ever get to the merits of this case today if you try to require reports of trade associations and unions because it is another way of doing what unions will fight to the bitter end if you do by legislation, and a lot of people are talking about the necessity, Westbrook Pegler and a lot of other people are talking, there is a lot of agitation, to have these fellows put their financial affairs in order and to disclose their affairs.

I would rather regard the event of a little more development of that as a matter of public policy than to stick our necks out at a time when labor people at least are inclined to think that the Administration is drifting away from them and that we are kicking them around a little bit. Maybe they need it, but I would be opposed to doing it at this time.

H.M.Jr: Why can't we do what I asked for five or six years ago, simply say - is it too late for this year? - that for '41 any organization enjoying tax exempt status would have to prove that it is worthy of it, for '41? Is it too late to do that?

Graves: Well, you couldn't do that this year. You could make a start on it. But I don't think that gets you where you are trying to go, if I understand where you are trying to go.

H.M.Jr: No, wait a minute, somebody else is trying to go somewhere. I didn't start this thing. This is all comparatively new to me. I didn't start this thing. For the time being, I don't know whether there are twenty-six thousand tax exempt organizations, but I would like to go back to where I was and simply say that all of these be canceled for '42, and anybody who wants a tax exempt status for '42 would have to put in an application and prove that he is entitled to it.

White: Which means he would have to prove that it is a church or a labor union or a charitable organization and the demonstration of that proof would be a reasonable demonstration that it was a non-profit organization.

H.M.Jr: Yes.

White: I can see that.

Gaston: What about the law on that? There are certain classes of organizations that are by law exempt from filing returns and from paying taxes.

H.M.Jr: But, Herbert, we make the regulations as to what is exempt.

Kades: We require a labor union in the first instance to give us an account.

Gaston: Well, I think that would be the answer, to move in on this thing gradually.

Sullivan: Another way this can be handled, Mr. Secretary--

H.M.Jr: What do you think of that, I mean for '42 just make them start all over again?

Odegard: Of course that won't do what was in mind here.

H.M.Jr: I didn't start this. What Morris Ernst wants, Morris Ernst is gunning for America First.

Well, it is wrong to set up a - to try to have the whole Treasury organization, Internal Revenue, gun for one organization anyway. You can't do it.

White: It has boomerangs.

H.M.Jr: You can't do it.

Odegard: No, I think that is right.

H.M.Jr: If he wants to do it, let him introduce an act in Congress.

Sullivan: Well, that can be done. Whenever a question

is raised about the right of an organization to this exemption, an investigation can be made in that particular case, and I pointed that out to Morris, and he didn't agree with me that that would be sufficient.

H.M.Jr: Well, listen, it is very nice for Morris Ernst to sit up in New York behind his desk and have me as a cat's paw, but I wish you would re-examine this thing along the lines that for the year '42 anybody who wants to enjoy a tax exempt status will have to start de novo. I mean, I am not issuing an order. I would like you to consider that. Talk it ~~over~~ with these people in the room and then come back in a couple of days and talk to me about it again. Where would that lead to, you see.

Sullivan: That is in this.

White: With a lot of other things.

Sullivan: Yes.

H.M.Jr: But supposing you just did that honestly and nothing else.

Sullivan: Is there to be a Cabinet meeting tomorrow?

H.M.Jr: No, there won't be any more until - for a week.

Sullivan: Well, when this thing comes up, there is another way of accomplishing this. If the feeling is--

H.M.Jr: The President leaves tomorrow and will be gone for a week.

Sullivan: If the feeling is that the Treasury shouldn't take sole responsibility for this, everything

that is set forth in this Treasury decision can also be set forth in a statute for the Congress to pass on.

H.M.Jr: But they won't pass on it.

Sullivan: Well, I don't know.

H.M.Jr: Well, look, John, it is past four o'clock and I am no good at this hour. Re-examine it and talk it over with these people. Don't bother Harold. I just brought him in to - but I would like Odegard on account of - you know. There is a big repercussion on the morale of the country on this thing, on the whole question of upsetting these people unnecessarily, getting their minds off building guns and buying defense stamps and so forth and so on, you see. That is why I want you in on it.

What?

Odegard: Yes, I can see it.

Gaston: You will have to consider, I think, too, the physical dimensions of the job, as to when it would be undertaken and whether the Bureau could carry the load, how big a job it is going to be.

H.M.Jr: They could do it next year because the burden of proof is on these organizations, Herbert. I mean, simply say, "Gentlemen, beginning the first of January, nobody has a tax exempt status. You have got to come in and prove that you are worthy of it."

Sullivan: I will go over this with the Commissioner in the morning.

H.M.Jr: All right.

Thank you all.

November 27, 1941
4:27 p.m.

HMJr: Hello.

Senator
O'Mahoney Hello, Henry.

HMJr: How's Wyoming?

O: Fine and dandy. Henry, I sent you a note the other day.....

HMJr: Yeah.

O:transmitting a copy of a telegram or the telegram I had received.....

HMJr: Yeah.

O:from the Sturgis Posture Chair Company out in Sturgis, Michigan.

HMJr: Well, I've got a backache today. I've got lumbago, so it's a good day to talk to me about it.

O: Fine. Well, it's very simple.

HMJr: What do they want?

O: They don't want a darned thing. They want to be permitted to stay in business.

HMJr: What do they want.....

O: The reason I was sending it to you was this.

HMJr: Yeah.

O: They have a factory making metal furniture.

HMJr: Yeah.

O: They have orders on hand for eight weeks. They also have on hand the metal with which to fill these orders.

HMJr: Yeah.

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- Q: But OPM gave out an order which prevents them from using the metal they have on hand to fill the orders they have on hand; and if they'd obey the order, they'd have to close the factory and throw fifty-four people out of work. And a large number of those people are buying defense bonds. Some of them have bought as much as five hundred dollars.
- HMJr: Yeah.
- Q: Here's the other case, of a factory at Elkhart, Indiana, which personally - which itself - purchased thirty-five thousand dollars worth of defense bonds; and under the same order, it's being crippled.
- HMJr: Yes.
- Q: Now, I'm getting reports of this from all over the country. That's why I have said - I said in a broadcast on Tuesday night over the Columbia Broadcasting Company - that civilian business is the goose that lays the golden egg that will pay for the defense program.
- HMJr: Yeah.
- Q: And if we kill civilian business, we kill the goose.
- HMJr: Yeah.
- Q: Now, nobody ought to be more interested in preserving this goose with the golden eggs than Henry Morgenthau.
- HMJr: Yeah. Well.....
- Q: Henry, something ought to be done about it, or we're going to catch hell.
- HMJr: Well, Joe - let - these two companies, I'll have them looked into at once.
- Q: Oh, well, no. I don't want you to bother with that.

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HMJr: Oh, no, no. I'd look into it, because I just - I don't know the status; but let me look into it, because there's another angle that you may not know of where I may be able to be helpful for these two cases.

O: Uh huh.

HMJr: After all, we place a lot of business through Procurement.

O: Yeah.

HMJr: Maybe we can buy something from these companies.

O: Well, by gosh, they're not permitted to ship the damn stuff.

HMJr: Well, if.....

O: The OPM orders.....

HMJr: Yeah, but if we buy it, we get priorities for them.

O: Yeah.

HMJr: See?

O: Oh, yes. Sure.

HMJr: I mean, that's another angle.

O: That's right.

HMJr: Look, I'll have that explored tonight.

O: All right.

HMJr: And.....

O: But the fundamental thing is the thing we must get after, Henry.

HMJr: Well, I'm tremendously interested, and I appreciate your calling me.

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O: How are you feeling except for this wrenched back?

HMJr: Oh, pretty good. I wish things were going better.

O: How's your father?

HMJr: Oh, he's fine.

O: Give him my best, won't you?

HMJr: I'll do that.

O: Henry, we can put this thing in ship-shape if we'll only do it.

HMJr: Well, I'm interested, and I'll look into this and call you about it myself.

O: Okay.

HMJr: Thank you.

O: Thank you.

November 27, 1941
4:30 p.m.

RE FINANCING

Present: Mr. Bell
Mr. Haas
Mr. Murphy
Mr. Hadley
Mr. Morris
Mr. Schwarz
Mrs. Klotz

H.M.Jr: All right, Bell, give me a report.

Bell: I haven't heard from Mr. Eccles. I didn't know what the situation was until I talked to him.

H.M.Jr: I have got a letter here, ¹¹⁻²⁷ "I would appreciate it if you would tell the Secretary I am sorry, the text did not get to him sooner." I don't know.

Bell: Well, I think you can get enough from New York.

H.M.Jr: I think whatever we decide, I would call him up on the phone and tell him.

Bell: Sproul and Rouse, I talked to them this morning and they considered it and they are going to call me back late this evening. They said they strongly feel that we should not go down to a hundred million, that you decided some weeks ago that you were going to create

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a bill market, and they think you have got a bill market, that you have got good distribution over the country, and that you should keep that, and if you have got too much cash, go out of the month with too much cash, then you should reduce your billion and a half offering. They think if you bring it down to a hundred you will have a less stable market and that you might pull the bills back into New York where you don't want them. They are now pretty well distributed, and they are out there in the country where the excess reserves are. They would like to see you reduce it to a hundred and fifty and complete the cycle and then consider whether or not you want any more bills.

H.M.Jr: I won't decide on it tonight, so let's just pigeonhole that for tomorrow.

What is the next thing?

Bell: The billion and a half, they see no objection to announcing tonight that the issue would be not more than a billion and a half, that is, the offering. I had thought it ought to be that way, not more than a billion and a half. They saw no objection to that.

Schwarz: I wonder why they say it like that, not more?

H.M.Jr: Why not just say a billion and a half?

Bell: Well, I did ask them if they had in mind this twenty-five per cent increase that we have been discussing, and they said, "No," that your last statement was it would be more than a billion.

H.M.Jr: You want a billion and a half, don't you?

Bell: Yes.

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H.M.Jr: I would tell them it is going to be a billion and a half.

Morris: Would you want it if you keep up your bills?

Bell: Yes. The hundred and fifty million of bills to complete the cycle is in our picture between now and September 15th.

H.M.Jr: I am not in a mental condition to argue about anything. I don't have to make up my mind. I would like to get out the billion and a half, though.

Bell: All right. We don't have to do the other until --

H.M.Jr: You can come back at me Monday.

Bell: Monday you can do it. I just thought maybe it might help a little if we had some reduction in the bills, but at the same time --

H.M.Jr: What?

Bell: The market. It might help the market a little.

H.M.Jr: I would like to think on that.

Bell: But it is all right to let it go over until Monday.

H.M.Jr: Well, I can do it tomorrow. Does anybody disagree on a billion and a half? They weren't afraid of it?

Bell: Sproul and Rouse?

H.M.Jr: Yes.

Bell: No.

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- H.M.Jr: Well, what I would say is, a billion and a half - you (Bell) tell Eccles - I mean, give him five minutes. Go in there, Chick, while he calls up Eccles. You may have to go to sleep for an hour, but let him go in and talk to Eccles --
- Schwarz: Eccles talks to him.
- H.M.Jr: And unless Eccles says "No", I would say a billion and a half. Let's call up Eccles now.
- Bell: You are taking on something.
- Klotz: You are taking a lot of punishment today.
- H.M.Jr: I know. You are going up on the Hill for me tomorrow at ten o'clock. I am not going.
- Bell: Oh, you are not going?
- H.M.Jr: No, you are going up. You sit up on the dais there in my place.
- Bell: It is quite an honor. I can't vote, can I?
- H.M.Jr: Yes, you can vote. I don't know whether I can vote either.
- Bell: Oh, yes, you are a member of the committee, by the resolution.
- H.M.Jr: Well, you go up there.
- Bell: But there is no provision for a substitute or an alternate.
- H.M.Jr: I can't go up there without losing my temper and I don't want to lose my temper. Old Bob Doughton will say, "We won't have any more taxes without the billion and a half and

without cutting out the WPA and he won't say so publicly.

(The Secretary held a telephone conversation with Mr. Marriner Eccles as follows):

November 27, 1941
4:41.p.m.

HMJr: Hello.

Operator: Chairman Eccles.

HMJr: Hello.

Marriner
Eccles: Hello.

HMJr: Marriner.....

E: Yes, Henry.

HMJr:we're planning to give out for tomorrow morning's papers next week, barring some unforeseen international situation - I always want that as a hedge - that we're proposing to borrow a billion and a half cash.

E: Yes. Dan called up this morning.

HMJr: Yeah, he couldn't get you.

E: What is it?

HMJr: I - did he talk to you?

E: He talked to Piser.

HMJr: Yeah.

E: And then I talked to Piser immediately after. As I understood it, you were going to ask for a billion and a half and that's practically all that you've given out, that the terms and.....

HMJr: That's all. Just so that the market would know the size.

E:and that you're going to discontinue bills - that is, you're going to take care of the tum-over only, or the roll-over.

HMJr: Well, we're not going to say anything about that, because New York wants us to keep on a hundred and fifty; and I'm too tired to argue tonight.

E: Yeah, well.....

HMJr: I thought we'd just say a billion and a half tomorrow.

E: Now, as I understand it; we're going to meet.....

HMJr: Tuesday.

E:Tuesday at two-thirty; and there'll be no further statement on it, and no decision until that time.

HMJr: No, no. We might want to do something about the bills, but I thought.....

E: No, I meant on the billion and a half.

HMJr: No, no. There'll be nothing more without - I certainly wouldn't say anything more without calling you up the way I am now.

E: Yes. I sent a note over. I don't know whether John Sullivan has seen you. John called me this morning about the.....

HMJr: He gave it to me.

E:statement in New York, and I didn't know that you weren't - that you didn't get that. I was out of town.

HMJr: I got an awful pounding from the press on it, and I just told them I hadn't seen it.

E: Yeah. Well, maybe it's just as well, then. But my note explains the - did you read it?

HMJr: He just gave it to me. I haven't read it yet.

E: Well, I think you'll find the note explains it. It was just a mistake in the office. I mean, I - they were supposed to send it over - they've had instructions - it just wasn't done. And I hope you will at least read that portion of the statement that I have marked.

HMJr: I will.

E: And it's all I said on the tax question and also on the function of banking in relation to the defense program.

HMJr: Well, I'll read it, Harriner.

E: And if - I'd like to get your reaction. I mean, if you feel there's any.....

HMJr: If there's anything, you'll get it - direct.

E: I don't think there will be.

HMJr: Okay.

E: All right, Henry.

HMJr: But as we stand now, I just want to know that a billion and a half didn't frighten you.

E: No, it doesn't frighten - no, it - how can you get along with less?

HMJr: Well, I don't know.

E: No, I'm not - I'm not a bit - I think that the easiest part of the defense program is the money end of it. If the labor and the production end was as easy to handle as the money end, I think.....

HMJr: Well, maybe this sounds terribly conceited, but maybe it's because the money end is done well.

E: Well, I think that we - I think that the other you're dealing with human nature. I think on the money end, that between the Treasury and the Reserve, we've got most of the trump cards.

HMJr: Yeah, but maybe it's because we do it well.

E: Well, I think that has something to do with it. I mean that.....

HMJr: But I think the other thing could be done if it was done properly - the production.

E: Well, of course, you're dealing with the human nature problem there, which is.....

HMJr: Well, I'm told that the pocketbook is supposed to be the most sensitive nerve.

E: We've got the control on the money picture - I mean if - I think we have. (Laughs)

HMJr: Yeah. Well, anyway, I'll be seeing you; and we'll not make any announcements on the financing unless either Bell or I check with you first.

E: Okay.

HMJr: Thank you, Marriner.

E: All right. Good-bye.

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H.M.Jr: You have control of the money market until it goes sour.

Haas: Yes.

H.M.Jr: And the Fed. --

Bell: He is relaxed now. The money end of it is the easy part of it.

H.M.Jr: Sure, until it goes sour, until the Federal Reserve does something without telling us.

Goodnight. Remember, announce a billion and a half, barring --

Schwarz: Unforseen international situations.

H.M.Jr: Or another speech by Marriner Eccles.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

107

OFFICE OF THE CHAIRMAN

November 27, 1941.

Dear John:

I am enclosing copies of the speech that you called me about and regret that they did not get over to you sooner as, of course, I mean to have them sent just as soon as they are completed and, if possible, in advance of their getting into the press. In this case, I was not making a long speech and merely wanted to avoid a repetition of what happened a year ago when I spoke to the same group and what I said off the record was very badly garbled. I made some last minute changes in the text of this speech so it was not ready until late Tuesday evening. But it is largely a repetition of what I have said publicly before.

I have marked some passages in which you might be interested as to the fact that central banks have properly become the servants of government and as to taxes. With regard to the tax picture, I felt that I was backing up the Treasury's position in general, so I think you would have no occasion for criticism.

I would appreciate it if you would tell the Secretary that I am sorry the text did not get to him sooner.

Sincerely yours,

Honorable John L. Sullivan,
Assistant Secretary of the Treasury,
Washington, D. C.

enclosures

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Takes - p. 10 et seq.

ADDRESS AT MEETING OF
NATIONAL INDUSTRIAL CONFERENCE BOARD
NEW YORK CITY
TUESDAY EVENING, NOVEMBER 25, 1941

BY

MARRINER S. ECCLES

FOR RELEASE IN MORNING NEWSPAPERS OF
WEDNESDAY, NOVEMBER 26, 1941

It is particularly gratifying to me to be on the same program with such distinguished speakers as Sir Arthur Salter and Dr. James, for it so happens that the two books which made the deepest impression on me in the depths of the depression nearly a decade ago came from their respective pens. When I pleaded my inability to measure up to the high oratorical standards of such eminent economists and authors, the arrangers of your program intimated that they wanted me for contrast. As I recall, Dr. Jordan, in introducing me a year ago, said that I had the habit of saying the things you did not like to hear. If I succeed in living up to that dubious reputation, I can lay some of the blame at the door of Sir Arthur's "Recovery--The Second Effort" and to Dr. James' "The Road to Revival". These volumes have been in my office ever since I have been in Washington, and in glancing back at them a few days ago, I noted again passages which I had marked nearly ten years ago -- what I think were prophetic words.

For instance, Sir Arthur wrote: "The role of finance is to be the handmaid and servant of economic activity", and in recording "The Passing of Laissez-faire", he visualized the development of a "system in which competition and individual enterprise on the one hand and regulation and general planning on the other will be so adjusted that the abuses of each will be avoided and the benefits of each retained."

And I noted again in Dr. James' book his remark that "the final aim of economic activity is the enriching of human life", and his statement that our industrial potentialities make it "possible, by the redistribution of national income on a sounder social basis, to offer to the average man

"and woman a standard of living more worthy of economic civilization."

I apologize to the authors for snatching these too brief random statements from their context -- yet they serve to point up what I wish to say. During the intervening years the democracies have been moving (slowly but, I think, surely) along these paths, seeking to realize these objectives.

In a recent issue of The Economist, of London, I noted the statement that the end of the gold standard also marked "the end of the Financial Age, the failure of the last attempt to restore the dominance of finance over economics." And the article added: "The foundations of a new order of ideas have been laid in the ensuing years, in Britain, in America and in Germany, and the war will carry the process much further. The world is showing an unmistakable tendency to argue that, if a thing is physically possible, whether it be fighting a war, or removing unemployment, it must not be stopped by considerations of 'sound finance' alone. In war, finance is manifestly a mere camp follower, and the tendency is to reduce it to dependent status in peace as well."

Sir Arthur's relegation of finance to the role of "handmaid and servant" and not the master of our destinies is echoed in this comment ten years later from The Economist. Dr. James' vision of the "redistribution of national income on a sounder social basis" is today, even in a world at war, much more of a reality, as evidenced by the trend of social legislation in the democracies and the shaping of fiscal, monetary and other public policies toward a wider, more equitable distribution of national income. We propose to save democracy, as we say, but not to repeat the economic mistakes that lie at the bottom of so much of the world's disorder. We

propose to preserve democracy as the hope of civilized peoples to achieve the economic progress that the machine age makes possible. The tragedy is that the world has turned the machine to producing for war instead of for peace. Engulfed in the tide of human madness, we have no choice but to arm. Yet we may well take thought now of the kind of peace we mean to have on earth and the use to which we may turn our industrial and technological might when once we are free again to move on toward the goal of "enriching human life."

My own economic philosophy, if I may call it that, is based on the conviction that, if we have the understanding and the will, we can make our capitalistic democracy produce as fully for peace as for war times -- with vastly fewer complications and enormously greater benefits for the human race.

The experience of the last eight or ten years and even of the present points the way to combine intelligent government regulation and planning with freedom of private enterprise and competition. It can be done without regimentation and without abandonment of representative government, though I agree that it calls for adaptation of our political processes so that there may be far more foresight, far better direction and timing in public policy than has been the case in bygone eras. One does not have to be an easy optimist to believe that a far greater, a much more widespread and enduring prosperity -- "a standard of living more worthy of economic civilization" -- will result.

While we cannot hope to realize these high aspirations in a world at war, they need to be kept in view as the ultimate goal and vindication

of the system we mean to defend and preserve. And with these objectives in mind we can perhaps better judge whether changes which have already taken place in our economic processes are improvements and not the evils that they may first appear to be.

Not the least significant change is the subordinated role of finance in the world today. Central banks, for example, are no longer the creatures of powerful private groups. They have everywhere become more and more the servants of government.

Where the color of independence still remains, it is largely a fiction. The interest rate is determined, whether admittedly or not, by governments, not by banking or finance. In Great Britain, and in Canada, and to a lesser extent in our own country, the government has, in effect, asserted its sovereign power over the supply and the cost of money. Governments no longer deal at arms length with the financial world. They are no longer obliged to finance at the high rates that prevailed in the last war. Government action and policy are responsible for the rate structure, and with the assumption of this responsibility governments no longer think merely in terms of how good a bargain they can drive in the financial markets, but larger considerations of public policy have to be taken into account. In Great Britain, in Canada, the primary consideration is not how cheaply the war effort can be financed, but whether the rate structure is so adapted as to utilize most effectively the existing money supply and whether the rates are such as will permit the private credit system to continue its function on an effective basis.

It is highly commendable, in my opinion, that these are some of the considerations which our own government has been weighing in its financing

operations. Extremists in all countries will not agree, of course. On the one side are the groups that clamor for the issuance of non-interest bearing government securities. While professing to be in favor of preserving capitalism and democratic processes, nevertheless, they would strike at the heart of both by destroying the private credit mechanism. On the other side are the old-line conservatives who measure all things by the departed gold standard. Despite the evidence in the late 20's of the ineffectiveness of high interest rates in preventing or even restraining speculative excesses, despite the record since then that low rates are not by themselves sufficient to bring about recovery, they cling to the belief that inflation can be curbed or deflation remedied by the simple device of the interest rate. It is highly unfortunate that orderly economic progress cannot be arranged that easily. However, I cannot view with alarm the trend throughout the world to discard such a fallacy.

The assumption by governments of responsibility for the supply and cost of money has greatly altered the role of central banking operations. Not only must central banking authorities work in close cooperation with those responsible for government fiscal and financial policies, but they must be prepared to use central banking powers to support and sustain those policies, once they are formulated by the government. Nor do I view this as a backward step. It seems to me to be wholly in accord with democratic principles that elected governments shall have command over the most important functions essential for successful administration. It can hardly be denied that control of the supply and cost of money is one of the most vital of all functions. Those of your generation and mine are hardly in a position to

argue that governments will be less enlightened, less capable of successful and proper management of this function than private interests have been. And there is always the redress in a democracy of supplanting any government that misuses or abuses such vital powers.

But beyond this trend -- the subordination of finance to economics -- it seems to me to be significant and fortunate for democracy that the new emphasis is on production. It is, of course, tragic that the world thus far can only gear itself to full utilization of its man power and material resources in the making of war or the implements of war. It will be a world tragedy if, when peace is restored, we revert to the doctrine that we cannot afford to employ our human and material resources in full production.

Yet there will be such a reversion unless we prepare now to make the transition back to peace -- unless we plan to keep the emphasis upon full production -- the maximum that can be called forth by private enterprise and initiative, but with government prepared to assure useful employment to all who are able and willing to work who cannot find jobs in private activity. Again, I think it significant and fortunate for democracy that the most important political leaders of all parties agree upon that fundamental, however much they may disagree about how to apply it. I cannot view with alarm the trend throughout the world toward engineering rather than finance economics as a means to full production. The defeatists are those who say it can't be done -- that we can't afford it, that democracy can't achieve it. If that were so, then democracy could not and would not deserve to survive. Surely we are not saving democracy from destruction by war to have it destroy itself in the aftermath.

Production is the keynote of economics of peace as well as of war. We do not ask today whether we can afford full production. We are prepared to make every sacrifice to obtain it. Unhappily, as I have said, it is production for destructive, not constructive, things, and it is of necessity concentrated upon the industrial sectors of the economy. Our economic problems are not only those of the inflationary side of the cycle, but they are tremendously complicated because we must turn out more and more of the implements of war and less and less for civilian consumption. In peace times there would be no such complications.

Since I spoke here a year ago we have witnessed the gradual evolution of our national policy toward what, in the words of the President, has now become an "unlimited commitment" on the part of the American people that there shall be a free world. In that period we have taken the first steps in the program of all-out production that is necessary to implement that policy. Our effort thus far has been carried on in an economic atmosphere which was favorable to the expansion of both military and civilian output, and, for this reason, the public is as yet inadequately prepared for the sacrifices that must be faced if the defense effort is to be carried to a successful conclusion. While defense expenditures have risen in the past year from 300 million dollars to 1,500 million dollars a month, national income expanded to an annual rate not far from 100 billion dollars a year and industrial production has increased by about a third.

As long as defense production could be increased without diminishing civilian output, little if any sacrifice was required. It is true that taxes have been increased and also that we have had to pay the comparatively

small penalty of 10 per cent increase in the cost of living. But even with these offsets, our population in the aggregate has seen better times than ever before due to greater production, wages and employment. The ironic fact is that until now the defense effort has been a blood transfusion for civilian welfare.

We seem clearly to be at the end of the rising curve of civilian output. Although we have not yet exhausted our resources of unused labor and industrial capacity in some categories, we have drawn heavily upon them. The defense program has expanded in total volume far beyond what anyone envisaged a year ago. It is still impossible to foresee its total cost or to estimate what proportion of our national income it will require at its peak. At the moment, its total cost is scheduled at almost 70 billion dollars. Defense expenditures are currently absorbing about 18 per cent of our national income. While these expenditures have almost doubled since last June, there has been comparatively little change in the physical volume of production, a fact which, while attributable in part to temporary circumstances, suggests that it will be increasingly difficult to maintain the rapid rate of increase in output that characterized the period up to last June.

In the light of these circumstances it is unlikely that in the future the full requirements of the defense program can be met by drawing unutilized reserves into the productive process. Resources now devoted to the production of goods and civilian supplies must inevitably be curtailed. I am speaking not only of consumer requirements but also plant, equipment, and other capital goods available to replace and to expand productive capacity outside the defense industries themselves.

What I have just said refers, of course, only to the over-all total of goods for civilian use. There are many items like foodstuffs, various non-durable goods, entertainment and other services which the public can buy in increased volume without using resources needed for defense, but the expansion in these sectors will be balanced and doubtless overbalanced by the contraction in the production of durable goods using scarce raw materials, machine tools and skilled labor.

The basic problem is manifestly a physical one. It is one of production -- not of finance. Insofar as it is possible, the expansion of output is the answer to our major difficulties. I believe that our people as a whole confronted with the choice between consuming less or working harder would prefer to minimize the sacrifice of living standards by doing more work. In terms of the present economic situation this means longer hours of work, maximum utilization of equipment by working as many shifts a day as technical considerations will allow, and abandonment of output-restricting practice. It means drawing surplus agricultural labor from farms into factories and it means an increasing number of women going from household work to commercial and industrial employment. It means emphasis on industrial training programs and the removal of discrimination against hiring the aged and other groups able to make a contribution to the nation's productive effort.

But with all these extensions of effort we shall not be able to avoid a temporary reduction in the standard of life if we are to devote our productive resources to defense to the extent already planned. The reduction we should permit needs definition. On the one hand, there are many Americans

whose scale of living is so irreducibly low that no sacrifice can be demanded in that quarter. Above this level reductions must be allocated to all groups. The generally required reduction should be shared on an equitable basis. This means that sacrifices will have to be distributed all along the line in the lower middle brackets, the upper brackets and in the corporate tax structure. We should reach a condition where no one is able to talk piously about sacrifices when he is making none himself and is really referring to the sacrifices of the other fellow.

Meanwhile, government net expenditures will continue to rise. Aggregate money incomes will continue to increase. In the absence of special restraints the people receiving these increased incomes will seek to spend them. The prospect of an increasing flow of money and of a diminishing volume of goods available for the civilian market inevitably spells one thing of which we have heard a great deal since I met with you a year ago -- inflation. While it is conceivable that a very large and complex enforcement machinery, backed by rigorous penalties, might be able to hold prices steady in the face of the mounting pressure of demand, the task will be made infinitely easier to the extent that the growth of demand is held in check by taxation and by other functional as well as selective restraints upon the flow of incomes and the expansion of credit.

Of all the available restraints taxation is at once the most effective and most equitable. Since the middle of 1940 we have passed three major revenue acts, representing in the aggregate well over 5 billion dollars per annum of additional revenue. Measured by past standards, that is a very large tax program and one that has sharply increased the levies upon many

groups of taxpayers. The normal rate of corporate income tax has been increased by about a third and a new surtax has been imposed making the total rate of tax payable in corporate income in general about 63 per cent higher than it was in 1939. We have taken the first steps in the direction of effective taxation of excess profits. We have measurably increased some of our excise taxes. Rates have been increased and exemptions have been lowered under the individual income tax. As a result of these changes and the rising level of business activity, tax collections can be expected to be about 6 billion dollars greater in the calendar year 1942 than in the current year.

The tax structure as it now stands will be an important restraint upon the growth of private expenditures. In addition, of course, other restraints have been or will be applied in the form of direct price controls, priorities and allocations that promote defense but curb civilian production in housing and other durable goods, regulation of instalment credit, and the proposed increase in social security taxes. While it is impossible to estimate how far such measures will go in preventing demand from outrunning civilian supply, we know that by the middle of next year defense expenditures will probably be running at an annual rate of somewhat more than 15 billion dollars above the middle of the current year. The conclusion is inescapable, therefore, that additional taxation must be imposed and further restraints applied.

So far as further taxation is concerned, I hope that it will first tap the corporate excess profits and the middle and upper individual income brackets and close numerous conspicuous loopholes in the corporation, individual income, inheritance and gift tax structures. At the same time it

is important that Congress enact an effective price control measure and that some curbs be applied to repeated demands for wage and salary increases, as well as to agricultural prices. Beyond all this, however, I believe it will be necessary ultimately to adopt measures that will tap all incomes, dividends and other such payments at the source, possibly in the form of the so-called withholding tax or such a tax in combination with an enforced diversion of such income payments into government savings bonds redeemable after the emergency is over.

From the standpoint of public morale, it is essential that the long purses be tapped first and heaviest in accordance with the equitable principle of capacity to pay, and that there be no attempt to shift the tax burden to the lowest income groups whose standard of living is already down to or under reasonable subsistence levels. Only when those at the top of the income scale, who have the most at stake and who do not have to make real sacrifices in their supply of food and other necessities, have been made to bear their full share of the tax load can reaching into the shorter purses of those who have the least at stake be justified.

The timing as well as the nature of all measures of restraint is of great importance. Public morale is as vital to defense as the implements of defense. The government has to take account of mass psychology, of the fact that the public is not yet fully awake to the gravity of the international situation and the sacrifices that must be made. So far as the economic front is concerned, our people have the choice either of paying taxes, subscribing to savings bonds and cooperating in other measures to curb price inflation, or of seeing the buying power of their money progressively shrink. The former is the only intelligent choice for anyone who even re-

motely understands the evil consequences, now and in the future, of inflation.

I think the situation was admirably summed up in the recent report which the Emergency Board, appointed in September under Section 10 of the Railway Labor Act, made to the President. "The huge incomes disbursed by both defense and civilian industries," said the report, "magnify the demand for civilian goods. But the output of civilian goods is not likely to expand significantly, if it expands at all, in the months ahead. This condition alone sets the stage for a dangerous inflation, and the process is being activated by wage adjustments to rising living costs and price adjustments to rising wages -- the familiar vicious circle. . . . No group has more to lose from inflation than the nation's wage earners. To save this nation from the blight and chaos of inflation it will probably be necessary to impose drastic new taxes on the public as a whole, immobilize a part of the expanding purchasing power by some organized scheme of savings and, most important of all, adopt a comprehensive plan in regard to wages, profits, and the prices of both agricultural and industrial commodities."

The government, as the report said, is cognizant of the problem, and the government alone is able to make a well formulated and coordinated attack upon the problem. It is fair to say, I think, that the government today shows a far greater awareness and understanding of the problem and a far greater determination to deal with it effectively than was the case in the last war. And this is attributable partly, at any rate, to that trend I spoke of at the outset -- the increasing assumption by government of responsibility for economic welfare. With that responsibility goes the obligation to act wisely, fairly, in the interest of the nation as a whole

and not in the interest of any group, class or section of the country.

The prophets of disaster we always have with us. And they would have us believe that the only alternatives to a laissez-faire, gold standard world are dictatorships and an end of our economic system. I see no such portents of evil in the broad trends in democratic countries toward responsibility for economic welfare. And, as a banker, I recognize that this involves government command over the creation, cost and flow of money in the economy. To my way of thinking, these changes are not the forerunners of dictators or other disasters. They are necessary steps in the adaptation of our political and economic processes to meet the challenge of a new day.

NOV 27 1941

My dear Mr. Black:

The present method of financing governmental corporations and credit agencies by issuing guaranteed obligations of the United States is making our financing more complicated as time goes on, especially in view of the large Treasury financing requirements made necessary by the defense program. I propose, with the approval of the President, to undertake to provide funds to governmental corporations and credit agencies which heretofore have raised funds by the issuance of guaranteed obligations in the market, to cover their current requirements as well as to refund any obligations now outstanding as they mature or are called for redemption.

In line with this policy the Treasury will be prepared to purchase notes from the Federal Farm Mortgage Corporation, from time to time as funds are needed. The interest which will be charged on notes purchased by the Treasury will be at the rate of 1% per annum as long as the average interest rate on the outstanding public debt is 2-1/2%, or thereabouts. If the average rate of interest on the outstanding public debt should increase, the Treasury will reconsider the rate of interest charged on notes of the Federal Farm Mortgage Corporation purchased by it.

It is understood that consideration is now being given to the matter of calling for redemption the Corporation's 3% bonds of 1942-47 which are subject to call for redemption on and after January 15, 1942, and also its 2-3/4% bonds of 1942-47 which are subject to call for redemption on and after March 1, 1942. The Treasury will purchase notes of the Federal Farm Mortgage Corporation subject to the authorization and approval of the Corporation's Board of Directors, in order to provide it with funds for the purpose of redeeming the above-mentioned bonds if they should be called for redemption at their earliest call date or purchased by the Corporation prior thereto. It is suggested that the Corporation's notes mature June 30, 1942, at which time provision can be made for the substitution of any notes then held by the Treasury with a renewal issue. Provisions will be made whereby the

Corporation may at its option at any time before maturity pay all or any part of the amount due on the notes issued by it. This will provide flexibility and permit current receipts in excess of the Corporation's requirements to be immediately applied to the reduction of its indebtedness.

It is understood that steps will be taken to obtain the necessary authorization from the Board of Directors of the Corporation to carry out this arrangement.

Very truly yours,

(Signed) D. W. BELL
D. W. Bell Secretary of the Treasury.

Honorable A. G. Black,
President,
Federal Farm Mortgage Corporation,
Washington, D. C.

Prepared by: Mr. Barnett
Mr. Foy
Mr. Hursey
Mr. Hass

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DEPARTMENT

INTER OFFICE COMMUNICATION

DATE November 27,
1941.

TO Secretary Morgenthau
FROM Mr. Hass
Subject: Recent Changes in Excess Reserves and Interest Rates

I. Recent Changes in Excess Reserves

In our memorandum of November 13 we pointed out that excess reserves of New York City banks have been much harder hit by the developments of the past year than excess reserves of all member banks, and that excess reserves in New York City occupy a critical position in the money market. A pinch in excess reserves in New York City could cause a substantial rise in short-term interest rates, which might possibly spread to long-term interest rates, even if the reserve position of member banks outside of New York City were fairly easy.

Excess reserves of member banks at New York City amounted to \$773 millions on November 5, the first reporting date after the increase in requirements. This was a decline of 79 percent from the all-time high of \$3,675 millions reached on June 19, 1940. Movements since the outbreak of the war in excess reserves at all member banks and at member banks in New York City are shown in Chart I.

In the course of preparing our previous memorandum, we consulted with Mr. Roelse of the Federal Reserve Bank of New York with respect to the probable future course of excess reserves. He estimated that the excess reserves of all member banks would decline by about \$375 millions between November 5 and December 24, the probable date of the seasonal high of currency in circulation. Of this decline, he expected that about \$250 millions would occur in New York City. After the seasonal decline of money in circulation (which he expected to be completed by the end of January), Mr. Roelse believed that excess reserves would continue to decline, slowly at all member banks and more rapidly at New York.

In the two weeks between November 5 and November 19 (the last reporting date now available), excess reserves of all member banks have increased by \$278 millions. During this period Treasury cash and deposits with the Federal Reserve Banks have decreased by \$346 millions. This has the effect of increasing excess reserves by about 80 percent of the amount of the decrease. Except for this one factor, therefore, excess reserves during the two-week period would have remained almost unchanged. The decrease in the Treasury balance is, of course, a temporary factor which will be offset at the time of the next financing. As this will occur prior to December 24, Mr. Roelse quite properly made no allowance for a decrease in the Treasury balance in making his estimate of changes in excess reserves for the November 5-December 24 period.

During the two-week period, November 5 to November 19, money in circulation increased \$114 millions and monetary gold stock decreased \$10 millions. These changes, which would have caused a decrease in reserves of \$124 millions, were almost exactly offset by increases of \$61 millions in "other Reserve Bank credit" and \$7 millions in "Treasury currency" and a decrease of \$58 millions in "non-member deposits and other Federal Reserve accounts". Most of these factors will be of little importance over any considerable period. Unless a considerable volume of funds now frozen in the Federal Reserve Banks are used to purchase securities (which would tend to increase excess reserves via a decrease in "non-member deposits"), the only one of them which is likely to exert a continuing influence between now and Christmas is money in circulation. There is no reason, therefore, on the basis of the experience of the last two weeks, to set aside Mr. Roelse's estimate of the probable decrease of excess reserves of all member banks between now and Christmas.

Mr. Roelse estimated that excess reserves of New York City banks would decrease by about \$250 millions between November 5 and December 24. Actually, they have increased by \$192 millions during the first two weeks of this period. Most of this increase is probably due to the decrease in the Treasury balance during the period, but the proportion due to this cause cannot be estimated with any degree of accuracy for a portion of the banking system.

Mr. Roelse's estimate for the entire period to Christmas is predicated upon a continuation of the outflow of funds from New York which has been going on for over a year. During the two-week period, there was actually an inflow of

funds to New York, but this may well have been merely a temporary interruption of the long-term tendency. In the case of excess reserves at New York also, therefore, it seems too early to appraise Mr. Roelse's forecast.

II. Changes in Interest Rates

Short-term interest rates firmed while long-term rates continued to decline between the announcement of the increase in reserve requirements and its effective date. Since the effective date, short-term rates have continued to harden, while long-term rates have also risen slightly. This is shown in the following table which compares the yields of three Treasury securities of widely varying maturity classes as of September 23, November 1, and November 26, respectively:

Changes in Yields of Treasury Securities

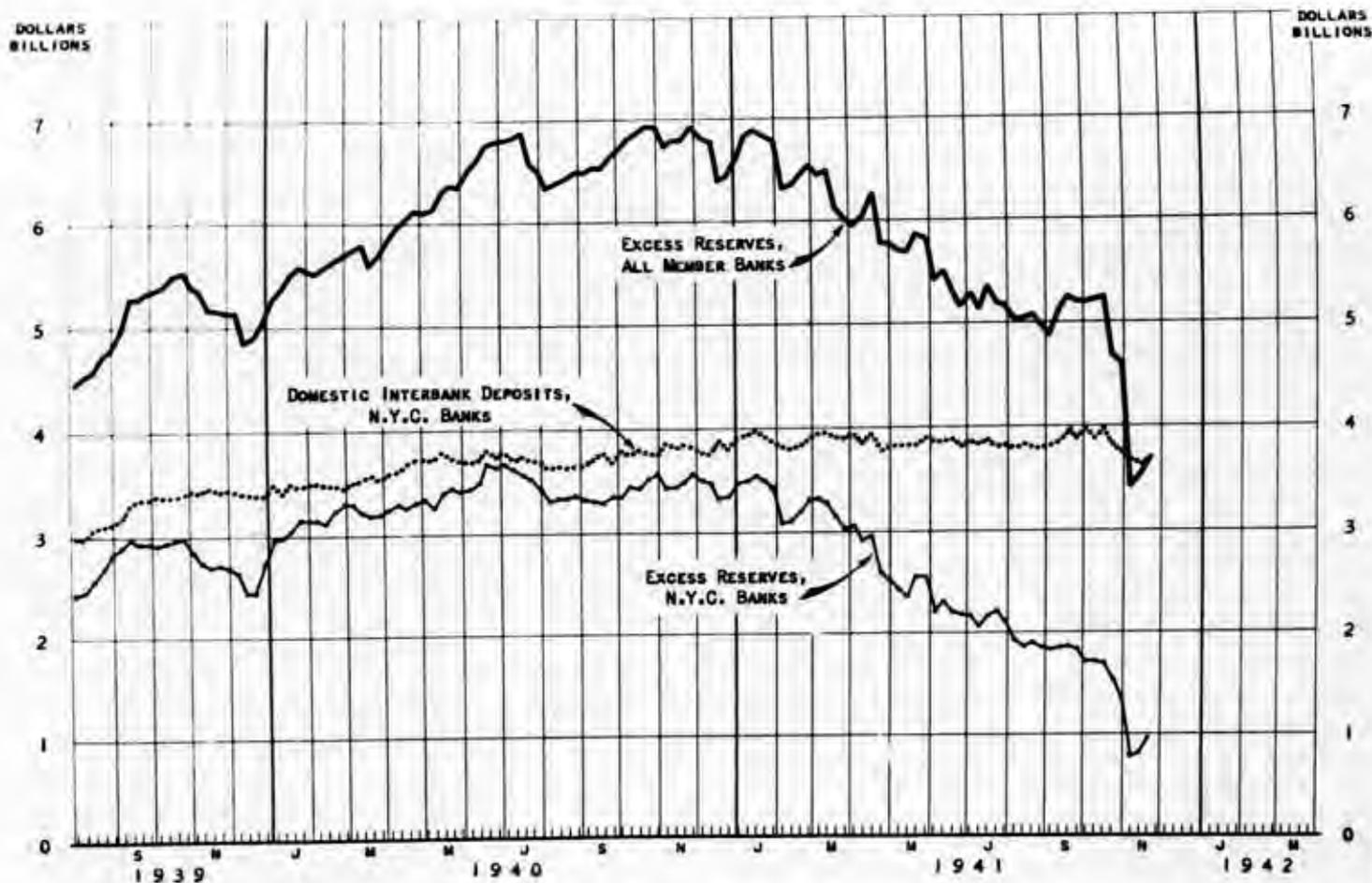
September 23 - November 26, 1941

| | Sept. 23 | Nov. 1 | Nov. 26 |
|--|-----------|--------|---------|
| | (Percent) | | |
| 2-1/2's of 3/15/56-58 | 2.15 | 2.08 | 2.11 |
| 3/4's of 9/15/44 | .60 | .72 | .80 |
| 91-Day bills (Average yield of last issue) | .04 | .07 | .27 |

What will be the future tendency of rates is hard, as always, to predict. If excess reserves at New York follow Mr. Roelse's forecast, it is likely that short rates will continue to firm. Whether such a tendency would spread to long rates is more questionable. The Federal Reserve Board appears to believe that it will not. It is interesting to note, however, that in 1937, when the Board held a similar expectation, long-term bond prices finally broke sharply after continuing strong for three months, during which short-term securities had been acutely weak (Chart II).

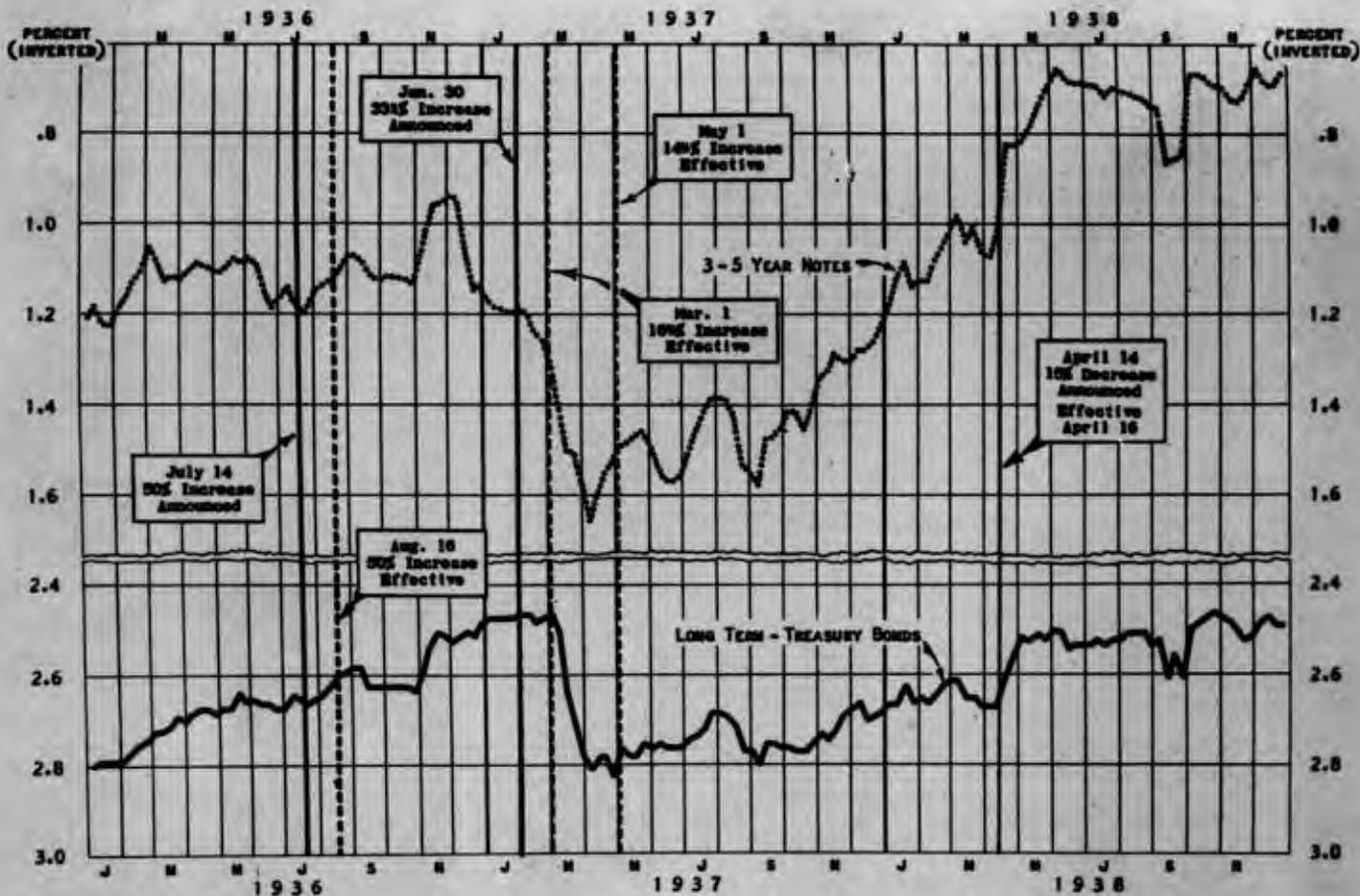
Attachments

CHART
EXCESS RESERVES AND INTERBANK DEPOSITS



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EFFECT OF PAST CHANGES IN RESERVE REQUIREMENTS ON YIELDS OF U. S. SECURITIES



128

UNITED STATES SAVINGS BONDS

Comparative Statement of Sales During
 First Twenty Business Days of September, October, and November, 1941
 (September 1-24, October 1-23, November 1-26)
 On Basis of Issue Price

(Amounts in thousands of dollars)

| Item | Sales | | | Amount of Increase or Decrease (-) | | Percentage of Increase or Decrease (-) | |
|-------------------------|------------------|------------------|------------------|---------------------------------------|------------------------------|---|------------------------------|
| | November | October | September | November over October | October over September | November over October | October over September |
| Series E - Post Offices | \$ 33,438 | \$ 31,500 | \$ 30,959 | \$ 1,938 | \$ 541 | 6.2% | 1.7% |
| Series E - Banks | <u>62,919</u> | <u>60,050</u> | <u>53,559</u> | <u>2,869</u> | <u>6,491</u> | <u>4.8</u> | <u>12.1</u> |
| Series E - Total | 96,356 | 91,549 | 84,518 | 4,807 | 7,031 | 5.3 | 8.3 |
| Series F - Banks | 16,206 | 16,853 | 13,676 | - 647 | 3,177 | - 3.8 | 23.2 |
| Series G - Banks | <u>91,026</u> | <u>92,986</u> | <u>84,464</u> | - 1,960 | <u>8,522</u> | - 2.1 | <u>10.1</u> |
| Total | <u>\$203,589</u> | <u>\$201,388</u> | <u>\$182,658</u> | <u>\$ 2,201</u> | <u>\$18,730</u> | <u>1.1%</u> | <u>10.3%</u> |

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

November 27, 1941.

Source: All figures are deposits with the Treasurer of the United States on account of proceeds of sales of United States Savings Bonds.

Note: Figures have been rounded to nearest thousand and will not necessarily add to totals.

UNITED STATES SAVINGS BONDS

Daily Sales - November 1941

On Basis of Issue Price

(In thousands of dollars)

OFFICE
OFFICE

| Date | Post Office Bond Sales Series E | Bank Bond Sales | | | | All Bond Sales | | | |
|---------------|---------------------------------------|-----------------|-----------|-----------|-----------|----------------|-----------|-----------|-----------|
| | | Series E | Series F | Series G | Total | Series E | Series F | Series G | Total |
| November 1941 | | | | | | | | | |
| 1 | \$ 1,017 | \$ 1,750 | \$ 567 | \$ 4,201 | \$ 6,518 | \$ 2,767 | \$ 567 | \$ 4,201 | \$ 7,535 |
| 3 | 3,377 | 3,421 | 1,442 | 9,092 | 13,954 | 6,798 | 1,442 | 9,092 | 17,332 |
| 4 | 1,061 | 2,818 | 738 | 7,205 | 10,761 | 3,879 | 738 | 7,205 | 11,822 |
| 5 | 1,175 | 1,694 | 744 | 3,794 | 6,232 | 2,869 | 744 | 3,794 | 7,407 |
| 6 | 1,968 | 3,899 | 988 | 6,962 | 11,850 | 5,867 | 988 | 6,962 | 13,818 |
| 7 | 2,062 | 4,278 | 1,258 | 9,280 | 14,816 | 6,340 | 1,258 | 9,280 | 16,878 |
| 8 | 1,289 | 3,113 | 352 | 1,457 | 4,922 | 4,402 | 352 | 1,457 | 6,211 |
| 10 | 2,452 | 3,383 | 994 | 3,459 | 7,836 | 5,835 | 994 | 3,459 | 10,288 |
| 12 | 2,181 | 3,321 | 936 | 5,312 | 9,569 | 5,502 | 936 | 5,312 | 11,750 |
| 13 | 852 | 2,115 | 602 | 4,145 | 6,862 | 2,967 | 602 | 4,145 | 7,714 |
| 14 | 1,249 | 3,862 | 547 | 3,107 | 7,515 | 5,110 | 547 | 3,107 | 8,764 |
| 15 | 1,191 | 2,563 | 473 | 2,375 | 5,412 | 3,754 | 473 | 2,375 | 6,603 |
| 17 | 2,724 | 3,840 | 797 | 3,259 | 7,897 | 6,564 | 797 | 3,259 | 10,621 |
| 18 | 953 | 2,683 | 612 | 4,025 | 7,320 | 3,636 | 612 | 4,025 | 8,273 |
| 19 | 1,503 | 3,285 | 807 | 4,811 | 8,903 | 4,788 | 807 | 4,811 | 10,405 |
| 21 | 2,497 | 3,978 | 1,149 | 4,542 | 9,669 | 6,475 | 1,149 | 4,542 | 12,166 |
| 22 | 1,173 | 2,803 | 840 | 1,987 | 5,631 | 3,976 | 840 | 1,987 | 6,804 |
| 24 | 2,332 | 3,736 | 753 | 3,996 | 8,485 | 6,068 | 753 | 3,996 | 10,817 |
| 25 | 829 | 2,638 | 637 | 3,387 | 6,662 | 3,467 | 637 | 3,387 | 7,491 |
| 26 | 1,553 | 3,737 | 969 | 4,631 | 9,337 | 5,290 | 969 | 4,631 | 10,890 |
| Total | \$ 33,438 | \$ 62,919 | \$ 16,206 | \$ 91,026 | \$170,151 | \$ 96,356 | \$ 16,206 | \$ 91,026 | \$203,589 |

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

November 27, 1941.

Source: All figures are deposits with the Treasurer of the United States on account of proceeds of sales of United States Savings Bonds.

Note: Figures have been rounded to nearest thousand and will not necessarily add to totals.

Regraded Unclassified



OFFICE OF
THE ADMINISTRATOR OF
VETERANS AFFAIRS

VETERANS ADMINISTRATION
WASHINGTON

November 27, 1941.

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

My dear Mr. Secretary:

I have had opportunity to review the economy suggestions you submitted to the Joint Committee on Reduction of Non-Defense Expenditures and I wish to congratulate you upon the excellence of your presentation.

I think we all realize the problems before the country at this time in connection with the cost of government and defense and the Veterans Administration is, I assure you, exerting every proper means to maintain economy in administration. //

Sincerely yours,

FRANK T. HINES,
Administrator.

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Arthur T. Vanderbilt
Newark, N. J.

Stuart John Templeton
Chicago, Ill.

Erwin Guswold
John Maguire
Harvard Law School

Bernhard Krollenberg
Yale University

Harvey Silverman
Tappel & Brach
19 Rector Street
New York

Edward S. Reid
Penobscot Bldg
Detroit

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Harley Stevens
Standard Oil Co.
225 Bush St
San Francisco

TREASURY DEPARTMENT

135

INTER OFFICE COMMUNICATION

DATE November 27
1941

TO The Secretary
FROM Mr. Blough

The attached list of economists with tax experience in the Federal service (not including those in the Treasury Department) has been prepared in accordance with your request. The list, although compiled on the basis of the Directory of Federal Statistical Agencies and the National Roster of Scientific and Specialized Personnel, as well as personal knowledge, is not necessarily complete.

RIB

Economists with tax experience in the Federal Service*

- Barkmeier, Joseph H. - Economist - Department of Commerce
- Burr, Mrs. S. S. - Senior Economist - Federal Reserve Board
- Colm, Gerhard - Principal Fiscal Analyst - Bureau of Budget
- Despres, Emile - Principal Economist - Coordinator of Information
- Driver, John C. - Senior Economist - Office of Production Management
- Dulles, Mrs. E. L. - Principal Analyst - Social Security Board
- Fleming, John W. - Economist - Office of Emergency Management
- Gilbert, Richard - Division Chief - Office of Price Administration
- Goldsmith, Raymond - Division Assistant Director - Securities Exchange Commission
- Hanson, Alvin - Consultant - Federal Reserve Board
- Higgins, Benjamin - Principal Economist - Federal Works Agency
- Hynning, Clifford - Senior Economic Analyst - Office of Price Administration
- Jaszi, George - Associate Economist - Federal Reserve Board
- Kilpatrick, Wylie - Senior Economist - Bureau of Census
- Krost, Martin - Senior Economist - Federal Reserve Board
- Labovitz, I. M. - Senior Economist - Bureau of Budget
- Lovaas, Leslie - Economist - Tariff Commission
- Musgrave, Richard - Associate Economist - Federal Reserve Board
- Nelson, Richard W. - Division Chief - U. S. Forest Service, Department of Agriculture

- 2 -

Rightor, Chester - Division Chief - Bureau of Census
Salant, W. S. - Economist - Office of Price Administration
Stigler, George J. - Consultant - Securities Exchange
Commission
Studenski, Paul - Consultant - Social Security Board
Sundelson, J. W. - Consultant - Social Security Board
Treanor, Richard G. - Senior Economist - Tariff Commission
Woodworth, Leo D. - Economist - Federal Works Agency
Wynne, William H. - Senior Economist - Office of Price
Administration

* Not including those in the Treasury Department.

November 27, 1941

Dear Archie:

Thank you for your letter of November 26. I assume that your inter-departmental committee is the successor to the one which was formed under Mayor LaGuardia's auspices.

Of course it is entirely up to you whether or not to issue a press release about the personnel of this committee. The draft which you sent me is perfectly satisfactory to me if you find it necessary to publish it. I appreciate your thoughtfulness in sending it to me.

As I told you when we last discussed the Office of Facts and Figures, I should like you to count on my complete cooperation in this vitally important job which you are doing.

Sincerely,

[Signed] Henry

Hon. Archibald MacLeish,
Director, Office of Facts and Figures,
Washington, D. C.

FK/hkb

11/27/41

cc Thompson

OFFICE OF FACTS AND FIGURES

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WASHINGTON

THE DIRECTOR

November 26, 1941

My dear Mr. Secretary:

It may shortly become necessary to announce the personnel of the inter-departmental advisory committee to the Office of Facts and Figures which we have called "The Committee on Defense Information". Should there be a news "leak" concerning the meetings of the Committee, the resulting stories would certainly be inaccurate. It would seem to be preferable, therefore, to announce the actual situation in advance of any such unauthorized publication. Moreover, since the Office of Facts and Figures was established by the President to provide the public with fuller information on defense programs and policies, it would seem to me to be appropriate that the Office of Facts and Figures should keep the public informed of its organization.

Since, however, the announcement involves your Department, I should like you to see the proposed release before it is made public. I should appreciate any comments you might care to make as to its form, or any other circumstances in connection with it, and therefore I am enclosing a copy of the proposed statement. May I tell you again how deeply I appreciate your cooperation in this undertaking which seems to me to be one of considerable potential usefulness.

Faithfully yours,

Archibald MacLeish
Archibald MacLeish

Director, Office of Facts and Figures

Enclosure

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

Statement by Archibald MacLeish, Director, Office of Facts and Figures

For Immediate Release

Archibald MacLeish, Director of the Office of Facts and Figures, announced today that an interdepartmental committee to be known as the Committee on Defense Information had been formed to advise the Office of Facts and Figures in its task of extending and improving the country's information on the defense effort.

Members of the Committee on Defense Information were designated, in the case of the Departments, by their respective Secretaries; in other cases by the heads of the agencies who have elected in some instances to serve themselves. The personnel is as follows:

James C. Dunn, Adviser on Political Relations to the Secretary of State

Ferdinand Kuhn, Special Assistant to the Secretary of the Treasury

John J. McCloy, Assistant Secretary of War

Adlai Stevenson, Special Assistant to the Secretary of the Navy

L. M. C. Smith, Special Assistant to the Attorney General

Lowell Wallett, Director, Office of Government Reports

Wayne Coy, Liaison Officer, Office for Emergency Management

Oscar Cox, General Counsel, Lend-Lease Administration

Captain Robert E. Kintner, U. S. A., Board of Office of Facts and Figures

Archibald MacLeish, Director of the Office of Facts and Figures,
Chairman

The Office of Facts and Figures is charged with the responsibility, under the direction and supervision of the President, for formulating programs designed "to facilitate a widespread and accurate understanding of the status and progress of the national defense effort and of the defense policies and activities of the Government". The interdepartmental Committee on Defense Information will advise with the Office of Facts and Figures on ways and means of increasing the amount of public information on defense activities and policies.

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Mr. Mac Leish also announced that the following are now engaged in organizing the Office of Facts and Figures:

Captain Robert E. Kintner, United States Army

Mr. William B. Lewis, Vice President, Columbia Broadcastin System, on leave of absence

Mr. John R. Fleming, detailed from the Department of Agriculture

Mr. Douglas Meservey, Program Sales Manager, National Broadcasting Company

Mr. Rensis Likert, detailed from the Department of Agriculture

Mr. George Barnes, detailed from the Department of Agriculture

Mr. Alan Barth, detailed from the Treasury Department

Mrs. Delia Kuhn

Mr. Lowell Mellett, Director of the Office of Government Reports has accepted an appointment as a member of the Board of the Office of Facts and Figures.

In announcing the organizing staff of the Office of Facts and Figures, Mr. MacLeish said, "The Office of Facts and Figures will operate principally within the government, as an intra-governmental clearing house and adviser on public information on the defense program. Its task will be to obtain additional facts and figures for the average citizen on the defense program."

INFORMATION

SE 8 MA 15 8 25

RECEIVED BY THE OFFICE OF THE ATTORNEY GENERAL

NOV 27 1941

Dear Mr. President:

I have the honor to recommend the appointment of Honorable Man Wood Honeyman of Portland, Oregon, as Collector of Customs for Customs Collection District No. 29, with headquarters at Portland, Oregon, to succeed Judge Fred Fisk whose term of office will expire on April 30, 1942.

Mrs. Honeyman is sixty years of age. She was educated in the Portland schools and was graduated from St. Helens Hall and later attended Finch School in New York. She was elected a Representative to the State Legislature in 1934 and served during the regular and special sessions of 1935. Mrs. Honeyman was elected to the Seventy-fifth Congress representing the Third Congressional District of Oregon and served from January, 1936 to January, 1938.

I am transmitting herewith a nomination for Mrs. Honeyman's appointment.

Faithfully yours,

(Signed) H. Wergastau, Jr.

The President,

The White House.

A. M. C.

Handled by Thompson

THE WHITE HOUSE

_____, 194_

To the

SENATE OF THE UNITED STATES

I nominate **HAN WOOD HONEYMAN** of Portland, Oregon,
to be Collector of Customs for Customs Collection District
No. 29, with headquarters at Portland, Oregon, to succeed
Judge Fred Fisk whose term of office will expire on
April 30, 1942.

NOV 27 1941

My dear Mr. Secretary:

Civil aircraft arriving in the United States from a foreign port or place are required by the Air Commerce Act of 1926, as amended (U. S. C. title 49, sec. 177) and the regulations thereunder, to make the first landing at an airport of entry unless permission to land elsewhere is obtained in advance from the Commissioner of Customs, Washington, D. C.

The term "civil aircraft" does not include aircraft used exclusively in the governmental service of the United States or a foreign country and not carrying persons or property for commercial purposes. Therefore, military and naval aircraft arriving in the United States are not subject to the requirement cited. However, merchandise and baggage brought into the United States on such aircraft are subject to customs entry, examination, and payment of duties, if any are due, in the same manner as like merchandise and baggage brought in by other modes of transportation.

In order to assist the customs service of this Department in the enforcement of the laws which it is charged to administer, it is requested that you issue appropriate instructions to the commanding officers at U. S. air bases and to the operators of naval and military aircraft under your jurisdiction so that in the event any merchandise or baggage is brought into the United States in military or naval aircraft, the nearest customs officer will be notified immediately and the merchandise or baggage held intact until customs inspection and clearance can be had. A similar request is being made of the Secretary of War.

- 2 -

This Department would like advise as to any instructions which you may issue so that the customs officers may be appropriately informed. Your cooperation in this matter will be greatly appreciated.

Very truly yours,

(Signed) Herbert E. Gaston

Acting Secretary of the Treasury.

The Honorable,

The Secretary of the Navy.

LPJ:mc
11/26/41

NOV 27 1941

MEMORANDUM FOR MR. MACK:

I understand that in the past few years starts have been made at an overall study of procurement problems and policy, in an attempt better to carry out the function of Government procurement. Instances of these are (1) A study of steel costs, prices and profits made under the direction of Admiral Peoples in 1936 or 1937; (2) A study of Government purchasing activities, prepared for the TNAC under Admiral Peoples' direction; (3) An economic commentary on Government purchasing, also prepared for the TNAC under the direction of Dr. Morris A. Copeland of the Bureau of the Budget (Monograph 19, TNAC); and (4) A special study of special treatment steel prices of the Carnegie-Illinois Steel Corporation (prepared in the Federal Works Agency in November, 1939).

The defense program has made these studies obsolete. Starting with these reports, however, it should be possible to assemble essential data on cost and price without which the Government is in no position to negotiate a contract with a supplier at a reasonable price.

I am particularly interested in the steel industry and I should like you to prepare for me as promptly as possible a report on the situation in that industry with particular reference to its costs and prices. I have also asked Mr. Norman Cann, Assistant to the Commissioner of Internal Revenue to make a similar report regarding profits in the steel industry.

In addition I should like you to submit a memorandum to me indicating what steps you are taking to meet the problem of purchasing at reasonable prices during this period when, admittedly, we are no longer in a position to rely on the forces of competition to protect us on price.

(Initialed) H. M., Jr.

JJO'C. Jr/Lsw
11-27-41

November 27, 1941

My dear Mr. Hoover:

I am writing to acknowledge receipt of your two confidential letters dated November 25th. The information contained therein has been noted with interest.

Yours sincerely,

(Signed) H. Morgenthau: JSE

Mr. J. Edgar Hoover,
Federal Bureau of Investigation,
Department of Justice,
Washington, D. C.

11/27/41¹⁴⁸

Photostatic copies to:

Mr. Foley

Mr. Pehle

**Federal Bureau of Investigation
United States Department of Justice
Washington, D. C.**

November 25, 1941

PERSONAL AND CONFIDENTIAL
BY SPECIAL MESSENGER

The Honorable
The Secretary of the Treasury
Washington, D. C.

My dear Mr. Secretary:

As of possible interest to you, information has been received from a confidential, reliable source that the Swiss Minister, E. Traversini, Rio de Janeiro, Brazil, during July, 1941, in discussing methods of payment to effect the liquidation of Swiss frozen credits in Brazil and the proposals of the Swiss National Bank and the Bank of Brazil in regard to this matter, said that the Bank of Brazil suggested the liquidation of frozen Swiss credits according to the following plan:

1. In order that the Bank of Brazil can legally clear the drafts which are outstanding, it should be in a position to declare that it has received an amount of milreis corresponding to a similar amount in Swiss francs. According to the suggestion of the Swiss National Bank, the Bank of Brazil would pay out from the milreis thus received, a sum equivalent to the required amount in dollars, while for the drawee the question would still remain open as to whether the dollars thus acquired could finally be converted into Swiss francs for an amount great enough to produce the amount in Swiss francs, of the respective drafts.

2. The suggestion of the Bank of Brazil, according to the official information of the Director of Exchange of this establishment, would consist of the following procedure:

- (a) The Swiss National Bank would place at the disposal of the Bank of Brazil a sum in Swiss francs to the amount necessary to cover the needs corresponding to the accumulated credits of the Swiss exporters.

- 2 -

The Honorable
The Secretary of the Treasury

(b) Against these Swiss francs, the Bank of Brazil would place at the disposal of the Swiss National Bank the sum in dollars equivalent to the amount of the Swiss francs converted at a rate of Swiss francs 4.34 to the dollar.

(c) The Bank of Brazil would place these dollars at the disposal of the Swiss National Bank wherever the Swiss National Bank wished to draw upon them in the United States.

According to the information received, the Swiss Minister feels that there is every reason to believe that the formula for liquidation finally adopted by the two Banks would become the compulsory method of settlement for other banking institutions of the two countries interested in the liquidation of Swiss credits.

Sincerely yours,

J. E. Hoover

11/27/41 151

Photostatic copies to:

Mr. Foley

Mr. Pehle

Federal Bureau of Investigation
United States Department of Justice
Washington, D. C.

November 25, 1941

PERSONAL AND CONFIDENTIAL
BY SPECIAL MESSENGER

The Honorable
The Secretary of the Treasury
Washington, D. C.

My dear Mr. Secretary:

The Boston Field Division of this Bureau has been advised by Mr. Henry P. Melzer, Assistant Manager of the Foreign Department of the First National Bank of Boston, Massachusetts, that that Bank has been sending to various payees in Norway sums of money for the purpose of supporting families of seamen and others in this country.

Mr. Melzer stated that he had recently been informed, through the National City Bank in New York, that the Oslo Bank, through which these funds clear, has written that no more money will be paid to the payees when the remitters are seamen, unless the name of the ship of the remitter and the last voyage of the ship be given. Mr. Melzer indicated that this might be a German method of learning the movements of merchant ships.

Please be advised that this matter has been discussed with the officials of the War, Navy and State Departments and in the opinion of these Departments the information requested should not be given. The Boston Field Division of this Bureau has been instructed to advise Mr. Melzer of the attitude of the Departments named.

Sincerely yours,

J. E. Hoover

November 27, 1941.

MEMORANDUM FOR THE SECRETARY'S FILES:

A meeting relative to the administration of Executive Order 8889 was held in Mr. Foley's office at 4:30 P. M. on November 26, 1941, attended from time to time by the following:

Messrs. Foley (Chairman), B. Bernstein, Pehle, Dietrich, S. M. Bernstein and Aikin for Treasury; Messrs. Acheson, Luthringer and Fisher for State; Messrs. Shea and Swidler for Justice; and Mr. Knapp for the Board of Governors of the Federal Reserve System.

Mr. Pehle reported that the North Africa licenses had been revoked and that transactions in respect to trade with that area would henceforth be handled on a specific license basis.

J. P. Morgan & Company, New York, according to Henry Alexander of that firm, who had been in to see Mr. Pehle, is holding \$9,784,000 for the French Government in respect to the servicing and amortization of the French Government 7% and 7½% issues, some of which do not mature until 1949. These funds are about sufficient to take care of both issues. Mr. Pehle said that Morgan & Company desire to execute a trust instrument, the effect of which would be irrevocably to set aside these funds for the exclusive purpose of servicing the 7% and 7½% issues and paying them on maturity. To maintain their present fiscal agency arrangements with the French Government, Morgan & Company are anxious to execute the trust instrument so that if there is a change in the present French Government no new instructions with respect to the funds which Morgan & Company is holding for the bond issues would be valid. There was considerable discussion but no decision reached as to what Morgan & Company should be advised. The matter will be raised at a future meeting after it has been further considered.

Mr. Pehle reported that BIS under license had been investing their funds held at the New York Federal Reserve Bank in short term bankers acceptances. While recognizing the inflationary aspects of these operations, it was observed that they are presently confined to relatively small amounts, and it was agreed that the BIS should be permitted to continue to invest its funds in this manner. The Monetary Research Division and the Federal Reserve Board will make appropriate recommendations to the committee if at any point it should appear advisable.

TREASURY DEPARTMENT
WashingtonFOR IMMEDIATE RELEASE
November 27, 1941Press Service
No. 28-64

The Treasury Department today issued a general license liberalizing the freezing control restrictions with respect to certain classes of refugees who have been residing within the United States since June 17, 1940.

General License No. 42, issued on June 14, 1941 freed the accounts of bona fide refugees who had been both domiciled and resident in the United States since specified dates in 1940. The new General License No. 42A conferred similar privileges on those refugees who could comply with the residence and other requirements of General License No. 42 but could not meet the domicile requirement.

The Treasury's decision to make this liberalization was prompted by a special study of the census reports which have been filed on Form TFR-300. It was explained that because of the difficulties connected with obtaining immigration visas many refugees had been barred from the privileges of General License No. 42. It was also pointed out that in many other cases there was doubt as to whether the refugee could satisfy the domicile requirements of General License No. 42. It now will be unnecessary to resolve that point because such persons may take advantage of the new General License No. 42A.

Attention was called to the fact that while the property of persons licensed under General License No. 42 need not have been reported on census report Form TFR-300 no such exemption was made under the new General License No. 42A. The new general license expressly states that such reports are required to have been filed.

TREASURY DEPARTMENT
WashingtonFOR IMMEDIATE RELEASE
November 27, 1941Press Service
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FEDERAL RESERVE BANK
OF NEW YORK

November 27, 1941

CONFIDENTIAL

Dear Mr. Secretary: Attention: Mr. H. Merle Cochran

I am enclosing our compilation for the week ended November 19, 1941, showing dollar disbursements out of the British Empire and French accounts at this bank and the means by which these expenditures were financed.

Faithfully yours,

/s/ L. W. Knoke.

L. W. Knoke,
Vice President.

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

Enclosure

Copy:vw:11-28-41

- (a) Includes payments for account of British Purchasing Commission, British Air Ministry, British Supply Board, Ministry of Supply, Timber Control, and Ministry of Shipping.
- (b) Estimated figures based on transfers from the New York Agency of the Bank of Montreal, which apparently represent the proceeds of official British sales of American securities, including those effected through direct negotiation. In addition to the official selling, substantial liquidation of securities for private British account occurred, particularly during the early months of the war, although the receipt of the proceeds at this Bank cannot be identified with any accuracy. According to data supplied by the British Treasury and released by Secretary Morgenthau, total official and private British liquidation of our securities through December, 1940 amounted to \$334 million.
- (c) Includes about \$85 million received during October, 1939 from the accounts of British authorized banks with New York banks, presumably reflecting the requisitioning of private dollar balances. Other large transfers from such accounts since October, 1939 apparently represent the acquisition of proceeds of exports from the sterling area and other currently accruing dollar receipts.
- (d) Includes payments for account of French Air Commission and French Purchasing Commission.
- (e) Adjusted to eliminate the effect of \$20 million paid out on June 25, 1940 and returned the following day.
- (f) Includes \$4.6 million transferred to de Javasche Bank account.
- (g) Includes \$9.3 million of "overnight" items received on November 19 but not actually credited until November 21.
- (h) Includes \$3.5 million transferred from Commonwealth Bank of Australia account and \$1.0 million from account of Central Bank of Turkey.
- (i) \$15.0 million paid, under license, to New York account of French Paymaster General to cover exports from U. S. to French possessions in Africa.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

159

DATE November 27, 1941

TO Secretary Morgenthau

FROM Mr. White

Subject: British Film Settlement

Appended is the information you requested on the settlement the British Government has made with American film companies operating in England. The following are the outstanding points in the agreement:

1. Transfer of accumulated sterling balances.

a. The 8 agreement companies may, as a group, transfer 50% of the blocked sterling held on October 26. The transfer may be made in 2 installments, on October 30, 1941 and on April 1, 1942, the 2 installments to be equal except that the first will be an estimated amount subject to correction in April. Sir Frederick estimates the blocked sterling accounts to amount to \$40 million, of which \$20 million will be transferred in the 2 installments.

b. The non-agreement companies may also transfer 50% of their blocked sterling. Sir Frederick has estimated their blocked funds at \$1 million.

2. Transfers of revenues for the film year, October 27, 1941 to October 26, 1942.

a. The agreement companies may by means of transfers at the end of each quarter transfer up to \$20 million during the year. This amount will be reduced, however, by the agreement made by Warner Brothers, on the occasion of their purchase of British cinema properties, to leave a substantial portion of their revenues in sterling.

b. The non-agreement companies may transfer that amount of their revenues that will make the proportion of transfers to revenues equal for the agreement and non-agreement companies.

3. The companies are to make no substantial change in their arrangements for distributing films.

THE BRITISH SUPPLY COUNCIL IN NORTH AMERICA

160

TELEPHONE: REPUBLIC 7860



Box 680
BENJAMIN FRANKLIN STATION
WASHINGTON, D. C.

PERSONAL

17th November, 1941.

My dear White,

You asked me the other day for further details about the new Film Agreement.

I now enclose copies of correspondence between Mr. Winant and Sir Kingsley Wood, which have just reached me, and which give the whole story, so far as I know it.

If there is any additional information which you need, you might be able to get it from the State Department, who will no doubt have received a report from your Embassy in London.

So far as I know the exchange of letters has not been published, and as I do not know whether or not it is intended to make them public, I must in the meantime ask you to treat them as confidential.

Yours sincerely,

(T.K. Bewley)

Dr. H. D. White,
Director of Monetary Research,
United States Treasury,
Washington,
D. C.

22nd October, 1941.

My dear Ambassador,

Thank you for your letter of October 19th informing me that the eight American Film Companies concerned accept the Treasury's proposal.

I confirm that the arrangements set out in the first paragraph of your letter also apply to the non-Agreement Companies, except that in their case the amount to be transferred in respect of the 1941/42 Film Agreement year is the amount equivalent to the same proportion of their sterling revenues available for remittance as would be represented by the transfer of 20 million dollars in the case of the Agreement Companies. The procedure (which is of course not quite the same as that in respect of the Agreement Companies) will be similar to that which has applied heretofore, it being of course understood that the Companies for their part make no substantial alteration in the general arrangements whereby films are distributed in this country.

I approve the terms of the draft Agreement for 1941/42 and, if it suits Mr. Allport's convenience, it could be signed at the Treasury tomorrow. Perhaps he could be good enough to get into touch with my Private Secretary to let us know what time would suit him.

I agree to your suggestion that the Agreement Companies should transfer on October 30th, 1941 an amount representing one-half of the amount provided for in Article 2 (a) (ii) of the Agreement, subject to subsequent adjustment if necessary as you propose. The payment to the non-Agreement Companies would be made as soon as the necessary calculations can be made.

I understand that Mr. Allport will make application to the Bank of England on behalf of the Agreement Companies concerned for the transfer of sterling into dollars, and the Bank of England will make the dollars available to Mr. Allport or to such persons as he may designate without delay.

I think you know that when Warner Brothers bought their shareholding in a cinema owning Company in the United Kingdom it was agreed that they would surrender to the Treasury a substantial part of their share of any global dollar allocation which might be agreed for the year 1941/42, and accordingly the aggregate transfers which will be provided against the global allocation will fall short of 20 million dollars by the amount arranged with Warner Brothers.

I note with pleasure that you will be ready to discuss the wider questions of future films policy mentioned at the end of my letter of October 4th. We can return to this at a convenient moment.

Finally I should like to say how glad I am that this question has been so satisfactorily settled and to express my thanks to you for all the help which you have given to me in bringing the negotiations to a quick conclusion, which is what we both desired.

Yours sincerely,

(Signed) KINGSELEY WOOD.

His Excellency
The Hon. J.C. Winant

EMBASSY OF THE UNITED STATES OF AMERICA,
London, England.

(W 12586/37/49)

19th October, 1941.

Dear Chancellor,

In reply to your two letters of October fourth and eleventh respectively with regard to the new Film Agreement for 1941-42, I have received word that the eight American Companies concerned therewith accept the Treasury's proposal that : (a) the transfer of 50 percent of their blocked sterling as on October 26, 1941, will be permitted in two equal instalments, the first on October 30th next and the second on April 1, 1942, and (b) for the film year from 27 October, 1941, to October 24, 1942, the Agreement Companies will be permitted to transfer \$20 million; such transfers to take place at the end of each quarterly period.

It is understood that the preceding arrangements also apply to the Non-Agreement Companies, except that in their case the amount to be transferred in respect of the 1941-42 Film Agreement year is the amount equivalent to the same proportion of their resources available for remittance as would be represented by the transfer of \$20 million in the case of the Agreement Companies.

In accordance with our conversations, the Agreement Companies understand that the text of the new Film Agreement will contain the same provisions as were embodied in last year's Agreement except for the insertion of the new transfer figures and the required change in dates. For your approval, I am attaching a draft of last year's Agreement with the necessary alterations to conform with the new arrangements agreed upon between us.

The amount of the unremittable balances held by the Agreement Companies as of October 26, 1941, probably cannot be finally determined before October 30th next. Might I, therefore, suggest that the Agreement Companies be permitted to transfer, by October 30, 1941, in one lump sum, an amount representing one quarter of their estimated 1939-41 unremittable funds. If it was subsequently found that the total sum thus transferred was less than the amount the Companies were permitted to transfer by October 30, 1941, an immediate transfer of the difference could be made, leaving the remaining quarter of their balances - unremittable prior to October 26, 1941 - to be transferred on April 1, 1942. I have suggested to the Companies that their estimate of the total amount for transfer on October 30th next should be calculated conservatively so that there would be no danger that the October 30th transfer will exceed the proportion of the total sum upon which we have agreed.

Should this procedure meet with the Treasury's approval, arrangements could be made to obtain from the Agreement Companies here the sterling equivalent of an estimated sum representing one fourth of their unremittable monies for the film years November 1, 1939, to October 25, 1941, inclusive; the dollars representing this lump sum could then be transferred under the authority of the Bank of England to such recipient in the United States as may be requested by the Companies. In view of the brief time before the end of this month, I would appreciate any assistance you may see fit to give to ensure that the permit for transfer is obtained to enable the dollars to reach the Companies by October 30th next.

/In

The Right Hon. Sir Kingsley Wood, M.P.
The Treasury,
Whitehall,
S. W. 1.

In accordance with the arrangements followed in the past two years in respect to the formalities connected with the acceptance by the Companies of the new Agreement, Mr. F. W. Allport, Foreign Representative of the Motion Picture Producers and Distributors of America, Incorporated, will be prepared to sign the Agreement on behalf of the eight Companies, as soon as the Treasury indicates an agreeable time for this final procedure.

I hope the suggestions outlined above will meet with your approval.

In connexion with the last paragraph of your letter of October 4th, I shall, of course, be glad to discuss with you, at your convenience, the difficulties which you envisage. I also want to take this opportunity to let you know how much I have really appreciated your co-operation and your readiness to meet the view advanced by my Government.

Yours sincerely,

(Signed) JOHN G. WINANT.

COPY
(W 12285/37/49)

Treasury Chambers,
S.W. 1.

11th October, 1941.

My dear Ambassador,

With regard to the two points you raised with me about my letter of the 4th October on films;

(1) I readily agree that the first of the two equal instalments referred to in the first paragraph of my letter should be paid on the 30th October 1941 instead of on the 1st November 1941.

(2) In view of what you said to me, I agree to withdraw the suggestion made in the third paragraph of my letter of 4th October.

I ought also to take the opportunity to explain that the first paragraph of the letter was intended to provide for 50 percent of the blocked sterling being transferred to the Agreement Companies as a whole, and not as entitling individual Companies to transfer in each case 50 percent of the balance accumulated by that Company. I understand that in the case of the Agreement Companies the sterling balances vary from something very small to very considerable sums and it is essential that the arrangements should be interpreted as applying to the Agreement Companies as a group and not to each individual Company.

Yours sincerely,

(Sgd.) Kingsley Wood.

His Excellency
The Honourable
J. G. Winant.

TREASURY CHAMBERS,

4th October 1941.

My dear Ambassador,

Films.

I have promised to put into writing the settlement which we have discussed. My proposal is that both the Agreement and the non-Agreement Companies should be entitled to transfer 50% of the blocked sterling as on October 26th, 1941, in two equal instalments, the first on 1st November, 1941, and the second on the 1st April, 1942.

As regards the Film Agreement year 27th October, 1941, to 26th October 1942, the Agreement Companies would be entitled to transfer up to \$20 millions and the non-Agreement Companies to transfer the same proportion of their resources available for remittance as would be represented by the transfer of \$20 millions in the case of the Agreement Companies. Transfer would take place at the end of each quarterly period.

Sterling not available for transfer under this arrangement would be placed in separate banking accounts in the name of the Companies, the operation of which will be subject to Treasury permission, it being understood that such permission will normally be granted without question for payments in the normal course of business of the Companies.

Not contingent on these payments but as a separate matter I hope that it will be possible to discuss the wider questions of future Films policy about which I spoke to you. As you know, I feel strongly that in the true interests of both parties there should be co-operation in an attempt to frame a constructive policy designed both to build up an efficient British film industry and to develop in our common interests by mutual help the aggregate market for English speaking pictures.

As you know, the offer which I am making to you imposes a serious charge on our very limited dollar resources, while the large and growing business which the American Companies are doing here seems likely to create a post-war liability which you and we will find embarrassing. These are matters which I should like to discuss further with you in due course. In the meantime I have thought it right, despite these facts, to put forward my offer now in view of the importance attached by the President and the Secretary of State to a speedy adjustment of the immediate situation.

Yours sincerely,

(Sgd.) KINGSLEY WOOD.

RECEIVED
Treasury Department

NOV 1 1941

His Excellency
The Ambassador
Washington, D.C.

Minant.

THE BRITISH SUPPLY COUNCIL IN NORTH AMERICA

166

TELEPHONE: REPUBLIC 7860



BOX 880
BENJAMIN FRANKLIN STATION
WASHINGTON, D. C.

22nd October, 1941.

My dear Dr. White,

I promised to send you a line on the subject of the settlement with the U.S. motion picture industry.

I have not got any very up to date figures but I gather the receipts of the companies in the U.K. have passed a figure of \$50 millions a year, and that the amount they expend in sterling in various ways is equal to about \$15 millions, leaving a balance of upwards of \$35 millions. In the year to October 1940 we allowed them to remit \$18 millions, and the year to October 1941 we allowed them to remit \$12.9 millions, but promised that they should have a better deal later on.

In the recent discussions with Mr. Winant the Chancellor of the Exchequer agreed that in the year to the 26th October, 1942, the agreement companies would be entitled to transfer up to \$20 millions, and the non-agreement companies to transfer the same proportion of their resources available for remittance as would be represented by the transfer of \$20 millions in the case of the agreement companies. The transfer would take place at the end of each quarterly period. The non-agreement companies are not very important and I think probably \$20.5 millions in all would cover the amount to be remitted under this part of the agreements. Sterling not available for transfer under this arrangement will be placed in separate bank accounts in the name of the companies, the operation of which will be subject to Treasury permission.

As a result of the working of the agreement since the outbreak of war there is some £10 millions accumulated in the hands of the companies. The Chancellor of the Exchequer agreed that he would allow the companies to transfer

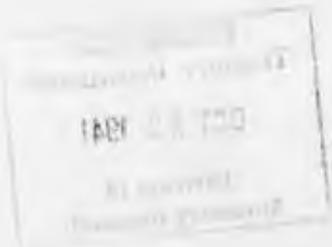
Dr. H. D. White,
Director of Monetary Research,
United States Treasury,
Washington,
D. C.

-2-

50% of this across the exchange in two equal instalments, one on the 1st of November 1941, and the other on the 1st of April, 1942.

Yours sincerely,

F Phillips



November 27, 1941.

Federal Reserve Bank of New York,
33 Liberty Street,
New York, New York.

Gentlemen:

Attention: Mr. L. W. Isaacs

Reference is made to your letter of November 26, 1941, enclosing copies of letters of the Irving Trust Company, New York, the Cerro de Pasco Copper Corporation, Hoady & Harman and Guaranty Trust Company of New York, all of which relate to the cancellation of the following contracts entered into by the Irving Trust Company, covering the purchase of silver from the Cerro de Pasco Copper Corporation, pursuant to authorizations received from the Federal Reserve Bank of New York, as fiscal agent of the United States:

| <u>Date of Purchase</u> | <u>Purchase Authorization Number</u> | <u>Number of Ounces</u> | <u>Delivery</u> |
|-------------------------|--------------------------------------|-------------------------|-------------------|
| 7/29/41 | D 910 | 100,000 | October-November |
| 8/1/41 | D 911 | 200,000 | November-December |
| 8/1/41 | D 912 | 200,000 | " |
| 8/1/41 | D 913 | 100,000 | " |
| 8/1/41 | D 915 | 200,000 | " |
| 8/19/41 | D 917 | <u>100,000</u> | " |
| | | <u>900,000</u> | |

As Hoady & Harman is in need of the silver in order to place it at the disposal of the Guaranty Trust Company of New York for coinage purposes, the Treasury, in view of the statements made in the letters of Hoady & Harman, Guaranty Trust Company of New York and Cerro de Pasco Copper Corporation, is agreeable to the cancellation of the above mentioned contracts. The Federal Reserve Bank of New York, as fiscal agent of the United States is hereby authorized to cancel the above mentioned contracts.

- 2 -

In connection with the cancellation of such contracts there is enclosed a draft of a letter which you are authorized to send to the Irving Trust Company.

Very truly yours,

(Signed) D. W. FELL

Secretary of the Treasury.

FD: dms 11/27/61

Encl: FD. BB. FH - VFC - EAD. WRT

COPY

REPLY

November 26, 1941.
PL:EDIrving Trust Company,
New York, N. Y.

Dear Sirs:

Attention: Mr. Brugger,
Vice President.

Reference is made to your letter of November 24, 1941, with which you enclosed a copy of the letter of the same date from Cerro de Pasco Copper Corporation, New York City, to you and a copy of a letter dated November 21, 1941, from Handy & Harman, New York, to Cerro de Pasco Copper Corporation, and to the letter of November 26, 1941, from Handy & Harman to this bank.

In your letter you request us to endeavor to arrange for the cancellation of contracts which you made pursuant to authorizations from this bank as fiscal agent of the United States, with Cerro de Pasco Copper Corporation for the delivery in November and December, 1941, of approximately 900,000 ounces of silver .999 fine as follows:

| <u>Date of Purchase</u> | <u>Purchase Author- ization Number</u> | <u>Number of Ounces</u> | <u>Delivery</u> |
|-------------------------|--|-----------------------------|-------------------|
| 7/29/41 | D 910 | 100,000 | October-November |
| 8/ 1/41 | D 911 | 200,000 | November-December |
| 8/ 1/41 | D 912 | 200,000 | ⋮ |
| 8/ 1/41 | D 913 | 100,000 | ⋮ |
| 8/ 1/41 | D 915 | 200,000 | ⋮ |
| 8/19/41 | D 917 | 200,000 | ⋮ |
| | | <u>900,000</u> | |

Since it appears from the copy of the letter dated November 21, 1941, and from the letter of November 26, 1941, from Handy & Harman that it is in urgent need of silver for delivery to one of the United States Mints to fill a coinage order for a friendly nation, and will pay the commissions due to brokers and banks in respect of the original contracts and will use cash silver only to meet the requirements of its coinage order at no added profit, and since it appears from the letter dated November 24, 1941, from Cerro de Pasco Copper Corporation that it will sell the silver to Handy & Harman at the price of 35 cents per ounce .999 fine for delivery in November and December, 1941, the Treasury has consented to the cancellation of such contracts. Accordingly, we, as fiscal agent of the United States, authorize and request you to effect the cancellation of such contracts.

Very truly yours,

Copy:cmh:11.27.41

Treasury Department ¹⁷¹
Division of Monetary Research

Date. 12/6/41 19

To: Miss Chauncey

I think the Secretary might take
a quick glance at the appended letter
to Secretary Hull (top page) merely
for his information.

MR. WHITE
Branch 2058 - Room 214½



DIVISION OF MONETARY RESEARCH

TREASURY DEPARTMENT
WASHINGTON

November 27, 1941

Dear Mr. Secretary:

I am sending to you herewith, for transmission to the Cuban Government, the first report of the American Technical Mission to Cuba.

This report deals only with certain immediate problems. The Mission's recommendations concerning Cuba's long-term monetary and banking requirements will be the subject of a later report now in preparation.

Sincerely yours,

/s/ H. D. White

H. D. White, Chief,
American Technical Mission to Cuba.

The Honorable

The Secretary of State.

Enclosure

FOR DEFENSE

BUY
UNITED
STATES
SAVINGS
BONDS
AND STAMPS

American Technical Mission to Cuba

FIRST REPORT TO THE CUBAN GOVERNMENT

November 26, 1941

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AMERICAN TECHNICAL MISSION TO CUBA

The American Technical Mission to Cuba is pleased to submit the following report.

The Mission wishes, before presenting concrete proposals, to express its appreciation of the generous assistance extended it by those persons with whom it worked, and to cite their contribution to the new program. During its sojourn in Cuba, the Mission was impressed by the understanding and constructive attitude of Cuban Government officials — particularly in the Department of Finance — and of a number of private individuals and organizations in Cuba, regarding Cuba's financial problems and possible means of solving them.

In this initial report to the Cuban Government, the Mission undertakes to deal only with measures designed to meet the immediate situation, most of which were discussed in the meetings of October 30 and 31, 1941, in Habana. The suggestions which it offers at this time for consideration by the Cuban Government are not intended to foreshadow or govern in any way the main report which the Mission will presently submit with regard to measures of a more permanent character. While it is believed that the measures proposed in the present report will all tend to facilitate adoption of the long-term program, some of them may have to be considerably modified or eliminated entirely when the permanent machinery is set up.

The purposes of the suggestions for immediate consideration are:

- (1) To accumulate an official reserve of foreign exchange by utilizing the growing strength of the peso;

(2) To supply sufficient peso currency to meet the needs of Cuban circulation during the coming sugar-grinding season without the reintroduction of dollar currency; and

(3) To increase the banks' capacity to lend pesos in order to enable them more adequately to meet Cuba's growing credit needs.

If no steps are taken in time, it seems likely that the present very small discount on the peso may disappear within the next few months, as a result of the foreign exchange demand for pesos, and that dollars will be drawn into internal Cuban circulation. The Mission believes that it would be preferable for any dollar currency which is brought into Cuba to be accumulated in an official peso stabilization reserve than to be dissipated into general public circulation. An official reserve of gold or dollars would be most helpful in the initiation of any long-run program of Cuban monetary reform. Such a reserve would help stimulate public confidence in the peso and enable the Government to aid in maintaining stability of peso exchange.

The following detailed suggestions for obtaining the above objectives are submitted for immediate consideration.

(1) The Mission recommends that the Cuban Government undertake to maintain a slight discount on the peso (or, conversely, a slight premium on the dollar) by purchasing gold or dollars at some appropriate price.

The premium on the dollar should be only large enough to minimize the use of dollars for internal Cuban circulation yet not so large as to disturb confidence in the peso. It is tentatively suggested that

this premium may be set at some point between 25 cents and two dollars per 100 dollars.

It is possible that the desired exchange premium on the dollar could be maintained merely by withholding from the market an appropriate amount of dollars received by the Cuban Stabilization Fund from sugar exports. If it should be necessary to acquire more dollars than are available to the Fund in this manner, they could be purchased in the exchange market. Methods of obtaining pesos for these operations are discussed in section (2). The legal authority for the Government to buy, hold, pledge and sell gold and dollars should of course be clearly established.

Sale of the gold or dollars accumulated in the reserve should be made solely for the purpose of aiding in maintaining the stability of the peso in the foreign exchange market. The task might be made easier by public announcement of this policy. The precise level at which, and the circumstances under which, the peso will be supported should not be announced at this time. Appropriate policies to pursue in promoting stability of the peso will be discussed further in the Mission's final report. In the interim, should the Cuban Government desire any further consultation regarding such policies, the Mission will be glad to be available.

(2) The pesos to be used to pay for the dollars accumulated in accordance with section (1) may be obtained in several possible ways:

(a) The Cuban Government might borrow pesos from the banks in Cuba, offering the accumulated dollars as collateral for these loans.

A relaxation of reserve requirements, as recommended in section (3), should facilitate such loans.

On the basis of preliminary discussions, it is believed that at least some of the banks in Cuba would be willing to consider such loans. Since the collateral consists of dollar balances, it is assumed that the rate of interest should be low.

The number of dollars purchased with the borrowed pesos would, of course, be less than the number of pesos by the amount of the premium on the dollar. Should the banks insist upon having the loans completely collateralized, the Cuban Government could, if it wished, make up the very small margin in either of two ways:

- (i) Make some of the proposed purchases of dollars with Treasury peso funds other than those borrowed from the banks for this purpose and pledge the dollars as additional collateral;
- (ii) Keep part of the Treasury's peso working balances on deposit in the lending banks.

The non-borrowed funds required would be about the same under either method and would be relatively insignificant, amounting to the 1/4 to 2 percent of the peso bank loans which would not be covered, dollar for peso, by the purchased dollars. The amount borrowed from the banks would be slightly less under the first method.

It should be noted that the arrangement suggested in this section could be put in effect without waiting for new currency.

- (b) The Government might issue peso currency against a full-value reserve of gold or dollars.

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The precise amount of pesos to be issued might correspond either to the par value of gold or dollars accumulated by the Government, or to the premium price at which the dollars are purchased in accordance with section (1) above. In the first case, 100 pesos would be issued against 100 dollars or the equivalent amount of gold at \$35 per fine ounce. In the second case, 100.25 to 102.00 pesos would be issued against 100 dollars or the equivalent amount of gold, depending upon the price selected in section (1). If pesos are issued against dollars or gold only at their par value, a smaller amount of pesos will be issuable against the accumulated reserve than will have to be paid for the gold or dollars at the premium price.

Whether greater confidence would be created by having the reserve in actual gold rather than in dollars is a matter which the Cuban officials are better able to decide than is the American Mission. Any dollars accumulated by the Cuban Government can be used to purchase gold from the United States if the Cuban Government complies with the United States regulations regarding gold. The United States Government, however, charges $1/4$ of one percent for purchases or sales of gold.

If it would facilitate the issue of pesos against gold for the purposes outlined in this section, the United States Stabilization Fund would be willing to sell gold to the Cuban Government on credit provided that the aggregate amount of gold for which payment has not been made does not exceed \$5 million at any one time, and provided that the Cuban Government issue no notes against this gold in excess of the cost thereof. The United States Stabilization Fund

would assume that the dollars purchased with the pesos issued against such gold would, as soon as practicable, be used to pay for the gold.

Whenever it is considered advisable to support the peso on the foreign exchange market, the Government should use such part of its reserve of gold or dollars as seems appropriate to buy pesos, thereby aiding in stabilizing the foreign exchange value of the peso. The pesos received by the Government in this process should then be applied to reducing the bank loans incurred under section (2)(a) and to retiring peso currency issued under section (2)(b).

Power to issue new currency for the purchase of gold or dollars is a desirable alternative device for the Government to possess. It should, however, be employed in such manner as to avoid creating unnecessarily large bank reserves.

(3) The Mission recommends that the Treasury, pending further developments, reduce from 56 percent to a nominal figure the percentage of their legal reserves which the banks must hold in pesos, and also that consideration be given to making balances abroad in specified banks eligible as reserves.

The purpose of these recommendations is to enable peso currency now immobilized in the banks to be used to meet the seasonal demand for currency during the coming sugar season and to increase the capacity of the banks to expand their peso loans and to carry larger deposits in either dollars or pesos. How great the withdrawals of currency from the banks will be next winter is, of course, impossible to forecast with certainty. The Mission has received tentative estimates

that run as high as 20,000,000 pesos. While this would be extremely large in relation to any previous seasonal increase it appears to be at least a possibility in view of the anticipated increased value of the coming sugar crop. In addition, if deposits continue to grow as they have for the past year, the required reserves of the banks will be increased. Since dollars are to be kept out of circulation, both the withdrawals of currency from the banks and the increase of required reserves will reduce the 7,000,000 of excess peso reserves reported held by the banks in Cuba on September 30, 1941. It is clear that this 7,000,000 pesos, some of which the banks must hold for their own working purposes, may be quite inadequate to meet the seasonal demands unless legal reserve requirements are reduced or new currency is issued in adequate volume. In the absence of such measures the banks might be forced to take restrictive action.

The Mission believes that the Government will find it possible to finance its purchases of dollars by utilizing the existing peso resources of the banks only if it frees peso reserves in sufficient volume to meet the winter demands with ease. If, on the other hand, the Government were to rely almost wholly on new note issues to finance its purchases of dollars it is possible that bank reserves, increased by the new issues, might be large enough to meet the winter demands without a reduction of existing reserve requirements. This would not necessarily be the case, however, and the Mission therefore recommends that as a first step, and until the situation has developed more clearly, reserve requirements should be relaxed.

Reduction of the 56 percent requirement alone might prove unavailing if the banks were unwilling to transfer dollar currency from New York to Habana. Most of the reserves in Habana, as the attached tables show, are already needed to complete the required reserve of 25 percent against total peso and dollar deposits. There are at present only about 2,000,000 of free dollar reserves in Habana; hence elimination of the 56 percent requirement without importation of dollars by the banks would add only 2,000,000 pesos to the existing 7,000,000 of excess peso reserves, making 9,000,000 pesos in all.

If the banks are prepared to bring dollars to Habana, it is estimated that a maximum of 10,000,000 pesos could be freed, over and above the 9,000,000 mentioned above. This is based on information offered the Mission to the effect that banks would deem it advisable to hold working peso cash reserves of about 15 percent of peso deposits (or about 11 million pesos) even in the absence of legal requirements.

Some of the banks, however, might be reluctant to move large amounts of dollars to Habana. For this reason and because of the cost of shipping large amounts of currency, the Mission suggests the possibility of re-defining legal reserves so as to include balances in banks abroad specified by the Cuban Government.

The exact peso reserve requirement to be specified in the new ruling is, in the view of the Mission, properly left to the decision of Cuban officials. In order, however, to provide the maximum of freedom to the banks in their use of their present peso reserves the Mission considers that the peso reserve requirement should be nominal

even though the banks would apparently want to hold 10 to 15 percent of their peso deposits in readily-available peso cash for their own protection.

It would be helpful in encouraging the banks' expansion of loans if definite indication were given by the Government to the banks that the new reduced requirements would not subsequently be revised upward until adequate notice had been given them by the Government.

(4) A considerable supply of peso currency should be ordered from the printers immediately. Not additional amounts of notes are needed for the measure suggested in (2)(b). Fresh currency (but not a new addition) is also needed to replace the excessively worn notes now in circulation and to make change for larger denomination notes. It is understood that the Cuban Government now has available only 4 million of unissued notes. However, the new notes obtained for these two purposes should not exceed the amount estimated to be necessary during the period before the new program can be put into effect. Whether or not the currency issued under (2)(b) can be of the same type as that used to replace worn notes is a question which should be given early consideration by the Cuban Government. There is appended to this report a note setting forth in some detail certain facts relating to the provision of new currency notes.

There are also attached some statistical tables which have been compiled from material made available to the Mission. It has not been possible to verify all of these data but the figures cited in certain portions of the report have been in large part drawn from the tables and they are therefore added as of possible interest to the Cuban Government.

In concluding this report we wish to point out that the recommendations submitted can in almost all cases be modified to meet particular Cuban conditions, but choice among the possible alternatives and suggestions as to modifications can best be made by Cuban officials familiar with the local problems and conditions. The Mission would be most willing to discuss the recommendations and possible changes in them whenever the Cuban Government desires in such place and manner as can be mutually agreed upon. Furthermore, the Mission would be glad to work out jointly with the Cuban Government any mutually satisfactory statement to be published under the name of the American Mission, the Cuban Government, or both, if the Cuban Government feels it would be desirable in introducing the program to the Cuban public.

November 26, 1941

AMERICAN TECHNICAL MISSION TO CUBA

Provision of New Currency Notes

(Addendum to report of November 26, 1941)

Secret Service and banknote engraving experts agree that badly-worn paper currency offers the easiest opportunity to counterfeiters. Counterfeiters have great difficulty in producing new notes of sufficient quality to pass for the genuine. In the case of well-worn notes, however, only experts may be able to detect counterfeits. Most counterfeiters are said to put out well-worn paper. Accordingly it would seem desirable for the Cuban Government to proceed immediately to improve the condition of the notes circulating in Cuba to prevent counterfeiting, if for no other reason.

In the United States, paper currency of \$1 denomination is replaced on the average every nine months. There is said, however, to have been little replacement in Cuba since silver certificates were first issued seven years ago.

The recommendation in section (4) of the report involves the technical tasks of holding stocks of unissued currency, of accounting for retirements, and of destroying currency after retirement. In this regard it is understood that the Cuban Treasury has set up records of each note by number. The United States does not keep such records, having found them unnecessary as well as excessively burdensome. No official use is now made of the numbers on United States currency, other than for occasional Secret Service work. The American Mission is prepared to go into the question of these procedures in more detail if the Cuban Government desires it to do so.

The United States Government is willing to give a Cuban order for paper priority over its own orders from the one company which produces it. The paper used for Cuban currency is identical with that in United States money except for the omission of the blue threads. Three weeks are required to make the paper if it is to have maximum durability. The Bureau of Engraving and Printing has in stock only 22,000 sheets, which make 12 notes each, of the paper purchased for the previous issues of Cuban pesos. The United States Treasury will proceed to order paper from the paper company upon the receipt of a definite order from the Cuban Government. An early order is recommended. The cost currently is slightly under \$10,000 for 1 million sheets.

At the present time, all private American banknote companies are said to be operating at capacity and unable to take on new jobs. Even if they accepted a new commission, it is believed that it would take nearly a year to produce new dies.

If the Bureau of Engraving and Printing is commissioned to use the original dies from which the previous issues of Cuban pesos were produced, with only minor changes, notes could be printed within a few weeks. The original dies have been preserved and there has been no deterioration in them. The two engraved signatures on the face of the notes could be changed in about three weeks after the receipt of the new facsimile signatures. Shipment of notes could begin at the end of an additional three weeks for printing. Minor changes in the other wording on the notes would require a month or more to make. A new note or a new portrait or border would take as much as a year to produce. Official estimates of the cost of each process are now in process and will be forwarded within a few days.

Notes will last longer if they are aged from three to four months after printing before being placed in circulation.

It seems clearly desirable to place immediate orders for enough silver certificates to replace the present worn circulation, to supply more flexibility among different denominations, and to keep a reserve stock on hand for future replacement. Whether or not the present silver certificate plates can also be used for the notes to be issued under (2)(b) is a question for Cuban official determination and one on which the Mission does not feel qualified to make a specific recommendation. It is recognized that the legend concerning a reserve of silver pesos would not be correct. At the same time, it is known that a small amount of silver certificates have already been issued against gold. A law might conceivably permit the use of silver certificates backed by dollars or gold during the present emergency, it being expressly provided that coined pesos need not be kept in the Treasury to the extent that dollars or gold are held as reserve. If such law is not feasible it might be possible to obtain legislation authorizing an issue of Cuban silver certificates against United States silver dollars.

The Mission believes that consideration might well be given to a large initial issue of 100-peso notes. This would provide a form of currency suitable for bank clearings, which would be more convenient for the banks than batches of small denomination notes. The Bureau of Engraving and Printing could turn out a given value more quickly in 100 peso notes than in notes of small denomination. These notes would not only finance Governmental purchases of dollars and facilitate

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clearing operations but they would automatically release the small denomination currency now immobilized by law in bank reserves. It would not be appropriate, however, for the banks to acquire more than a few million pesos of the new clearing notes until they were assured that the Government was in a position to convert them into smaller denomination currency in case of a run on the banks or other withdrawals of an abnormal character. For this reason and in order to meet the needs of active circulation it is important that the Government should proceed to take the additional steps required to obtain an adequate supply of fresh small denomination notes.

Table 1

RESERVE POSITION OF BANKS IN CUBA ON VARIOUS ARRANGEMENTS
AS OF SEPTEMBER 30, 1941

(In thousands)

| Bank | Deposits | | | Available reserves | | | Required reserves: 25% of total deposits | Excess peso reserves | | |
|-------------------------------|----------------|---------------|---------------|-----------------------------|---------------|--|---|--|--------------|---|
| | | | | Local reserves in Havana | | Dollar balances abroad (August 31) | | Assuming 50% of total re- quired reserves in pesos* and counting only local reserves in Havana | | Assuming 50% requirement sus- pended, but 15% of peso de- posits needed in peso cash for working purposes* Counting only local reserves in Havana |
| | Total | In pesos | In dollars | In pesos | In dollars | | | | | |
| Royal Bank of Canada | 51,088 | 50,380 | 20,707 | 10,229 | 4,300 | 6,042 | 12,772 | 1,757 | 1,757 | 5,672 |
| Bank of Nova Scotia | 12,277 | 6,163 | 6,114 | 3,081 | 1,613 | 4,801 | 3,069 | 1,362 | 1,025 | 2,197 |
| Canadian Bank of Commerce | 2,477 | 1,156 | 1,320 | 518 | 428 | 4 | 619 | 171 | 327 | 331 |
| National City Bank | 30,499 | 13,415 | 17,084 | 5,331 | 3,595 | 6,635 | 7,625 | 1,061 | 1,301 | 3,319 |
| First National Bank of Boston | 18,407 | 9,561 | 8,846 | 4,002 | 2,468 | 5,260 | 4,602 | 1,425 | 1,868 | 2,568 |
| Chase National Bank | 8,254 | 2,939 | 5,315 | 1,954 | 947 | 1,464 | 2,064 | 798 | 837 | 1,513 |
| H. Gelats y Cia. | 22,792 | 6,128 | 16,664 | 3,503 | 3,201 | 3,580 | 5,698 | 312 | 1,086 | 2,584 |
| Banco del Comercio | 2,047 | 1,187 | 860 | 517 | 423 | 365 | 512 | 230 | 339 | 339 |
| Banco Comercial | 140 | 123 | 17 | 44 | 1 | 2 | 35 | 10 | 10 | 12 |
| Banco Nufes | 2,593 | 2,492 | 101 | 768 | 138 | 70 | 648 | 258 | 258 | 328 |
| Total | 150,574 | 73,544 | 77,028 | 29,947 | 17,194 | 28,223 | 37,644 | 7,384 | 9,408 | 18,823 |

* Insofar as dollar reserves are insufficient to meet the remainder of the 25 per cent total requirement, pesos must make up the deficiency and count as required, rather than as excess, reserves.

Table II

RESERVE POSITION OF BANKS IN CUBA ON VARIOUS ASSUMPTIONS
AS OF SEPTEMBER 30, 1941
(In thousands)

| Bank | Total required reserves: 25% of total deposits | Assuming 56% of total required reserves in pesos* and counting only legal reserves in Havana | | | | Assuming 56% requirement suspended, but 15% of peso deposits needed in peso cash for working purposes* | | | | | | | |
|-------------------------------|--|--|---------------|--------------|--------------|--|---------------|--------------|-----------|---|---------------|---------------|---------------|
| | | Required | | Excess | | Counting only legal reserves in Havana | | | | Counting dollar balances abroad in reserves | | | |
| | | Pesos | | Dollars | | Pesos | | Dollars | | Required | | Excess | |
| | | Pesos 1/ | Dollars | Pesos | Dollars | Pesos 2/ | Dollars | Pesos | Dollars | Pesos | Dollars | Pesos | Dollars |
| Royal Bank of Canada | 12,772 | 8,472 | 4,300 | 3/1,757 | 0 | 8,472 | 4,300 | 1,757 | 0 | 4,557 | 8,215 | 5,672 | 2,127 |
| Bank of Nova Scotia | 3,069 | 1,719 | 1,350 | 1,352 | 263 | 1,456 | 1,613 | 1,625 | 0 | 924 | 2,145 | 2,157 | 4,269 |
| Canadian Bank of Commerce | 619 | 347 | 272 | 171 | 156 | 191 | 428 | 327 | 0 | 187 | 432 | 331 | 0 |
| National City Bank | 7,625 | 4,270 | 3,355 | 1,061 | 240 | 4,030 | 2,595 | 1,301 | 0 | 2,012 | 5,613 | 3,319 | 4,617 |
| First National Bank of Boston | 4,602 | 2,577 | 2,025 | 1,425 | 443 | 2,134 | 2,468 | 1,868 | 0 | 1,434 | 3,168 | 2,568 | 4,560 |
| Chase National Bank | 2,064 | 1,156 | 907 | 799 | 40 | 1,117 | 927 | 837 | 0 | 441 | 1,623 | 1,513 | 788 |
| N. Gelats y Cia. | 5,698 | 3,191 | 2,507 | 312 | 774 | 2,417 | 3,281 | 1,086 | 0 | 919 | 4,779 | 2,584 | 2,082 |
| Banco del Comercio | 512 | 287 | 225 | 230 | 198 | 178 | 334 | 339 | 89 | 178 | 334 | 339 | 454 |
| Banco Comercial | 35 | 34 | 1 | 3/10 | 0 | 34 | 1 | 10 | 0 | 32 | 3 | 12 | 0 |
| Banco Nuñez | 648 | 510 | 138 | 3/258 | 0 | 510 | 138 | 258 | 0 | 440 | 208 | 328 | 0 |
| Total | 37,644 | 22,563 | 15,060 | 7,384 | 2,114 | 20,539 | 17,105 | 9,408 | 89 | 11,124 | 26,520 | 18,823 | 18,897 |

* Insofar as dollar reserves are insufficient to meet the remainder of the 25% total requirement, pesos must make up the deficiency and count as required, rather than as excess, reserves.

- 1/ Except in the case of the Banco del Comercio, all peso cash listed in this column for individual banks must be held to meet the 25 per cent legal requirement, which requires more peso cash than the 15 per cent of peso deposits assumed to be needed for working purposes.
- 2/ All the peso cash listed in this column for individual banks represents only the 15 per cent of peso deposits assumed to be needed for working purposes, except that more peso cash must be held by the Canadian Bank of Commerce, the Banco Comercial, and the Banco Nuñez to meet the 25 per cent legal requirement.
- 3/ By transferring dollars from abroad to Havana, 1,481,000 additional pesos could be released as follows: Royal Bank of Canada, 1,320,000; Banco Comercial, 14,000; Banco Nuñez, 147,000.

Table III

PESO MONEY BY DENOMINATIONS: 1 TO 100 PESOS
AS OF SEPTEMBER 30, 1941

(In millions of pesos)

| Denomination | Total net issue | New notes held by Fiscal Commission | In Treasury | In banks ^{2/} | In circulation | |
|--------------|-----------------|-------------------------------------|-------------|------------------------|----------------------|-----------------------------|
| | | | | | Amount ^{2/} | Per cent of total net issue |
| 1 peso coins | 4.2 | --- | * | 3.3 | 1.0 | 23 |
| 1 peso notes | 11.3 | <u>1/2.3</u> | .1 | 2.8 | 6.1 | 53 |
| 5 " " | 25.5 | 1.8 | .1 | 7.7 | 15.8 | 62 |
| 10 " " | 12.9 | --- | * | 3.0 | 9.9 | 77 |
| 20 " " | 13.9 | --- | * | 4.6 | 9.4 | 67 |
| 50 " " | 9.0 | --- | * | 2.1 | 6.8 | 76 |
| 100 " " | 11.0 | --- | * | 1.8 | 9.1 | 83 |
| Total | 87.8 | 4.2 | .3 | 25.4 | 58.1 | 66 |

* Less than 50,000 pesos.

1/ Excluding 1.4 million pesos destroyed by the fire in the vaults.2/ The total of 25.4 million pesos "in banks" includes .1 million pesos listed by three banks as "unclassified", but is less by 1.3 million than the total given in the monthly report to the Treasury for the same date. Possible reasons for the apparent incompleteness of the banks' reports to the Mission by denominations are suggested on page 2 of the Explanatory Note. Since bank holdings are slightly understated in this table, money in circulation outside the banks is slightly overstated.

Explanatory Note to Tables

Required reserves of the banks can be computed so as to release for other purposes a maximum of peso currency or a maximum of dollars. In Tables I and II the computation has been so made as to release the maximum of peso currency since it is in this type of currency that there is most likelihood of a shortage.

In computing excess peso reserves the basic assumption is that 25 percent of total deposits must be held in pesos or dollars. This is the legal requirement that has been in effect since 1885, and it is regarded as unchanged throughout the computations. Within this framework several assumptions as regards other features of reserve requirements are made. In Table I it is first assumed that the Treasury maintains its present ruling that 56 percent of total required reserves must be held in pesos. On this basis the banks had 7,384,000 pesos in excess of legal requirements on September 30, 1941.

It is next assumed that the 56 percent requirement is suspended and that so far as the law is concerned the banks are free to pay out all their pesos, providing they maintain a reserve in dollars in Havana equivalent to 25 percent of their total deposits. The banks did not have on September 30, 1941, however, enough dollars in Havana to free more than a small portion of their peso reserves. Even without the 56 percent requirement they would have had to continue to apply the greater part of their pesos to meeting the 25 percent requirement. Hence their pesos in excess of legal requirements on this assumption rise only to 9,408,000.

A further assumption has been made in this second case, which is, however, practically without effect under the conditions of September 30, 1941. It is assumed that even if the banks could legally free all their pesos they would have to keep some working reserves. What those reserves must be is a matter for each bank to determine; but the Mission was told by the banks that they would for their own protection have to keep an amount of peso cash equivalent to 10 to 15 percent of their peso deposits even if there were no legal reserve requirements. The assumption has therefore been made in this second case that, while the 56 percent requirement is suspended, the banks cannot let their peso cash fall below 15 percent of their peso deposits. As a matter of fact, on the basis of September 30 figures, all the banks except the Banco del Comercio would have been forced by the requirement that 25 percent of total deposits must be held in dollar or peso reserves to hold more in pesos than 15 percent of their peso deposits. Hence the assumption that 15 percent of peso deposits must be held in peso cash is without appreciable effect in this second case.

In the third case, however, it is the governing assumption. The assumptions are the same in the third as in the second case except that instead of counting only dollar reserves in Havana it is assumed that dollar balances abroad are also included in reserves. This could be achieved without a change in the present definition of reserves if the banks moved their dollars from abroad to Havana. Or it could be achieved by extending the present definition of reserves to include dollar balances abroad. Whatever the method of introducing dollars abroad into reserves, it would, on

Explanatory Notes to Tables - continued

the basis of September 30 figures, set free virtually all the peso reserves of the banks were it not for the assumption that they must hold peso cash equivalent to 15 percent of their peso deposits for their own working purposes. The 18,823,000 pesos shown as excess reserves in the final column of the table are all in excess of this 15 percent.

The contrast between this excess of 18,823,000 pesos in the third case and the 7,384,000 and 9,408,000 pesos in the first and second cases is really greater than it seems. In both the first two cases the banks, if they used up their so-called excess reserves, would be down to their legal minimums (on the 50 percent basis in the first case, and on the 25 percent basis in the second). In the third case they would be down only to their discretionary working reserves. While the banks can dip below their legal minimums without penalty and have often done so, they must nevertheless plan their business so that such deficiencies will not become chronic. Hence they would not feel comfortable in paying out all the excess reserves shown in the first two cases. In the third case the whole amount of 18,823,000 pesos could be withdrawn and still leave the banks with normal working reserves and plenty of dollars to meet the 25 percent requirement should they from time to time have to dip into their working reserves. The only banks without sufficient dollar balances abroad to enable them to take full advantage of the conditions assumed in this third case are the Canadian Bank of Commerce, the Banco Comercial, and the Banco Nuñez, all of them small.

A more detailed analysis of the reserve position of the banks is contained in Table II. In this table the reserve position of the banks in each of the three cases is developed in four columns instead of one. Required, as well as excess, reserves are shown both in pesos and in dollars. The absence of excess dollars in the second case and their abundance in the third are sharply brought out in this table.

In Table III the peso cash of the banks is analyzed by denominations of from 1 peso to 100 pesos. This is to test whether the banks' holdings are suitable for general circulation. The table shows that they are. The banks' holdings are largest in the small denominations that are in active circulation. They are least in the 100-peso notes, the denominations most suitable for clearing purposes.

The Banco Comercial, which held only 41,000 pesos of cash on September 30, 1941, did not supply figures by denomination to the Mission, and data for the other banks were supplied at a time when they could not be checked against the reports of individual banks to the Treasury as of September 30, 1941. The total of all denominations for the nine banks reporting to the Mission is 1,300,000 pesos less than the aggregate shown in the regular reports to the Treasury. It may be that several of the banks in reporting denominations to the Mission failed to cover cash in tellers' tills or in branches. The proportions in the different denominations, however, cannot have been materially altered by the omissions.

TELEGRAM SENT

DAS

PLAIN

November 27, 1941

AMERICAN CONSUL

SHANGHAI, (CHINA) via H. R.

1052, twenty-seventh

Your 1762, November 24

You will be guided by the following reply from the Treasury Department.

QUOTE. Re instructions of November 11, 1941 relating to General License 5B and invoices certified thereunder and re your 1762 of November 24.

Philippines are included in term quote United States unquote as defined in Section 5 (b) of Executive Order 8389. Special certification procedure is applicable on invoices for Philippines.

You should note in connection with shipments from China to the Philippines that for local Philippine customs duty purposes merchandise is frequently invoiced in sterling although payments are to be made in United States currency. This practice is not (repeat not) disapproved of.

You are,

-2- #1052, November 27, to AMERICAN CONSUL
SHANGHAI, (CHINA) via N. R.

You are, therefore, authorized to place the special certification on invoices relating to such merchandise provided that all requirements stated in the instructions have been complied with and notwithstanding the fact that invoices presented for certification are in terms of sterling rather than United States currency.

Care should be exercised to see that statements from appointed banks in fact relate to the transactions covered by invoices certified by you. In so doing you should ascertain that the sterling values actually correspond to the dollar payments authorized.

Repeat to all offices in China. UNQUOTE.

MULL
(FL)

FD:FL:EMCB

FE

COPY

BS

PLAIN

Tientsin via N.R.

Dated November 27, 1941

Rec'd. 4:15 a.m., Dec. 1st

Secretary of State,

Washington.

150, Twenty-seventh.

Yokohama Specie Bank circular dated November 26 notifies exporters on behalf of Federal Reserve Bank that export of local products from North China to United States of America Britain Netherlands India Hong Kong and other designated countries will be permitted from now forward provided that the corresponding import covers foodstuffs sugar oil gum products mineral goods and any other essential commodities which have already been or will surely be imported into the northern ports in reply to an inquiry by this office the Federal Reserve Bank stated that the issuance of permits for exports to designated countries suspended since the freezing order will be resumed for non-embargoed goods except bristles and furs provided exchange has been settled against export of the above listed articles. This will allow exporters to clear shipments direct to ultimate destinations rather than to Shanghai for reconsignment as has been done since the freezing order.

Sent to the Department, repeated to Chungking, Peiping and Shanghai.

XIP

CALDWELL

sh:copy
12-2-41

TREASURY DEPARTMENT

196

INTER-OFFICE COMMUNICATION

DATE November 27, 1941

TO ^{Chauncey} Secretary Morgenthau
 FROM Mr. Dietrich

CONFIDENTIAL

Registered sterling transactions of the reporting banks were as follows:

| | |
|------------------------------------|----------|
| Sold to commercial concerns | £58,000 |
| Purchased from commercial concerns | £112,000 |

Of the latter amount, £100,000 were reported as representing the proceeds of machinery exports.

Open market sterling remained at 4.03-1/2, and there were no reported transactions.

The Uruguayan free peso advanced another 50 points (1/2¢) to close at a new high of .5025. The free peso is now quoted at a level 6¢ higher than the rate of October 1, when the current upward movement began.

In New York, closing quotations for the foreign currencies listed below were as follows:

| | |
|--------------------------|------------------|
| Canadian dollar | 11-1/4% discount |
| Argentine peso (free) | .2390 |
| Brazilian milreis (free) | .0515 |
| Colombian peso | .5775 |
| Mexican peso | .2070 |
| Venezuelan bolivar | .2580 |
| Cuban peso | 1/8% discount |

There were no gold transactions consummated by us today.

No new gold engagements were reported.

In London, spot and forward silver remained at 23-1/2d, equivalent to 42.67¢.

The Treasury's purchase price for foreign silver was unchanged at 35¢. Handy and Harman's settlement price for foreign silver was also unchanged at 34-3/4¢.

We made no silver purchases today.

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SECRET

COORDINATOR OF INFORMATION

THE WAR THIS WEEK

No. 7

November 20 - 27, 1941

No. 25

Secretary of the Treasury

Coordinator of Information

THE WAR THIS WEEK

No. 7

November 20 - 27, 1941

SECRET

The crescendo of German military and diplomatic offensives during the past week strongly suggests the hope of high Nazi circles that a last great effort will level the barriers to the construction of a German Europe. Russian resistance is to be broken, or seriously compromised, by the renewed offensives in north and south. The ousting of Weygand appears to be only the prelude to the "coordination" of France with the German system and the possible occupation of French North Africa. Seven new states have been forced to sign the Anti-Comintern Pact, among them much battered Finland.

These initiatives have doubtless been timed with the Kurusu Mission to dissuade the Japanese from any compromise unfavorable to the Nazis. Finally, the Germans are gradually unveiling the outlines of the "New Europe," and there are rumors that after the new year the states of the Continent will be convened in Congress at Vienna to consecrate that system.

ANGLO-AMERICAN OFFENSIVE

This broadly conceived German bid for victory on the Continent has met sharp rejoinders from the enemy. The long prepared British offensive in Africa has lashed out to the west in an attempt to encircle and destroy the Axis forces in the desert. The American government has suspended

the operation of the North African economic accord (in response to the ousting of Weygand), has made lease-lend aid available to the Free-French, and has despatched troops to strategic Dutch Guiana from which this country draws seventy per cent of its total bauxite requirements (1940).

THE GERMANS ADVANCE IN RUSSIA

The new German drive against Moscow has thrown out prongs from Kalinin in the north and Tula in the south with the apparent object of encircling the capital. With the forces of the Nazis reported within a few miles of the city, the decision in the Battle for Moscow may be only a matter of hours now.

In the southern battlefield, despite a terrific Russian counter-offensive north of Rostov,

the Germans are still in possession of the city and have cut the main oil-transport artery between the Caucasus and the heart of Russia. An immediate danger is that the Germans will strike south-eastward from Rostov and possess themselves of the Maykop and Grozny oil fields, which lie north of the Caucasus mountains and are militarily far more accessible than the fields to the south of the mountains.

These two fields produce together some five million tons of oil a year or about a third of the total product now available to the Axis. It is doubtful whether Soviet destruction could deprive the Germans of this oil for many months, and there is reason to believe that even refineries could be replaced within a year. In the last analysis the

availability of even a notable proportion of this oil would give the Germans a supply for a war of almost indefinite term. The conquest of these fields might be a major disaster for the Allies.

Urgent Anglo-American representations were made to the Russian government on November 21, pointing out the importance of immediate measures to prepare for the prompt eventual destruction of the wells in these fields and offering to supply Russian oil deficiencies during the war and the period of reconstruction and to provide machinery desired for replacement on at least as favorable a basis as to other states resisting aggression.

NAZI PLANS FOR RUSSIA

German plans for the eventual disposition of occupied Russia and the Baltic countries are

still veiled in secrecy but the statements in the press suggest that Russia is to be eliminated once and for all as a factor in the power politics of Europe. In a lecture by one Professor Schuessler, widely publicized by the German press, Communism and Czarist imperialism are declared to be substantially the same thing, and it is baldly stated that Germany contemplates the complete elimination of European Russia and the control of her economic resources.

The German press also lauds Hitler for the reconstruction of the "scorched earth" in Russia and compares this vast task in the east to the "pioneering" of the Teutonic Knights. The immediate problem of reconstructing the administration has been entrusted to Alfred Rosenberg, Nazi

ideologist and Russian-speaking Balt, who becomes Reich-minister for the occupied east area.

FINIS WEYGAND

After weeks of rumor and speculation, General Weygand was removed from the African scene with undramatic ease. The final blow was the result of a German ultimatum, according to Petain, but it reflected also opposition to Weygand in Paris and Vichy, the General's personal aide declares. The head of the Vichy regime states that he was menaced with German occupation of all France and military penetration of French Africa, if he failed to yield.

Weygand himself insists that nothing is changed, and both he and certain of his associates urge that American economic aid to French North

Africa be continued. But others take a different view. One of Weygand's immediate entourage declares that Vichy had ample means for resistance, if it had wanted to use them, and that concessions have been made to the Nazis for the military use of Tunisia and possibly of all North Africa. (Some color is lent this statement by the appearance of uniformed members of the German Armistice Commission on the streets of Casablanca and by the landing by air of fifty uniformed and fully armed German soldiers at the same place on November 22.) It is perhaps noteworthy that Weygand's exact title, Deleque General, has not been conferred upon either of the two new and most important appointees, Juin and Chatel. This

situation has suggested to some observers that the title is being reserved for an active collaborationist.

General criticism of Petain in government circles is reported from Algiers, and one official resigned and tore up a picture of the Marshal in the presence of his colleagues, to whom he declared roundly that he would no longer serve a six-starred mummy who was taken out of the frigidaire by the Germans every time they needed him. There is no substantial reason to believe that this is not a fair appreciation of Petain at this time or that he will not weakly yield to the next German demands for concessions. Indeed it is reliably reported that the Marshal will soon go to occupied France for a conference with a "high German personage."

THE NAZIS' "NEW EUROPE"

Rumors of a German peace offensive have been general for some time, and preliminary "feelers" by Petain and Darlan were noted in last week's analysis. With Russian power in Europe shattered, the time would be ripe for the making of a continental peace, and it is reported that Berlin is preparing a meeting about the first of the year in Vienna at which the new order would be created.

German insurance companies, industrial corporations, and banking institutions are steadily expanding in all the occupied countries. So is German buying of industrial stocks. In France the Vichy Government ventured upon some weak measures to counteract the German buying of French

industry by slowing down the sending of stocks and bonds from unoccupied France to Paris. The Germans have now compelled them to withdraw these measures and German buying goes on busily. The theory is widely held on the Continent as well as in London that Hitler will propose a peace and offer to withdraw from many conquered areas, among them France, as soon as this process approaches completion.

Less subtle moves toward the "New Order" also are in evidence. By alienating opinion in the United States, the ousting of Weygand has already made Vichy more dependent on Germany. There are stories that French business is to be decoyed into collaboration by suggestions that it will be allowed to participate in the reconstruc-

tion of the industry of the Ukraine. Finally the addition of seven new "states" to the Anti-Comintern front is to be viewed as another preparation for the closer knitting of the continental system under German hegemony. The scene is gradually being prepared for the realization of the most grandiose imperial scheme since the days when the Napoleonic Empire sprawled over most of the Continent.

COUNTER-STROKE IN LIBYA

As a counter-blast to Nazi initiatives the Libyan campaign promises to be more spectacular than immediately significant. Some German planes may be drawn off from the eastern front, thus relieving the Russians, but it is doubtful if they

will be numerous. German planes are probably available also in the Balkans, Crete, and Italy for this purpose.

The long-run effects of a British victory would be more important. It would lift the Axis menace from Egypt and provide bases for concentrated air attack on Italy and on Axis convoys bound for Africa. The results, so far as Italy is concerned, might be disastrous. Such a victory would presumably also free British troops for action elsewhere in the Middle East.

THE KURUSU MISSION

Latest reports are that the Kurusu negotiations are threatened with collapse as the result of the arrival in Indochina of fresh Japanese

forces. Even in its inception the Kurusu Mission appeared to pose the old problem of the irresistible force and the immovable object. The policies of both sides were clear-cut and apparently irreconcilable.

Kurusu, said the Tokyo radio, will stay "as long as necessary, but not too long." Both the Japanese press and radio continue to maintain that war or peace depends on the United States and that both official and press opinion in this country do not conduce to optimism.

Saburo Kurusu is now one of Japan's senior career diplomats in active service. He is reported to be on good terms with former Foreign Minister Hirota and with the Army--presumably with Army leaders, such as General Sugiyama, who are

not yet committed to all-out association with Germany. Although he signed the Three Power Pact while Ambassador to Berlin, he is reported to have been personally opposed to it, and both rumor and record suggest that he is not enthusiastic over Japan's association with the Axis.

Kurusu's wife is an American, he has strong American associations, and his attitude toward this country is reported to be friendly. The following factors may have contributed to his appointment to the present mission: his good relations with Foreign Minister Togo and consequent ability to transmit the views of the new Tojo Cabinet, his reputation as an experienced and thoroughly reliable diplomat, his superior command of the English language, and his extensive experience in commercial negotiations.

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BRITISH EMBASSY
WASHINGTON, D.C.

November 27th, 1941.

PERSONAL AND
SECRET

Dear Mr. Secretary,

I enclose herein for your
personal and secret information a copy
of the latest report received from
London on the military situation.

Believe me,

Dear Mr. Secretary,

Very sincerely yours,

Halifax

The Honourable
Henry Morgenthau, Jr.,
United States Treasury,
Washington, D.C.

TELEGRAM RECEIVED FROM LONDON NOVEMBER 26TH, 1941.NAVAL.

H.M.A.S. "Sydney" six days overdue at Fremantle she was returning from escort duty. Believed she sank an enemy raider but definite news of "Sydney's" fate uncertain. British tanker has picked up German seamen from a raft, others have been sighted in lifeboats two of which reported came ashore in Western Australia. Indications are that Sydney was on fire when last seen by Germans.

2. H.M.S. Dunedin in Central Atlantic has not answered signals for 36 hours, may have been torpedoed as Germans claim torpedoing H.M.S. "Dragon" in that area.

3. H.M. drifter Fishergirl has been sunk in Falmouth harbour by near miss bomb.

4. H.M.S. Cornwall intercepted French merchant ship of 1129 tons northbound southeast of Cape Guardafui carrying food and rum. Prize crews taking her to Aden.

5. H.M.S. Kenya with 2 British and 2 Russian destroyers bombarded fort and batteries at Vardo Varanger Fjord at 07.31/25. Results not observed.

6. H.M. Submarine "Sea Wolf" during the night of 21st./22nd. northwest of Vardo sank with one and possibly two hits 3000 ton tanker in unescorted convoy. During night of 23rd./24th "Sea Wolf" attacked 4 ships in convoy in same area and scored one hit on a merchant ship which probably sank.

MILITARY./

-2-

MILITARY

7. German advance east of Tula and Orsk continues to make progress.

ROYAL AIR FORCE.

8. United Kingdom. Day 25th. 6 Blenheims bombed Marlaix aerodrome and spf fires machine-gunned aircraft on the ground on Calais Marck aerodrome.

Night of 25th/26th. Attacks made on Cherbourg (17) where results reported most successful and Brest (18) where bombs included 45 of 2000 lbs.

9. Libya. Between night of 23rd./24th and night of 24th/25th inclusive. Attacks made on dispersed aircraft on Benina and Berca aerodromes and near Benghazi Concentrations of enemy tanks and M.T. and A.F.V.'s attacked in El Adem area near Sirte and Misurata. Near El Adem hits claimed on at least 18 tanks and on many M.T. vehicles and near Misurata hits with bombs claimed on 22 petrol lorries. 20 tons of H.E. dropped on Benghazi where railway workshops customs house and military H.Q. claimed hit.

RESTRICTED

G-2/2657-220; No. 554 H. I. D., W. D. 11:00 A.M., November 27, 194

SITUATION REPORTI. Eastern Theater.

Ground: The German forces are driving hard in a northeasterly direction north and south of Moscow. East of Tula the Germans have reached Mikhailov and Skopin; north of Moscow they have crossed the Moscow-Kalinin railroad southeast of Klin.

On the Orel-Kharkov front, the German advance continues slowly.

The Germans claim to have stopped the Russian counter-attack in the area east of Artemovsk.

Air: Yesterday's communique from Kuibyshev reported that American and British fighter planes had gone into action on the Moscow front.

II. Western Theater.

Air: The British claim to have renewed their attack on Germany with raids on Emden and other targets in northwestern Germany. Ostend was also bombed. Nazi raiders operated over the coast of South Wales.

III. Middle Eastern Theater.

Ground: In Libya according to Axis communique fighting is continuing unabated.

The British say that heavy fighting continues in the Rezegh area. Contact has been made between the British attacking force and the Tobruk garrison. An Axis raid across the Egyptian frontier near Sidi Omar has apparently been driven back. British capture of Gialo Oasis is confirmed.

Air: The British today claimed continued air superiority although they admit that Germany is rushing air reinforcements to this theater.

RESTRICTED

TREASURY DEPARTMENT
Washington

FOR RELEASE, MORNING NEWSPAPERS,
Friday, November 28, 1941.

The Secretary of the Treasury, by this public notice, invites tenders for \$200,000,000, or thereabouts, of 91-day Treasury bills, to be issued on a discount basis under competitive bidding. The bills of this series will be dated December 3, 1941, and will mature March 4, 1942, when the face amount will be payable without interest. They will be issued in bearer form only, and in denominations of \$1,000, \$5,000, \$10,000, \$100,000, \$500,000, and \$1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, two o'clock p. m., Eastern Standard time, Monday, December 1, 1941. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of \$1,000, and the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 10 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Secretary of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Payment of accepted tenders at the prices offered must be made or completed at the Federal Reserve Bank in cash or other immediately available funds on December 3, 1941, provided, however, any qualified depository will be permitted to make payment by credit for Treasury bills allotted to it for itself and its customers up to any amount for which it shall be qualified in excess of existing deposits when so notified by the Federal Reserve Bank of its district.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, shall not have any exemption, as such, and loss from the sale or other disposition of Treasury bills shall not have any special treat-

ment, as such, under Federal tax Acts now or hereafter enacted. The bills shall be subject to estate, inheritance, gift, or other excise taxes, whether Federal or State, but shall be exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest. Under Sections 42 and 117 (a) (1) of the Internal Revenue Code, as amended by Section 115 of the Revenue Act of 1941, the amount of discount at which bills issued hereunder are sold shall not be considered to accrue until such bills shall be sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418, as amended, and this notice, prescribe the terms of the Treasury bills and govern the condition of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.