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January 1, 1941  
10:40 a.m.

FISCAL MEASURES

Present: Mr. Bell  
Mr. Morris  
Mr. Murphy

H.M.JR: All right, sir, I think I can stay away for an hour if you can.

MR. BELL: You remember that we discussed at several meetings on the draft of the budget message the question of putting in the rate, two and a half percent, or the limit on rates that we should pay for war financing.

H.M.JR: Yes.

MR. BELL: I don't know what will be in the budget message, and this will all have to be checked when it comes out, but we thought that we might want to issue a statement at about the same time that the budget message - a joint statement of the Federal Reserve Board and the Treasury on interest rates, and we have worked with Ronald Ransom and Goldenweiser. This statement hasn't been cleared with anybody else over there. We have talked to the members of the board in town and they have several suggestions, but the principle of the thing is all we want this morning, to see whether or not we can get something on paper that can be issued quickly if we want to.

H.M.JR: Look, have you got a copy there?

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MR. BELL: Yes.

H.M.JR: Why George Haas doesn't come in when everybody else is working today, I don't know. Doesn't he know?

MR. BELL: He is coming in.

H.M.JR: But not until one o'clock. I mean, everybody else - he should have asked. Did he ask anybody?

MR. BELL: Well, I think you said yesterday at the luncheon of the nine-thirty staff meeting--

H.M.JR: Well, I won't get angry about it.

MR. BELL: I think that is probably true of a number of them around.

H.M.JR: I said I wouldn't call anybody until after one. I will keep my word. Now, starting there, "There is no need in our borrowing" and so forth, I don't like that statement, "There is no need." I am willing - I would say this: "Our borrowing to finance is apt to incur--"

MR. BELL: "Should be" or "will be"?

H.M.JR: "Should not be conducted at a high rate of interest." Is that all right with you? I mean, it puts the emphasis different.

MR. MORRIS: I would like to avoid "it should not be" because it sounds like you are not too sure that it won't have to be.

H.M.JR: Well, I am not.

MR. MORRIS: Well, I am not either.

H.M.JR: "There is no need--"

MR. BELL: There was some question in the Board

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over there as to whether that whole paragraph shouldn't come out. It is a little argumentative. I think we have got to make it strong.

H.M.JR: Well, I think if you said the Secretary of the Treasury pledges to carry out the policy and so forth, and then just add one sentence. It is our joint purpose - well, let me give you my idea. The way you had it in that one sentence was satisfactory to me. You remember you went over and over that thing, the thing we finally sent over to the Budget on interest rates, that very last thing.

MR. BELL: Well, that is quoted there.

H.M.JR: Here?

MR. BELL: Yes, that is quoted.

H.M.JR: Well, I would say, "The Secretary of the Treasury has the power to carry out," period. I would stop right there.

MR. BELL: I think we ought to go further.

H.M.JR: Well, you will have to do a little selling on me.

MR. BELL: I think the market and the people ought to know that we are going to--

H.M.JR: Look, Dan, old man, I will go that far, and I will say we will do everything in our power to carry out that thing, a low interest rate, just the way that is, but I have seen - I worked with the Federal Reserve Board, and I - my God, they went three days after December 7 and got cold feet.

MR. BELL: Yes, but they have got to get over that.

H.M.JR: Have you ever convinced Marriner Eccles

of anything fundamental? Have you ever won an argument with him? Now, give me a yes or no. Have you ever won an argument with him?

MR. BELL: I suppose not.

H.M.JR: All right.

MR. BELL: But I think this is war, and we have got to go to town here.

H.M.JR: Well, I am willing to stop right there.

MR. MORRIS: There was one thought, it may not be a good one, for getting in the other two. It was that they would so commit the Federal that they couldn't get cold feet any more.

(Mr. Murphy entered the conference.)

H.M.JR: Good morning. Draw up a chair.

When you say, "The Treasury and the Board of Governors pledge all their power and authority to carry out the policy," and thus and so, that is saying a mouthful.

MR. BELL: Yes, but that might mean a rate of two and three-quarters, and then your two and a half's would go down to ninety-five.

H.M.JR: I don't want something like that to hit me in the face, I mean the lower part. I will go this far this morning, down to the middle. That is all I will do this morning.

MR. BELL: The market of course didn't take it very seriously yesterday, apparently, the fifty billion dollars--

H.M.JR: You were wrong on that. You thought when the budget came out on the big thing, they would,

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and there was nothing about taxes in this to offset it.

MR. BELL: But I am still a little afraid of next Wednesday.

H.M.JR: Well, there can't be anything worse.

MR. BELL: I say it may have discounted this whole budget program, but it may still be a shock, and you may want some pretty strong statement.

H.M.JR: All right. Well, as of right now, as of this morning, I will go half way through, I will go half way through and then I draw a Maginot Line.

MR. MURPHY: It is half way down the paper, but I don't think it is nearly half way through the statement.

H.M.JR: But Henry, I don't want to sit here a year from today with you three gentlemen and maybe pay two and three-quarters percent, which wouldn't be so God awful, and then have somebody call me up from the White House, "Well, what about that?" Or Jesse Jones or somebody that would like to make trouble for me. "Why don't you carry out your contract?" That is a contract.

MR. BELL: No, I don't think that is a contract. It is a commitment of the Treasury to do everything in its power. We may spend a lot of money trying to do it.

H.M.JR: That is good enough.

MR. BELL: We may fail.

H.M.JR: Dan, you can't get me beyond that.

MR. BELL: I think it is important.

H.M.JR: All right. Well, don't let's take too much

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time on that. You can write something else, and I will take another look at it, but as of this morning, half way down.

MR. BELL: Well, I think we ought to have something Wednesday.

H.M.JR: Well, I am here Friday, Saturday, and Sunday, and so forth and so on.

MR. BELL: Because if anything should happen, it would be psychologically a good thing if we could issue it right after the Budget to show that we were ready on the thing.

H.M.JR: Now, if you want me to, we have something in my Sunday night statement - I am going on the air Sunday night.

MR. BELL: Next Sunday night?

H.M.JR: This Sunday night, on Defense Bonds.

MR. BELL: That might help.

H.M.JR: And the time is before it happens. After it has happened, it is too late.

MR. BELL: That is the what, sixth or seventh? Is it this coming Sunday? That is before the budget message. We had in mind before trying to put something in your speech of the twenty-seventh.

H.M.JR: Well, it is three days from now that I am going on the air.

MR. BELL: Well, we would have to think about that. I don't know whether that ought to come out before the budget message. You might put something in there.

H.M.JR: Well, I am just throwing that out at you.

MR. BELL: O.K. The next thing is, you remember

that Eccles discussed with you two weeks ago the question of getting the law changed so that the Federal could buy securities directly from the Treasury.

H.M.JR: I passed my word on that.

MR. BELL: Yes, you said that is O.K. I think maybe we ought to think about it a little more because it might disturb people. We are afraid that we can't finance this war and that we are just laying the groundwork for--

H.M.JR: Well, I don't agree with you at all, but I am perfectly willing to have you argue with Eccles. I passed my word, and I don't see anything in it. I think it is good business. I think the way we do now, we just play every time into the hands of the dealers. If you could unsell Eccles on it, all right, but I told him I would go along.

MR. BELL: I am not so sure I want to unsell him, but I think we should talk about it a little more, as to what effect it might have on the minds of the people.

H.M.JR: I can't see it.

MR. BELL: You don't see it, and you are not afraid of it?

H.M.JR: No. I think it is a mechanism that they ought to have.

MR. MORRIS: I think it is a mechanism that they ought to have, but its having been removed to do it at this time is going to scare some people.

H.M.JR: Well, let them get scared and get over it.

MR. BELL: You and Eccles were going to see Glass, you know.

H.M.JR: Well, I talked to him, and Glass didn't

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come to that Byrd economy meeting.

MR. BELL: Well, anyway, this ought to be in any omnibus bill.

MR. MORRIS: What it really is, is a mechanical proposition.

H.M.JR: I will bet it will go through and nobody will even write it up.

MR. BELL: I hope so.

H.M.JR: You don't need to worry.

MR. BELL: All right. The next is the refunding.

Now the budget message is coming out, I take it, about Wednesday the seventh.

H.M.JR: Well, I find now that the President is only going up to Congress on Tuesday with his annual message, and you and I know that he likes two days in between, so my guess is the budget will be on the eighth.

MR. BELL: Normally he comes back from the Capitol, from the state of the union message, and has a press conference, and then the budget message goes up the next day at twelve.

H.M.JR: That is all right.

MR. BELL: That would be Wednesday. Normally we would offer a refunding issue on Thursday, the eighth.

H.M.JR: I didn't realize that.

MR. BELL: Yes. You see we have got a maturity of three hundred million.

H.M.JR: When?

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MR. BELL: On the fifteenth, for the RFC, and then there is a call issue of two hundred thirty-six million, I think.

H.M.JR: How much?

MR. MORRIS: Two hundred thirty-six, Federal Farm Mortgage.

H.M.JR: No, we can't do it that weekend.

MR. BELL: Well, there is a billion and seventy-six million of which five hundred million, a little over, matures on the fifteenth, and there is a hundred and thirty-six million, I think, a hundred and three million that matures on March 1, and four hundred twenty-six million on March 15.

H.M.JR: Now, wait a minute. Have you got that written down?

MR. MORRIS: This is a carbon.

H.M.JR: That is all right. Henry Murphy has got everything in his head.

MR. MORRIS: It is those four items, totaling a billion and seventy-six.

H.M.JR: A billion and seventy-six?

MR. BELL: That is the total refunding that we announced to the press that would be--

H.M.JR: It is three ten, four twenty-six, two thirty-six, and a hundred and three, is that right?

MR. BELL: Yes.

H.M.JR: A billion and seventy-five?

MR. MORRIS: Yes. I have left fractions off. It

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does come to an extra million.

MR. BELL: It is a billion seventy-six million and sixty-three thousand.

H.M.JR: You can't do all that.

MR. BELL: That is what worries us. Now, you have got two of them that come in on the fifteenth.

H.M.JR: Well, we will just have to--

MR. BELL: And it is a little difficult to pay them off in cash, because we have announced there is going to be a refunding. There are some right values there.

H.M.JR: What did we say? Which one did we say we paid off?

MR. BELL: We didn't say we would pay any of them off. We said we would refund all of them for - early in January.

H.M.JR: Well, refund them into Federal securities.

MR. BELL: Into Federal securities, that is right.

H.M.JR: Why can't you do it the week of the fifteenth?

MR. BELL: Well, the week of the fifteenth--

H.M.JR: Why can't you do it on the twelfth?

MR. BELL: That is Monday.

H.M.JR: Yes, give them certificates.

MR. BELL: Well, to do it on Monday doesn't give you time to get your securities in.

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H.M.JR: Well, yes it does. You can leave it open for two days.

MR. BELL: Well, let's see, Wednesday is the fifteenth, isn't it?

H.M.JR: Yes.

MR. MURPHY: We discussed that at some length and it seemed to Mr. Haas and myself that it might be done without even making physical delivery of interim certificates, if that was impossible. There is no cash changing hands except an interest adjustment, because it is merely an exchange of securities, and we could issue securities the next Monday that would be dated back to the fifteenth if necessary, and the--

MR. BELL: If the people will do that. Most of them will. Your big banks wouldn't care whether they got immediate delivery or not. They don't often take interims anyhow.

H.M.JR: This is in the hands of the big banks anyway.

MR. BELL: Seventy-six percent of the total is. There is about two hundred twenty-one million outstanding in the hands of the public. We don't know where it is.

H.M.JR: I think I would do it on Monday, the twelfth.

MR. BELL: That means that we would have to make up our minds on Saturday.

H.M.JR: Yes.

MR. BELL: And announce it over the weekend.

H.M.JR: Well, nothing can happen over the weekend.

MR. MURPHY: When you are in war, less can happen

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over a weekend really than in peace.

H.M.JR: The only thing that might happen, something in the Philippines, and certainly by the twelfth we will know - by the tenth.

MR. MORRIS: It looks now as though that is going to be over soon.

H.M.JR: I say by the tenth of January we will certainly know about the Philippines. What? What do you think about the twelfth?

MR. MORRIS: Well, it is only the mechanical end that is troublesome. Certainly from every other point of view, it is better. I don't like doing it on a Monday.

H.M.JR: Well, I won't do it the week before.

MR. BELL: I don't know whether we could do it Friday. That would only give us one day.

H.M.JR: We ought to give the market a chance to adjust itself.

MR. MURPHY: It seems to me we ought to give them two full days since there are two F.F.M.C.'s and there are still a substantial number of individual cases of persons who took them in exchange for mortgages and who are not hair-trigger operators.

H.M.JR: What I would do is give it out Saturday for the Sunday papers, so that they would have it Sunday and that would give them an extra day's notice.

MR. BELL: Of course, we could leave this open right up to the fifteenth. It is a refunding operation, and there is nothing much they can do with the securities except to exchange them.

H.M.JR: Oh, two days is enough. Sunday's papers

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will carry it and that gives them three full days.  
What?

MR. BELL: Yes.

H.M.JR: Announce it Saturday for Sunday morning's papers. What are you worrying about, Dan?

MR. MORRIS: Then they subscribe Monday and Tuesday, and you close the books Tuesday night.

H.M.JR: Yes.

MR. BELL: I guess we can do it.

H.M.JR: All right.

MR. BELL: We will just have to print up some interims.

H.M.JR: What are you men thinking about, what kind of an issue?

MR. BELL: Well, we haven't gotten down to details yet. We are thinking about a short bond due to the fact that eighty percent of them are held by banks. I think we ought to have a bond somewhere in the neighborhood of '47 to '51 or '52. We did discuss a little the other day about opening the two's at '48-'50.

MR. MORRIS: Yes, we talked about that yesterday.

MR. MURPHY: They are up nearly a half from there, but that doesn't bother me.

H.M.JR: By the way, did you men decide to put some of these long bonds into - what was that fund we never used?

MR. BELL: I want to discuss that.

MR. MORRIS: Social Security.

MR. BELL: I want to discuss that a minute.

H.M.JR: Two's at '48-'50.

MR. MORRIS: They say they are up a little since we talked about them. They were about one point ten at the time we talked.

MR. MURPHY: They are about twenty-three now. There are two forty-eight fifty's, but these are the ones with the "T."

MR. BELL: This would put another billion dollars in the two-year call period which I don't like very well, but I wouldn't worry much about it. We are probably going to have to do a lot of filling up before this is over.

H.M.JR: You say it is a little rich?

MR. BELL: It is a little rich at that price.

MR. MURPHY: It is really awfully early to say whether it is rich or thin until after the budget message is out.

MR. MORRIS: Yes, I was going to say--

MR. MURPHY: You have to change your views on it every day.

H.M.JR: Could I see that slip I had on the re-funding? Then we are in - we are all right on refunding until--

MR. MORRIS: July.

H.M.JR: That is very nice. You have done a nice job of outlining this.

MR. BELL: We got very little this year. It is pretty good.

H.M.JR: Yes, we are in nice shape.

MR. BELL: We have got plenty of cash, though.

Now, the next thing--

H.M.JR: How much have we spent to date for national defense? I mean, what was - how much have we spent this month?

MR. BELL: This month?

H.M.JR: Yes.

MR. BELL: We have spent a billion seven hundred sixty million.

H.M.JR: Will it go to two billion?

MR. BELL: A little over a billion eight this month, December.

H.M.JR: What was it last month.

MR. BELL: Last month it was a billion four fifty. It has really gone way up. Of course last month was a short month.

H.M.JR: What is the total for the year so far?

MR. BELL: Eight billion and ninety-seven million. It will go to eight, one, or one fifty.

H.M.JR: Will they spend - how much will they spend in the next six months?

MR. BELL: Well, according to those estimates that you have got, they ought to spend about fourteen billion dollars.

H.M.JR: Do you think they will?

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MR. BELL: Which is a little over two billion dollars a month average. They have got to be up at better than three billion dollars by the end of June to do it.

H.M.JR: How much?

MR. BELL: Better than three billion dollars for the month of June to do it.

H.M.JR: All right, what else have you got?

MR. BELL: Next thing is investments. If we are going to support this market like we have been on the fifty-fifty basis with the Federal Reserve System, we have got to get some decision on what we are going to use for money, what funds.

H.M.JR: Yes.

MR. BELL: Now, we have authority if we want to just use the general fund and retire the securities.

(The Secretary left the room temporarily and returned.)

MR. BELL: I just started to say that if we are going to continue to go fifty-fifty with the Fed in supporting the market, we have got to determine as to what funds we are going to use. Heretofore we have used largely the Postal Savings and the Federal Deposit Insurance Corporation. Now, we still have special obligations in Postal Savings of about sixty million and in the FDIC of about the same amount. Now, we got some little amounts in others, but I think we ought to keep them, and I think we ought to keep about sixty million in each of those funds as a cushion. If we had a run on those and they needed money quickly in either case we could redeem them and give them their funds quickly. As I suggested to you the other day, we could use the Federal Old Age and Survivors Insurance Trust Fund which - we have been investing that fund in

two and three-eighths percent, special securities. We have a right to do that under the law. We can buy securities just out of the general fund and retire them.

H.M.JR: Well, I will tell you, Dan, you spoke to me about that before and it gave me a chance to think about it. I think we may have to come to it, but I wouldn't like to do it now--

MR. BELL: Come to what?

H.M.JR: Using the Old Age Funds. I think we sort of subject ourselves to unnecessary criticism.

MR. BELL: Well, that is Haas' and Murphy's view. I don't know why, but what are we going to use then?

H.M.JR: Well, I would much rather do it under the general fund, right out in the open.

MR. BELL: Then you retire the securities? We have got a sinking fund, of course.

H.M.JR: Well, what is the matter--

MR. BELL: But I would hate to use the sinking fund to retire securities that you put out last month. I think any other securities that have been out some time you can use.

H.M.JR: Murphy feels the same way I do.

MR. BELL: They feel that this is a bad time to use that fund, that you might be criticized. I am not so sure that the criticism might not go the other way, that here is an opportunity to invest these funds at two and a half percent, and you are investigating them at two and three eighths percent.

MR. MURPHY: Of course there is a middle ground between that, Mr. Bell. I think that a question could

be raised of why we are only getting two and three eights on them when issues are available at two and a half, but perfectly as a clear cut way of doing it, in which you are playing straight as a fiduciary thing and avoiding all criticism is to cut them in on a new issue at par because then they are getting two and a halves in terms customary for two and a half's, but the question that would be raised now could be raised very easily, and we know that almost any questions that even could be raised about the Old Age Fund is something to which people are very sensitive. When these securities were selling for a hundred and three or more, why weren't they cut in on them at par then? Why is there only cut in at par at a time when they appear to be worth more than par. That is, any security which sells at par by virtue of support is presumptively worthless. Why should they be taken on board now? The timing is all wrong from a fiduciary standpoint.

H.M.JR: Your argument is sound, but it doesn't help Bell solve his problem.

MR. MURPHY: Of course, we would have a different solution to the problem.

MR. BELL: What he is saying today has been true for eight years in the use of trust funds. We have used trust funds to support the market, and I don't think from a fiduciary standpoint we had a right to do it at all.

MR. MURPHY: I concur.

H.M.JR: How much of that last issue have you got unallocated?

MR. BELL: We have got just under fifty million. I have allocated only three or four hundred thousand dollars to the Indian Fund.

H.M.JR: How would you like to allocate that amount?

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MR. BELL: That is the next question on the agenda.

H.M.JR: I will come back to the other thing in a minute.

MR. BELL: We haven't got anything available to take up that fifty million dollars except something like this Old Age. That was the next question I wanted to suggest.

H.M.JR: Well, I am willing to put the Old Age in. You have got to pick it up. You can't let it lapse. I mean, that would be terrible.

MR. BELL: Oh, yes, we can let it lapse, but it would be better, I think, to pick it up.

H.M.JR: Oh, that would look bad.

MR. BELL: Now, let me read you the law on the Old Age. It says, "It shall be the duty of the managing trustee to invest such portion of the trust fund as is not, in his judgment, required to meet current withdrawals." Then it tells you that you can invest them in original issues at par or you can issue specials or you can buy them on the market. Now, it says that "such special obligations shall be issued only if the managing trustee determines that the purchase of other interest-bearing obligations of the United States or of obligations guaranteed as to both principal and interest of the United States on original issue at the market price is not in the public interest."

H.M.JR: Say that again.

MR. BELL: "Such special obligations - " that is the ones you are now issuing to the funds - "shall be issued only if the managing trustee determines that the purchase of other interest-bearing obligations of the United States on original issue at the market price

is not in the public interest."

H.M.JR: What does that mean?

MR. BELL: Well, that means the discretion is entirely yours, and that you have determined up to this time that the purchase of these securities in the market is not in the public interest and that it is in the public interest to keep these funds out of the market. Now, at the meeting of the Board, the question was raised at this meeting on December 7, 1939, as to whether the Secretary of the Treasury, as managing trustee, should be required to go into the market and purchase securities periodically for this fund, it will be continually upsetting the Government securities market. From the Treasury standpoint, which is coincidental with the public interest, it would seem advisable to continue the policy of investing in special issues and go into the market only when the Secretary determines that it would not upset the Government security market. These factors seem clearly in the public interest. The Board members agreed that this procedure should be followed.

H.M.JR: Well, there is no reason in the world why I shouldn't pick up this fifty million.

MR. BELL: Not at all. I am in favor of it.

H.M.JR: So am I. How about you?

MR. MURPHY: Would there be any record as to the time when it was picked up? Would it appear of record that they hadn't been picked up until now or would those allocations all--

MR. BELL: No, they are all--

H.M.JR: Do it as of the first of January. What is the matter with doing it as of the first of January?

MR. MURPHY: I think it is all right. I just

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had a certain qualm that we didn't pick them up until after they had gone down, but in view of the fact - of course picking them up, as I understand, for this allocation merely puts more money in the general fund. It doesn't take any off the market. I think I would concur.

H.M.JR: Well, you would do it as of the first of January. "How did you do it?" "Well, we were looking over our situation and they had funds to invest." What?

MR. MORRIS: Yes. I think it is a little bit wishful thinking, but nevertheless it does give you an argument at some time if you need it. When you first asked me to look into this, I got an opinion from Foley's office as to what "in the public interest" or "not in the public interest" meant, and they say that it works both ways and that the public interest is so tied up with the Treasury that to help make an orderly market, it is advisable to buy the funds in the public interest.

H.M.JR: Well, that sounds kind of like saying to the lawyer, "I want to do this. Now give me an opinion backing me up."

MR. MORRIS: That is right.

MR. MURPHY: It is a good law, but I don't think it is good public psychology.

H.M.JR: Isn't that right? "I want to do this. Give me an opinion."

MR. MORRIS: Yes, "Help me out as much as you can." But I mean we have that, if you need it.

H.M.JR: Well, I don't think we will need it. It is all right to have it. I am glad you went into it. Well, Dan, let's say on that we pick that up for old age and then that still leaves you how much of

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these special twos? How many special twos have we with Postal and with FDIC?

MR. BELL: We have got sixty-three million with the Postal, and sixty-five million with the Federal Deposit Insurance Corporation, and we have got six and a half million with the Government Life Insurance fund, and five million with the Federal Savings and Loan Association.

H.M.JR: What is that, a hundred and thirty or forty million?

MR. BELL: That is a hundred and twenty-eight, thirty-four, about a hundred and forty million dollars in that particular fund.

H.M.JR: Which all could be used?

MR. MURPHY: No.

MR. BELL: Yes, they could all be used.

MR. MURPHY: Well, they physically or mechanically all could, but after all, that would mean that if there was any fall-off in Postal Savings, you would have to sell securities in the market in order to meet it. It seems that there should be some expansion joint left in the funds.

MR. BELL: Well, we could use them. I think there ought to be a cushion there too as a reserve, but we could use that hundred and forty million dollars.

H.M.JR: Well, my own feeling as of this morning, you have got that, and then if you need fifty to a hundred or two hundred million dollars, the way I feel today, I would buy them from the general fund.

MR. BELL: That means retire them.

H.M.JR: Yes.

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MR. MURPHY: Is it permissible to raise the more fundamental question of the desirability of going fifty-fifty?

H.M.JR: Not today. I want to get through the bottom of this list, you see.

MR. MURPHY: I don't want to begin the new year wrong.

H.M.JR: No, no, keep raising it.

MR. MURPHY: We feel --

H.M.JR: Go ahead, you feel what?

MR. MURPHY: We feel it is quite inadvisable.

MR. BELL: Well, I feel that way, too, but the Secretary, I take it, feels the other way.

H.M.JR: Well, --

MR. BELL: I think we are borrowing money to --

H.M.JR: Well, I --

MR. BELL: .... to retire debt --

H.M.JR: I haven't got any good scientific argument to answer you with, but as I have explained to Bell, it is a matter of personal relations between the Treasury and the Board, and you go - as soon as they buy it all, they immediately get dictatorial. They have done with it. As long as we take half of it.

MR. BELL: I think there is a different attitude now.

H.M.JR: Well, you have seen --

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MR. MURPHY: We just haven't got the resources to go into any big operation.

MR. BELL: If it goes to half a billion, we have got to re-examine it, your position.

H.M.JR: I wouldn't wait that long (laughter). I mean, look, Dan, you have seen more of these people than I have. You think that they have got religion.

MR. BELL: No, not so much that as they will do anything you want them to. I think all you have to say is that, "I want the Federal to --"

MR. MURPHY: Goldenweiser says --

MR. BELL: And they will do it.

MR. MURPHY: Goldenweiser says Eccles is suffering from temporary lapse.

H.M.JR: What does that mean?

MR. MURPHY: He says Eccles has temporarily lapsed into a high interest rate philosophy, but if we give him time, he will come out of it.

H.M.JR: You didn't explain what the lapse was, whether it was a lapse of memory or what.

MR. BELL: There is one other question in connection with this fifty million. If we were to do that right away, we would have to redeem some of those special securities in the Federal Old Age Survivors' Organization Fund.

H.M.JR: I can't get that.

MR. BELL: We would have to redeem some of the securities, because there isn't enough cash. During

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the month of January we ought to get in from the Old Age - for the Old Age Fund, about thirty-five to forty million dollars, and we ought to increase that cash, rather than redeeming, but in order to invest it all, we would have to redeem some of them. Now, what we have been doing, and which was approved by the Board when it met in December, '39, was to re -- is to redeem the three per cent obligations in order to make all benefit payments, and invest all funds coming in at the two and a half - new rate. You remember we discussed the question as to whether we should redeem all of the three percent obligations outstanding at that time, and put them in the securities for the new rate. Miss Perkins thought that we would be criticised, but she thought that we could redeem the threes as we go along for current expenditures.

H.M.JR: I vaguely remember it.

MR. BELL: Well, that is in the record.

H.M.JR: Well, you have been reading the record, and you can't expect me to remember it.

MR. BELL: That is right, and I am telling you.

H.M.JR: And I am listening. You read it and then you say, "Don't you remember it?"

MR. BELL: That is a figure of speech (laughter).

H.M.JR: Well, anyway, what is your suggestion?

MR. BELL: I think for this that if we redeem any of them, maybe we had better redeem some of the two and three eighths. This is really not a current expenditure in the terms that it is used.

H.M.JR: How many would we have to redeem?

MR. BELL: We would probably have to redeem twenty million, because all the funds won't come in by January 15th.

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H.M.JR: That is too bad.

MR. MURPHY: Is there any reason, Mr. Bell, why this -- do you think it would -- why this whole amount of the two and a half's has to be allocated? That was a bogey, that wasn't a commitment, was it?

MR. BELL: Well, I would have to look up. I don't know whether we said in the press statement it would be allocated within thirty days.

H.M.JR: Oh, I think it would look very bad to do that. You can't have an overdraft for ten millions for old age.

MR. BELL: No.

H.M.JR: Well, look, Dan, when you get down to that end, I will leave it to you three gentlemen.

MR. BELL: Well, I will tell you what we might do. We might go to the Unemployment Trust Fund, which is about the same character, and we will get some money in there in January, and we might invest that.

H.M.JR: Well, having decided we want to invest it with those funds, how you do that, I will leave that with you.

MR. BELL: O.K. You are willing to invest anyhow this fifty million in those?

H.M.JR: Yes.

MR. MORRIS: Somewhere in the region.

MR. BELL: Well, that is all I need.

H.M.JR: Now, what else have you got?

MR. BELL: Well, we have got a lot of financing to do, and I suppose it is all right for us to go

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ahead and work on various types of financing, and we may want to discuss some different types with you pretty soon. We have got a big --

H.M.JR: All right. You ask for the time.

MR. BELL: .... problem ahead of us.

H.M.JR: All right. Do you think that is enough for today?

MR. BELL: I think that is enough. Now, I have got some things on the Bank of America.

H.M.JR: No, not on New Year's Day.

MR. BELL: It has been hanging fire for a little while.

H.M.JR: Let me just see whether Foley is in, because I have got a job to do with him. We will have more time on the Bank of America.

MR. BELL: Yes. Well, I have got a couple of those same kind of cases that I would like to have you go over.

H.M.JR: Well, I want to see the Comptroller and have him in.

MR. BELL: He has given me a memorandum on the two types of cases and you may want to approve them all at once, or just one at a time.

DRAFT (12-29-41)

JOINT STATEMENT OF THE SECRETARY OF THE TREASURY  
AND THE BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

The President's Budget Message, submitted to Congress on January \_\_, 1942, after discussing the necessity for additional taxes, the necessity for allocating and controlling all production for defense purposes, and the necessity for curtailing production and consumption of many consumer's goods, made the following statement with respect to financing the war program:

"With adequate funds available for investment in Government securities and with the effective operation of a program of allocations and rationing we can finance our war effort without danger of disruptive inflation and without departing from our low interest rate policy."

The Secretary of the Treasury and Board of Governors of the Federal Reserve System pledge all their power and authority to carry out the policy thus enunciated by the President.

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We should clearly realize that the total amount available to be borrowed is no greater at a high rate than at a low one. It is determined only by our willingness to restrict our expenditures for purposes other than the war effort. ~~There is no need that~~ our borrowing to finance the deficits incurred during this period be conducted at a high rate of interest.

Our longest bond issue sold in the week prior to the attack on Pearl Harbor pays 2-1/2 per cent. We do not intend to pay a higher rate for the financing of this war except for securities especially designed for small savings, like our present Series E Savings Bonds. Furthermore, we do not intend to let the present long-term securities outstanding in the market fall below par.

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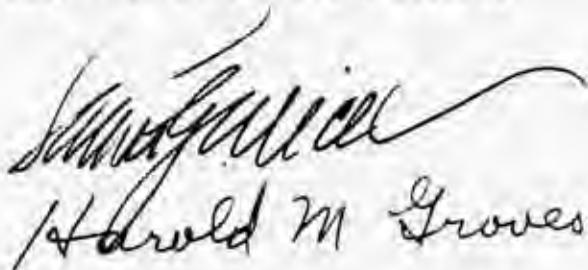
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MEMORANDUM FOR THE SECRETARYINTERGOVERNMENTAL FISCAL RELATIONS  
DURING THE DEFENSE PERIOD

\* \* \* \* \*

The staff in charge of the study of Federal-State-local fiscal relations submits herewith a preliminary report concerning the special problems in its field arising during the defense period and because of the defense program. The staff has not had sufficient time to arrive at final conclusions respecting all of the intergovernmental fiscal problems here considered. Moreover, the rapidly moving events may invalidate certain of the observations and recommendations. The report is submitted now because of the timeliness of some of the problems involved. The subject will be treated again along with the more traditional problems of intergovernmental fiscal relations in the final report.



Harold M Groves

January 1, 1942.

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INTERGOVERNMENTAL FISCAL RELATIONS  
DURING THE DEFENSE PERIOD

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Summary of Findings

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This report deals with problems in intergovernmental fiscal relations created by the defense program. Its principal findings are here summarized.

I. The impact of the defense program on State and local finances

1. The finances of State and local governments, and especially those of State governments, have improved as a result of the national defense program. State tax collections for 1941 are estimated to be 7 percent above those for 1940. Income tax collections rose 17 percent. Practically every revenue category showed some increase.

2. Although welfare loads are declining, wage and material costs are increasing and some States are required to provide additional services. Some increases in State expenditures may be expected but are not yet reflected in the State financial statistics.

3. The fiscal situation of the local governments also appears to be improving, but three qualifications must be noted:

(a) The situation is spotty and some cities have been adversely affected by the defense program; (b) the local units have not as yet experienced the full effect (in fact have hardly begun to experience the effect) of the defense taxes upon their revenues; and (c) the possible effects of inflation and post-defense readjustments on local finance are matters of considerable and warranted apprehension.

4. The effect of the war upon automobile traffic may involve a very important loss of revenues from motor vehicle taxes (particularly gasoline taxes) to state and local governments. These taxes are the single most important source of revenue for states and of considerable importance for local governments. On the other hand, highway expenditures by states and to a lesser extent their subdivisions, (except where such expenditure is for servicing debt), can be and to some degree must be curtailed. States diverting motor taxes to general governmental expenditures cannot thus escape the impact.

5. State and local interest-bearing debt is estimated to have declined \$31 million during fiscal year 1941. In the near future the volume of State and local borrowing may be expected to decline more rapidly as improved tax collections reduce the need for short-term borrowing, as Federal loans and grants are supplied to defense areas for public improvements and as labor and material shortages and price increases result in the postponement of capital expenditures.

## II. The division of financial responsibility for defense-created governmental services

1. The growth of industrial, military and naval activity incident to the defense program is making it necessary for some local governments in the defense areas to provide added public works facilities and to meet added costs of operation and maintenance. The resultant financial problems have been especially difficult in the communities which have been newly-created as the result of the defense program.

2. The governmental services required as a result of the defense program are largely those which traditionally have been locally financed. However, local governments are frequently unable to meet these defense created needs promptly because their financial resources are limited. State governments in turn are of little assistance because many of the functions involved are traditionally considered to be outside the sphere of State activity. Moreover, State aids to local units are both inflexible and slow to reflect sudden changes in local requirements.

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3. Much of the financial responsibility for defense-created activities must of necessity fall to the Federal Government because the extensive interstate migrations of population and the concentration of defense activity in some areas is the result of Federal decisions and because the availability of adequate local public facilities and services is essential to the effective prosecution of the war. Congress has recognized a large measure of Federal responsibility by appropriating \$150 million to be apportioned among local units to meet these needs.

4. From present indication further Federal appropriations will be required for this purpose. The precise amount required can not now be estimated.

### III. Federal payments in lieu of local taxes on Federally-owned properties

1. Federal payments in lieu of taxes on Federal properties located within the boundaries of local governments presents one of the more difficult and less satisfactorily handled problems in intergovernmental fiscal relations. The problem is not new. It, however, has been aggravated by the defense program and the acquisitions of large tracts of land for reservations, cantonments, airfields, arsenals, ammunition depots, and other defense facilities. In addition the Reconstruction Finance Corporation has acquired defense plants and other Federal agencies have developed extensive defense housing projects.

2. Acquisitions of properties by the Federal Government affect local finances because they deplete the local tax base and because in many instances Federal properties make it necessary for local governments to expand governmental services. On the other hand, in some cases, the location of Federal property has probably added indirectly to the tax base more than enough to compensate for the additional services involved.

3. The Federal Government has adopted the practice of making payments in lieu of taxes to local units. However, the practice has been opportunistic and unsystematized. The arrangements have varied with different Federal projects.

4. Local dissatisfaction with payments in lieu of taxes was already in evidence in the pre-defense period. It has been enhanced by recent developments. Local units maintain that Federal payments are insufficient to compensate for the cost of locally provided services and necessitate large increases in local taxes. The resulting irritation in Federal-local fiscal relations encourages resistance to the Government's efforts to improve the tax system.

5. Those opposing the discontinuance of the issue of tax-exempt securities have made a major point of the quantity of tax-exempt Federal property. They maintain that the cost of local functions and debt service is increased at the same time that Federal property purchases reduce the local tax base.

6. This matter is now under study by the Federal Real Estate Board and other agencies. Until the findings of these studies are available (in the near future) and in the absence of more research, a definite recommendation on the subject would be premature. However, a solution along the following lines merits consideration:

- (a) Where services are sold by governmental agencies to private individuals, as in the T.V.A. and housing projects, the commercial element of the property involved could be valued by the Federal Government through a capitalization of the rental or other income. The Federal Government could then pay local taxes on such a valuation corresponding to the taxes that would be paid if the property were privately owned; and
- (b) where property held by the Federal Government does not result in the sale of services to private individuals, the Federal Government might be charged only for the cost of those local services which benefit property as distinct from those which benefit persons. Such procedure would reimburse local units for the cost of fire protection, for instance, but not for the cost of health, education, or welfare services.

IV. State and local taxation of Government contracts

1. The controversy involved in the taxability of Government contracts under State and local sales and use taxes has been aggravated by the defense program. While the controversy pre-dates the defense program, it was then of relatively minor quantitative importance.

2. The United States Supreme Court recently held that in the absence of Congressional declaration to the contrary, the purchases of cost-plus-fixed-fee contractors engaged on Government contracts are subject to State and local sales taxes. The matter will probably be the subject of Congressional consideration in the near future.

3. Several factors suggest the desirability of permitting the States to tax these purchases. States are entitled to some compensation for services rendered to defense industries. Federal consent to State taxation of defense contracts is a comparatively desirable form of Federal aid to States. Moreover, a liberal Federal policy in this respect would strengthen the Government's case against the continued issuance of tax-exempt securities.

V. Federal and State use of the same tax base in time of war

1. The need of financing the war has raised the question whether States should be eliminated from the taxation of incomes, in order to leave the Federal Government a freer hand in this field. Federal-State income tax duplication is said to deprive the Federal Government of the most effective use of an important instrument of public policy. The financing of the war, it is said, will require a maximum fiscal effort, including the fullest possible exploitation of the Federal income tax but the existence of State income taxes with widely varying rates interferes with this objective.

2. The present provision which permits income taxes paid to States to be deducted in computing net income for Federal tax purposes and the corresponding practice in more than two-thirds of the income tax States which allows Federal tax payments to be deducted in computing net income for State tax purposes, exclude the possibility of the

combined Federal and State tax rates becoming confiscatory. These practices have the further effect of reducing substantially the differentials in burdens among taxpayers living in different States. For example, if both governments allow the deduction of taxes paid the other, the combined load of an eighty percent Federal and a fifteen percent State rate is only 80.7 percent (77.3 percent of Federal and 3.4 percent State). Even in the absence of State provisions for the deductibility of Federal tax payments, the existing Federal provision allowing the deductibility of State taxes substantially reduces the variation in income taxes paid by taxpayers in income tax States and in non-income tax States. While at the lower levels of income the effect of deductibility is not so conspicuous, the same general relationships apply. At the \$5000 income level, the differential in total income taxes between a New York and non-income tax State taxpayer is 1.1 percent of net income and 14.7 percent of the total tax of the latter taxpayer.

Because of the deductibility feature of Federal and State income tax laws, the Federal Government can and should feel free to order its war-time income tax schedules without much regard to the present State levies or possible changes in the latter.

3. The deductibility provision in the Federal law not only protects the taxpayer but also gives a substantial advantage to income tax States in that the Federal Government collects substantially less from the taxpayers of such States than from those with equal incomes (before taxes) in other States. The advisability of this "subsidy" may be questioned but the deductibility feature applies equally to nearly all taxes and may be supported in addition on the ground that it encourages the States to maintain a progressive element in their tax systems.

4. Since the adequacy of State revenues and a measure of State financial independence is a concern of the Federal Government, it would be undesirable at least now for the Federal Government to pursue a course which would result in the abandonment of income taxation by the States. The requirements now in evidence do not appear to warrant such drastic curtailment of State financial independence. Moreover, the States can be expected to take some account of the Federal Government's revenue requirements for the

prosecution of war and not press their income tax programs further than absolutely necessary. In the interest of maximum Federal revenues, State deductibility for Federal taxes might be encouraged. To be sure, developments not now foreseen may necessitate an alteration in these tentative conclusions.

#### VI. Other defense-created intergovernmental fiscal problems

1. The task of financing the war would be facilitated by a more active Federal-State cooperation in tax administration. States already make extensive use of Federal facilities. However, thus far, corresponding Federal use of State facilities has been negligible. Since some States, as a result of the effective integration of diverse local industrial and governmental informational sources, are now successfully collecting income taxes from the low income groups, they facilitate the Treasury's efforts in the same field. The Treasury should attempt to tap the stores of information and experience now available in the States.

The cooperation of the States would also be helpful in the administration of the newly imposed automobile use tax. The new automobile use tax seemed to furnish the ideal opportunity for Federal-State collaboration in administration. However, the very impressive difficulties encountered by the Bureau of Internal Revenue when such program was contemplated serve principally to demonstrate the fact that such collaboration cannot be improvised successfully and would require long planning and careful arrangements as to detail. More study is being given to this as a type case of possible Federal-State administrative collaboration. But since the tax is highly inequitable, since it will be costly to administer, and since it aggravates Federal-State fiscal relations, it would be preferable if this tax were repealed.

2. As a result of improved economic and fiscal conditions, some State and local governments are accumulating surplus revenues. The disposition of these surpluses has an important bearing on the Government's efforts to prevent an inflationary price rise. These efforts would be facilitated if State and local governments converted their surpluses into reserves and more particularly if they used these reserves to purchase United States Defense

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Bonds. The development of a non-negotiable bond subject to ready liquidation and otherwise adapted to the needs of State and local reserve funds would stimulate the use of such funds and their investment in Federal securities. The use of surpluses to reduce indebtedness would also be helpful. Conversely, if improved State and local financial conditions resulted either in tax reductions or expenditure increases, the Federal Government's anti-inflation program would be handicapped. State governments can facilitate the war effort also by extending financial assistance to the defense-affected cities, which are required to provide essential governmental services to defense industries and their workers.

3. The Government's effort to prevent inflation is of vital importance to State and local governments. Experience during the last war indicated that an inflation can seriously disturb the equilibrium of State and local finances. Today these governments have even more to fear from inflation than they had in 1917. Their tax resources are more fully utilized and they have less scope for tax increases, especially in the field of property taxation. A severe inflation at the present time might render it extremely difficult to sustain State and local governmental services.

4. While some planning of post-war public works and some effort to build a "public works reserve" are already in process, a further investment in these directions is needed. It is particularly important to have the details of the post-war public works program so completely worked out that its execution can be launched, on a large scale, at any time on short notice. Legislation now before Congress would contribute to this objective.

I. Impact of the Defense Program  
on State and Local Finances

It was expected that the first impact of the defense program on State and local finances would be favorable. This was reported to have been the case in Canada and seemed a logical result of heavy Federal defense spending. On balance and on the average, especially in the case of State governments, this expectation has been realized.

A. State governments

Tax collections in the 48 States for the fiscal year 1941 are estimated to be 7 percent higher than for 1940. <sup>1/</sup> These in turn were 7 percent above 1939. Total tax collections in 1941 amounted to \$4,451 million, compared with \$4,171 million for 1940. Exclusive of unemployment compensation taxes, the corresponding totals were \$3,570 million and \$3,327 million.

Some increases were registered in virtually every revenue category. The greatest relative increase occurred in income taxes, which rose 17 percent, composed in turn of a 27 percent rise in corporation and an 11 percent rise in individual levies. Total income tax collections rose from \$358 million in 1940 to \$420 million in 1941, an all-time high. In both years, taxes on individuals represented approximately three-fifths of total income tax collections.

<sup>1/</sup> U. S. Bureau of the Census, "State tax collections, 1941", October 6, 1941, p. 9.

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The other tax sources registered varying increases. Severance taxes, including levies on lumber, oil and mineral products, rose 13 percent; general sales taxes, 13 percent; gasoline taxes and liquor taxes, each 8 percent; and tobacco taxes, 6 percent. Motor vehicle license receipts rose 7 percent; and unemployment compensation taxes 4 percent; and inheritance taxes 3 percent. Miscellaneous sales taxes, business licenses, and other license receipts rose only slightly.

Table 1. Estimated State Tax Collections, 1940 and 1941  
(Amounts in millions)

Type of tax	Collections		
	: 1941	: 1940	: % Change
General and selective property taxes	\$ 254	\$ 263	- 3%
Severance taxes	59	52	+13
Sales taxes:			
General sales	552	490	+13
Gasoline sales	910	845	+ 8
Alcoholic beverages	215	200	+ 8
Tobacco products	103	97	+ 6
All other sales	16	14	+14
Total	<u>1,796</u>	<u>1,647</u>	<u>+ 9</u>
Motor vehicle licenses	416	388	+ 7
Taxes on specific businesses	452	444	+ 2
Net income taxes:			
On corporations	157	123	+27
On individuals	208	188	+11
Undistributable	55	46	+19
Total	<u>420</u>	<u>358</u>	<u>+17</u>
Inheritance, estate, and gift taxes	122	118	+ 3
Poll, hunting and fishing, documentary and miscellaneous	51	58	-12
Unemployment compensation <u>1/</u>	881	844	+ 4
Total collections:			
Including unemployment compensation taxes	4,451	4,171	+ 7
Excluding unemployment compensation taxes	3,570	3,327	+ 7

1/ Contributions to State clearing accounts, obtained from the Social Security Board.

Detailed tax collection data are available for 31 States. These indicate annual increases in two States as high as 18 percent. Eleven out of the 31 States whose fiscal years ended on June 30, 1941, reported increases of 10 percent or more in their collections. The States with conspicuous increases appear to be scattered throughout the country.

Table 2. Percentage Change in the Tax Collections of 31 States, Between Fiscal Year 1940 and Fiscal Year 1941

Less than 6%		6 - 12%		Over 12%	
Delaware	-0.7	Idaho	6.1	Oregon	13.0
New Hampshire	0.7	New Jersey	6.2	South Carolina	13.2
Oklahoma	1.6	Vermont	6.5	Georgia	13.3
Iowa	2.7	Tennessee	6.7	Kentucky	13.4
Minnesota	2.9	Mississippi	7.1	North Dakota	14.5
Indiana	3.0	Utah	7.3	North Carolina	15.4
Connecticut	3.5	Montana	9.0	Virginia	17.8
Nevada	3.9	Washington	9.7	Michigan	18.1
Illinois	4.0	Wisconsin	9.8		
Kansas	4.1	California	11.4		
New York	4.6				
New Mexico	5.4				
Colorado	5.9				
13 States		10 States		8 States	

Information on State expenditures is less complete. At all events, such data would not be indicative of the effects of the defense program on State finances, because

requirements for additional services, reduced welfare loads, rising wage and material costs, and other defense created factors would not have exerted their full effects by June 30, 1941.

New York has a \$7 million surplus and Illinois reported a surplus of \$6 million in June, with the balance rising to \$23 million by September 1941. Some reduction of taxes and indebtedness is reported.

B. Local governments

The available data on local revenues and expenditures are inconclusive regarding the effect of the defense program on local finances. Distortions in expenditures of communities located in defense areas are known to be currently developing but are not yet adequately reflected in the financial statistics. Some cities, particularly in non-defense areas are reducing tax rates; others are accelerating debt reduction. Receipts and expenditures in 1941 were relatively stable. Property tax revenues are not sensitive to changes in economic activity and the general decline in assessed values is only beginning to reverse itself. The tax delinquency situation continues to improve. Defaults, never relatively large, are becoming even less frequent. Small increases in local receipts of

shared State taxes were noted but grants-in-aid did not increase materially as compared with 1940. Utility and other revenues showed increases in most cases.

Local expenditures for capital outlays on public works are beginning to decline as a result of defense priorities and the movement to conserve materials. Welfare expenditures, particularly for relief and W.P.A., are also being reduced. In this case, the picture is spotty and somewhat disappointing because large numbers of the unemployed are unfitted by age, training, physique, or location to participate (at least directly) in the defense program. Some categories of expenditures, particularly in cities, are showing a general increase, as a result of defense requirements, such as an extension of fire and police service to protect property against sabotage. Outlays for vocational education have increased in many areas. "Of the 900 cities with vocational, trade, or industrial schools, 300 now have their school systems operating on a 24-hour basis with the objective of training the 2 million defense workers requested by OPM". <sup>1/</sup> Some adverse effects from the increase in wages and prices have already been felt.

On the whole the defense-area increases in expenditures will be more apparent in 1942 operations, as facilities and

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<sup>1/</sup> Albert Lepawsky, "Impact of National Defense on State and Local Finances".

services expand to care for large population influxes. In these areas, property tax revenues will be adjusted slowly to rising expenditures because of the lag in placing new values on tax rolls, the lag in assessed values behind economic activity and the existence of tax limitation and tax exemption problems.

Although the fiscal trend in local areas is generally one of improvement, three qualifications must be noted:

1. The situation is spotty and some cities have been adversely affected by the defense program;
2. The local units have not as yet experienced the full effect (in fact have hardly begun to experience the effect) of the defense taxes upon their revenues;
3. The possible effects of inflation and post-defense readjustments on local finance are matters of considerable and warranted apprehension.

With respect to the impact of the defense program on governmental costs, cities appear to fall into three broad categories: (a) so-called defense-affected cities or boom towns; (b) cities struck by priorities unemployment; and (c) cities in neither of the above classes.

The defense-affected cities are confronted with the problems of transitional readjustment. The defense program is estimated to have caused the migration of at least 750,000 persons (by June 30, 1942), resulting in radical changes in the population of some communities. The City of Radford, Virginia, for example, because of the location of two new ordnance works 5 and 7 miles distant, is estimated to "enjoy" an increase in population from 6,898 in 1940 to 13,000 in 1942. Charlestown, Indiana, 15 miles north of Louisville, with 936 people "suddenly found itself the site of a powder and bag loading plant to cost \$25 million, but which as a result of the added Axis victories and our own skyrocketing defense program, was boosted to a \$75 million project before its completion. Twenty-six thousand construction workers have moved into the general area of Charlestown beside a good crew of managers, consultants and planners."<sup>1/</sup> Cities such as these are facing problems of rapid expansion in municipal outlays for education, sanitation, recreation and other services.

The problems of priorities-unemployment cities are more recent. The plight of these cities arises mainly from inability to secure materials and, to a lesser degree tools and skilled labor, with which to manufacture durable goods

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<sup>1/</sup> Albert Lepawsky, "Impact of National Defense on State and Local Finances", address before National Tax Conference, 1941 and monograph submitted to the Treasury.

not useful for national defense. For example, one Ohio city with a peak factory employment of 13,123 in July, 1941 and a population of 37,000, anticipated in October a displacement of 1,360 workers in 60 days and 2,452 by early 1942. Factory employment had risen from 9,582 in July 1940, and relief cases had fallen from 511 in July, 1940 to 268 in July 1941. The displacement might temporarily rise to 4,600 as a result of a shortage of raw materials and orders to curtail output. The production affected was consumers' electrical appliances, tires and rubber goods, stoves, plumbing supplies and other metal products. A substantial number of other communities faced similar prospects. In these cases, as distinguished from the defense-affected cities, no provision has been made for Federal financial assistance. However, efforts are being made to facilitate a transition which will adapt these resources to defense production.

Many local government areas, including some urban centers, fall in neither of the above classes. Their industries have not been affected directly by the defense program. They are reaping the benefits of a general improvement in economic conditions.

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Substantial reductions in State and local motor vehicle taxes are the most important and imminent threat to State and local revenues growing out of the war. Unless the supply routes for rubber imports are reestablished or substitutes are quickly developed, it is almost certain that civilian use of automobiles will necessarily be restricted. As this situation continues, the effect may be expected to bear down more and more on civilian consumption of gasoline. There is also a remote possibility that increased war needs for petroleum either by ourselves or by our Allies may necessitate reduction in civilian consumption of gasoline, unless refinery capacity can be enlarged. A recent report indicates that refineries are operating close to 94 percent of capacity. <sup>1/</sup> Furthermore, transportation and distribution difficulties may necessitate rationing of civilian consumption in areas where, for various reasons, gasoline supplies are limited. Finally, in a long war priorities on automobiles themselves may cut civilian consumption of gasoline on highways.

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<sup>1/</sup> Wall Street Journal, Friday, Dec. 26, 1941. p. 2

There are also some possibilities of reduction in motor vehicle license tax revenue. In some States, non-use of automobiles on highways permits owners to completely avoid payment of the license fee. Many State license laws provide for fees graduated downward with increasing age of the automobile. Oklahoma's license tax is of this nature. Moreover, in many States, automobiles are subject to State or local property taxation, or both. These taxes are based on value of the automobile and severe cuts in new automobile production will tend to cut this tax base, the amount depending on the severity of restriction in production, and the length of time of such restriction.

In 1940, for all States combined, the two most important motor taxes provided over 1-1/4 billion dollars of revenue, or 39 percent of State tax collections. Gasoline taxes amounted to over one-fourth (26 percent) and motor vehicle license fees to one-eighth of State taxes. These figures conceal significant variations in importance of these revenues in particular States. In Massachusetts, these two sources accounted for one-fourth (24 percent) of State taxes as contrasted to two-thirds (67 percent) in Florida. In one-fourth of the States, these taxes amounted to over 50 percent of State taxes. (See Chart I). In Nebraska and Florida, gasoline taxes alone accounted for over one-half

of State taxes. In New York, however, it accounted for only one-sixth (16 percent). There was even more variation in the fiscal importance of motor license fees with Mississippi obtaining only 1 percent from this source as compared with 26 percent in Vermont. Our economy and fiscal system have been geared to the automobile more than many have realized.

States can partially offset reductions in motor tax yields by reduction and postponement of highway construction and by cuts in maintenance expenditures on the present road plant. With regard to the first, States are already faced with priority problems resulting from the war. New highway materials can be obtained only when projects are considered essential to the war effort. With regard to the second, less motor travel on highways will permit some economies in maintenance.

But not all the effects of declining revenues from motor taxes can be offset so easily. Almost three fourths of the States have pledged motor taxes for servicing indebtedness - mostly State and local highway bonds. One extreme illustration is the case of Arkansas which in 1940 used two-thirds (68 percent) of its gasoline taxes to service bonded indebtedness. It is also well to recall that in 1940 the States distributed \$202,956,000 in gasoline taxes and \$118,115,000 in motor vehicle license fees to local governments.





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Motor taxes are also used for non-highway purposes. When this is true the curtailment of the former would affect Governmental functions other than highways. In 1940 the Public Roads Administration reported \$192,000,000 of motor tax revenues used for non-highway purposes. State and local general funds received 72 percent and education 15 percent of this "diverted" revenues. In 1940 Florida used \$8,677,000 of motor revenues for support of education.

C. State and local borrowing

With regard to borrowing, the Treasury Department's annual estimate of the volume of tax-exempt securities place the June 30, 1941, volume of State and local interest-bearing debt at \$19,860 million, only \$31 million below the corresponding figure for June 30, 1940. In recent months, the volume of State and local financing is showing a more appreciable drop. This trend can be expected to continue as (1) improved tax collections obviate the need for short-term borrowing, (2) Federal loans and grants are supplied to defense areas for public improvements, and (3) as labor and material shortages and price increases lead to the postponement of State and local capital expenditures. All these factors, however, will have a relatively little and slow effect on the total volume of State and local debt, because of the magnitude of the total outstanding debt compared with the size of current operations.

## II. The Division of Financial Responsibility for Defense-created Governmental Services

The division of financial responsibility among governmental units for defense-created public expenditures has created difficult and delicate problems in Federal-State-local fiscal relations. The growth of industrial, military and naval activity incident to the defense program has exerted heavy pressure on some local governments in the defense areas to provide added public works facilities and to meet added costs of operation and maintenance. Increases in population and in property to be served have been general in such areas. The resultant financial problems have been especially difficult in the communities which have been newly-created as a result of the defense program. Naval yards, shipbuilding centers and army reservations are examples. Increases in governmental costs have appeared also in established industrial centers where activities have increased.

School, sanitary, fire, police, road and health services are those most drastically affected by the defense development. The cost of providing these services has frequently expanded beyond the ability of limited local revenue sources to meet it promptly and adequately.

The governmental services required as a result of the defense program are largely those which traditionally have been the responsibility of local governments. In the interest of orderly public administration it would be desirable that they continue to be locally-financed as far as possible.

The responsibility of State governments must of necessity be limited. State grants-in-aid to local units for capital outlays have always been restricted and such meager funds as have been made available were mainly for school buildings. State grants-in-aid for the operation and maintenance of strictly municipal services such as police and fire protection, sewer, water and other sanitary services have also been exceptions. These functions are traditionally considered to be outside the sphere of State activity.

Through grants-in-aid, States have transferred substantial amounts to local units for roads, schools and welfare. However, State grants have not met the extraordinary current operating requirements of the defense communities, even for schools. This is due partly to limitations on the amount of State funds, but more particularly to the fact that grant-in-aid formulae are commonly fixed by statute and that the adjustments in grants lag

behind changes in needs such as those generated by the defense program. The amount of State disbursements for grants-in-aid is usually fixed for the year, and for the current fiscal year, budgets were adopted some time ago, many under biennial appropriation. Moreover, the statistics employed in the formulae designed to measure local needs will not reflect for some time needs arising from defense developments. In the distribution of school aids, for example, attendance or enrollment figures for the preceding year are used to allocate funds in the current year.

In the case of those local functions which States have previously recognized as partially their responsibility, special State assistance toward meeting defense-created needs would be desirable. There appears to be a strong measure of State responsibility in adapting State support to rapid changes in local problems.

Congress has recognized a measure of Federal responsibility toward the local communities seriously affected by the influx of defense workers and military and naval personnel, by the passage of the Defense Public Works Act. <sup>1/</sup> Federal responsibility stems not only from the fact that Federal decisions have produced extensive interstate and intrastate

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<sup>1/</sup> Public Law 137, 77th Congress, June 18, 1941.

migrations of population and the concentration of defense activity in some areas, but also because many local units have limited financial capacity to meet distorted capital outlay expenditures and because States lack funds and machinery for providing immediate assistance.

The Defense Public Works Act authorizes an appropriation of \$150 million for grants, loans, or both, to public or private non-profit agencies for public works and equipment. Such public works may also be constructed directly by the Government and contributions may be made to local agencies for operation and maintenance of any public works essential to defense. Qualified public works include primarily schools, waterworks, sanitary and health facilities, recreational facilities and streets and access roads. The Federal Works Administrator is given virtually full discretion, subject to Presidential approval, to meet the shortage of public works necessary to health, safety or welfare in defense areas when such works cannot or will not be provided locally, or could be provided only by excessive local taxation or by exceeding local debt and tax limits. Existing facilities are to be used or extended as far as possible, and works are to be Federally-operated only if local agencies are unwilling or unable to do so with their own personnel and under the grants and loans provided.

The 2,824 project applications filed by October 13, 1941, represent a total cost of \$815,665,850. Proposed local sponsor-funds on these applications amounted to only \$138,862,062. The entire \$150 million appropriation was tentatively allocated in November and a second appropriation of a similar amount is now under discussion. The 432 projects which had received actual allotments as of October 13 included 175 for Army and Navy recreational facilities; 116 for schools; 100 for water and sewers; 30 for hospitals and clinics; 5 for roads and streets; 4 for fire stations and equipment; and 1 each for incinerator and power plant. These allotments involved a total cost of \$84,953,390, to be covered \$24,691,233 or 29 percent from local sponsors' contributions; \$2,902,425 or 2 percent from Federal loans; and \$57,359,732 or 68 percent from Federal grants.

From present indications another Federal appropriation will be required in the near future. The volume of valid applications is large, while a part of the present appropriation was allocated to strictly Federal activities, such as service recreational projects, and only the most urgent projects connected directly with camps, housing projects, etc., could be provided for from the available

funds. The actual extent of further requirements will depend on the further development of encampments and yards, the continued decentralization of industrial activity and the expansion of existing industrial facilities.

The Defense Public Works Act provides that the \$150 million appropriation be apportioned among the several purposes and governmental units by the Administrator of Public Works in a discretionary manner. The discretionary basis of apportionment of loans and grants leaves much to be desired, but under the circumstances was unavoidable. The need to facilitate the functioning of defense areas was urgent and no satisfactory apportionment formula was available. Small rural communities suddenly transformed into sizable industrial areas lack the tax base, the borrowing capacity and the personnel necessary to provide needed public works. Even the more mature industrial areas may be operating at, or in excess of, their legal tax and debt limitations. All of these factors, as well as local willingness to serve housing projects and strictly Federal properties, such as reservations and yards, have to be recognized in the allocation of Federal aids. The varying interpretations possible as to the degree of local benefit and the

proportionate allocation of cost between local and Federal funds seem to justify the apportionment on a discretionary basis.

Preferring to trust the discretion of an administrator, the Federal Government for several years distributed emergency relief funds without prescribing specific formulae. A formula could hardly be expected to operate in the present more complex situation. From the standpoint of public administration, discretionary distribution of funds is admittedly very difficult. Such discretionary power requires the administrator to weigh the numerous factors involved, resist the pressures, and make decisions destined to have important repercussion on local communities. The urgency for performance of the work may not permit adequate time for either investigation or bargaining and frequently direct Federal construction must be undertaken without delay, leaving the determination of ultimate financial responsibility to a later date.

The question of financial responsibility for local services is especially difficult in cases where the local communities have sought the location of defense industries within their boundaries. 1/ Some have gone further and

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1/ "Thousands of business men looking for contracts and sub-contracts went to Washington. Hundreds of representatives of local business associations accompanied

offered inducements, such as exemption from property taxes. This occurred in a number of communities in Mississippi and Louisiana. Further, difficulties are presented when the local communities involved are operating under extremely severe property tax and debt limitations provisions.

An examination of city applications for aid revealed a number of communities whose difficulties were in part due to the fact that they had frozen their tax systems with legal restrictions. There is some indication that this was the case with Pascagoula and Tullahoma in Tennessee and with Leesville and De Ridder in Louisiana. 1/ The difficulty seemed to be in the exemption of both industries and new homes, which greatly increased the helplessness of the towns in handling a large influx of new industries and population. 2/

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them to explain the advantages of their communities from the standpoint of industrial production. Hundreds of city officials likewise visited Washington for the same purpose". (Owsley & Miles, Cities and the National Defense, May, 1941, p. 30)

1/ Defense Public Works, Docket No. Miss. 22-106, Tenn. 40-104, La. 16-101, La. 16-102.

2/ The case of Pascagoula is particularly interesting. The Ingalls' Ship Building Corporation was established at Pascagoula under the Mississippi Industrial Act. Jackson County furnished all land upon which the yard is located and floated a \$100,000 bond issue to carry out all necessary dredging and other work. The firm was exempted from taxes for five years. War orders have greatly expanded activities at the yard and increased the communities' population by almost fifty percent.

### III. Federal Payments in Lieu of Local Taxes on Federally-owned Properties

Federal fiscal responsibility to local governments because of the ownership of Federal properties within the boundaries of such local governments presents one of the more difficult and less satisfactorily handled problems in Federal-State-local fiscal relations. It is not a new problem but one that has been aggravated by the defense program. The Federal Government has acquired large amounts of property for reservations and cantonments, artillery ranges, airfields, arsenals, ammunition depots and the like. In addition, the R. F. S. has acquired defense plants and other Federal agencies have developed extensive defense housing projects. Local finances are affected by these developments both because of the depletion of the local tax base and because the Federal property in most instances requires varying amounts of local servicing. On the other hand in some cases the location of Federal property has probably added indirectly to the tax base more than enough to compensate for the additional services involved.

Federal payments in lieu of taxes have been on a more or less opportunistic basis for several years and arrangements have differed with different Federal projects. It appears to have been difficult to find a consistent principle to apply. The matter is now under investigation

by the Federal Real Estate Board, created by Executive Order in 1939, 1/ and other agencies.

In the case of pre-defense housing projects, the usual practice was to require local contributions in the form of exemption from property taxes. Payments-in-lieu of-taxes were generally nominal, usually not in excess of 5 percent of rentals. Defense housing projects, affected with a larger Federal interest, have usually carried contracts (for the emergency only) including contributions up to 15 percent of rentals and in no case in excess of taxes. The 15 percent is distributed among functions according to a study of the service costs for the average city. It contains no provision for flexibility among municipalities or with changed conditions. Situations among municipalities differ very substantially and are especially difficult where a new housing project is developed in one community while the factory employing the men housed on the project is located in another.

Local dissatisfaction with "payments in lieu of taxes" was already in evidence even before the defense era. It was alleged that the arrangements concentrated an undue burden on taxable real estate. The dissatisfaction has continued into the defense period. The objection is now raised that Federal payments are insufficient 1/ House Doc. No. 111, 76th Congress, 1st session. Wash. 1939.

to compensate for the cost of services provided by the local units and result in undue additions to the local tax rates.

In Clark Township, Union County, New Jersey, where certain defense public housing projects were being constructed, attempts were made to exclude the Federal project from the township proper and render it a reservation or separately incorporated municipality. A measure to this effect passed the Legislature, but was vetoed by the Governor. This local resistance was in part traceable to the fact that the jurisdiction was small, chiefly residential, and the housing project would not add sufficiently to the tax base to cover the costs of the added local services. The industrial property is located outside the township in large urban centers. The excessive subdivision of local units long noted in the New Jersey area and unusually high tax rates added further to the problem. 1/

A similar incident in the same State occurred in Caldwell Township, a rural community of 6,000 acres with a population of 1,383. Opposition was raised to a proposal for centering a 250-house housing project in this locality, although an aircraft propeller plant employing some 1,600 persons had also been located there. The local

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1/ Hearings Before the Committee on Public Buildings and Grounds, 77th Congress, 1st Session, on H.R. 5211, July 9-23, 1941, pp. 169-170.

group cited the alleged fact that complete sewer, water, gas and school facilities would be needed, and even if all were provided by Federal funds, operation and maintenance would "probably double the tax rate of the present inhabitants". 1/

In a recent report to the House on a bill to increase the appropriation for defense housing by \$300,000,000, the Committee on Public Buildings and Grounds has suggested the following change in policy: 2/ Since defense housing is designed to serve government personnel and industrial workers who must be considered to be self-sufficient in character, there is no reason for payments measurably below local taxes. Payment of annual sums in lieu of taxes should be mandatory and should approximate what would have been paid if the property had not been tax exempt; allowance should be made for capital expenditures by the Government for streets, and other utilities to serve the houses in question.

In the case of R.F.C. defense plants, the rule stemming from the statute creating the Corporation and 1941 legislation is that real estate owned by the agency and its subsidiaries is subject to local property taxation. Personal

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1/ Ibid., p. 212.

2/ November 28, 1941: Report to Accompany H.R. 6128.

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property and other attributes of these Federal undertakings are exempt from local taxes. Reservation property is exempt from local taxation and this is also true of most Army and Navy acquisitions, including housing developments for personnel. In the latter case, some services are provided directly, others by contract. Particularly in the case of school services for the children of Army personnel, a great variety of arrangements have been made. 1/

Both pre-defense and defense experience justify the conclusion that techniques for Federal payments in lieu of taxes are subject to much improvement. Local intelligibility, flexibility and adequacy are objectives to be sought. No easy solution is available but improvement seems quite possible. Certainly the field is worth an investment for it is one which occasions great irritation in Federal-local relationships. These irritations, bad in themselves, encourage resistance to the Government's efforts

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1/ No uniform Congressional provision is made for payment for school tuition of service personnel. This matter has been handled in the past by combinations of direct service provision and maintenance of post schools; voluntary support of post schools; tuition payments by parents or post exchange and recreation funds to public schools; provision of free tuition by State law or by local units; Army transportation; contracts with local units for operation of post schools or adjacent schools. State and local units have frequently extended educational services to children residing on reservation property, although Federal jurisdiction is exclusive and there is no legal obligation to provide services.

to improve the Federal tax system. Those opposing the discontinuance of the issue of tax-exempt securities by State and local governments have made a major point of the extent of tax-exempt Federal property, holding that costs of local functions and debt service would be increased at the same time that Federal activity is reducing tax bases. 1/

Pending the forthcoming report of the Real Estate Board on this subject and further study of the matter, a definite recommendation would be premature. It seems possible, however, that a solution can be reached along the following lines:

1. Where services are sold by Governmental agencies to private individuals, as in the T.V.A. and housing projects, the commercial element of the property involved should be valued by the Federal Government through a capitalization of the rental or other income. The Federal Government could then pay local taxes on such value corresponding to the taxes which would be paid if the property were privately owned.

2. Where property held by the Government does not result in the sale of services to private individuals, the

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1/ C. H. Chatters, "The Case Against Taxation of Governmental Securities" in Annals of American Academy, March 1941, p. 77.

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Federal Government might be charged only for the cost of those local services benefiting property as distinct from those which benefit persons. Such procedure would reimburse local units for the cost of fire protection, for instance but not for health, education, or welfare services.

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#### IV. State and Local Taxation of Government Contracts 1/

The taxability of government contracts under State and local sales and use taxes is one of the defense created problems in intergovernmental fiscal relations. Pending the Supreme Court's determination of the taxability of defense contracts, the Justice Department endeavored to obtain suspension of State tax collections. A number of States complied. Objection was raised to such State taxation on the ground that the latter would add to the cost of the defense program and that the legal status of operations of many defense contractors as private individuals or agents of the Government was unclear. Of particular significance was the status of cost-plus-fixed-fee contractors. This type of contract is used extensively by the War Department, Navy Department, Public Buildings Administration, and the Maritime Commission

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1/ In October 1940 the Buck Act (Pub. No. 819, 76th Congress) was passed to authorize States to extend sales, use, and income taxes to persons residing on or carrying on business in Federal areas and to transactions occurring in such areas. The provisions did not apply to "authorized purchasers" (military, naval and civilian employees) from Federal instrumentalities. Some attempt has been made to amend the act to further clarify Army and Navy authority over reservations and to extend to Army and Navy personnel exemption from State income taxes, but no legislation has been passed to date.

It is used also by the Reconstruction Finance Corporation. Some one billion dollars in cost-plus contracts was awarded by the Quartermaster's Division alone in 35 States, involving building construction as well as munitions and supplies.

Several States ruled that the cost-plus contractors working on defense contracts are subject to sales, use, gross receipts and similar taxes in the same manner as private contractors.

The Department of Justice took the position that the cost-plus contractor is an agent of the United States and the assessment of State sales and use taxes on the materials would be direct taxation of the Federal Government, 1/ because:

1. The cost-plus contractor is reimbursed by the Government for all expenses and costs of equipment, materials and labor and then receives a fixed fee for the use of his organization, services and overhead;

2. The Government supervises all procurement, may itself supply the materials, may specify the kinds of materials, and the Quartermaster approves virtually all purchases and receives delivery, and many of the invoices are on Federal forms, and because

3. Title vests in the United States at the site of the work.

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1/ S. O. Clark "State Tax Affairs and the Defense Program" Paper before Municipal Law Section of American Association, Sept. 30, 1941 (mimeographed).

The Justice Department did not contest State and local taxation when the tax is actually on the seller but did so when the "legal incidence" is on the buyer. Taxes on sales within a State are usually collected from the seller but occasionally are levied on the purchaser and more often there is a requirement that the tax be passed on to purchasers. In such cases, the Department argued, the buyer carries the legal incidence of the tax. Use taxes and gross receipt taxes measured by payments received by the contractor from the Government for his expenditures on materials and labor were held to involve the same principle as sales taxes. State net income taxes and gross receipts taxes on the contractor's fee were not challenged.

Of some 91 separate sales taxes, including motor fuel taxes, a large number offer express exemption to the United States, and some States have extended exemption by administrative ruling. "In 7 States the administrative construction has exempted the cost-plus-a-fixed fee contractor from excise taxes; in 6 States a qualified exemption has been granted; in 16 States exemption has been denied; and in 8 States there has been no clear administrative construction." 1/ The classification submitted in an appendix to the Government's Brief in the Boozer case is found below:

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1/ Brief for the United States in State of Alabama v. King & Boozer, 1941, pp. 105-9.

Status of State Transaction Taxes with Regard to  
the Taxability of Purchases by Cost-Plus-Fixed-Fee-Contractors

	Gross Sales <u>18/</u>	Receipts <u>19/</u>	License <u>20/</u>	Motor Fuel <u>21/</u>	Total
Taxes on vendees with exemption	6	3	1	23	33
Taxes on vendees without exemption	9	4	5	16	34
Taxes unclassified with exemption	1	-	-	1	2
Taxes unclassified without exemption	2	-	-	1	3
Total <u>22/</u>	18	7	6	41	72
Taxes on vendors with exemption	-	-	-	6	6
Taxes on vendors without exemption	4	1	-	8	13
Total	22	8	6	55	91

18/ Includes taxes measured by gross receipts from sales of tangible personal property at retail. Use taxes at same rates were not considered separately.

19/ Includes taxes measured by gross receipts on account of labor or by entire gross receipts less gross receipts on account of tangible personal property on which retail sales tax is imposed. Taxes measured by gross receipts on account of payroll reimbursements to cost-plus-a-fixed-fee contractors are not, strictly speaking, "vendor" or "vendee" taxes. They are classified as "vendee" taxes since they are taxes levied upon the contractor directly.

20/ Includes taxes levied directly on contractors, in a fixed sum or graduated according to the total amount of the contract. Again the "vendor" and "vendee" terminology is descriptively inexact, but license taxes are placed in the "vendee" category, since they are levied directly upon the contractor.

21/ Includes taxes levied specifically upon gasoline and other motor fuels. The insignificance in rate and number of taxes on lubricating oil and kerosene, together with the relatively low total value of purchases of these products, made omission thereof appear advisable. For identical reasons gasoline inspection taxes were omitted.

22/ The total of vendees and unclassified taxes is taken as the possible number of the taxes not applicable to cost-plus-a-fixed-fee contractors.

The confusion concerning cost-plus contractors was due to lack of legal precedent and the fact that Congress took no specific action, other than to refuse to include express immunity in the appropriation act. Two test cases have recently come before the United States Supreme Court: U. S. and Dunn Construction Co. v. Curry and Alabama v. King and Boozer. <sup>1/</sup> The first case tested an Alabama use tax on property purchased for construction of a camp. The second involved an Alabama sales tax on lumber for the same camp. The Supreme Court of Alabama had upheld the Federal Government in these cases. The U. S. Court held that the Alabama taxes were applicable.

Justice Stone for the Court in the Boozer case stated that the contractors "were not relieved of the liability to pay the tax either because the contractors in a loose and general sense were acting for the Government in purchasing the lumber or, as the Alabama Supreme Court seems to have thought, because the economic burden of the tax imposed upon the purchaser would be shifted to the Government by reason of the contract to reimburse the contractors." Concerning this latter point the Chief Justice added: "The Government, rightly we think, disclaims any contention that the constitution, unaided by congressional legislation,

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<sup>1/</sup> Decided, November 10, 1941.

prohibits a tax exacted from the contractors merely because it is passed on economically, by terms of the contract or otherwise, as a part of the construction cost to the Government. So far as such a nondiscriminatory state tax upon the contractors enters into the cost of the materials to the Government, there is but a normal incident of the organization within the same territory of two independent taxing sovereignties."

Estimates of Additional Federal Cost Involved in Allowing the States to Tax Defense Contracts

The brief presented by the Government included an estimate of additional costs which would result from the free taxability of sales. <sup>1/</sup> This involved some elaborate analysis and calculations performed with the assistance of the Bureau of Labor Statistics, Department of Labor. The calculations assumed that States now exempting defense contracts would discontinue the practice. In this respect the figures must be taken to represent a maximum though it is stated that otherwise the calculations were conservative estimates. Expenditures by lump-sum contractors, not at issue, were so far as possible excluded. In the case of construction contracts the Bureau of Labor Statistics estimated that the margin of error in its estimates was probably less than 10 percent.

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<sup>1/</sup> Brief for the United States, Alabama v. King and Boozer, Appendix B.

The estimated sales, gross receipts, and license taxes in connection with the activities of cost-plus-fixed-fee contractors and cost-plus-fixed-fee sub-contractors on 405 construction contracts in effect on June 15, 1941 and including both actual expenditures and estimated expenditures to the completion of the projects were \$15,333,490. Motor fuel taxes on the same contractors similarly computed were \$7,358,290. <sup>1/</sup> On the basis of a sample study, sales and gross receipts taxes on 143 cost-plus-fixed-fee supply and equipment contracts executed prior to September 15, 1941 were calculated at \$17,155,684. This makes a total of \$39,847,464. These figures include 548 contracts and an estimated cost of \$6,720,929,777. The figures are cumulative and not confined to one fiscal year. Projecting the estimates into the future it was found that the total outlay for fiscal 1942, might be about \$54,000,000. A figure was also ventured to cover the possibility that the Government might be held not immune from taxes on any of its purchases. The figure ventured for fiscal 1942 to cover this eventuality was \$137,000,000.

Questions of Policy and Principle Involved

To attempt to draw lines as to what should and should not be taxed in the field of governmental instrumentalities

<sup>1/</sup> This figure, however, as stated in the report, makes no allowance for special state exemption for gasoline used off the highways, which might cover about 80 percent of the purchases in 39 states (however, in some cases the lower general sales taxes would cover such purchases where the motor fuel tax would not.)

as a matter of principle and public policy is exceedingly difficult. There is first of all the line to be drawn between the taxation of property and that of sales. Few, if any, have seriously contended that the property owned by the Federal Government should be subject to State taxation at the will of the States. Of course, this is not to say that no payments should be made on Federal property in lieu of taxes. No one has contended that Federal purchases should be taxed at the will of the States, either. Congress should retain power to accept or waive direct taxes on its instrumentalities as it sees fit. Of course, after the Boozer decision it is doubtful if Congress even has the power to immunize contractors on their purchases for Federal contracts. But at least it has power to immunize so far as its direct purchases are concerned and perhaps it has this power in the case of cost-plus and independent contractors. Assuming it has all the power it needs what should be its policy?

A stronger case can be made for leaving the States free to impose transaction taxes on Government purchases than for following a similar course in the case of property. A transactions tax always involves three parties, one almost always private. The economic incidence of the tax as between the vendor and vendee is usually somewhat obscure. A property tax on Government property involves no third parties.

The sales tax is ordinarily nondiscriminatory in administration; this is often not true of the property tax.

If the Federal Government were to allow all of its purchases to be subject to nondiscriminatory State sales taxes, could it adopt a similar policy with regard to Federal excises on State and municipal purchases? Would such a program require the consent or be subject to the discretion of the States? This is a question which remains to be answered by the Court. On the basis of the present trend in the Court's decisions it seems quite possible that the application of a nondiscriminatory excise even on direct State purchases with or without the consent of the States or even against legislation to the contrary in the States might be sustained.

On principle it seems that the Federal Government might well go considerable distance toward waiving immunity of its purchases from State transaction taxes. In support of this position the following considerations are offered:

1. All transactions of purchase, particularly those through a contractor, represent economic activity carried on in some State and local environment. They all require the usual amount of State and local governmental services. Taxes under such circumstances are, to repeat the words of the Court, "but a normal incident of the organization

within the same territory of two independent taxing sovereignties". In the defense era this economic activity often represents a substitution for other economic activity which would otherwise be fully taxable. To be sure, State and local territories get compensatory benefits from the location of defense industries within their borders. They get similar benefits from the location of private industries within their borders. It may be "good business" for these areas to hold out tax inducements to new industries or to retain old ones. Some communities have thought so. But somebody has to bear the costs of government, including the overhead left out of account in such decisions. It seems better that full cost be divided among all of the economic activity. Indirect subsidies are always confusing and usually bad policy.

2. It is true that the imposition of sales taxes on Government business will increase the cost of defense. But this is not in any sense a dead loss. The extra cost to the Federal Government appears again as extra receipts for State and local governments. The same public is involved in supplying the treasuries of both. The Federal Government has much more adequate fiscal

powers than the State and local governments. In recognition of this fact it distributes annually millions and in recent years billions of dollars of Federal aid. In fact, it is urged by many to collect all of the taxes now jointly used by it and the States. Much of the present distribution involves difficult formulae to determine the portion which should go to each unit. No formulae are involved in the payment of nondiscriminatory State and local taxes. To be sure, the State and local governments are showing an improvement in tax collections during the defense era. But many of them have also been subject to a long period of financial strain resulting in some cases in prolonged deficits and a heavy floating debt. If these governments can improve their credit standing during the war period they will be in better condition to meet the stresses of the post-defense era and to cooperate with any public works program the Federal Government may then see fit to inaugurate.

3. The policy of waiving immunity for State and local taxes on Federal transactions would strengthen the Treasury's position concerning the elimination of the tax-exemption privilege in the application of the Federal income tax to the interest on State and local bonds. One of the objections commonly urged to such

action is that the Federal Government is constantly encroaching upon the fiscal resources of the State and local governments. Moreover, in defending its case for the elimination of tax-exempt securities the Federal Government makes much of the argument that the income tax is a nondiscriminatory tax and its application to the interest on Government bonds would be "but a normal incident of the organization within the same territory of two independent taxing sovereignties." The position of the Federal Government in this issue would be stronger if it showed a greater willingness to apply these arguments against as well as for itself.

These arguments do not finally answer the question as to just what policy Congress should follow and the Treasury should indorse concerning the taxability of Federal purchases. Some immediate action by Congress to clear away the confusion seems likely and advisable. In the light of the above analysis, it is concluded that such action should (and perhaps in any event must) concede the taxability of independent and cost-plus-fixed-fee contractors. Going further it might allow taxes on all defense purchases. It is perhaps too much to expect that it will go the whole way, attempting to eliminate all immunity on all Government purchases. But even this would, in our opinion, be well within the bounds of sound public policy.

V. Federal and State Use of the  
Same Tax Bases in War-Time

Several problems arise during the defense period from the use of the same tax sources by both the Federal Government and the States. These problems are not new. They are aggravated, however, by the Federal Government's fiscal needs and the probability that the Federal Government must embark upon an "all-out" tax program. The principal problems are:

1. Will a combination of Federal and State taxes prove excessive for the taxpayer?
2. Will the combination unduly embarrass the Federal Government or the States and result in the impairment of maximum war-time fiscal effort?
3. In the event the answer to these questions is in the affirmative, should an attempt be made to persuade the States to abandon certain revenue sources for the duration of the emergency?

In view of the extensive and intensive development of the Federal income tax and its probable further development, the question of excessive burdens on the taxpayer is especially directed to the possibility of a confiscatory or near-confiscatory incidence of a combination of Federal and State income tax rates. The present maximum Federal

Table I

Deductibility of Federal Income Taxes from Gross Income in  
Computing Net Income for State Net Income Tax Purposes 1/

State	Individual Income Tax	Corporation Income Tax
Alabama	Yes	Yes
Arizona	Yes	Yes
Arkansas	Yes	Yes
California	No	No
Colorado	Yes	Yes
Connecticut	None imposed	No
Delaware	Yes	None imposed
District of Col.	No	No
Georgia	Yes	Yes
Idaho	Yes	Yes
Iowa	Yes	Yes
Kansas	Yes	Yes
Kentucky	No	Yes
Louisiana	Yes	Yes
Maryland	No	No
Massachusetts	Interest	No
	Dividends	No
	Capital Gains	No
	Partnerships	Yes
	Business income	Yes
	Wages and salaries	Yes
Minnesota	Yes	Yes
Mississippi	No	No
Missouri	Yes	Yes
Montana	Yes	Yes
New Mexico	Yes	Yes
New York	No	No
North Carolina	No	No
North Dakota	Yes	Yes
Oklahoma	Yes	Yes
Oregon	Yes	No
Pennsylvania	None imposed	Yes
South Carolina	No	No
South Dakota	Yes	Yes
Utah	Yes	Yes
Vermont	Yes	No
Virginia	No	No
West Virginia	Yes	None imposed
Wisconsin 2/	Yes	Yes

1/ In general, each State which permits the deduction of Federal income taxes limits such deduction to taxes paid on that part of income subject to its own income tax.

2/ Applicable to income of 1941 and subsequent years, the deduction is limited to 10% in the case of corporations and 3% in the case of noncorporate taxpayers.

rate of 80 percent and the maximum State rate of 15 percent (North Dakota and California) appear to approach within a narrow margin of confiscation. But the appearances are deceiving. The deductibility of the State tax in calculating the base of the Federal tax, together with the deductibility of the Federal tax in calculating the base of the State tax in more than 2/3 of the income tax States, make the effective rates considerably less than the nominal rates.

Deductibility of the Federal tax is allowed by 21 States. (See Table I.) Eight States, including California and New York, and the District of Columbia, deny deductibility. Wisconsin now grants a limited deduction and Massachusetts in its classified income tax allows a deduction on some types of income. The combination of Federal and State tax rates under various assumptions produces the following results:

Table II

Effective Rate of a Combination of an 80 Percent Federal and a 15 Percent State Tax on that part of Income Subject to the Maximum Rate

Assumption	Effective Rate
1. That neither tax is deductible in the calculation of the other	95 percent State 15 percent Federal 80 percent
2. That the State tax is deductible in the calculation of the Federal (as presently provided in the Federal law)	83 percent State 15 percent Federal 68 percent

- |  |   |
|--|---|
| 3. That the Federal tax is also deductible in the calculation of the State tax (as presently provided in the laws of about two-thirds of the States having an income tax). | 80.7 percent<br>State 3.4 percent<br>Federal 77.3 percent |
| 4. That the State has no income tax.   | 80 percent<br>Federal 80 percent                          |

From the above table it can be seen that the combination of Federal and State taxes results in an effective rate only slightly higher under the third assumption than under the fourth, and not conspicuously higher under the second assumption than under the fourth. (However, the differentials are greater than they seem for they should be compared with what the taxpayer has left after taxes as well as with his net income.) Thus, the deductibility feature is an insurance against a confiscatory combination. A Federal rate of 90 percent and a State rate of 15 percent under the second assumption above would result in a combined maximum effective rate of 91.5 percent; under the third assumption 90.2 percent.

Although reciprocal deductibility results in the avoidance of confiscation in the application of the income tax to the high brackets and also means the reduction to relatively small margins of differential tax burdens among taxpayers residing in different States who enjoy the same level of income, the latter aspect appears not to be true

for taxpayers with low incomes and relatively low taxes. Thus, with an effective rate of 4 percent in both State and Federal laws, mutual deductibility would leave a total tax burden of 7.68 percent in an income tax State as compared with 4 percent in a non-income tax State.

However, the appearances are deceiving once again. The relatively low prevailing State rates and the operation of a progressive scale, which causes the deduction to be applied at a higher rate than the effective one, lead in actual practice to very much smaller differentials than the above illustration suggests. The difference in tax actually payable by a married taxpayer, without dependents, with a \$5,000 income in New York as compared with Pennsylvania (a non-income tax State) is only 1.1 percent of the net income even though New York allows no deduction for the Federal tax. However, in this case 1.1 percent of net income is 14.7 per cent of the total income tax in a non-income tax State.

As to the second question, that of fiscal embarrassment, the answer seems to be that the present arrangements are fairly flexible. The third and fourth assumptions (Table II), either reciprocal deductibility or State withdrawal from the income tax field, give the Federal Government a fairly free hand in the development of an income tax rate structure. The second alternative, while less favorable to the taxpayer, leaves more revenue to the States.

Further tables presented below and in Appendix A indicate that the benefits of reciprocal deductibility extend to taxpayers in all brackets of income and become quite sizable at the \$100,000 level. The benefits have risen considerably in value as a result of the 1941 increases in Federal rates. The benefits of the deductibility provisions in State laws vary from State to State according to the schedule of rates in each State. The more severe the rate schedule, the more substantial the savings to the taxpayer.

The Federal deductibility feature is tantamount in one sense to a subsidization of the State income tax by the Federal Government. A portion of the State tax can be said to be offset by a reduction in Federal tax resulting from the deduction of the State tax in the calculation of Federal tax. The "subsidy" still holds true, but to a lesser extent, where reciprocal deductibility is extended by the State to the Federal levy; the Federal Government collects less revenue on the same income in a State with an income tax than in a non-income tax State. Thus the deductibility provision in the Federal law not only protects the taxpayer but also gives a substantial advantage to the income tax States. The advisability of this concession may be questioned but the deductibility feature applies equally to nearly all taxes and may be supported in addition on the ground that it encourages the States to maintain a progressive

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Table III-a

Percent of Net Income\* Required to Pay Federal and State Income Tax in California, Minnesota, New York and Pennsylvania at selected net income levels on assumption of reciprocal deductibility.

<u>Net Income</u>	California	Minnesota	New York	Pennsylvania
\$ 3,000	4.7	4.9	4.8	4.6
5,000	7.8	8.4	8.4	7.5
20,000	23.7	25.2	25.0	23.1
100,000	53.2	54.0	53.7	52.7
1,000,000	74.0	73.9	73.7	73.3
5,000,000	79.1	78.9	78.8	78.4

Table III-b

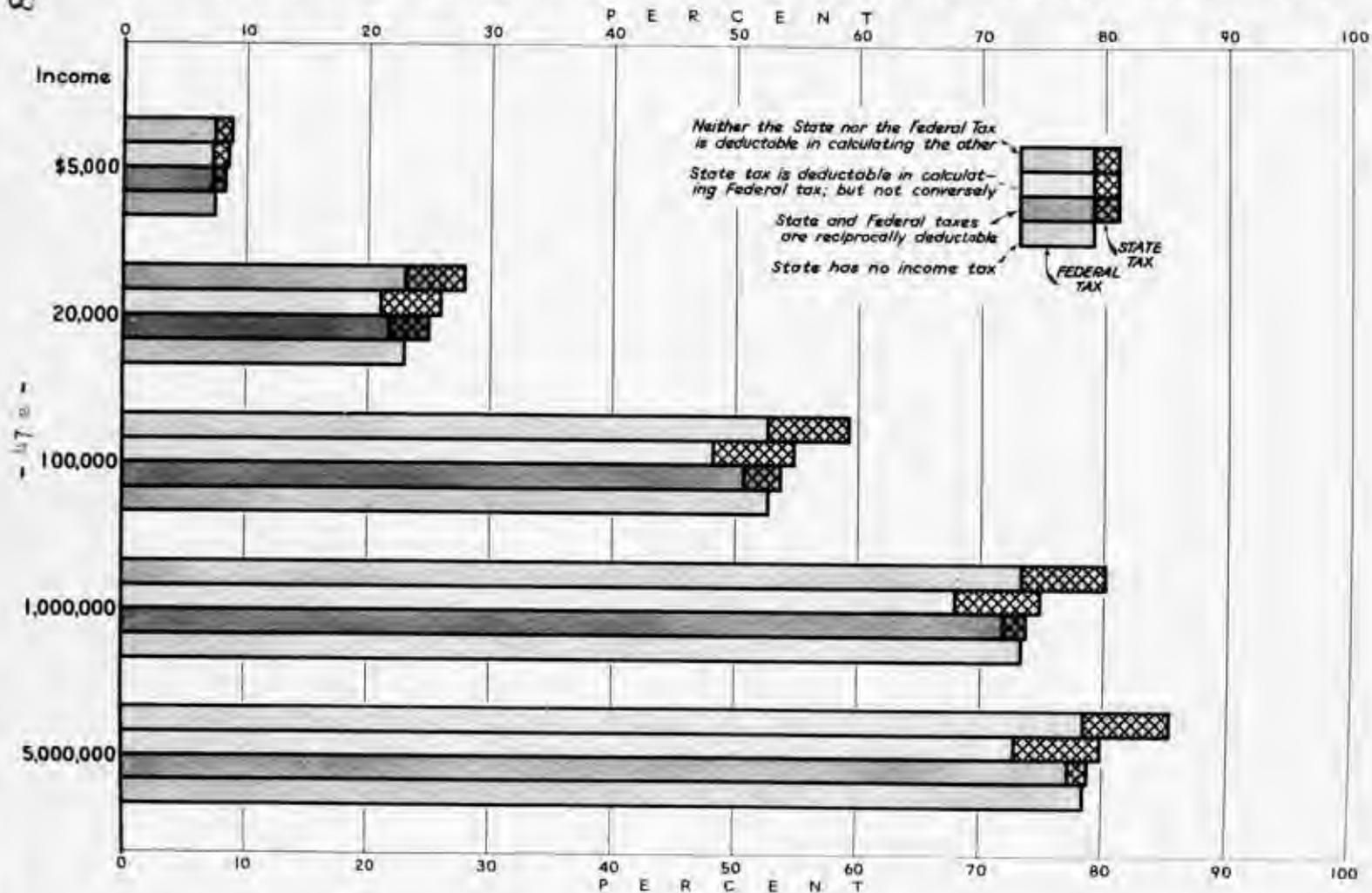
Percent of net income\*actually required to pay Federal and State Income Tax in California, Minnesota, New York and Pennsylvania, at selected net income levels.

<u>Net Income</u>	California	Minnesota	New York	Pennsylvania
\$ 3,000	4.8	4.9	4.9	4.6
5,000	7.9	8.4	8.6	7.5
20,000	24.2	25.2	26.0	23.1
100,000	55.2	54.0	54.8	52.7
1,000,000	76.3	73.9	74.8	73.3
5,000,000	81.3	78.9	79.8	78.4

\* The taxpayer is a married man without dependents; community property law in California disregarded.

INCOME TAX LIABILITY FOR A MARRIED MAN WITHOUT DEPENDENTS.  
 UNDER 1941 FEDERAL AND NEW YORK STATE RATES UNDER VARIOUS ASSUMPTIONS

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element in their tax systems.

Of the State tax collected on the \$20,000 income of a married man, without dependents, in Minnesota, a portion will come from the Federal Government in the sense that the Federal Government will collect less from this individual than it would if he lived in a non-income tax State; a portion will come from the taxpayer in that his total income tax bill will be greater in an income tax than in a non-income tax State. Under the 1941 law, the Federal share of the Minnesota State income tax on the \$20,000 income is calculated to be 42 percent and the taxpayer's share 58 percent (Table IV). This means that the Federal Government has in effect reduced the burden of the State income tax to the taxpayer by nearly half and that the State in effect has received this as a differential subsidy from the Federal Government.

The tables also indicate that the encroachment of the new Federal tax upon the State income tax base will be quite substantial in those States which allow the Federal tax as a deduction. It will not affect the other States (Table V). Whether or not, in the case of the former, the upward trend of State income tax receipts will persist, is a question which cannot now be answered.

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element in their tax systems.

Of the State tax collected on the \$20,000 income of a married man, without dependents, in Minnesota, a portion will come from the Federal Government in the sense that the Federal Government will collect less from this individual than it would if he lived in a non-income tax State; a portion will come from the taxpayer in that his total income tax bill will be greater in an income tax than in a non-income tax State. Under the 1941 law, the Federal share of the Minnesota State income tax on the \$20,000 income is calculated to be 42 percent and the taxpayer's share 58 percent (Table IV). This means that the Federal Government has in effect reduced the burden of the State income tax to the taxpayer by nearly half and that the State in effect has received this as a differential subsidy from the Federal Government.

The tables also indicate that the encroachment of the new Federal tax upon the State income tax base will be quite substantial in those States which allow the Federal tax as a deduction. It will not affect the other States (Table V). Whether or not, in the case of the former, the upward trend of State income tax receipts will persist, is a question which cannot now be answered.

Table IV

BREAKDOWN OF STATE INCOME TAX\* THAT WOULD BE PAYABLE IN CALIFORNIA, MINNESOTA AND NEW YORK UNDER 1941 AND 1940 FEDERAL RATES INTO PORTIONS PAID BY TAXPAYER AND BY FEDERAL GOVERNMENT, UNDER ASSUMPTION OF RECIPROCAL DEDUCTIBILITY

	CALIFORNIA			MINNESOTA			NEW YORK			CALIFORNIA		MINNESOTA		NEW YORK	
	Total	Federal share	Taxpayer's share	Total	Federal share	Taxpayer's share	Total	Federal share	Taxpayer's share	Federal share %	Taxpayer's share %	Federal share %	Taxpayer's share %	Federal share %	Taxpayer's share %
\$5,000 41 rates	0.1	0.0	0.1	0.3	0.0	0.3	0.2	0.0	0.2	0.0	100.0	0.0	100.0	0.0	100.0
\$3,000 40 rates	0.2	0.0	0.2	0.3	0.0	0.3	0.3	0.0	0.3	0.0	100.0	0.0	100.0	0.0	100.0
\$5,000 41 rates	0.4	0.1	0.3	1.0	0.1	0.9	1.1	0.2	0.9	25.0	75.0	10.0	90.0	18.0	82.0
\$5,000 40 rates	0.5	0.0	0.5	1.1	0.0	1.1	1.2	0.0	1.2	0.0	100.0	0.0	100.0	0.0	100.0
\$20,000 41 rates	1.1	0.5	0.6	3.6	1.5	2.1	3.3	1.3	2.0	45.0	55.0	42.0	58.0	39.0	61.0
\$20,000 40 rates	1.6	0.3	1.3	4.7	1.0	3.7	4.2	0.9	3.3	19.0	81.0	21.0	79.0	21.0	79.0
\$100,000 41 rates	1.4	0.9	0.5	4.1	2.8	1.3	3.0	2.0	1.0	64.0	36.0	68.0	32.0	67.0	33.0
\$100,000 40 rates	3.1	1.8	1.3	5.5	3.4	2.1	4.0	2.3	1.7	58.0	42.0	62.0	38.0	58.0	42.0
\$1,000,000 41 rates	3.5	2.8	0.7	2.8	2.2	0.6	1.9	1.5	0.4	80.0	20.0	79.0	21.0	79.0	21.0
\$5,000,000 41 rates	3.4	2.8	0.6	2.3	1.8	0.5	1.6	1.2	0.4	82.0	18.0	78.0	22.0	75.0	25.0

Table IV breaks down the percentage of the individual taxpayer's income payable to the state as income tax into two portions: the part "paid" by the individual taxpayer and the part "paid" by the Federal Treasury. Literally speaking, all of the state income tax is paid by the taxpayer. However, in this context "payment" is used in the sense of additional burden to the taxpayer. The latter pays that portion of the State tax which equals the excess of his total income tax bill (State plus Federal) over what his income tax bill would be in a non-income tax state. The Federal Government "pays" the remainder.

The taxpayer is a married man without dependents; community property law in California disregarded.

Table V-a

Per Cent of \$20,000 Income\*that would be payable as Income Tax to States of California, Minnesota and New York under 1941 and 1940 Federal Rates on Three Alternative Assumptions of Tax Deductibility.

Table V-b

Per Cent of \$100,000 Income\*that would be payable as Income Tax to State of California, Minnesota and New York under 1941 and 1940 Federal Rates on Three Alternative Assumptions of Tax Deductibility.

Table V-c

Per Cent of \$1,000,000 and \$5,000,000 Incomes\*that would be payable as Income Tax to States of California, Minnesota and New York under 1941 Federal Rates on Three Alternative Assumptions of Tax Deductibility.

	<u>Calif.</u>		<u>Minn.</u>		<u>N. Y.</u>	
	1941 Rates	1940 Rates	1941 Rates	1940 Rates	1941 Rates	1940 Rates
No Deductibility	2.0	2.0	5.7	5.7	4.9	4.9
State Tax Deductible	2.0	2.0	5.7	5.7	4.9	4.9
Reciprocal Deductibility	1.1	1.6	3.6	4.7	3.3	4.2

	<u>Calif.</u>		<u>Minn.</u>		<u>N. Y.</u>	
	1941 Rates	1940 Rates	1941 Rates	1940 Rates	1941 Rates	1940 Rates
No deductibility State Tax Deductible	7.7	7.7	9.1	9.1	6.6	6.6
Reciprocal Deductibility	1.4	3.1	4.1	5.5	3.0	4.0

	\$1,000,000			\$5,000,000		
	Calif.	Minn.	N.Y.	Calif.	Min.	N.Y.
No Deductibility State Tax Deductible	14.0	9.9	6.9	14.8	10.0	7.0
Reciprocal Deductibility	3.5	2.8	1.9	3.4	2.3	1.6

\* The taxpayer is a married man without dependents; community property law in California disregarded.

Other considerations supporting the mutual deductibility of income taxes paid are:

1. Since most jurisdictions allow most taxes as deductions in income tax laws, it would be difficult to justify an exception for net income taxes. To be sure, the net income tax deduction provided by the Federal law amounts in effect to a subsidy to the States. But in so far as other taxes are allowed as deductions to the person who bears their final incidence, the same argument can be made regarding the other taxes.

2. Net income after taxes is the true surplus out of which income taxes must be paid. The former is also the fairest base to use in comparing the ability to pay of one individual with that of another. For example, let us assume that A and B both have \$10,000 incomes before income taxes but that A, by some provision of State law, has to pay a \$1,000 State income tax while B does not. It is submitted that B has more ability to pay Federal income taxes than A and that most people when confronted with these facts would agree with this conclusion.

In so far as a consumer is able to deduct the excise taxes levied on the tobacco he smokes, the law in effect allows him an addition to his personal exemption for

living expenses. The income tax may be regarded as (1) an outlay (like any other professional or business expense) involved in the creation of income; (2) a utilization of income; (3) a transfer to provide a better distribution. Whichever of these views is taken, and they all have some validity, it is difficult to see how anything is gained by disallowing the deduction. It can be argued, of course, that income before all taxes should be the basis of income taxation. But this contention would make no adequate allowance for genuine differences among taxpayers and it would reduce the equity of the income tax.

3. It can be maintained that deductibility of income taxes is unnecessarily deceiving to the public; that the latter looks only at nominal rates and does not see the considerably lower effective rates which result from deductibility. This argument supposes that the public is intent on having the current nominal rates prevail as effective rates. Viewing the Federal and State tax systems separately, as the public is inclined to do, this may be true. But it is not at all clear that if the public were made to see the tax structure as one whole that it would not prefer the present combination of Federal and State nominal rates, with deductibility, over the same nominal rates minus deductibility.

4. The argument is likewise advanced that deductibility of Federal income taxes in State income tax laws tends to make the effective rates of the State laws regressive. This is equivalent to saying that State and Federal laws should be viewed and developed without regard for each other. It is such disregard which creates the problems of an uncoordinated revenue system.

5. Alternatives to the recommendation of mutual deductibility are not attractive. Disallowance of deductibility, particularly by the Federal Government, would create the two major difficulties mentioned above:

- a. It would leave grave dangers of confiscatory taxes;
- b. It would leave very large differentials in the total net income taxes paid by citizens located in different States.

Both of these major difficulties were featured by the recent Canadian Report 1/ as reasons for the elimination of Provincial income taxes in Canada. Both difficulties might be mitigated by agreement with the States to reduce the top rates of their schedules but this would involve complicated and uncertain arrangements and the degree of mitigation would probably be slight.

1/ Report of the Royal Commission on Dominion-Provincial Relations, 3 Volumes.

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It can, of course, be argued that the States should retire from the income tax fields for the emergency.

However, since the adequacy of State revenue is a concern of the Federal Government, and since there is also an interest in allowing as much fiscal independence to the States as possible, there is strong ground for avoiding a course which would call for the abandonment of the income tax by the States. Moreover, it may reasonably be expected that the States will take due account of the revenue requirements of the Federal Government and press their income tax programs no more than necessary. In the interest of maximum Federal revenues, State deductibility for Federal taxes might be encouraged. To be sure, developments not now foreseen may necessitate an alteration in these tentative conclusions.

Because of the deductibility features of Federal and State income tax laws, the Federal Government can and should feel free to order its war-time income tax schedules without much regard to present State levies or possible changes in the latter.

The above discussion relates to the personal rather than the corporate income tax but the relationships found in the case of the former apply also in the case of the latter.

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A somewhat similar situation in Canada has resulted in a program under which the Dominion proposes to pay the provinces to stay out of the income tax field for the emergency. However, the Canadian laws in several conspicuous cases provided no deductibility of taxes and resulted in possible confiscation or near-confiscation of income for some taxpayers. While the Canadian program does achieve maximum freedom for the national development of the tax in all brackets of income, the gains are quite dearly purchased.

It is possible that the Federal Government during the defense period may wish to tax tobacco or liquor so severely that the combination of Federal and State levies will prove embarrassing either to the industry involved or the consumer. But this prospect does not appear to be an immediately serious problem.

## APPENDIX A

Further Analysis of the Effects of Deductibility  
for Taxes in Federal and State Income Tax Laws

Table VI shows the percentage of a given income that is paid out as income tax under different circumstances. Four principles of classification are applied simultaneously:

1. Income bracket
2. State residence
3. Tax deductibility
4. Government jurisdiction

1. The incomes chosen for study are: \$3,000, \$5,000, \$20,000, \$100,000, \$1,000,000, \$5,000,000. The first four are considered under both the 1941 and 1940 Federal rates. Since the 1940 and 1941 rates are about equal at the million dollar level and above, only one calculation is made in these brackets. Throughout, we have assumed the income recipient to be married, with no other dependents.
2. The States studied are California, Minnesota, New York and Pennsylvania.

- a. California has the highest maximum State rate of 15 percent. The progression is gradual, reaching the top rate at the \$250,000 mark. The exemption for a married head of a family is \$2,500.

- b. Minnesota has a top rate of 10%, which is reached at \$20,000. The exemption used is \$2,000.
  - c. New York has a top rate of 7%, reached at \$9,000. The exemption is \$2,500.
  - d. Pennsylvania is a non-income tax State.
3. Three conditions of "tax deductibility" are considered.
- a. No deductibility. Under this assumption, neither the Federal Government nor the State allows the income tax paid to the other jurisdiction to be deducted from its own tax base.
  - b. Only the State tax is deductible. While the Federal Government permits in every instance the deduction of State income taxes from the Federal tax base, some States do not accord like treatment to Federal taxes. California and New York are examples of such States.
  - c. Reciprocal deductibility. The Federal Government allows State income taxes to be deducted from the Federal tax base and the State allows Federal income taxes to be deducted from the State income tax base. Minnesota is an example.

Statutory provisions are as stated. However, it is expedient to study the three States under identical conditions of tax deductibility, given their respective rate structures and exemptions.

4. The percentage of income payable as income tax to the State and Federal Government and the total of the two levies are calculated.

The computations are derived from the substitution of prevailing Federal and State tax rates in a pair of simultaneous equations: 1/

$$F = S, + \frac{I - (P_F + S + I,)}{r,} + \frac{I - (P_F + E_F + S)}{.04}$$

$$S = S,, + \frac{I - (P_S + E_S + F + I,,)}{r,,}$$

When I = Total Income less allowable deductions other than Federal and State income taxes paid.

$P_F$  = Federal personal exemption

$P_S$  = State personal exemption

$E_F$  = Federal earned income credit

$I,$  = Federal surtax net income below top bracket

$I,,$  = State tax base below top bracket

$S,$  = Federal surtax on  $I,$

$S,,$  = State tax on  $I,,$

$r,$  = Federal surtax rate on top bracket

$r,,$  = State rate on top bracket

$F$  = Federal tax

$S$  = State tax

1/ Formulae taken from Division of Tax Research Memoranda.

TABLE VI

PERCENT OF FEDERAL INCOME TAX WHICH IS PAID BY LOCAL TAXES, FEDERAL AND STATE,  
IN CALIFORNIA, MINNESOTA AND NEW YORK, UNDER 1941 AND 1940 FEDERAL RATES,  
SHOWING THREE ALTERNATIVE SITUATIONS OF TAX INCENTIVELY

		\$3,000			\$3,000			\$5,000			\$5,000			\$20,000			\$20,000			\$100,000			\$100,000			\$1,000,000			\$5,000,000		
		1941 Federal Rates	1940 Federal Rates	1941 Federal Rates																											
California	Total Tax	4.0	4.0	4.3	3.1	3.0	3.2	8.0	8.7	9.8	9.5	9.2	9.1	20.1	18.8	27.0	17.5	18.4	19.5	50.4	51.8	59.5	47.2	46.6	45.9	87.3	83.2	80.2	93.3	88.4	85.4
	Federal Tax	4.0	4.0	4.3	0.9	0.9	0.9	7.5	7.5	7.5	2.0	2.0	2.0	23.1	23.1	23.0	10.6	10.6	10.6	52.7	52.7	52.7	39.5	39.5	39.3	73.3	73.3	73.3	78.5	78.4	78.4
	State Tax	0.0	0.0	0.0	0.2	0.3	0.3	0.5	1.2	1.3	0.5	1.8	2.3	2.0	5.7	4.9	2.0	5.8	4.9	7.7	9.1	6.6	7.7	9.1	6.6	14.0	9.9	6.9	14.8	10.0	7.0
Minnesota	Total Tax	4.0	4.0	4.0	1.1	1.2	1.2	7.9	8.5	8.6	2.5	3.2	3.2	24.7	25.5	26.0	12.2	13.1	14.4	55.2	56.6	54.8	42.6	43.2	42.1	76.3	75.4	74.6	81.3	80.4	79.8
	Federal Tax	4.0	4.0	4.0	0.2	0.2	0.2	7.4	7.3	7.3	2.0	2.0	1.9	23.7	23.6	24.1	10.7	9.4	9.5	47.5	48.9	46.2	34.9	34.1	35.5	68.3	68.5	67.9	66.5	70.4	70.8
	State Tax	0.0	0.0	0.0	0.2	0.3	0.3	0.5	1.2	1.3	0.5	1.2	1.3	2.0	5.7	4.9	2.0	5.8	4.9	7.7	9.1	6.6	7.7	9.1	6.6	14.0	9.9	6.9	14.8	10.0	7.0
New York	Total Tax	4.7	4.9	4.6	1.1	1.2	1.0	7.6	8.4	8.4	1.8	3.1	3.0	33.7	25.2	25.0	11.9	14.3	13.9	53.8	54.0	53.7	40.8	41.6	41.0	74.0	73.2	73.7	79.1	76.9	76.8
	Federal Tax	4.0	4.0	4.0	0.9	0.9	0.9	7.4	7.4	7.3	2.0	2.0	2.0	28.0	21.6	21.7	10.3	9.6	9.7	51.7	49.9	50.7	37.6	38.1	37.0	70.5	71.1	71.8	75.7	76.6	77.2
	State Tax	0.7	0.9	0.6	0.2	0.3	0.1	0.2	1.0	1.1	0.5	1.1	1.0	1.1	3.6	3.3	1.6	4.7	4.2	1.4	4.1	3.0	3.1	3.5	4.0	3.5	2.8	1.9	3.4	2.3	1.6

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## VI. Other Defense-created Inter-governmental Fiscal Problems

### A. Cooperation in tax administration

Intergovernmental cooperation in the administration of overlapping taxes is an important field for future development about which more will be said in subsequent reports. Suffice it here to observe that some experimentation with intergovernmental cooperation is highly desirable as a war measure. Informal arrangements by which the States make use of Federal income tax facilities and income tax information are now extensive. The Federal Government might well make some use of the accumulated experience of the States in the administration of the income tax in the very low income brackets. A number of States have succeeded in so integrating diverse local industrial and governmental sources of information as to enable a comparatively effective collection of the income tax from the low income groups. This, admittedly, cannot be said of the Federal tax. More effective income tax collection at the low income levels is vitally important in the interest of public morale, especially at this time and the States are in position to facilitate the Treasury's efforts in that direction.

The new automobile use tax seemed to furnish the ideal opportunity for Federal-State collaboration in administration. However, the very impressive difficulties encountered

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by the Bureau of Internal Revenue when such program was contemplated serve principally to demonstrate the fact that such collaboration cannot be improvised successfully and would require long planning and careful arrangements as to detail. Among the difficulties encountered were different State collection dates, possible unwillingness of States to cooperate, absence of State and Federal authority for such arrangement without specific action by Congress and by the respective State legislatures, decentralized State administration, (in some cases), problem of bonding State officials, State political opposition. It seems probable that the Federal Government cannot rely on State administration in a case of this sort without more adequate means of holding the States accountable and without being in a position to administer the tax directly if the States fail to observe standards. More study will be given this experience as an excellent type case of possible Federal-State administrative collaboration.

With regard to the automobile use tax, an additional observation may be in order. Although the Federal Government has prior claim to the right-of-way in taxation during the defense period, it is exceedingly doubtful whether Federal invasion of a field long occupied by the States and their subdivisions and one well adapted to administra-

- 62 -

tion at the State and local level -- namely the automobile use tax -- accomplishes any useful purpose. This tax will be very difficult and costly to administer at the Federal level. Moreover, the Federal Government already imposes manufacturers' excises on motor vehicles and motor fuel.

The motor vehicle use tax leaves much to be desired from the point of view of equity as well. Available information on the estimated distribution of ownership of family automobiles by family income groups in 1935-6 indicates that almost 52 percent of the passenger cars were then owned by families with annual incomes of not more than \$1,500. A comparison of the \$5 automobile use tax with average 1940 automobile registration fees in the States reveals that the \$5 Federal use tax is equal to 27 percent of the average State registration fee in one State and 195 percent in another.

Available information on the estimated market value of passenger cars in use on December 31, 1939, indicates that the average value of the cars was then \$238 and that the \$5 use tax is equivalent to 2.1 percent of the average value of all passenger cars. More than half of the cars in use on December 31, 1939, had a value of less than \$173.

Data on the distribution of motor vehicles by community size classes indicates that more than half of the burden of the \$5 use tax will fall on communities with 10,000 persons or less and that 31 percent of the burden will fall on those living on farms and in unincorporated areas.

These equity considerations, together with the importance of the issue to wholesome Federal-State relations, indicates the desirability of immediately repealing the Federal automobile use tax.

B. Utilization of State and local surplus revenues during the defense period

As a result of improved economic conditions, lower welfare and capital expenditures, and reduced tax delinquency, some State and local governments will receive surplus revenues during the defense period. The disposition of these surplus revenues has an important bearing on the Government's efforts to prevent an inflationary rise in prices.

To the extent that the States and local units convert their surpluses into reserves, and more particularly to the extent they use these reserves to purchase United States Defense Bonds, a volume of purchasing power will be impounded and the inflationary pressure on prices correspondingly eased. <sup>1/</sup> In part, similar results will follow from the use of current revenues to reduce indebtedness. Although such action would return purchasing power to bondholders, the expenditures of the latter are not likely to be substantially increased thereby. While many municipalities are limited in their power to retire debt, they have substantial scope of such action with reference to short-term and floating obligations. Under some conditions, State and local governments may also find it possible and advisable to accumulate additional sinking funds for future bond payments. Such use of surpluses, in addition to easing the inflationary pressure on prices, would result in a general strengthening of the credit position of State and local governments, a factor which may be of great importance in the post-defense era.

The development of a non-negotiable bond subject to ready liquidation and otherwise adapted to the needs of state and

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<sup>1/</sup> The State of Washington has invested \$325,000 in Federal bonds, circumventing the \$50,000 maximum, it is said, by making the investment cover several independent State funds. It is suggested that "how Texas is going to handle its \$11,000,000 cash reserve which it is hoping to invest in the same patriotic manner is a mystery. Perhaps it will have to content itself as did rich Belleville, New Jersey, the first city to buy Defense Bonds, with a paltry \$50,000 purchase of so-called Series F." (Albert Lepawsky, "Impact of National Defense on State and Local Finances")

local reserve funds would stimulate the use of such funds and their investment in Federal securities.

If the improved financial condition of State and local governments resulted either in the reduction of taxes or in the increase of expenditures, consumer expenditures would be increased and the problems confronting the Government in the prevention of an inflationary price rise would be enhanced. A deliberate policy of reducing local expenditures to create a surplus is to be encouraged where the saving can be made through the improvement of administration and the elimination of waste. A reduction in public works expenditure by releasing labor and materials will facilitate defense. The maintenance of most local services at their present level, however, is essential in the interest of morale and productive efficiency.

During the defense period it will be necessary for the Treasury to borrow on a wide scale. In this connection, with a view to maximizing borrowing from individuals, the Treasury has promoted the sale of Defense Savings Bonds and Stamps. Many local governments have cooperated generously in this program. Such cooperation is very helpful and its continuation and expansion is desirable.

State governments can facilitate the defense effort also by assuming some further responsibility for special or general aid to the defense-affected cities, many of which have appealed to the Federal Government for assistance in providing the necessary services for new defense workers and their families.

C. State and local interest in an anti-inflation program

Although the present danger of inflation and the measures necessary to prevent it are subjects not directly within the mandate of the coordination study, they are indirectly very much involved. This is true because inflation would greatly upset the equilibrium of State and local finances and because the new taxes which have been and may be inaugurated to cope with inflation have an important bearing on the present and the future distribution of the over-all tax load.

Regarding the effect of inflation on State and local finances, the experience during the last war is illuminating. Because of rapidly rising prices, State and local governments found that the materials required for operation and construction had become much more expensive. Employees presented well-supported demands for increases in pay. Due to these facts (and also to the increase in the volume of services) total gross State and local governmental expenditures increased 186 percent from 1913 to 1923. The average increase per year was 18.6 percent. By way of comparison, the increase during the expansionary period of the middle and late twenties (1923-1929) averaged 8.2 percent per year.

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## State and Local Expenditures, 1913 and 1923

	Reported expenditures			
	Amount, in millions		Per capita	
	1913	1923	1913	1923
State	\$ 383	\$1,244	\$ 3.97	\$11.14
Local	1,844	5,136	19.10	45.98
Total	\$2,227	\$6,380	\$23.07	\$57.12

Source: National Industrial Conference Board, Cost of Government in the U.S. 1926-27, New York 1928, p. 2.

A large part of the war-period increases in State and local costs were borne by those paying general property taxes. Between 1912 and 1922, assessed values, property tax levies and tax rates recorded the following increases:

	1912	1922	% Increase
Assessed values subject to State and local general property taxes (000 omitted)	\$69,452,936	\$124,616,675	79.4
All general property tax levies (000 omitted)	1,349,841	3,503,725	159.6
Average tax rate per \$100 assessed value	1.94	2.81	44.8
Per capita general property tax levies	13.91	32.23	131.7

Choosing a few States for which data are conveniently available, the increases in property taxation were as follows:

Percentage Increases in State and Local Property Tax Levies, Assessments and Average Rates for Selected States, 1916 - 1921.

<u>States</u>	<u>Levies</u>	<u>Assessments</u>	<u>Rates</u>
Wisconsin	104.77%	40.73%	
New York	65.52	28.74	
Iowa	94.28	14.5	
West Virginia	137.9	30.6	82%
Ohio	-	-	54.18%

Sources:

- Report of the Wisconsin Tax Commission to the Governor and Legislature - Madison, Wisconsin, 1930, p. 44.  
 Annual Report of the State Tax Commission, New York, 1923, J. B. Lyon, Albany, New York, 1924, p. 126.  
 State Board of Assessment and Review - Annual Report, State of Iowa, Des Moines, 1938, pp. 272-4.  
 9th Biennial Report of the State Tax Commissioner of West Virginia, Charleston, W. Va., 1922, p. 453.  
 11th Annual Report - The Tax Commission of Ohio, Springfield, 1921, p. 15.  
 20th Annual Report - The Tax Commission of Ohio, Springfield, 1930, p. 16.

Thus, in two of the above States property tax levies more than doubled in the brief space of six years, and in a third the amount nearly doubled. Since assessments did not rise nearly as rapidly as levies, very substantial increases in rates were necessary, involving in one case a more than 80 percent increase. The new rates and levies

did not drop to their former level at the close of the War. With some exceptions during the depression of the thirties they continued to increase, although the increases have been more moderate than in the inflationary period of World War I. 1/

1/ Available data on average farm real estate taxes for the entire period also serve to illustrate the rising trend of general property taxes in the War period and the failure of these taxes to decline in the post-war period.

Farm Real Estate Taxes Per Acre and Per \$100 of Full Value

<u>Year</u>	<u>Farm Real Estate Taxes Per Acre</u>	<u>Farm Real Estate Taxes Per \$100 of Full Value</u>
1909-13 Average	\$ .21	\$ .50
1913	.24	.55
1914	.24	.56
1915	.26	.57
1916	.28	.57
1917	.31	.58
1918	.33	.57
1919	.41	.59
1920	.51	.79
1921	.54	.94
1922	.54	.96
1923	.55	1.01
1925	.56	1.07
1929	.58	1.19

Source: U. S. Dept. of Agriculture - Year Book of Agriculture 1935, pp. 688-691 and U.S.D.A. - Agricultural Statistics, 1940, pp. 587-88.

In 1916, the property tax was a relatively elastic source of revenue and could stand this increased burden without undue strain. Pre-war rates were much higher at the beginning of this war emergency than in 1913.

Tax delinquencies were a negligible problem at the earlier date since there had been a period of relative prosperity, generally rising land values and real estate development. In 1941, although current collection ratios are vastly improved, many cities and rural units of government still have substantial delinquent tax arrears left over from the serious delinquency cycle of the Thirties. Many rates are at very high levels and close to legal limits. Other local units have reduced property tax rates in the course of depression campaigns for property tax relief and State replacement revenues, but lowered tax limits will restrict flexibility in their use of the property tax. In other cases, the local base of taxable property is seriously narrowed by homestead exemptions and other exemptions, and rates on remaining taxable property are already high. Real estate values have not increased greatly after a long period of depression. Assessed values were slowly reduced in this period and are still relatively high in many areas. Adjustments to any increase in market values will be made slowly.

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The property tax increases of the last war period and post-war period were due to a combination of the following causes:

1. continuing upward trend in Governmental services;
2. lags in values, assessments, and collection during the inflation period;
3. inertia of rates and levies during the post-war deflation.

Thus the States and their local units have more to fear from inflation in 1941 than they had in 1917; their tax resources are more fully utilized and there is less leeway for increases in taxation, particularly property taxation. A severe inflation at the present time might render it extremely difficult to sustain State and local governmental services. The experience under the inflation of the World War period was such as to recommend a prevention of a repetition of the experience, if possible.

D. Preparation of a Public Works Program for the Post-Defense Era

Although this report is devoted exclusively to the problem of Federal-State-local fiscal relations during the present emergency, it seems proper to include a problem of the post-war period in so far as the latter requires action before the emergency expires. While the nature of the post-defense era is difficult to predict, it seems

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highly probable that it will involve grave problems of unemployment attending the transition from a war to a peace economy. The problem may be augmented both as to time and degree by the reappearance of those tendencies toward under-investment and under-consumption which proved so troublesome during the Thirties. These problems will be discussed in greater detail in later reports but here it may be observed that it is of the greatest importance to do some advance planning of ways and means to combat post-defense unemployment. This advance planning should include not only such general studies of the problem as are now going on but also the accumulation of very specific blue prints of projects. The latter is exceedingly important for the reason that it takes time to put public works projects into operation and time may be an exceedingly important factor in reducing post-defense confusion and demoralization. Legislation now before Congress calls for an agency and an appropriation "to prepare, develop, and maintain a reservoir of projects \* \* \* to be ready for prosecution when the need arises." 1/ While some efforts toward a works reserve have already been made, they are far from adequate. Some legislation of this sort should be enacted soon. The more complete and definite the plans which can be developed, the greater will be our security in the post-war period.

- S - 1833 A Bill to promote the general welfare of the Nation by providing work on public projects to persons in need of employment, and for other purposes.
- S - 1617 To Amend the Employment Stabilization Act of 1931.



Office of the Attorney General  
Washington, D. C.

January 1, 1942

Dear Henry:

With reference to Lauchlin Currie's letter of December 11 with the attached memorandum to the President with respect to Louis Johnson's statement in New York, I am enclosing you a confidential memorandum from the Federal Bureau of Investigation. It seems to me unnecessary to make any further investigation.

I return the letter and the memorandum.

Sincerely yours,

*From Currie*

The Honorable

The Secretary of the Treasury

Copy to Mr. Currie

FEDERAL BUREAU OF INVESTIGATION  
United States Department of Justice  
Washington, D. C.

PERSONAL AND  
CONFIDENTIAL

December 30, 1941

MEMORANDUM FOR THE ATTORNEY GENERAL.

With reference to the note addressed to the Secretary of the Treasury under date of December 11, 1941, by Mr. Lauchlin Currie which concerned an off-the-record address made in New York by Louis Johnson, and in accord with your request, I have had a most discreet investigation conducted for the purpose of determining the source from which Louis Johnson obtained the material which he used in this address.

When Louis Johnson was interviewed, under appropriate pretext, concerning this publication he indicated that the material which he utilized had not been obtained by him directly from either the War or Navy Departments but represented the "consensus" of the best thought which was current in Washington about the Pearl Harbor attack. For your confidential information Mr. Johnson was approached through an outside party in such a manner as to encourage Johnson to disclose completely and fully any and all information in his possession, with particular reference to the sources of his information. Johnson talked freely concerning the material which he utilized in his talk in New York and indicated that out of the conflicting rumors and reports which were prevalent in Washington generally, he had pieced together certain fundamental facts which appeared sound and had utilized these facts in his address.

Johnson was encouraged to contribute material to the person who interviewed him in order to carry out certain objectives which Johnson indicated were controlling his public addresses and operations. Johnson indicated that he was particularly anxious to do everything possible to speed up production and in the course of the interview conducted with him, it was indicated that the interviewer's fundamental purpose was to assist Johnson in his efforts in behalf of speeding up production. Johnson indicated to the interviewer, however, that he had absolutely no source of information within the War or Navy Departments and had as a matter of fact refrained from making any contacts in those departments since he had left the War Department. Johnson indicated that any information which he might furnish to the interviewer would be predicated upon discussions, rumors and gossip which reached Johnson and that consequently the interviewer would have to evaluate the information furnished by Johnson very carefully in order to determine its accuracy and reliability.

Johnson indicated further to the interviewer that he would participate only in any program which was definitely on the constructive

Memorandum for the Attorney General

2.

side and that he would not have anything to do with any publication or utterance which was critical of the President or ranking officers of the Army and Navy.

Unless you desire further inquiries in this case, I do not anticipate any further action.

I am returning herewith the letter of December 11, 1941, addressed to Mr. Morgenthau by Mr. Currie, together with the enclosure referred to therein.

Respectfully,

s/s J. Edgar Hoover

John Edgar Hoover  
Director

Attachment

118

THE WHITE HOUSE  
WASHINGTON

December 11, 1941.

Dear Mr. Secretary:

You may be interested in the attached report on a meeting I attended last night.

What I perhaps should have added is that too many of the business men present are still fighting the wrong enemy -- the New Deal, labor, and, obliquely, the President.

Sincerely yours,



Lauchlin Currie

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

December 11, 1941.

MEMORANDUM FOR THE PRESIDENT:Re: Dissemination of war information by Louis Johnson.

Stacy May and I flew up to New York last evening to attend a dinner meeting of some eighty or ninety important industrialists. Louis Johnson was there. He told me he was going to give the low-down on Hawaii. I advised him strongly not to. When it came to his turn to speak he said that since it was an off-the-record meeting he would communicate to them what he had learned in Washington the day before. He made the following allegations:

1. Our losses were three battleships and seven cruisers.
2. The fleet was bottled up by mines and the West Virginia was lost by hitting a mine.
3. Out of sixty PEY's, only two were left.
4. The Japs came in after the completion of the dawn patrol.
5. Two German battleships were with the Japs.
6. American bombers flying to Hawaii were shot down over the field, since they had grease in their guns instead of ammunition.
7. Naval supremacy had passed to the Japs.

He was followed immediately by a Dr. Stolper, former Budget Director of the German Reichstag, who gave a completely defeatist speech, predicting that both China and Russia would come to an agreement with their Axis foes. He even suggested that we had backed the wrong horse in the Far East and that we should have strung along with Japan.

I got very hot under the collar and went after them both hard for their defeatism, and reminded Johnson in particular of what you had said about the dissemination of stories giving assistance to the enemy. He retorted that this was a closed meeting and that people had a right to know, and went on to intimate that an important portion of the German air fleet was now operating in Japan.

In view of this performance I feel that something should be done to prevent Johnson's continued access to information at the War Department.

Lauchlin Currie

LC:ma

**TREASURY DEPARTMENT**

**INTER OFFICE COMMUNICATION**

**120**

**DATE** January 1, 1942

**TO** Mr. Graves  
**FROM** Mr. Callahan *W*

In response to your two questions, there are approximately fifteen more citations coming along for participation in the "Treasury Hour". When these are signed it will clear up all citations in connection with this program.

There will be a continuance of citations for the two programs "For America We Sing" and "America Preferred". These run three or four a week.

The citations are awarded (1) to artists who volunteer their services to the "Treasury Hour" or other Treasury programs, and (2) to persons performing unusual service for the Treasury in connection with radio. In each case there is a definite contribution on the part of the person receiving the citation.

New Years Day, 1942.

UNITED STATES SENATE  
Washington, D.C.

Dear Secretary Morgenthau:

Yes I will cooperate as you request.

Any time that Mr. Julian Street Jr. finds convenient will suit me. A telephone call before he starts might expedite our meeting.

Pardon this holiday mode of writing and accept my best wishes.

Sincerely,

/s/ Warren W. Austin

## UNITED STATES SAVINGS BONDS

Sales Since May 1, 1941, by Months  
On Basis of Issue Price

(In thousands of dollars)

Month	Series E			Series F	Series G	Total
	Post Offices	Banks	Total			
May	\$ 42,836	\$ 57,745	\$ 100,581	\$ 37,817	\$ 211,420	\$ 349,818
June	40,788	61,729	102,517	28,876	183,134	314,527
July	50,558	94,717	145,274	27,359	169,498	342,132
August	40,725	76,878	117,603	20,318	127,685	265,606
September	38,117	67,123	105,241	18,099	108,987	232,327
October	41,634	81,250	122,884	22,963	124,866	270,713
November	37,997	71,478	109,475	18,978	105,035	233,487
December	<u>103,154</u>	<u>237,930</u>	<u>341,085</u>	<u>33,272</u>	<u>154,242</u>	<u>528,599</u>
Total	<u>\$395,811</u>	<u>\$748,350</u>	<u>\$1,144,560</u>	<u>\$207,682</u>	<u>\$1,184,867</u>	<u>\$2,537,210</u>

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

January 1, 1942.

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

Comparative Statement of Sales During  
October, November and December, 1941

On Basis of Issue Price

(Amounts in thousands of dollars)

Item	Sales			Amount of Increase or Decrease (-)		Percentage of Increase or Decrease (-)	
	December	November	October	December over November	November over October	December over November	November over October
Series E - Post Offices	\$103,154	\$ 37,997	\$ 41,634	\$ 65,157	-\$ 3,637	171.5%	- 8.7%
Series E - Banks	<u>237,930</u>	<u>71,478</u>	<u>81,250</u>	<u>166,452</u>	- <u>9,772</u>	<u>232.9</u>	- <u>12.0</u>
Series E - Total	341,085	109,475	122,884	231,610	- 13,409	211.6	- 10.9
Series F - Banks	33,272	18,978	22,963	14,294	- 3,985	75.3	- 17.4
Series G - Banks	<u>154,242</u>	<u>105,035</u>	<u>124,866</u>	<u>49,207</u>	- <u>19,831</u>	<u>46.8</u>	- <u>15.9</u>
Total	<u>\$528,599</u>	<u>\$233,487</u>	<u>\$270,713</u>	<u>\$295,112</u>	- <u>\$37,226</u>	<u>126.4%</u>	- <u>13.8%</u>

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

January 1, 1942.

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 - December 1941  
 On Basis of Issue Price  
 (In thousands of dollars)

Date	Post Office Bond Sales	Bank Bond Sales				All Bond Sales			
		Series E	Series F	Series G	Total	Series E	Series F	Series G	Total
December 1941									
1	\$ 2,976	\$ 3,904	\$ 1,333	\$ 7,220	\$ 12,458	\$ 6,880	\$ 1,333	\$ 7,220	\$ 15,434
2	1,229	2,592	623	5,750	8,964	3,821	623	5,750	10,193
3	1,510	2,734	870	5,289	8,893	4,244	870	5,289	10,403
4	2,411	4,036	726	7,530	12,292	6,447	726	7,530	14,703
5	2,015	4,805	1,152	12,357	18,314	6,820	1,152	12,357	20,329
6	1,001	2,293	656	2,776	5,725	3,294	656	2,776	6,726
8	3,282	4,764	1,011	3,810	9,585	8,046	1,011	3,810	12,866
9	1,828	3,877	601	4,996	9,475	5,706	601	4,996	11,304
10	1,651	3,566	491	2,612	6,668	5,217	491	2,612	8,320
11	1,909	4,763	719	3,423	8,905	6,672	719	3,423	10,814
12	2,773	5,012	658	3,768	9,437	7,785	658	3,768	12,211
13	2,767	5,030	584	2,120	7,734	7,798	584	2,120	10,501
15	7,185	11,679	1,022	4,462	17,162	18,864	1,022	4,462	24,347
16	2,113	3,956	893	1,901	6,750	6,069	893	1,901	8,863
17	4,164	9,750	1,180	6,327	17,257	13,914	1,180	6,327	21,421
18	5,382	11,630	1,337	6,826	19,793	17,012	1,337	6,826	25,175
19	5,995	10,205	1,172	5,214	16,591	16,201	1,172	5,214	22,586
20	4,091	11,890	1,270	5,921	19,081	15,981	1,270	5,921	23,172
22	10,916	23,269	2,490	8,067	33,826	34,185	2,490	8,067	44,742
23	4,393	10,642	1,972	6,831	19,445	15,035	1,972	6,831	23,838
24	3,613	13,085	1,629	8,900	23,613	16,698	1,629	8,900	27,226
26	9,593	29,934	3,536	10,076	43,547	39,527	3,536	10,076	53,140
27	3,503	6,412	530	3,255	10,197	9,915	530	3,255	13,700
29	8,852	24,247	3,060	10,353	37,661	33,100	3,060	10,353	46,513
30	3,460	7,283	1,450	5,382	14,115	10,743	1,450	5,382	17,575
31	4,540	16,571	2,307	9,077	27,956	21,112	2,307	9,077	32,496
Total	\$103,154	\$237,930	\$ 33,272	\$154,242	\$425,444	\$341,085	\$ 33,272	\$154,242	\$528,599

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

January 1, 1942.

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

Comparative Statement of Sales During  
Last Twenty-three Business Days of December, November and October 1941  
(October 6-31, November 1-29, December 4-31)  
On Basis of Issue Price

(Amounts in thousands of dollars)

Item	Sales			Amount of Increase or Decrease (-)		Percentage of Increase or Decrease (-)	
	December	November	October	December over November	November over October	December over November	November over October
Series E - Post Offices	\$ 97,439	\$ 37,997	\$ 34,894	\$ 59,442	\$ 3,103	156.4%	8.9%
Series E - Banks	<u>228,701</u>	<u>71,478</u>	<u>70,441</u>	<u>157,223</u>	<u>1,037</u>	<u>220.0</u>	<u>1.5</u>
Series E - Total	326,140	109,475	105,335	216,665	4,140	197.9	3.9
Series F - Banks	30,446	18,978	19,133	11,468	- 155	60.4	- 0.8
Series G - Banks	<u>135,983</u>	<u>105,035</u>	<u>99,548</u>	<u>30,948</u>	<u>5,487</u>	<u>29.5</u>	<u>5.5</u>
Total	<u>\$492,568</u>	<u>\$233,487</u>	<u>\$224,016</u>	<u>\$259,081</u>	<u>\$ 9,471</u>	<u>111.0%</u>	<u>4.2%</u>

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

January 1, 1942.

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.

**TREASURY DEPARTMENT****CONFIDENTIAL****INTER OFFICE COMMUNICATION****126**

DATE January 1, 1942

TO Secretary Morgenthau  
FROM Mr. Haas  
Subject: Supply of Series E Savings Bonds in the Field

1. Attached to this memorandum are (1) a chart and table showing the number of days' supply of Series E savings bonds in the field, (2) a table summarizing telegrams received this morning showing the number of bonds requisitioned by sales agents that the Federal Reserve Banks and the Post Office Department's central office and were unable to fill last night, and (3) a table showing the number of bonds delivered each day since December 1 by the Bureau of Engraving and Printing.

2. Some progress in liquidating local shortages of bonds in the field was made yesterday. A comparison of the tables attached with the tables submitted to you yesterday shows that unfilled requests for savings bonds declined 90,000 pieces of all series.

3. The situation should improve further tomorrow and Saturday due to the fact that the Bureau of Engraving and Printing expects to turn out approximately 400,000 pieces today and tomorrow, while sales reported on New Year's Day are likely to require a relatively small number of pieces.

Attachments

Number of days supply of Series E Savings Bonds on hand, December 1 to date

(Based on sales of \$300 millions per month)

Date	Denomination				
	\$25	\$50	\$100	\$500	\$1,000
December 1	23.0	44.1	29.5	74.5	64.0
2	23.6	44.1	29.8	76.0	65.5
3	23.9	44.1	30.4	77.6	67.0
4	24.0	43.8	31.2	78.9	68.3
5	24.0	43.6	31.9	78.3	67.7
6	23.8	43.3	31.6	78.1	67.5
7	23.8	43.3	31.6	78.1	67.5
8	23.7	42.9	32.2	77.4	66.8
9	23.4	42.7	33.0	76.9	66.3
10	23.3	43.2	33.9	76.4	65.8
11	23.2	43.3	34.6	76.8	66.2
12	23.6	42.6	35.2	76.1	71.1
13	24.4	42.0	34.8	78.3	73.2
14	24.9	42.0	36.6	87.9	73.2
15	24.3	40.3	35.0	101.5	71.5
16	24.1	39.8	37.6	101.0	79.4
17	24.1	38.6	36.4	99.8	106.9
18	23.7	37.1	34.9	98.3	105.5
19	23.8	35.7	33.5	96.9	104.1
20	24.3	36.0	32.1	95.5	102.7
21	26.5	38.4	32.4	95.5	102.7
22	25.6	37.9	30.1	92.6	99.7
23	26.5	39.3	29.7	91.3	98.4
24	27.8	40.5	28.9	89.8	97.0
25	30.6	43.1	29.8	89.8	97.0
26	29.4	41.3	27.4	86.4	93.5
27	31.6	40.4	27.8	87.4	94.5
28	34.1	43.0	29.3	89.4	96.4
29	33.8	43.2	27.8	88.4	95.4
30	35.3	45.6	28.3	89.4	96.3
31	36.5	45.7	27.9	89.5	96.3

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

Agents' requests for savings bonds unfilled at the close  
of business, December 31, 1941

(In thousands)

	Denomination					Total
	\$25	\$50	\$100	\$500	\$1,000	
<b>Federal Reserve Banks</b>						
Boston	48	17	32	4	2	103
New York	-	38	53	3	-	94
Philadelphia	-	-	4	-	-	4
Cleveland	-	6	9	1	-	16
Richmond	6	6	10	2	-	24
Atlanta	6	2	3	-	-	6
Chicago	135	60	60	13	-	268
St. Louis	4	6	7	-	-	17
Minneapolis	-	5	-	-	-	5
Kansas City	27	19	18	4	-	68
Dallas	2	-	-	-	1	3
San Francisco	22	11	1	-	-	34
Post offices	-	92	95	-	-	187
<b>Total</b>	<b>250</b>	<b>262</b>	<b>292</b>	<b>25</b>	<b>3</b>	<b>829</b>

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

Number of pieces produced December 1, 1941 to date  
(In thousands)

Day	Denomination					Total all denominations
	\$25	\$50	\$100	\$500	\$1,000	
December 1	75	10	25	10	10	130
2	75	10	25	10	10	130
3	60	10	40	10	10	130
4	50	10	50	10	10	130
5	50	10	50	-	-	110
6	-	-	-	-	-	-
7	-	-	-	-	-	-
8	50	10	50	-	-	110
9	15	10	50	-	-	75
10	30	30	50	-	-	110
11	40	20	50	5	5	120
12	80	-	50	-	30	160
13	121	-	10	15	15	161
14	44	-	70	50	-	164
15	80	-	-	80	-	160
16	28	-	120	-	45	193
17	92	-	-	-	155	247
18	92	-	-	-	-	92
19	120	-	-	-	-	120
20	150	50	-	-	-	200
21	175	75	10	-	-	260
22	160	75	25	-	-	260
23	180	85	35	-	-	300
24	220	80	25	-	-	325
25	225	80	35	-	-	340
26	180	50	40	-	-	270
27	240	-	50	10	10	310
28	200	80	55	10	10	355
29	205	95	55	10	10	375
30	200	100	55	10	10	375
31	240	60	55	10	10	375

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

AT THE WHITE HOUSE  
WASHINGTON

January 1st, 1942.

My Dear Mr. Morgenthau,

Thank you so much for your Christmas greetings, and for sending me such an interesting collection of records which I look forward to playing when I get back to my gramophone at home.

Yours truly,  
Franklin D. Roosevelt

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

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

131

DATE January 1, 1942.

TO Secretary Morgenthau  
FROM H. D. White

Sir Frederick Phillips called at three o'clock on December 31 at his request. He submitted to Mr. White a copy of a letter which he had received from Under Secretary of War Patterson informing him that the War Department was going to pay the British Government cash for the planes it had taken from the British. No sum was mentioned in the letter and Sir Frederick did not know but thought it would be somewhere between \$120 million and \$200 million.

Sir Frederick also submitted a memorandum dealing with the possible sale of ship-building plant facilities for consideration by the Treasury. Both memoranda are appended. *See also the Memorandum Cover 112 to which memo is att.*

Mr. White stated that he would take both the matters up with the Secretary and was sure the Secretary would be pleased with the letter Sir Frederick received from Mr. Patterson.

There is also appended a letter from Sir Frederick to Secretary Morgenthau, expressing Sir Frederick's appreciation of Secretary Morgenthau's efforts in the matter.

Attachments

Willard Hotel,  
Washington, D.C.,  
December 31, 1941.

Dear Mr. Secretary,

With reference to our conversation last week, I enclose copy of a letter from Mr. Patterson, and wish to express my hearty thanks for your invaluable help.

Yours sincerely,

*F Phillips*

The Honourable

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

C  
O  
P  
YWAR DEPARTMENT  
OFFICE OF THE UNDER SECRETARY  
WASHINGTON, D.C.

December 27, 1941.

Sir Frederick Phillips,  
British Supply Council,  
Willard Hotel,  
Washington, D.C.

My dear Sir Frederick:

I refer to our recent telephone conversation relative to remunerating the United Kingdom for aircraft contracted for by it and which were recently taken over by the United States.

At the moment it seems impossible to reach a definite conclusion as to the actual money value of the articles taken. This reaction was subscribed to by personnel in the Air Corps and in the British Purchasing Commission.

This is to inform you that it is the definite intention of the War Department to make payment at the earliest practicable date in United States dollars for the amount found to be due.

Sincerely yours,

(SGI) ROBERT P PATTERSON,  
Under Secretary of War

## TREASURY DEPARTMENT

134

## INTER OFFICE COMMUNICATION

DATE January 1, 1942

TO Secretary Morgenthau  
FROM H. D. White

Mr. Gromyko of the Russian Embassy called on me yesterday afternoon at his request. He stated that his Government had instructed him to arrange if possible with the U. S. Treasury for a sale of \$20 million of gold for future delivery. The terms to be similar to the previous sale, i. e., gold to be delivered within 180 days. Mr. Gromyko stated that the dollars resulting from the sale of gold were to be used by the Russian Government for purchases in the United States.

I told Mr. Gromyko that I would take up the matter with the Secretary at the first opportunity and would let Mr. Gromyko know.

The Russian Government still has to deliver \$9,800,000 of gold against the previous advance of \$30 million. The last delivery was on December 10. Final delivery against that advance has to be made by April 8, 1942.

Mr. Gromyko stated that all their dollar payments which were due up to a few days ago have been met or provided for, largely with the aid of a receipt of \$21 million from the Army and Navy which repurchased some of their old dollar purchases.

At the close of business December 31, the cash balances of various Soviet Government agencies in the Chase Bank, the Federal Reserve Bank, and the Manufacturers Trust Company, amounted to \$34.3 million. Of this amount, more than \$30.7 million were committed against orders placed in the past, leaving an unobligated balance of less than \$3.6 million.

They need \$20 million to pay for goods which they are purchasing outside of the Protocol. He says, for example, they are about to purchase 4,000 tractors; and other items are constantly coming up. He did not know how long the \$20 million would last, but he said they need some dollars very soon.

*H. D. White*

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*Mr Cochran's voluminous report returned to Mr White for files*

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE January 1, 1942

TO Secretary Morgenthau  
FROM Mr. White

*[Handwritten signature]*

1. There is appended a summary (prepared by Mr. Friedman of my Division) of Mr. Cochran's report on his trip to China. Though many portions of the report are either of little importance or out of date because of the war, I think that you ought to read the whole summary.
2. The points made in Mr. Cochran's report which I believe will be of special interest to you are:
  - (a) Mr. Cochran promised the Chinese Government officials, including the Generalissimo and Dr. Kung, that the Treasury would gladly send out further personnel, if additional American assistance was required.
  - (b) K. P. Chen in his conversation with Mr. Cochran indicated his desire to withdraw from the Stabilization Board. Mr. Cochran says that he is sure that Mr. Chen would really like an invitation to the United States in connection with financial transactions which would give him a nice way off the Board and a nice leave-taking from you.
  - (c) Mr. Cochran, in Hong Kong and Chungking, emphasized that he believed it was vital for National China to maintain at least existing contacts with Shanghai and that the initiative for severing such relations should not come from Chungking.
  - (d) Dr. Kung made certain specific proposals on which he requested United States cooperation. These included:
    1. The setting up by the United States Treasury of a new and separate fund in United States dollars to constitute a reserve backing for Chinese currency.
    2. The consolidation of the last three, or perhaps four, of the American Export-Import bank loans to China, extending the term and increasing the amount.

3. Providing China with a few airplanes capable of transporting valuable ores from the interior to the coast.
- (e) The Generalissimo in one of his talks with Mr. Cochran stressed the need of a definite plan for economic assistance to China and said that the assistance should come within three months.
3. The various proposals referred to in Mr. Cochran's report are being studied here and the necessary memoranda are being prepared. After these proposals have been adequately analyzed and discussed within the Treasury they will be brought to your attention.
  4. Mr. Cochran has recommended that copies be given to Messrs. Bell, Foley, White, Livesey, Knoke and Mr. Pehle, when your approval is obtained.

## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE December 31, 1941

TO Mr. White

FROM Mr. Friedman

Subject: Summary of Mr. Cochran's report on his trip to China.

I. Trip to Hong Kong, September 26 - October 9

Mr. Cochran left Washington on September 26, 1941. On September 27, he arrived at San Francisco, where he discussed problems of the Far East with Mr. Ira S. Clark, Vice President temporarily in charge of the Federal Reserve Bank of San Francisco. In company with Sir Otto Niemeyer, Mr. Cochran left San Francisco on September 28 and arrived in Honolulu the next day. In Honolulu, Mr. Cochran discussed current problems with the Foreign Funds Control staff.

Mr. Cochran left Honolulu on October 4 and arrived at Manila on October 5. There, Mr. Cochran discussed technical problems arising under freezing control and operations of the Stabilization Board with the Foreign Funds Control staff and with the High Commissioner and members of his staff. Mr. Cochran recommended a weekly report of the Control's activities.

II. First stay in Hong Kong, October 9 - 15

On October 9, Mr. Cochran went to Hong Kong. In addition to meeting many people, including Consul General Southard; Treasury representative Nicholson; Mr. Cyril Rogers, Financial Adviser to the Government of Hong Kong; the members of the Stabilization Board; Mr. Baxter, Financial Adviser to Government of Burma, and Sir Mark Young, the Governor-General, Mr. Cochran discussed with Mr. Fox and the other members of the Board, and with the British visitors, Mr. Baxter and Sir Otto Niemeyer, the new plan of cooperation between the United States Foreign Funds Control and the Stabilization Board. The result of these discussions was a joint communication from Mr. Fox and Mr. Cochran to the Treasury dated October 15, 1941. The current Shanghai crisis was also discussed and Mr. Cochran recommended that the Board show a "generous and practical" attitude rather than point the necessity continually to develop for importers to go into the black market for their exchange. It was decided that no emotional step could be taken at this time.

### 3. First visit to Chungking, October 16 - 21

At Chungking, Mr. Cochran met a number of important officials including Dr. Y. C. Koo and Mr. O. K. Yui, Vice Ministers of Finance; Hollington Tung, Vice Minister of Information and Dr. H. H. Kung. The Finance Minister asked Mr. Cochran to thank the officials of the United States Government and particularly Mr. Morgenthau, for the assistance being given to China. Mr. Cochran told Dr. Kung that the Treasury would gladly send out further personnel, if additional American assistance was required. Dr. Kung then specifically outlined the assistance which he said would be most appreciated, if it could be provided. He referred to the request for an expert on the Federal Reserve system to be sent to China to study and improve the Central Bank of China. Dr. Kung hoped that someone would come out who could remain as long as three years. He hoped that we would approve the idea of his sending three apprentices to the United States who could spend some time studying the Federal Reserve Bank, the Board of Governors in Washington and the Treasury system of Foreign Funds Control. Mr. Cochran assured him that this could be arranged. Dr. Kung mentioned that he had asked Mr. Fox to serve as Honorary Adviser on Taxation. Mr. Cochran pointed out to Dr. Kung that Mr. Fox had been the American nominee to the Stabilization Board and also was looked on to conduct any economic research which might be required. Dr. Kung was asked by Mr. Cochran whether in addition to these two tasks he thought Mr. Fox would be in a position to serve also as Honorary Adviser on Taxation. Dr. Kung replied in the affirmative.

Mr. Cochran says that Dr. Kung definitely stood out head and shoulders above the other Government officials whom he met at Chungking.

### 4. Second stay at Hong Kong, October 21 - 22

On his return from Chungking to Hong Kong, Mr. Cochran had a talk with K. P. Chen in which the latter indicated his desire to withdraw from the Board. Mr. Cochran reminded him that the only condition which Secretary Morgenthau interposed when the Stabilization Agreement in China was contemplated was that he, K. P. Chen, should be Chairman of the Board, and that the Secretary would be grievously disappointed if the Board should lose his services. Mr. Cochran told Mr. Chen that he realized that there was need for greater harmony and strength within the Board's organization and that upon his return to the United States he would endeavor to arrange for the sending out of such additional American experts and assistants as might be required to improve the functioning of the Board. Shortly after this talk Mr. Cochran left for Shanghai.

5. Visit to Shanghai, October 25 - November 2

In Shanghai, Mr. Cochran interviewed many representatives, official and unofficial, of the foreign community and discussed with them the current problems facing Shanghai. He also spoke a few words at a meeting of the American Chamber of Commerce at Shanghai on October 27, where he said that he urged that no one should expect profits in Shanghai in these times. He did express the hope that the American concerns would be able to maintain their foothold. Mr. Cochran pointed out to them that there was no probability of the Board being discontinued during the life of the Stabilization Agreement and said that he admitted that the Board needed improved technical personnel and management, as well as more space. He told them that it was his definite plan to send out two or more Americans from the United States shortly after he returned to assist in the technical and office management end.

In Shanghai Mr. Cochran also discussed the question of the storage of fapi and in his report he expresses his belief that the Stabilization Board of China should arrange with the Minister of Finance to permit the destruction of the stored fapi notes, such burnings to take place under Government supervision and the Central Bank being given due credit on its books for the notes so destroyed. While in Shanghai, Mr. Cochran suggested to Mr. Lockhart that he utilize increasingly the services of Consul Horace Smith in connection with stabilization and Foreign Funds Control matters.

6. Third stay in Hong Kong, November 5 - 8

On his return to Hong Kong, Mr. Cochran was invited by the Stabilization Board to give the Board the benefit of the observations made on his Shanghai trip.

Mr. Cochran, conscious as he says, of the pressure from certain Governmental circles in China to diminish or even cut off foreign exchange from Shanghai, spoke directly to this point. He told the Board that he found the Shanghai people willing to listen to reason and that he thought that they were genuinely disposed to cooperate in our effort to help China and to bring economic pressure on Japan. It was his definite impression that Shanghai considered itself still a part of Old China and that there was no significant element in Shanghai desiring closer ties with Japan. It was vital for National China to maintain at least existing contacts with Shanghai and the initiative for severing such relations should not come from Chungking. The Board could afford to go along carrying Shanghai for the present. Vice Minister of Finance, Koo, told Mr. Cochran that he was particularly happy to have the observations of an outside official who had visited Shanghai so recently. Mr. Koo informed Mr. Cochran that he endorsed warmly Mr. Cochran's recommendations with respect to Shanghai.

After the account of his travels, there was a discussion of the new control regulations. Mr. Hall-Patch suggested postponement of license changes with respect to trade, and Mr. Tsu Yse Pei endorsed this proposal. Mr. Fox threatened to go home if the Board asked for a delay. Mr. Cochran made the point that the Board had already agreed to the American plan. It was decided not to delay.

At lunch on the same day, Mr. Chen said that he hoped that one of the American credits to China could be completely paid off during the next few months and that he would like to be in the United States when such final payment was made. Mr. Chen again urged that Mr. Morgenthau consent to his retirement from the Board at an early date. Mr. Cochran says that he is sure that Mr. Chen would really like an invitation to the United States in connection with financial transactions which would give him a nice way off the Board and a nice leave-taking from Secretary Morgenthau. At this time Mr. Cochran and Mr. Chen talked of the necessity of impressing upon Chungking that receipts from exports handled by the Chinese Government which are not required for loan services should be thrown into a common pool and be made available to the Stabilization Board rather than utilized by independent organizations of a political character.

On another occasion, Mr. Cochran says that Mr. Pei informed him that he thought Mr. Taylor's ability could better be employed in Hong Kong than in Chungking but he said that he and his Chinese colleagues on the Board would not feel free to urge Mr. Taylor's return to Hong Kong, realizing Mr. Pei's antipathy towards his alternate.

#### 7. Second visit to Chungking, November 8 - 10

At the invitation of the Generalissimo, Mr. Cochran paid a second visit to Chungking. On November 8, Mr. Cochran had an informal meeting with the Generalissimo. Generalissimo asked Mr. Cochran his advice as to what the attitude of the Stabilization Board should be towards Shanghai. Mr. Cochran briefly summarized to him the story which he had told to the Board and gave him "guardedly and entirely unofficially, my own observations as to what action the situation warranted on the part of the Board." Mr. Cochran said that his conversation with the Generalissimo covered several current topics of interest, but the serious part was with respect to the operations of the Stabilization Board insofar as Shanghai was concerned and as to specific measures which the Chinese Government desired to suggest to him for consideration by the American Government. The Generalissimo stated that he had discussed this latter question with his Minister of Finance and that Dr. Kung would communicate any proposals to him at a luncheon the next day.

In the interview with Dr. Kung, Mr. Cochran repeated the remarks which he made to the Generalissimo regarding Shanghai. Dr. Kung said that he was glad to have his views on Shanghai. At this interview Dr. Kung informed Mr. Cochran that he had learned that the United States Government had no objection to Mr. Fox's appointment and that Chairman Eccles was familiar with the Minister's request for the appointment of an expert and would receive the Chinese Ambassador in Washington for the discussion of this subject. He spoke highly of the untiring efforts of Mr. Frese and said that Dr. Taylor had ability and thought that Fox should utilize Dr. Taylor more directly on political and administrative matters in Hong Kong rather than at Kuming. Mr. Cochran told Dr. Kung that he hoped after his return to the United States to make recommendations which would provide American personnel which could assist in a more orderly organization and effective administration of the Board and its business. The Minister then referred to the Generalissimo's statement that the Chinese Government had certain specific proposals to suggest and proceeded to request United States cooperation on the following measures. (The exact text of Mr. Cochran's report regarding this matter are contained in Appendix A.)

1. The United States Treasury should dry up the supply of United States currency in Shanghai, thus removing this contributing factor from the black market and also prevent counterfeiting thereof by the Japanese.
2. United States Government should help control American exports to Shanghai, calling upon the Chinese Consuls or other Chinese officials in the United States for assistance if necessary.
3. The United States Treasury should set up in the United States a new and separate fund in United States dollars to constitute a reserve backing for Chinese currency. The British Government would be asked to act similarly if the United States Treasury approved of such a plan.
4. A consolidation of the last three, or perhaps four, of the American Export-Import Bank loans to China, extending the term and increasing the total amount.
5. United States should provide China with a few airplanes capable of transporting tungsten from the interior to the coast so that the production and marketing of valuable ores, especially tungsten, could be speeded up and the foreign exchange receipts of China correspondingly increased. Planes of the Condor type would suffice.
6. That the United States increase its economic pressure on Japan.

Mr. Cochran on this point reiterated to Dr. Kung the new plan for cooperation between the United States Treasury and the Stabilization Board and said that his only concern was that repercussions might be felt in Shanghai. Dr. Kung replied that the Japanese had already taken retaliatory action and that he thought that we should go ahead and take severe measures, irrespective of possible reprisals, economic or otherwise. During this conversation Mr. Cochran expressed to Dr. Kung his hope that he would not let the Board be embarrassed by any intervention by or conflict of duties on the part of the Foreign Exchange Commission. Dr. Kung assured Mr. Cochran that he would definitely take care of this situation. Dr. Kung said that he was glad to have the research work being done by Fox and Adler as well as by Sir Otto Niemeyer and the latter's assistants and he promised to continue to make available to those gentlemen such data as they might require in their studies.

On the same day, Mr. Cochran was invited to dinner by the Generalissimo at which he had another talk with him. The Generalissimo stressed the need of a definite plan for economic assistance to China. He said that the assistance should come within three months. He hoped for a plan of American aid in the economic field as definite and precise as that being developed in the military field. He was especially concerned over the currency and price problems. Mr. Cochran assured the Generalissimo that we are anxious to do everything possible for China. He would present to the Secretary of the Treasury upon his return to the United States his report of conditions as he found them and it would be his strong recommendation that everything possible be done on our side to augment and strengthen the American personnel participating in the Stabilization Board. After this conversation, Mr. Cochran talked with Mr. Lattimore who told him that his Chinese friends were very happy over Mr. Cochran's visit and were hopeful that the messages which he was taking back to Washington would be welcome and given careful consideration.

On the last day of his visit in Chungking, Mr. Cochran discussed with Sir Otto Niemeyer the latter's views regarding economic conditions in China. Sir Otto said that he thought it was perfectly obvious as to what was ailing China as all the usual and well-known symptoms of currency inflation were as clear as day-light. He suggested (a) rigid examination of expenditures, (b) increased taxation, (c) genuine patriotic drive for more loans raised from real savings.

#### 8. Fourth and last stay in Hong Kong, November 11 - 12

During Mr. Cochran's last visit to Hong Kong, Dr. Arthur A. Young, Financial Advisor to the Chinese Government, called on him and left with him two documents discussing Chinese economic problems.

#### 9. Return trip.

Mr. Cochran arrived in Washington on November 19, 1941.

APPENDIX AProposals made by Dr. Kung to Mr. Cochran

- (1) That the United States Treasury dry up the supply of United States currency in Shanghai, thus removing this contributing factor from the black market, and also preventing counterfeiting thereof by the Japanese. The Minister suggested that we follow the British example of "calling currency home". I told the Minister that we had at various times since the outbreak of the present war considered possible licensing control of exports and imports of our currency, but had so far taken no general step of the type of which he spoke. I told him that there were various reasons which had so far weighed against such action. For example, the dollar is used as a currency of refuge in many countries, including some of those now invaded. We should not like to take any action which would cause losses to individuals who had put their confidence in our currency and would not now be in a position to follow regulations for the repatriation within a specified time of their United States currency to this country. Furthermore, the dollar circulates in Cuba, the Philippines and certain parts of Latin America. To call home such dollars would likely interfere with commercial business and might even have an adverse effect upon certain currencies, particularly the Philippine peso. I told the Minister, however, that I was sympathetic with the idea that my country should do what it could to relieve the situation resulting from dollar currency being so sought after in Shanghai that the yuan depreciated unduly, as measured against the American dollar notes.
- (2) That the United States Government help control American exports to China, calling upon the Chinese Consuls or other Chinese officials in the United States for assistance if necessary. I replied that the new plan which we were then working on for cooperation between the American Treasury's Foreign Funds Control and the Stabilization Board of China would provide material assistance on our part. The Treasury could utilize various of its agencies, particularly its Customs Service, for strengthening and implementing regulations of Foreign Funds Control. We should not desire to complicate this system by enlisting the assistance of Chinese Consular or other officials in the United States until we might have an opportunity to give our own plan a trial and judge its results.

- 2 -

- (3) That the United States Treasury set up in the United States a new and separate fund in United States dollars to constitute a reserve backing for the Chinese currency. The British Government would be asked to act similarly if the United States Treasury approved of such a plan. Dr. Kung was not able to give any more specific suggestions in answer to my request for details of such a plan. He was simply anxious that we let the world know, and permit him to strengthen Chinese confidence in the yuan through such knowledge, that the United States and Great Britain were determined to maintain the stability of the Chinese yuan, and had set aside certain reserves to guarantee this undertaking. The Minister did not think it would be necessary to utilize such sums, feeling that the psychological effect would be sufficient. It was not his idea that such funds should be turned over to the Stabilization Board of China and used in the manner now followed with respect to the current assets of the Board.
- (4) That there be a consolidation of the last three, or perhaps four, American Export-Import Bank loans to China, extending the term and increasing the total amount. The Minister observed that the Customs receipts of China are pledged for some of these loans, but that the Japanese actually control most of the Customs. While the Secretary of the Treasury had been responsible for negotiations leading to the early financial assistance to China, I remarked that such consolidation as the Minister now suggested would be a matter for the Export-Import Bank. I was happy, however, to pass this request on through the Secretary of the Treasury. When the Minister spoke of the need for more money for imports, I reminded him that the credits had not yet been drawn on to their full extent; that much material was being provided China under Lend-Lease; thus reducing the necessity for direct financial credits; and that shipping and priority problems, and growing international political difficulties, would also cut down the amount of goods which could be exported to China.
- (5) That the United States provide China with a few airplanes capable of transporting tungsten from the interior to the coast, particularly Hongkong, so that the production and marketing of valuable ores, especially tungsten, could be speeded up and the foreign exchange receipts of China correspondingly increased. Dr. Kung reminded me that China had five Condor planes which were being used in service of this kind. I told him that I had seen some of these in the hangar at Hongkong and also had seen the bags of tungsten ore which had been transported by this route. Dr. Kung said that such planes as we might spare for this commercial purpose need not be the latest model. Something of the Condor type would suffice.

- 3 -

- (6) That the United States increase its economic pressure on Japan. I reiterated to Dr. Kung that the new plan for cooperation between the United States Treasury Department and the Stabilization Board of China should very materially strengthen the economic encirclement of Japan. My only concern was that early repercussions might be felt on Shanghai. Dr. Kung said that the Japanese had already taken retaliatory action, referring to the embargo which they put upon export of cotton manufactures from Shanghai, and that he thought we should go ahead with our severe measures, irrespective of possible reprisals, economic or otherwise.

APPENDIX BList of Enclosures

- Enclosure No. 1 Draft of cable from Treasury to Fox, September 29, 1941, containing proposed China program.
- Enclosure No. 2 Cable of October 2, 1941 from Fox to Treasury, in reply to Treasury's cable of September 29.
- Enclosure No. 3 Cable of October 6, 1941 from Fox to Treasury regarding proposed new program.
- Enclosure No. 4 Cable of October 8, 1941 from Fox to Treasury giving Chinese reaction to Treasury cable of September 29.
- Enclosure No. 5 Memorandum prepared by Mr. Cochran with respect to the American plan for cooperation by Foreign Funds Control with Stabilization Board.
- Enclosure No. 6 Memorandum of October 12, 1941 submitted by Mr. Hsi Te-mou regarding Central Bank of China.
- Enclosure No. 7 Letter from Foreign Exchange Control Commission to Stabilization Board with respect to the division of foreign exchange.
- Enclosure No. 8 Letter of October 13, 1941 from Board to Vice Minister Y. C. Koo regarding letter of October 7, 1941 from the Foreign Exchange Control Commission.
- Enclosure No. 9 Cable of October 13, 1941 from Consul General Southard to State Department regarding hiring of additional clerk.
- Enclosure No. 10 Memorandum of October 13, 1941 prepared by Mr. Tau Yu Pei regarding the American proposals.
- Enclosure No. 11 Memorandum of October 14, 1941, prepared by Mr. Cochran incorporating the views of the Board, together with the American proposals.
- Enclosure No. 12 Memorandum of September 23, 1941 by Mr. A. H. Young entitled "The Price Situation and Financial Policy."

- 2 -

- Enclosure No. 13 Revised draft of Pei's memorandum of October 13, 1941.
- Enclosure No. 14 Cable of October 15, 1941 from Cochran and Fox to Treasury containing proposals regarding new China Program.
- Enclosure No. 15 Newspaper story of October 16, 1941 of press conference with Mr. Cochran and Sir Otto Niemeyer.
- Enclosure No. 16 Copy of letter from Mr. A. N. Young to Central Bank of China regarding the controlling of exports from the friendly foreign countries to China.
- Enclosure No. 17 Letter from O. K. Yui to Mr. Cochran enclosing letter from Dr. Kung to Mr. K. P. Chen regarding new China Program.
- Enclosure No. 18 Cable of October 20, 1941 from Cochran to Treasury containing Dr. Kung's letter to K. P. Chen.
- Enclosure No. 19 Chungking news bulletin regarding visit of Mr. Cochran, Mr. Baxter and Sir Otto Niemeyer.
- Enclosure No. 20 There is no reference to enclosure No. 20, nor is there such in the appended enclosures.
- Enclosure No. 21 Meeting of American Chamber of Commerce on October 27, 1941.
- Enclosure No. 22 Letter of October 30, 1941 from Mr. A. E. Schumacher, Resident Manager of the Chase Bank, to Mr. Cochran.
- Enclosure No. 23 Memorandum of October 28, 1941 prepared by Consul Smith giving high lights of a discussion of an economic club meeting in the American Club.
- Enclosure No. 24 Copy of letter of October 14, 1941 from Mr. Mackay to Mr. Hart of National City, New York.
- Enclosure No. 25 Memorandum to Mr. M. R. Nicholson from Mr. Mackay dated October 28, 1941.

- 3 -

- Enclosure No. 26 Memorandum to Mr. Cochran from Mr. Mackay dated October 29, 1941.
- Enclosure No. 27 Memorandum to Mr. Cochran from Mr. Mackay dated October 30, 1941.
- Enclosure No. 28 Letter of November 1, 1941 to Mr. Cochran from Mr. Mackay enclosing copy of letter to Mr. Fox of September 17, 1941.
- Enclosure No. 29 Suggestions for modification of the Foreign Exchange Application System made by Mr. A. T. H. Shao, sub-manager of the Bank of China.
- Enclosure No. 30 Memorandum on life insurance in connection with the Stabilization Board and the American Freezing Act prepared by Mr. P. M. Anderson, General Agent for China of the Occidental Life Insurance Company.
- Enclosure No. 31 Note regarding imports of Tonkin Authracites in Shanghai submitted by Mr. P. Dupuy, Director of Hongay Sales, Ltd.
- Enclosure No. 32 Booklet on Shanghai Power Company. (not with report)
- Enclosure No. 33 Letter of November 1, 1941 from Mr. Hutchison, Commercial Secretary of the British Embassy to Mr. Cochran
- Enclosure No. 34 Letter of October 30, 1941 from Mr. Bruce M. Smith, a motor car dealer, to Mr. Nicholson.
- Enclosure No. 35 Cable from National City in Shanghai to Hong Kong and Shanghai Banking Corporation, Hong Kong, regarding contemplated issue of a new currency by the Nanking Bank.
- Enclosure No. 36 Memoranda and letters addressed either directly to Mr. Cochran from the Chase Bank in Shanghai and Hong Kong, or addressed to Mr. Nicholson and handed by him to Mr. Cochran.  
to 42
- Enclosure No. 43 Letter of October 29, 1941 to Mr. Cochran from Mr. N. P. Allman, an American attorney in Shanghai.

- 4 -

- Enclosure No. 44 Cable from Mr. Cochran to Treasury with respect to the liaison work of Consul Smith and recommending employment of Miss Miriam Forbes.
- Enclosure No. 45 Cable to Fox and Cochran from Treasury dated October 28, 1941 regarding Cochran's and Fox's proposals.
- Enclosure No. 46 Cable of November 5, 1941 from Dr. Kung requesting Mr. Cochran to visit Chungking.
- Enclosures Nos. 47 - 48 Copies of telegrams of November 6, 1941 to Chungking informing Dr. Kung of Mr. Cochran's coming visit.
- Enclosure No. 49 Cable of November 6, 1941 from Dr. Kung to Mr. Cochran again requesting him to Chungking.
- Enclosure No. 50 Memorandum submitted to Stabilization Board by Shanghai Municipal Council regarding foreign exchange needs.
- Enclosure No. 51 Memorandum of November 1, 1941 submitted by Mr. Chen on China's potential exports and on the position of American credits to China.
- Enclosure No. 52 Cable to Treasury from Fox and Cochran dated November 6, 1941.
- Enclosure No. 53 Memorandum submitted to Mr. Cochran by Mr. Tsu Yee-pei on how the provision of transportation facilities under the Lease-Lend can contribute towards improving the position of the national finance.
- Enclosure No. 54 Cable from Nicholson to Cochran and Fox giving Treasury cable on delay.
- Enclosure No. 55 Cable to Treasury from Fox and Cochran on delay sent to Nicholson for transmissal.
- Enclosure No. 56 Cable from Treasury to Fox on his appointment as Advisor to the Ministry of Finance.
- Enclosure No. 57 Memorandum prepared by Mr. Young on the Practicability of Chinese Government Borrowing from the Public.
- Enclosure No. 58 Analysis of policy regarding the Chinese currency situation dated March 31, 1941 prepared by Mr. Young.

37-1-42

Dear Mr. Price:

This is in response to your letter of December 27, 1941, raising the problem of financial aid for Chinese students in the United States who are deprived of funds from home.

In view of the circumstances you relate, it seems to me that this is a problem which the Government of China will want to handle. I do not think that Lend-Lease funds should be used for this purpose. A decision on the question of aid through other American channels might well be postponed until the Chinese authorities have been approached, and have indicated whether or not they can give the required aid.

The Chinese Foreign Minister, Dr. T. V. Soong, or the Ambassador, Dr. Hu Shih, whom you mention, would seem to me to be the authorities with whom you would want to discuss the problem.

If your discussions with the Chinese authorities do not yield a satisfactory solution of the problem, I hope that you will let me know. I think it important that these Chinese students who are in the United States should be taken care of, and I would be surprised if funds appropriate for this purpose were not available somewhere.

Sincerely,

Hughes H. Morganthau, Jr.

Secretary of the Treasury.

Mr. Ernest H. Price,  
Director,  
International House,  
Chicago, Illinois

VFC:ND:icn  
12/30/41.

*File in Chicago  
State file to N.S.A.C.*

INTERNATIONAL HOUSE  
CHICAGO

TELEPHONE YAIRPAE 8300

1416 EAST FIFTY-NINTH STREET

December 27, 1941

PERSONAL

Mr. Henry Morgenthau, Jr.  
Treasury Department  
Washington, D. C.

Dear Mr. Morgenthau:

Here is a matter on which you may be willing to express a personal opinion, without being quoted, or suggest a method of procedure.

As you doubtless know, we have here at The University of Chicago and, for the most part, resident at International House, a considerable number of Chinese students - some twenty-five or thirty. Their position was difficult enough before Japan declared war against the United States and Britain, but now with Hong Kong fallen, they are completely cut off from any possible source of funds from home. Hitherto we have helped them from funds raised locally, but now the situation has reached a point where it seems to me both our Government and that of China must take official cognizance of it.

What I am writing particularly to inquire is whether, in your opinion, the Lend-Lease funds made available to China could be used to meet the basic living expenses of Chinese students now cut off from any source of funds from home and physically unable to return home. If, in your opinion, the terms of the credit to China permit its use in this manner, how would you suggest that we proceed to bring this matter into official channels? I know Dr. Hu Shih personally very well, and I also used to know T. V. Soong. I did not want to approach them, however, until I had ascertained whether or not Lend-Lease funds could properly be used for this purpose.

I do not know how many Chinese students there are in America in the same predicament, but I think the problem represented by our group here is a rather large and complicated one. Unless the situation is handled pretty promptly, I fear we shall have an embarrassing situation on our hands the country over as well as locally.

Mr. Henry Morgenthau, Jr., 2

December 27, 1941

Our local situation is sufficiently serious that I would be glad to make a personal trip to Washington to talk the matter over with the appropriate people, if it would do any good.

With best personal regards, I remain

Yours very sincerely,

*Ernest B. Price*

Ernest B. Price  
Director

ehp/b

EJ

PLAIN

Chungking via N. R.

Dated January 1, 1942

Rec'd 5:26 a.m.

Secretary of State,  
Washington.

1, First.

FOLLOWING FOR TREASURY FROM FOX.

TF-W reference numbers two nine three and three two five. On Monday, December eight, bond of ONAC told me eight places were reserved for the Board if a plane left Hong Kong that night. I suggested preference be given Chinese and he added that Loy Chang of Chinese Customs should be included. Agreed that following should be given places: Chen and wife, Pei and Manager of Bank of China, Hsi Temou and wife, Chi and Lay Chang. When Loy Chang declined place little after nine p.m. I immediately phoned Fress making place available to him. He declined saying he preferred to remain with records. At midnight Hsi phoned that he and wife would not leave that night. As there was no transportation between Hong Kong and Kowloon after ten p.m. and as Fress and Taylor

WERE

-2- January 1, 1942, from Chungking via N. R.

were on the Hong Kong side the only way to make use of the three vacant places was for Adler, Hewlett and me to take them. Before leaving I gave bond priority list with names Frese and Taylor first and particularly requested that place be reserved for Frese on next plane. Bond subsequently informed me that he had phoned Frese on December ninth and that Frese had insisted that priority be given to Miss Howkins, Secretary to Hall-Patch which Bond refused. He said that if Frese and Taylor had been on the Kowloon side Tuesday evening they could have left on what transpired to be the last plane out of Hong Kong. There has been no further information on Frese and Taylor since TF-V.

Re your 304 of December 16 and your 328 of December 27 amendments to licenses noted and approved with one further suggestion. While the mechanism for effecting remittances developed in general licenses seventy-five is highly satisfactory, it should be valid only for remittances to free China and remittances to occupied China effected via free China.

GAUSS

HPD

## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Chungking, China

DATE: January 1, 1942, 9 a.m.

NO.: 2

This message is for the Secretary of the Treasury from Mr. A. Manuel Fox.

This is a message (WF-1) from the Stabilization Board to the Federal Reserve Bank of New York:

Concerning telegram no. 33 of yours, the Central Bank of China Building, in Chungking, is the place of operations of the Board. The Board's understanding that 207 is the new number effective as of December 20, 1941 is hereby confirmed.

It would be appreciated by the Board if you would notify it what amount of dollars (United States currency) disbursed by you on its account up to and including the 6th of December, 1941, and also what amount of disbursement, if any, which you since made on its account.

GAUSS

NMC

GRAY

Chungking

Dated January 1, 1942

Rec'd 5:36 a.m.

Secretary of State

Washington.

3, January 1, 11 a.m.

FOLLOWING FOR SECRETARY OF THE TREASURY  
FROM FOX: STROH-Y

One. A. returned from Kunming yesterday  
after two weeks visit.

Greatly impressed by efficiency of factories  
in that vicinity but disappointed in evidence of  
deflationary policy recently put into effect.  
Concerned lest it seriously affect production  
of all vitally necessary equipment and products  
which otherwise will need to be imported.

B. Found concern over very high prices  
and shortage of goods and over danger to value  
of fapi unless some basis of support is established  
and especially for meeting inevitable large deficit  
for 1942.

C. Having made arrangements in Kunming for  
strengthening Board's

-2- #3, January 1, 11 a.m., from Chungking

strengthening Board's office and provide as far as (?) facilities are (?) for maximum movement of goods into free China from Rangoon. In view of limitations of Burma Road and military demands on Road outlook for flow of goods and price situation not too promising.

Two. (?) (4) of your 304 of December 16, 9 p.m., I shall convey your message to Doctor Kung at the earliest opportunity and I am sure its spirit will be much appreciated. He has been seriously ill and it may not be possible to see him for a few days yet. To avoid embarrassment, I should appreciate it if you could notify me what his additional proposals to Mr. Cochran were.

Three. The Board asks me to transmit the following message to you: "Owing to the loss of its records in Hong Kong, the Board is temporarily unable to fulfill its obligations under paragraph 1 (D) of the Sino-American agreement of April 1941. The Board is making every effort to reconstitute its records and hopes to be able to resume the submission of its monthly reports to you at the earliest opportunity.

GAUSS

PEG

## TREASURY DEPARTMENT

158

## INTER-OFFICE COMMUNICATION

DATE January 1, 1942

TO Secretary Morgenthau

FROM Mr. Dietrich

STABILIZATION AGREEMENTS

China: On July 14, 1937, we made an agreement with the Central Bank of China to purchase yuan up to a total value of \$50,000,000. The agreement has been renewed each six months and now expires June 30, 1942. At present, we hold about 85,000,000 yuan, with a book dollar value of \$19,112,500, and this is collateralized by \$19,379,018 in gold held at the New York Federal Reserve Bank.

On April 1, 1941, we made an agreement with the National Government of the Republic of China and the Central Bank of China wherein we agreed to purchase yuan up to the equivalent of \$50,000,000, no collateral being required. So far, we have made no yuan purchases under this agreement, which expires June 30, 1942. The Chinese-American-British Stabilization Board began to operate in mid-August, and the Chinese Government banks have furnished their contribution of \$20,000,000 to the Joint Stabilization Fund. At the end of December, there was a balance of \$6,750,200 in the Chinese Stabilization Fund account at the New York Federal Reserve Bank.

Brazil: On July 15, 1937, we made an agreement with the United States of Brazil, which expires on July 15, 1942. We agreed to purchase milreis up to a total value of \$60,000,000, to be collateralized by gold. At present, we hold 160,000,000 milreis, with a book dollar value of \$8,000,000 and collateralized by \$2,089,092 in gold. The agreement also provides for the sale to Brazil of up to \$60,000,000 in gold by the United States, such gold to be earmarked for Brazil's account at the New York Federal Reserve Bank; by a modification of September 2, 1938 Brazil was permitted to ship gold here and place it in the earmarked account. To the end of December, we had sold Brazil \$29,465,771 in gold, and Brazil had shipped 11,332,765 in gold to New York; except for the amount set aside as collateral, all of this gold is under earmark for Brazil at the Federal.

Argentina: During December, no change took place under the January 1, 1941 agreement with the Banco Central de la Republica Argentina and the Government of Argentina, under which we agree to purchase Argentine pesos up to a total value of \$50,000,000, for which no collateral is required. Since this agreement has not yet been ratified by the Argentine Legislature, it is inoperative at present.

Mexico: As of November 1, 1941, the Treasury entered into an agreement with the Government of the Republic of Mexico and the Banco de Mexico, under which we agree to purchase Mexican pesos up to a total value of \$40,000,000, no collateral being required. This agreement, which expires on June 30, 1943, stipulates that Mexico shall have 180 days' notice and then an additional 180 days in which to re-purchase. We have not yet received official notification that the action of the Mexican Government and Bank in entering the agreement has been ratified; such notification is necessary for the agreement to become operative.

-2-

Colombia: A Stabilization agreement has been discussed with Colombia, under which we would buy Colombian pesos up to the equivalent of \$3,000,000, no collateral being required.

Ecuador: A Stabilization agreement with Ecuador has been discussed. In early conversations, \$5,000,000 was considered as the limit to such an agreement, but from an October 24 meeting with the Ecuadorian Ambassador, it was gathered that the maximum amount may be reduced to \$3,000,000, and \$1,000,000 of this would be provided by Ecuador.

Bolivia: In an October 24 discussion with Treasury officials regarding a Stabilization agreement, the Bolivian Minister stated that he thought his country would need between \$5,000,000 and \$8,000,000 to stabilize its currency.

Iceland: Discussion for a \$2,000,000 Stabilization agreement with Iceland began about the end of September. Iceland's approval of the agreement as drafted has not yet been received.

Cuba: In the initial report of the American Technical Mission to Cuba, one of the alternative recommendations was that Cuba might issue pesos against gold obtained on credit from the U. S. Stabilization Fund.

#### GOLD PURCHASE AGREEMENT

Russia: On October 10, 1941, we agreed to purchase from the Russian Government approximately \$31,605,000 in gold for delivery within 180 days, and gave Russia an advance of \$30,000,000 on October 11. By the end of December, there remained \$1,866,875 in gold still to be delivered by Russia, and the advance had been reduced to \$9,803,423.



BRITISH EMBASSY  
WASHINGTON, D.C.

January 1, 1942

PERSONAL AND  
SECRET

Dear Mr. Secretary,

I enclose herein for your personal  
and secret information 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.

BRITISH MOST SECRET

(U.S. SECRET)

CETEL No. 57

Information received up to 7 a.m., 31st December, 1941.

(I) NAVAL

Home waters 30th. A photographic reconnaissance of BREST during afternoon subsequent to attack mentioned in paragraph 3 below showed the SCHEER and PRINZ EUGEN in dry dock and GWEISENAU alongside the torpedo boat station with no apparent damage.

MEDITERRANEAN. 29th. A convoy escorted by cruisers and destroyers arrived at ALEXANDRIA from MALTA. The force had been several times attacked unsuccessfully by enemy aircraft.

12th. One of H.M. destroyers escorting a convoy to TOBRUK successfully drove off by gunfire two enemy torpedo bombers which attacked her Northeast of BARDIA.

One of H.M. gun-boats successfully engaged two enemy coastal defence guns in the vicinity of BARDIA. One of H.M. submarines has shelled and sunk 5 enemy schooners at SUDA BAY and at METHONI (Southwest GREECE). She also torpedoed an Italian destroyer inside NAVARINO HARBOUR on the 29th.

(II) MILITARY

LIBYA. It is now known that in the tank battle south of JEDABYA on 28th we destroyed 22 enemy tanks and severely damaged a further 20. Our losses were 6 tanks knocked out and 8 more left on the battle field and probably lost. No further battle had developed by 8.30 a.m. 30th. At that time 40 enemy tanks were reported advancing Northwest from EL BASHIAT (30 miles Southeast of JEDABYA).

MALAYA. The bridge at KUALA DIPANG (7 miles north of KAMPAR) has been successfully destroyed.

BURMA. BOKPYIN which was unsuccessfully attacked by our forces on 27th was evacuated by the Japanese during night 28th/29th and was occupied by our forces on the morning of 30th.

RUSSIA. Main Front. The Russian advance is continuing.

CRIMEA. The Russians have landed on the KERCH Peninsula and have recaptured KERCH and FEODOSTIA.

(III) AIR OPERATIONS

WESTERN FRONT. 30th. 9 Squadrons of fighters (200 Spitfires are missing) escorted 16 Halifax in an attack on the marshes at

- 2 -

BREST, the results of which were not observed. A.A. fire was intense and accurate. 3 of our bombers are missing, the crew of one being rescued from a dinghy 50 miles north of BREST. Four fighters destroyed 6 ME 109's and our bombers destroyed another, 7 more were probably destroyed. 30th/31st. 6 aircraft of coastal command attacked the docks at LA PALLIDE. Hits are claimed on the mole and a tanker was possibly damaged.

MEDITERRANEAN. LIBYA. 29th. 4 squadrons of Blenheims attacked enemy positions and the landing ground at JEDABYA, many vehicles and two aircraft were destroyed. Other Blenheims dropped bombs among dispersed motor transports 20 miles south of JEDABYA. 3 squadrons of Blenheims registered many hits on enemy positions at BARDIA. Blenheims attacked enemy vehicles in the areas of MISURATA and ZOHARA. 3 small ships and 3 lighters were sighted at RAS EIALI (26 miles west of EL AGHEILA). Supplies were apparently being landed at a temporary jetty there and also at RAS LANUF (43 miles Northwest of EL AGHEILA). At RAS EL ALI 500 M.T. were seen dispersed around the jetty.

MALTA. 29th. 5 enemy fighters machine gunned naval units. One ME 109 was probably destroyed by Hurricanes, two of which are missing. 12 bombers attacked LUQA causing some damage to aircraft on the aerodrome.

Night 29th/30th. 3 enemy aircraft dropped bombs on the island causing a few army casualties. 30th. 3 raids were made during the second (by 6 bombers escorted by 40 fighters) the aerodromes at TAKALI and LUQA and a dockyard were attacked, two bombers were destroyed and one probably destroyed by our Hurricanes.

FAR EAST. MALAYA. 29th. KUANTAN aerodrome again attacked but no damage caused. P.M. Enemy aircraft made 3 attacks on SINGAPORE Island, details of damage not yet known.

JOHORE. 29th. From army sources it is reported that LUANG was bombed and machine gunned.

(V) HOME SECURITY

29th/30th. Casualties at NEWCASTLE and in the NORTHUMBERLAND area are reported to be 11 killed and 32 seriously injured.

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE JANUARY 1, 1942

TO Secretary Morgenthau

FROM Mr. Kamarek

Subject: Summary of O.C.I. Bulletins No. 1 and No. 2  
("Iran - A Threat to Britain": "Axis Propaganda  
in the Moslem World")

Both of these bulletins have the same theme: The Arab peoples of the Near East want to be independent of foreign control. They have a long history of hatred of British imperialism. The Germans have tried and have been able, to some extent, to turn this hatred of the British into sympathy for the Axis in its war on the British. While Iran is now quiet, "it is the forced quiet of a conquered country."

The Axis radio at Zeesen, Germany, plays on the Arab hatred of the British, the upper-class fears of Bolshevism, the anti-Jewish feeling resulting from the political ambitions of the Zionists, and general Moslem conservatism. American association with England has led the Arabs to believe that we support the disliked British policies in the Arab world.

## COORDINATOR OF INFORMATION

# IRAN - A THREAT TO BRITAIN

The recent occupation by force of arms has deepened the long-standing Iranian hatred of the British to a point where the Iranians can be depended upon to do everything possible to impair the British war effort. Through lack of cooperation, sullen acquiescence, and outright sabotage, they could constitute a threat to the transportation routes which are of vital importance to the British even if the Germans do not drive through the Caucasus to the Iranian borders.



DECEMBER 23, 1941

## IRAN—A THREAT TO BRITAIN

Although Iran is occupied and officially "pacified," the anti-British feeling of the Iranians is so intense that they would do no more to help Britain than to help Germany. A nation whose people gloated over English soldiers being swept into the sea off Dunkirk is not likely to prove a willing ally.

This hatred of England is traditional. In 1907 the first partition of Iran into "spheres of influence" between Great Britain and Russia reduced Iran to the equivalent of three vassal states. As a result, Iranians neglected internal reform and concentrated their attention on an intense hatred of Russia and Britain.

Further experience with major powers came to Iran during the war of 1914-18. Iranian neutrality was repeatedly violated, and Iran suffered all the horrors of war with none of the compensations allowed the victors. After the war, Lord Curzon drew up an Anglo-Iranian treaty so one-sided in favor of England that riots took place in Iran and their Assembly failed to pass the bill.

This event marked the official shift from the Old Regime in Iran to the Iran of Riza Shah, who rode the wave of anti-British feeling into the Ministry of War, then into the position of Prime Minister, and finally on to the throne itself. It supported him throughout

his regime, for people who disliked Riza Shah still preferred him to the British.

Russia shared less in this bitter feeling, as at that time she was involved in civil war and had no energies to waste on Iran. It therefore became habitual for Iranians to blame the British for any and all misfortunes.

This feeling was heightened by the fact that the average Englishman greatly irritated the Iranian personally. More than other foreign groups, the British considered themselves "Sahibs," and the Iranians "natives." This galled the Iranians so much that the word "Inglise" came to be an adjective describing anyone excessively confident and complacent.

Meanwhile, the Germans were improving their standing with the Iranians as fast as the British were undermining theirs. The Germans whom the Iranians knew had migrated from Germany during the dismal days of the Weimar Republic, often arrived almost penniless, and were willing to accept any kind of work. Some bought old truck engines, made dynamos, and set up electrical installations; almost all lived on an economic level not much above that of the Iranians. As the new government began its program of industrialization, these Germans fitted into the picture admirably.

Until 1933 the Germans in Iran were politically unorganized, but after that no German had any chance to survive in business or to retain his German citizenship unless he became a member of the Nazi Party. Most of the newcomers were trained in all the techniques of penetration into vital positions. In addition, increasing numbers of Iranian youths were sent to Germany on various pretexts.

Germany gradually became one of Iran's best customers, partly because she needed many things in her preparations for war. In 1936 Dr. Schacht made a flying visit to Teheran and negotiated a trade agreement by which Germany bought heavily of Iranian agricultural exports. Iranian trade with other nations almost ceased.

German propaganda agencies were very successful in exploiting Iranian pride. They accorded Riza Shah the honors he expected, and the public was flattered by stories that the Iranians were pure Aryans and closely related to the Germans. So far as the war between Britain and Germany was concerned, the Iranians were fervently pro-German.

The average Iranian expectantly awaited the thrill of a vicarious victory over Britain, rising prosperity through unlimited trade with Germany, and the coming of the day when Hitler would recognize Iran's independence and give it a more important role to play. This world of dreams began to fade on June 22, 1941, and ceased to exist on the morning of August 25.

However, the seizure of Iran by the British and Russians was not as easy as is generally supposed. The Iranian Army did much more fighting than it has been publicly credited with, despite the fact that resistance was soon crushed. There followed the forced abdication of Riza Shah, who was taken on a British warship to the remote island of Mauritius, where a presumably "diplomatic" illness doubtless will detain him indefinitely. Many Germans fled by way of Turkey; others, perhaps 500 in all, were interned.

Riza's son, Mohammed Riza, took his place. The new Shah has promised to rule constitutionally and

has a ministry as nearly pro-ally as the country can provide. The vast system of state monopolies erected by Riza for governmental—and personal—profit has disintegrated completely and the expense of the State is being carried by the confiscated wealth of the “invalid” of Mauritius. Since this source of income will hardly prove inexhaustible, “political” loans may be expected from London.

The country is quiet, but it is the forced quiet of a conquered country. A military alliance against the Axis is being urged upon the new government. Since an alliance with Russia would be almost as universally unpopular as an alliance with Britain, the government is extremely reluctant to undertake it.

One prominent Iranian has summed up the attitude of the great majority of his countrymen in these words: “The Germans seized Norway in order to attack Britain. The British and Russians have taken Iran to protect their lines of communication. Great nations think their own independence so precious that to preserve it they may righteously destroy the independence of smaller nations.”

So it is hardly startling that Iranians are comparing the situation of today with that of 1907, and are skeptical of the benefits to Iran of “collaboration” with any imperial power, whether British, Russian, or German.



BULLETIN NO. 2

RESTRICTED

## COORDINATOR OF INFORMATION

AXIS PROPAGANDA  
IN THE  
MOSLEM WORLD

German propaganda in the Moslem world exploits hatred of the British, upper-class fears of Bolshevism, prevalent anti-Jewish feeling, and Islamic conservatism and prejudice. The British have not succeeded in counteracting this propaganda.

The increasing closeness of our relations with Britain is producing a change for the worse in the attitude of Near Eastern peoples to the United States.



DECEMBER 23, 1941

2

## AXIS PROPAGANDA IN THE MOSLEM WORLD

The Arab is a born dissenter and a lover of intrigue. In a country as small as Palestine, there have at times been as many as six different political parties functioning at once. Under such circumstances, there will always be found groups who will lend themselves to Axis propaganda, if only to spite their enemies.<sup>1</sup>

The Arabs are, however, united in one general purpose: To free their world from the domination of French and British masters. Arabs in Syria, Palestine, Egypt, and Iraq are apparently blinded to Italian imperialism in Libya and Ethiopia and to German domination of Europe by their anxiety to get rid of British control. This arises not only from a desire to play all European powers off against each other but from a naïveté which assumes that anyone who is against Britain is automatically a friend of the Moslems. They fail to realize that, in case of a British defeat, there would be a substitution of Axis for British imperialism.

<sup>1</sup> An example seems to be the pro-Axis minority among the predominantly pro-British Druzes.

Arab animosity toward foreigners and non-Moslems may be discriminated as follows:

A. *Anti-British sentiment.*

Despite the wishful thinking that continues to exist in Britain,<sup>2</sup> dislike and mistrust of Britain are strong throughout the Arab world, as well as in Iran and India. There are two reasons for this: One is British support of the Jews in Palestine and of other minorities for the apparent purpose of dividing and ruling the Arab states; the other is the reluctance of Britain to grant independence to mandated territories. The Arabs place little trust in British promises, which have been often broken in the past. Their distrust of British methods leads them to look for ulterior motives in every move made by Britain. If anything adverse happens, they automatically blame the British, without bothering to look into the facts of the case. This makes it easy for Axis propaganda to stir up Arab feeling; how easy is shown by the killing of the British Consul Mason at Mosul after German propaganda had accused the British of being responsible for the death of King Ghazi. The acquisition by Iraq and Egypt of their independence only after years of rebellion have convinced the Arabs that force is the only means by which they can extract what they regard as their rights from the British.<sup>3</sup>

<sup>2</sup> But see the realistic article, *Arab Nationalism and the War*, in *Round Table* (London), September 1941, pp. 696-706.

<sup>3</sup> An illustration of the strength of this attitude is the unpopularity of the Nashashibi faction in Palestine and the support by the Arab population, both in and out of Palestine, of the Mufti Hajj Amin, who is the apostle of force against the British. What success the Axis powers have had in playing up to this state of mind can be judged from the fact that the Mufti is now in Berlin.

The Zeesen radio has lately been giving unusual attention to the exile and persecution of Arab leaders by Britain, and this cannot help but have considerable effect upon the Arabs.

The Assyrians who were at one time entirely pro-British now contain a considerable element which denounces Britain for having let the Assyrians down in Iraq.

The Arabs are very sensitive and bitterly resent the attitude of superiority of many Britons whom they meet.

B. *Anti-American sentiment.*

This is of recent growth. It is a result of two things: (1) The expression by American public officials of sympathy with political Zionism (which they usually misjudge as being purely religious and cultural) in Palestine. This has resulted in a tendency in all parts of the Arab world (strongest in Palestine and Syria) to suspect the United States of siding with the Jews against the Arabs in Palestine. (2) America's increasingly close alliance with Britain has led the Arabs to believe that we support Britain's policies in the Arab world. The attitude of India toward the United States has taken a very definite turn for the worse as a result of the promulgation of the Atlantic Charter, from which India was specifically excluded. All these factors are being fully exploited by the Zeesen radio in broadcasts to the Near East and India as evidence of the hypocritical attitude of the United States in preaching independence and self-determination for minorities on the one hand, while supporting British imperialism on the other.

### C. *Anti-Jewish feeling.*

While Palestine is the focus of the problem, anti-Semitism has had an important effect on the Arabs of Syria and even of Saūdi Arabia, within whose boundaries there is hardly a single Jew. There can be no doubt that the situation created by the Zionist program in Palestine has caused the position of the Jews to deteriorate throughout the Arab world. Despite what Zionists say abroad for outside consumption, there are too many Jews in Palestine (and abroad) who adhere to the attitude expressed by William B. Ziff in *The Rape of Palestine*: The Jews are entering Palestine by divine right and intend to "make the Arabs go back to the desert where they came from." In North Africa there are grounds for anti-Jewish feeling which are separate from the Palestinian problem. Ever since the Arab invasion, the Jews there have been a despised element of the population, and this antipathy has been increased since the nineteenth century by the undoubted part which the Jews have played in facilitating foreign control of both French and Spanish Morocco.

Zeesen has recently been reading anti-Jewish passages from the Koran, emphasizing that the Jews are the "enemies of Islam."

### D. *Anti-French feeling.*

This flourishes in all areas where the French are in control and existed even before the end of World War I: Witness the testimony of the King-Crane report which expressly states that under no circumstances did either the Syrians or Iraqis want a French mandate, a mandate which Syria subsequently was

forced to accept. Anti-French feeling is relatively useless as an Axis propaganda implement as long as German-controlled Vichy retains holdings in the Arab East, except under the aspect of anti-de Gaullism in regions which might come under Free French control. Moreover, the setting up by the Free French of an "independent" Syrian state has stolen some of the Axis thunder. Zeesen propaganda blasts concentrate on denouncing Taj-al-Din, its head, as merely a de Gaullist-British tool.

### E. *Anti-Bolshevik feeling.*

The educated and propertied classes among the Arabs, who largely control public opinion, are extremely apprehensive of socialism and more particularly of a Bolshevik socialist revolution. Through broadcasts and other means of propaganda, the Axis powers have succeeded in impressing on the Arab world the belief that they are engaged in saving capitalist civilization from the menace of Bolshevism. Propertied Arabs feel that a Nazi regime would not seriously damage their position, whereas a Bolshevik regime would exterminate them and the system under which they are accustomed to live. Ambitious Arab leaders tend to conceive of themselves as future heads of states, freed from British or French domination, each a miniature Reich with its Fuehrer or Duce, subservient perhaps to the Axis, but each with a considerable measure of "absolute" power.

### F. *Moslem conservatism and prejudice.*

This makes an appeal to conservative Moslems throughout the entire East, from Morocco to India.

Many approaches can be used to exploit this: Anti-Christian bias, xenophobia, concern for Moslem minorities, etc. Recently Zeesen has been playing up the alleged suppression of the Moslem minorities in Russia; another curious anti-British blast from Zeesen accuses the British of being Pagans like the pre-Islamic Arabs and thus the natural enemies of Islam. It is doubtful whether such ridiculous appeals to presumed Moslem ignorance are going to help the Axis cause.

*G. Food shortage and economic ruin.*

The German radio at Zeesen has repeatedly stated that the food shortage in Morocco (especially in the Spanish Zone and Tangier) is being caused by the British blockade. In German broadcasts to the rest of the Moslem world, including Palestine, Egypt, Syria, Iraq, and Iran, it is made out that the British army is systematically stripping these countries, leaving the population to starve. At present the food situation does not appear to be bad except in Spanish Morocco and Tangier, but if it should become serious in other Moslem countries, this propaganda might have serious results. The announcement that Britain is stripping India of food is often repeated by Zeesen which adds that Britain means to sacrifice millions of Indian lives in a vain attempt to resist the Axis.

MILITARY INTELLIGENCE DIVISION  
WAR DEPARTMENT  
Washington, January 1, 1942

INFORMATION BULLETIN  
NO. 5  
MID 461

NOTICE

The information contained in this series of bulletins will be restricted to items from official sources which are reasonably confirmed.

This document is being given an approved distribution, and no additional copies are available in the Military Intelligence Division. For provisions governing its reproduction, see Letter TAG 350.05 (9-18-40) M-B-M.

EMPLOYMENT OF  
GERMAN ANTI-AIRCRAFT ARTILLERY  
IN RUSSIA

SOURCE

This bulletin is based on two reports submitted by American official observers in Berlin. Intended propagandistic effects in the translated articles, which appeared in Berlin newspapers, should not be overlooked.

The extract entitled "Combat Scene near Smolensk" is intended to portray very briefly some aspects of the German methods employed in river crossings.

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1. INTRODUCTION
2. ANTI-AIRCRAFT ARTILLERY AT THE FRONT
3. COMBAT SCENE NEAR SMOLENSK
4. COMMENT OF OFFICIAL OBSERVER

EMPLOYMENT OF  
GERMAN ANTI-AIRCRAFT ARTILLERY  
IN RUSSIA

1. INTRODUCTION

One of the conclusions reached in the study of the employment of German anti-aircraft artillery during the year 1940 was that this type of artillery would be used increasingly against ground targets. Subsequent events in the North African Campaigns, the Balkan Campaign, and the Russian Campaign have proved the soundness of this deduction.

Anti-aircraft fire, with its high muzzle velocity, is very accurate at short ranges. Because of ease of mechanical manipulation and accurate and rapid methods of fire control, it is very effective against enemy tanks. With special projectiles, it is deadly against fortifications. German commanders, therefore, are using it to an increasing extent for direct support.

German anti-aircraft artillery is a part of the German Air Force, although during recent months anti-aircraft units have been formed in the German Army proper and in the SS units. These latter, however, are only for local protection and are believed to be armed with only light (20-mm.) and medium caliber (37-mm.) guns.

German anti-aircraft artillery is organized into regiments, divisions, and corps. The regiment is a fixed organization, the exact details of which are unknown at the present time. The division and corps are task-force organizations whose composition depends on an estimate of the means necessary to accomplish a particular assigned mission.

The largest tactical anti-aircraft organizations assigned to the Berlin defenses are believed to be anti-aircraft corps. There are, or were, four panzer armies operating in the east under the command of Generals Hoth, Hoepner, Guderian, and Kleist. In an article describing the command-post operation of one of these armies, it was revealed that an anti-aircraft corps was a part of the command. Considering that much direct-support artillery has been and is being converted to armored assault artillery, the defensive fire power thus made available to a panzer army commander is enormous.

During 1940 the standard antitank caliber in the German Army was 37-mm. In 1941 the standard antitank caliber has been increased to 50-mm., although, of course, the 37-mm. is still being used. According to reliable information, even the high velocity 50-mm. gun will not stop all Russian tanks; so the need of larger caliber is obvious. This explains the employment so far forward of major caliber anti-aircraft artillery (88-mm.). All these large pieces have direct fire sights, and some current pictures show a protecting shield, which is open at the top to permit the gun to be elevated to its maximum elevation of 85 degrees.

The German Air Force has controlled the air in all campaigns to date. There are many indications, however, that a part of the Russian Air Force still exists, although it is used infrequently. This means that the German antiaircraft artillery units can be used primarily for antitank and other ground-support uses, especially when defensive German Air Force units are supporting the operations.

All German antiaircraft artillery weapons are equipped with at least two different types of projectiles: H.E. with sensitive fuzes for antiaircraft work, and H.E. with armor-piercing noses and delay fuzes for antitank work. It is not known whether a third type of projectile or the normal antiaircraft projectile is used for direct support, but it is thought that the regular antiaircraft projectile is used for this type of action. Because of the changes required in the fire-control director, it is probable that when the armor-piercing projectile is used against fortifications and tanks at short ranges, each gun operates independently, without the use of fire-control data, and uses direct fire only.

It should be noted in the article translated below that antiaircraft was used to wipe out machine-gun nests. It is reported that when the advance is halted by a considerable concentration of automatic fire, assaults are timed to start at dawn or dusk. Small and medium caliber antiaircraft cannon (automatic fire) are pushed well forward. As the German infantry attack starts, the hostile machine guns open fire, and their flashes are plainly visible in the twilight. Automatic cannon with sensitive fuzes then open fire on these revealing flashes with great destructive effect.

The tendency to use heavy AT-AA weapons for counterbattery work should not be overlooked. According to this narrative it is even used for interdiction fire.

## 2. ANTIAIRCRAFT ARTILLERY AT THE FRONT

"The German antiaircraft artillery has distinguished itself on all sectors of the front in the operations against the Russians. Antiaircraft artillerymen have not only helped to clear the air of Russian planes but have also prepared the way in ground operations for their comrades of the infantry. The achievements of one antiaircraft corps employed in the southern sector of the Eastern Front have been unusual. Up to September 8, 1941, the batteries of this corps have shot down a large number of Russian planes, but they have also executed other missions which are not ordinarily thought of as belonging to antiaircraft units.

"Since the beginning of operations on June 22, 1941, the words 'Antiaircraft cannon to the front' have often been heard and the result has been the destruction of many Russian bunkers, tanks, batteries, and machine-gun nests. Single antiaircraft cannons have repeatedly succeeded in breaking up Russian forces with direct fire. Numerous attempts by strong Russian units to launch counterattacks have collapsed under the concentrated fire of light and heavy antiaircraft cannons. In all these operations the antiaircraft corps have operated successfully against

varying units of infantry, cavalry, and artillery.

"The rear Russian service units particularly have suffered severe losses as a result of the well-placed fire of the German anti-aircraft guns, which have succeeded in destroying transport aircraft, horse-drawn vehicles, an ammunition train, and several locomotives, thereby causing severe losses to the Russian supply system. During the operations on the Dnieper the gunners carried out daring assaults, sinking five Russian gun boats and destroying a pontoon bridge. Also, a great amount of Russian ammunition has been captured by this anti-aircraft unit.

### 3. COMBAT SCENE NEAR SMOLENSK

"In the attack the squads and platoons of the assaulting infantry regiments, taking advantage of the terrain, fought their way forward from one storm position to another.

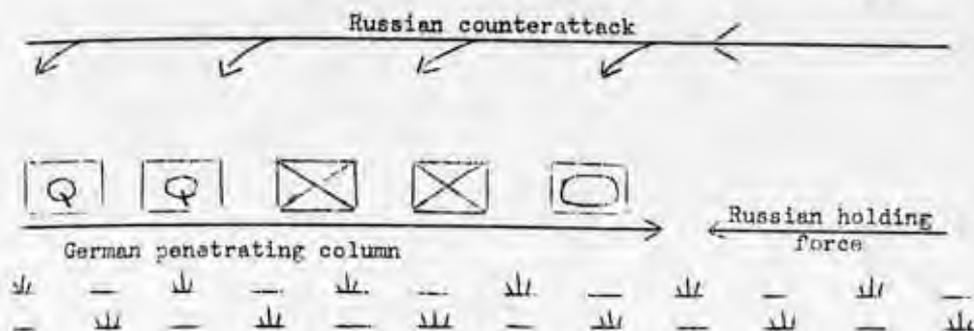
"The artillery and mortars fired at the hostile trenches on the other side of the river until they were ready to be assaulted, while heavy machine guns kept the enemy pinned to the ground. In the meantime, antitank weapons and accompanying infantry cannon were brought into position. Protected by this fire, infantry and pioneer assault troops sprang into pneumatic rafts, crossed the river, and overwhelmed the positions.

"After we had established a bridgehead, the Russians attempted a tank-supported counterattack, which collapsed under the fire of our antitank and anti-aircraft weapons and our artillery, all of which were assisted by a counterattack with our own tanks. At several points along the front these counterattacks lasted 4 or 5 hours. Some fighting was at such close ranges that hand grenades could be thrown from one side to another."

### 4. COMMENT OF OFFICIAL OBSERVER

a. The basic principle of German combat methods is a clever adaptation of fire and movement, with fire power increasing directly with the resistance encountered. Movement is normally from one piece of advantageous terrain to another, with maximum fire applied during the movement. Both fire and movements are applied with one purpose in view, and that is to attain the unit objective. This principle is applicable to the offensive combat of all units, from squads to armies.

b. Officers returning from the Eastern Front state that Russian counterattacks launched in a direction parallel to the German attacks, instead of against the shoulders of the German penetration, have caused considerable trouble. The direction of these counterattacks, however, may have been dictated by the terrain rather than by tactical choice. The schematic diagram below indicates the German embarrassment caused by these Russian methods.



As the diagram indicates, a successful Russian counterattack forces the German attacking force to defend with its "rear" held against a swamp or other obstacle and its mechanized elements contained on one flank, and its relatively unprotected supply columns on the other flank.

RESTRICTED

G-2/2657-220; No. 587 R.I.D., R.D. 11:00 A.M., January 1, 1942

SITUATION REPORTI. Pacific Theater.

Philippines: Following a northward movement throughout the past few days, our southern Luzon force has made contact with our northern Luzon force, thus forestalling a separation of the two forces by enemy infiltration from the east. Manila will be left uncovered by this movement, but the previous evacuation of the city by our troops has destroyed Manila's military value. Our forces have the entrance to Manila Bay entirely covered. Hawaii: A few rounds of gunfire from unseen hostile vessels damaged a shed on Hawaii and fired a canefield on Kauai. No other hostile activities reported. Malaya: Light activity in the east, but no change in the general situation. Enemy air raids on Singapore and British lines of communication continue. West Coast: No further confirmed reports of hostile activity.

II. Eastern Theater.

Ground: The Russians continue to push their advance west of Tula and report the capture of Kaluga and Novi Kirishi.

On the Crimea the Germans are pressing their attacks against the fortress of Sevastopol.

Air: The German High Command reports that German planes in the Crimea have counterattacked Russian troops which recaptured Kerch and Feodosiya. It further claims units of the German Air Force attacked Russian lines on the Moscow front.

III. Western Theater.

Air: A very heavy British attack was made on Brest during the day of December 30. According to the Press, two German Messerschmidts machine gunned towns along the Sussex coast yesterday.

IV. Middle Eastern Theater.

Ground: Fighting continues in the Agedabia area, with Axis forces counterattacking to prevent encirclement.

Air: German High Command reports day and night raids against Malta. According to the Press, the R.A.F. made low-altitude attacks upon retreating Axis motor transports and columns.

RESTRICTED

TREASURY DEPARTMENT  
Washington

FOR RELEASE, MORNING NEWSPAPERS,  
Friday, January 2, 1942.

The Secretary of the Treasury, by this public notice, invites tenders for \$150,000,000, or thereabouts, of 71-day Treasury bills, to be issued on a discount basis under competitive bidding. The bills of this series will be dated January 7, 1942, and will mature March 19, 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, January 5, 1942. 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 January 7, 1942, 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 treatment, 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 conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

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TO DIRECTOR

OPEN UTAH JAN 1 1942 412P

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FROM HARRY HOPKINS JR

SECRETARY OF TREASURY

RE REPLY FOLLOWING TELEGRAM TO HARRY HOPKINS QUOTE  
 CONSIDERATION BEING GIVEN TRANSFER OF  
 ADMINISTRATION OF FOREIGN FUNDS FROM TREASURY TO  
 DEPARTMENT OF JUSTICE STOP FOR PURPOSE OF HANDLING  
 TREASURY HAS BUILT AN EXPERIENCED ORGANIZATION  
 FEDERAL RESERVE BANKS AS AGENTS HAS  
 DURING THE PAST YEAR A PRACTICAL PROCEDURE  
 WHICH ARE WORKING EFFICIENTLY STOP BECAUSE  
 THE FACT THAT THE WORK  
 OF A FINANCIAL NATURE I STRONGLY  
 THERE BE NO TRANSFER STOP THE CLOSE  
 OF THE ADMINISTRATION OFFOREIGN FUNDS AND  
 PROPERTY MAKE SAME ADMINISTRATION DESIRABLE I  
 STRONGLY RECOMMEND THAT THE ALIEN PROPERTY CUSTODIANSHIP  
 IN TREASURY UNQUOTE WILL BE IN  
 MORNING BEST REGARDS

HARRY HOPKINS JR

January 2, 1942  
9:40 a.m.

GROUP MEETING

Present: Mr. Thompson  
Mr. Morris  
Mr. Haas  
Mr. Paul  
Mr. Sullivan  
Mr. Kuhn  
Mr. Blough  
Mr. Schwarz  
Mr. Graves  
Mr. White  
Mrs. Klotz

H.M.JR: I am sorry to keep everybody waiting, but I got my back to the wall on this alien property transfer to the Treasury, and that is what I have been working on all morning. I am not going to - I mean, it looks as though the whole thing was going to be transferred out of the Treasury, and I have decided to fight it, so I just had to drop everything. I am not going to give in so easily. Herbert?

MR. GASTON: At a meeting of the Censorship Policy Board on Wednesday they asked if we had any suggestion for the agenda. Have you any ideas?

H.M.JR: Policy Board of Censorship?

MR. GASTON: Yes. That is one that you were supposed to be a member of.

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H.M.JR: The only thing I have got an idea of is when you (Kuhn) go to the MacLeish board, I want to know what, if anything, they are prepared to tell the country in case anything should happen to the Philippines.

MR. KUHN: They talked about it last Monday at great length.

H.M.JR: What are they doing about it?

MR. KUHN: Well, they have got quite a program worked out to show the geographical and strategic realities in the Pacific, for example, to show how many different things--

H.M.JR: Are they doing anything?

MR. KUHN: I believe so. I can show it to you in detail on the minutes of last Monday, if you are interested.

H.M.JR: No, I don't want to see their minutes. I would like to know what is happening. You go there next Monday, don't you?

MR. KUHN: One thing they are going to do, they believe in putting these things out through the mouths of others, but they are getting out a great mass of stuff on the extent of the Navy's commitments, the fact that the Navy has to do jobs in the Atlantic and in Iceland and so on.

H.M.JR: Well, I would like to see what they put out.

MR. KUHN: I don't - I haven't seen anything.

H.M.JR: You go over there Monday, don't you.

MR. KUHN: Yes.

H.M.JR: When you go Monday, see what they have done.

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MR. PAUL: They must have persuaded Hanson Baldwin to write that.

MR. KUHN: I think they do a lot like that.

MR. SCHWARZ: I have heard a couple of articles emphasizing political objectives rather than military, too.

MR. KUHN: They get different people to go to town on these things.

H.M.JR: My answer to you (Gaston) is that I have nothing.

MR. GASTON: Yes. There is a rather important question as to how large the operating board of censorship should be, and my impression is that it ought to be a small board. They have asked us to make a recommendation as to what financial agency should be represented. Unless it conflicts with something else you are doing, I would want to recommend that no other financial agencies except the Treasury be represented on the operating board of censorship.

H.M.JR: Well, Herbert, you handle it anyway that you think right, will you? It doesn't interfere. I mean, it might interest you, but it doesn't interest me.

MR. GASTON: Right. I am planning to go to a Defense Communications Board meeting at ten-thirty.

H.M.JR: O.K. Anything else?

MR. GASTON: That is all.

MR. SULLIVAN: We are getting inquiries about the possibility of extending the date of filing income tax returns from March 15 to 16, because so many people who are paid on a two weekly basis get paid on the sixteenth. For your information, since the fifteenth of March falls

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on Sunday, the people will be permitted to file their returns at any time on Monday the sixteenth, automatically.

H.M.JR: All right.

MR. SULLIVAN: And in the publicity, the Bureau is going to stress that.

H.M.JR: All right.

MR. SULLIVAN: That is all, sir.

Incidentally, the fellow who was doing the announcing of the Rose Bowl game yesterday did about the best job for Defense Bonds and Stamps I have ever heard, and I think we ought to get - I spoke to Harold and Herb and Ferdie - I think they ought to get the transcript of that. It was perfectly swell, what little I heard.

H.M.JR: It is interesting. We were at the White House on New Year's Eve. The President had the radio turned on and waiting for the music and the signals. At just eleven fifty-nine they came on with a very good announcement on Defense Savings Bonds. He seemed to like it. It was just the last thing of the year, was this announcement. It was a very good one and a fitting one. He looked at me and smiled. He seemed to like it.

Paul?

MR. PAUL: I have just come back to find about nine billion dollars, but in the meantime Roy Blough has been preparing, scraping around at the bottom. We are going right into sessions as soon as we get through here.

H.M.JR: When will you want to see me?

MR. PAUL: Well, we can see you--

H.M.JR: Don't hurry, now.

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MR. PAUL: We can see you whenever you want.

H.M.JR: Are you going to be here tomorrow?

MR. PAUL: Oh, yes. I think it will be well to -  
for us to spend the day--

H.M.JR: Do you want tentatively ten o'clock  
tomorrow?

MR. PAUL: All right. There is a memorandum I  
would like to have you read for your information. I  
wouldn't bother you about anything that wasn't - that  
I didn't think quite important, but I have a fairly  
long memorandum which I think you said I was using as  
a Bible. I would like to have you look it over, and  
I will have a copy made for you.

H.M.JR: Will you have it in decent type? If  
you send it in to Mrs. Klots--

MR. PAUL: I will have to send it somewhere,  
because I only have the small type.

H.M.JR: Send it to her.

By one Gilbert?

MR. PAUL: It is written by Gilbert, but it is  
authorized by Henderson who has been over it.

H.M.JR: What else?

MR. PAUL: That is enough from me.

H.M.JR: All right. You look a little weak this  
morning.

MR. PAUL: Well, I don't feel so weak. Of course,  
I have been two nights on the train.

H.M.JR: Have you?

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Dave Morris?

MR. MORRIS: Nothing.

H.M.JR: Ferdie, when are you going to be ready with that speech?

MR. KUHN: Oh, I can show it to you late this morning or this afternoon.

H.M.JR: No, this afternoon is out.

MR. KUHN: Twelve o'clock?

H.M.JR: No.

MR. KUHN: Eleven-thirty?

H.M.JR: What is this, a Chinese auction? Isn't it written?

MR. KUHN: It is, but I want to do it over before I show it to you. It would save your time if I do that.

H.M.JR: Eleven-thirty?

MR. KUHN: Yes, sir.

H.M.JR: You are excused now. You had better go to it.

MR. KUHN: All right, fine.

H.M.JR: Just one thing, who is handling that request for me from the CIO Automobile Workers of Detroit?

MR. KUHN: I sent them a telegram saying that you couldn't let them know right away.

H.M.JR: Who has got that?

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MR. KUHN: I have it.

H.M.JR: Would you send it right in to me now, because I have got to handle the other - there are two others. Would you send it in here?

MR. KUHN: Yes, sir.

H.M.JR: And then eleven-thirty, Ferdie?

MR. KUHN: All right.

(Mr. Kuhn left the conference.)

H.M.JR: Harold?

Have you got any follow-ups, Mrs. Klotz? We usually have something for Harold. No, this has been taken care of.

Roy? How is the old stomach?

MR. BLOUGH: Oh, the stomach is all right.

H.M.JR: I needn't ask how your nerve is. It is all right.

George?

MR. HAAS: Here is a list on the four issues.

H.M.JR: Oh, yes.

MR. HAAS: The second sheet has the names.

H.M.JR: Well, that is a little bit early for me.

MR. HAAS: I can hold it.

H.M.JR: Yes, I think I would hold it.

MR. HAAS: Here are your Savings Bonds. And I

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brought this organization chart up to date.

H.M.JR: Did you give Irey a copy of this?

MR. HAAS: I am going to do that as soon as I get back. I have one on my desk.

H.M.JR: Well, Harold, December is the greatest month. I congratulate you.

MR. SULLIVAN: How much?

H.M.JR: Well, they did five hundred and twenty-eight million, of which the E was three hundred forty-one. We are not going to release the figures until Sunday night.

MR. HAAS: That is all I have.

H.M.JR: Harry?

MR. WHITE: You remember we wrote to the Minister of South Africa turning down their request on the gold mines and equipment. They wrote back another letter in which they are very, very sorry and so on, but they are going to come back at us with their dollar exchange position, which is what we wanted, and which they didn't want to tell us before, and here is a letter for your signature saying that we will be glad to consider that as soon as they bring it in. I have got about eight or ten items here which really can't wait much longer.

H.M.JR: Good. Eleven o'clock. What did you do about this Russian protocol thing that the President wrote about.

MR. WHITE: That is one of the things I have. It is ready for your signature.

H.M.JR: Well, I will give you half an hour. We

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ought to be able to do a lot of business if you are ready.

MR. WHITE: We are ready.

H.M.JR: Anything else?

MR. WHITE: All of this can wait.

H.M.JR: Norman?

MR. THOMPSON: I have just a couple of personnel things.

H.M.JR: We will do it now. O.K.

January 2, 1942  
9:41 a.m.

HMJr: Hello.

Operator: The Secretary is on the wire.

Justice  
Byrnes: Hello. Henry.

HMJr: Good morning.

B: What proportion of the monies that you have frozen are enemy funds, as distinguished from alien funds, not enemy?

HMJr: Now wait a minute. Let me write this down. What's this question you're asking me?

B: I'm asking you this. That Justice order that I talked with Foley about provides for enemy property.....

HMJr: Enemy property.

B: .....as distinguished from alien property.

HMJr: Enemy property as distinguished from alien.

B: Yeah. Now what I want to know is, how much alien property you have that's not enemy. You've got some like that, I understand.

HMJr: How much alien property we've got and how much enemy property we've got.

B: Well, if you just give me the alien property.

HMJr: Well, I can't do it offhand, but I'll get it for you.

B: All right. Ask them to ring me direct. I thought you might have some idea. Your boys are under the impression that all of the property of every nature and description, but I was reading the thing that night after they left - night before last - and I saw that this order made the distinction as between enemy property and alien.

HMJr: Right.

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B: And I understand you've got gold from some - you've got.....

WJr: We've got about eight billion dollars worth of property.....

B: In all.

WJr: .....in all, yes. And I'll try to have it broken down.

B: Well, just tell them not to go to any work, but just give me the alien - the amount of the aliens that are not enemies. That will answer it. I can deduct that from the eight, you know.

WJr: Yeah.

B: Fine. How are you?

WJr: I'm all right. I've got - I've asked for some help on this. I got a fellow by the name of B. W. Edwards to come up here to advise me.

B: Yeah.

WJr: Yeah.

B: Well, he's all right to advise on some things, but he doesn't know an alien because he's never had occasion to talk to one.

WJr: He's sitting right here now.

B: Well, he knows enemies - he's had some enemies - but he hasn't had any aliens.

WJr: Well, I just - well, I needed some advice so.....

B: It's all right.

WJr: .....I just wanted to let you know he's in town.

B: Give him my regards.

WJr: He'll be coming to see you.

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B: Fine.

HDJr: Okey.

B: Good-bye.

January 2, 1942

Dear Mr. Justice Byrnes:

Attached is a memorandum giving the information in regard to the amount of enemy property in the United States compared with the total amount of property under foreign funds control, which you requested of Secretary Morgenthau over the telephone this morning.

Yours sincerely,

(Signed) E. H. Foley, Jr.

Mr. Justice James F. Byrnes

The Supreme Court

Enclosure

EHF:s 1-2-42

DRAFT (Dictated over the telephone by Miss Dygert - 1/2/42, 3:30 p.m.)

Mr. Foley

Mr. Pehle

Justice Byrnes has inquired as to the amount of enemy property in the United States compared with the total amount of frozen property.

The total amount of property subjected to the freezing control is around 7-1/2 billion dollars. This property may be divided into the following main categories:

Barmarked gold	2.038 billion
Deposits	1.954 billion
Securities	1.993 billion
Direct investments	.549 billion
Miscellaneous	9 hundred million

In determining the amount of "enemy property" in the United States it is necessary to decide which areas are to be included in the concept of enemy territory. Under the definitions contained in the Trading with the enemy Act and in one of the drafts of the Executive Order prepared by the Department of Justice, the term "enemy territory" would include all territory occupied by the military, naval, or police forces of the enemy. The only blocked areas which fall outside this group are the unoccupied portions of China, the Dutch East Indies, Russia, the Free French and Belgian colonies, and the four neutral countries in Europe: Portugal, Spain, Sweden, Switzerland. A rough estimate of the amount of frozen funds held for these non-enemy blocked areas is two billion.

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The great bulk of this two billion, i.e., 1.3 billion, is in Swiss assets. Obviously much of the Swiss assets are actually enemy assets which have been concealed in Swiss names. The same is true to a lesser degree of other neutral countries.

The only other substantial amount of frozen assets which are not clearly enemy assets are the assets of blocked nationals who themselves are within the United States. The amount of these assets is roughly estimated at 400 million dollars.

January 2, 1942  
10:34 a.m.

HWJr: How are you?

Harold Salts: Pretty good.

HWJr: How are you coming along with the state of the nation?

B: Well, I tell you what they did on that.

HWJr: Yeah.

B: I began to nose around a little bit, and I found that much of the thing that the President was asking me to do had been done and had been done better than I could do.

HWJr: I see.

B: And what I did was to get MacLeish and Stacy May together.....

HWJr: I see.

B: .....and they had most of the stuff, and it had some bugs in it and we got some revision of it and MacLeish is taking it to - apparently Sherwood and Roseman are going to work on this draft.

HWJr: I see.

B: So I think - and I called Miss Tully about it to tell the President - so I think we've - at least I feel I have - discharged my obligation on the thing as best I can.

HWJr: I see. Well, he left it so up in the air I.....

B: Yeah, didn't he? I wasn't sure whether I had an assignment or whether you had one.

HWJr: Well, I didn't either, and that's really why I was telling you.

B: I felt sure, too, that he had asked somebody else

- 2 -

to do this and I found that he had asked Nelson and the Vice President to get some stuff together on production, and so we just improved and added to what they had done.

HMJr: Well, I didn't want to get a call from the White House about midnight tonight and say where was something?

S: Yes.

HMJr: So you think that's.....

S: I think it's all taken care of.

HMJr: Now, how's the Budget message coming?

S: Well, we haven't even had a chance to talk to the President about it yet.

HMJr: Yeah. Well, if and when that part which affects us, or as much as you'd care to let me see of it, I would like to see it.

S: Yeah. All right. I think if we can have a chance to go - we haven't even had a chance to discuss - he hasn't seen any of it - he hasn't had a chance to discuss the expenditure side with respect to NYA, CCC, and so on. We've got some real problems which we haven't resolved with him yet.

HMJr: Well, the philosophical side is what I'm more interested in.

S: Yeah, yeah.

HMJr: So if you felt inclined, why I would appreciate it.

S: Yeah. All right.

HMJr: I mean, particularly - well, as much as the - you know.

S: Yeah. All right. Well, wait until we get a chance to go over it with him once and see what his reaction is to the whole.

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HMJr: Right.

S: He'd probably want it revised.

HMJr: All right.

S: Yeah. All right.

HMJr: And I've got you down for lunch today.

S: Yeah. Okay.

HMJr: Fine. Thank you.

S: Good-bye.

January 2, 1942  
11:13 a.m.

WJr: It's a little bit late, but I could still undo it.

Dr. Jacob  
Viner: Yes.

WJr: Do you know Mollie Ray Carroll?

V: Yes.

WJr: We're thinking of - in fact, we've practically agreed to take her on under Thompson.

V: That's terrible.

WJr: Hello.

V: She's terrible.

WJr: She's terrible?

V: Yes. She's high-strung and unstable and gets into rows.

WJr: Oh, my God. She's terrible, huh?

V: Oh, yes. And muddle-headed.

WJr: Oh, God. No good in personnel work?

V: Oh, she'd be just impossible.

WJr: Oh, really?

V: That's where she'd be worst of all.

WJr: Oh, my God.

V: She gets into fights and quarrels and sulks and so on.

WJr: Oh, really?

V: Yes.

WJr: Oh, my God. Well, I'll just have to undo it.

All right. If I could only have gotten you fifteen minutes earlier - I just saw her. I tried to, but - but in personnel work she'd be terrible?

- V: I'm sure of that, because she was - she's had a record of that sort, of not being able to hold a job because of personality difficulties.
- HMJr: Oh, gee. Well, I'll try to - I'll have to find some excuse and undo it. But that's what - it was in personnel work that I wanted her.
- V: Oh, no. I'd say not at all.
- HMJr: All right.
- V: Of course, this is an impression I have. I've known her a little over the years, for many years.
- HMJr: Yeah.
- V: Yes. And it's been one failure after another.
- HMJr: Oh. Well, I should have called you first. Okay, Jake. When are you coming down?
- V: Sunday morning.
- HMJr: Righto. Good-bye.
- V: Good-bye.

Telephone Conversation with Dr. Harry Millis  
National Labor Relations Board  
January 2, 1942 - 2:25 P. M.

- Mr. White: Secretary Morgenthau asked me to get in touch with you. Jack Viner informed the Secretary that you would know a Miss Carroll, who is applying for a position here in the Personnel Division. The Secretary asked me to call on you and if you would prefer not to discuss the matter over the telephone, I shall be glad to come to your office but I thought possibly you might feel at liberty to tell me over the phone.
- Mr. Millis: Miss Carroll? She is now in the Department of Labor. Molly Carroll. -- What about her? What kind of a job?
- Mr. White: I am not certain but I think the position is for a person to see what can be done to improve the quality of the personnel and possibly to eliminate friction between various minority groups and be certain that tolerance, good judgment and complete justice is exercised in the selection of personnel.
- Mr. Millis: This woman I knew before she went into graduate work in Chicago. She was a Y.W.C.A. worker in Kansas. She took a Doctors degree -- wrote a thesis under me. I know her history.
- I would say she is not at all the woman for any such place. She does not understand people. She doesn't have that particular insight into people. I think one reason is she does not have the interests found in all sorts of people. She doesn't understand.
- Mr. White: That is a quality I believe would be essential for the position the personnel people have in mind -- an understanding of people.
- Mr. Millis: For that particular thing, I should say there must be a lot of people better than she.
- Mr. White: Thank you very much. I will pass that on to Secretary Morgenthau.
- Mr. Millis: I wouldn't want that repeated.
- Mr. White: That will be just for his ears. Thank you very much indeed.

January 2, 1942

HM Jr's pencilled notes on ideas for his speech  
delivered on 1/4/42.

I don't look  
 this way  
 with your help  
 we'll just  
 see a lot  
 harder it.  
 and this was  
 we can't  
 to get it  
 of a  
 the audience

processed with  
Lesy 1130  
1/1/42  
197  
DRAFT OF SECRETARY MORGENTHAU'S BROADCAST  
"THE JOB AHEAD"  
January 4th, 1941

1st draft

Tonight I can give you proof that we remember Pearl Harbor. I am happy to report to you that in the month of December more than five hundred million fighting dollars for fighting men poured into the Treasury from the sale of Defense Savings Bonds. Actual cash deposits from Defense Bond sales reached the record total of \$528,598,000 -- a total almost twice as large as the average for the previous seven months. Let our enemies take notice. This magnificent response is just one sample and one foretaste of what our people will do, in every field of the war effort, now that they are awake and aroused to their country's danger.

D-1

It is especially good news to me, and I think to you, that \$341,000,000 of the December total came from the sale of the Series E Bonds, the "people's bonds", that sell for as little as \$18.75. The sales of Series E Bonds are almost three times what they have been in previous months. I can give you no estimate as yet of the sales of Savings Stamps in December except that they are far ahead of any previous monthly figure. All this indicates that great numbers of people with moderate and small incomes have already acquired the good habit of saving for their country.

The rush to buy bonds was so great this month that there was a period, and there may still be such a period in some cities, when the supply of bonds ran out. We just couldn't supply the bonds fast enough after Pearl Harbor.

In Honolulu, while the smoke from Pearl Harbor still darkened the sky, the citizens of Hawaii replied to the bombs by buying bonds ten times as fast as ever before, and we had to authorize the issuance of receipts in place of bonds to meet the demand. As a result of that superb demonstration, and many others like it throughout the country, we promptly placed the Bureau of Engraving and Printing on a 24-hour basis. All night, every night, the presses are at work, and we now have several weeks advance supply of bonds to meet the demand that has not yet slackened and I am confident will never slacken until the war is won.

It is important, however, to keep a sense of proportion in figures as in grand strategy. In the month of December your Government spent four times as much on the war effort

as you subscribed in Defense Savings Bonds. In the months to come it must spend at a far greater and ever increasing rate. Next Tuesday you will hear Budget estimates calling for such huge expenditures in the coming year that even the half billion record you established in the purchase of Defense Bonds in December will seem to be small and almost insignificant. Wars are never cheap, but it's a million times cheaper to win than to lose. The cost of our war effort should frighten no one but our enemies. To us, it is just a measure of the size of the job ahead.

Now that we have embarked on a life and death struggle, we cannot compromise, we cannot hold back, we cannot delay in supplying our fighting men with the tools of war they need. Nothing short of overwhelming preponderance of planes, of ships, of tanks, of guns will serve to smash

the combination of enemies that boasts that it will break our world, our American kind of world, asunder. We cannot produce those weapons just by waving a magic wand. We shall have to produce them with sweat and muscle; we shall have to pay for them.

That is the chief reason why there is a direct obligation upon every one of us to buy Defense Bonds and to go on buying them, to win the war. But there is another secondary reason that is almost as compelling. We have another war to fight on the home front, the war against another treacherous and dangerous enemy, inflation. It is up to us to pay for victory in such a way as to avert a rising cost of living, with all the evils which that can bring. If we at the Treasury were to rely only on the banks for our borrowings, or if we were to encourage you

to buy bonds by taking your savings out of the savings banks, we should be encouraging the civilians of this country to spend their incomes on goods which are urgently needed for the war effort. We should thus be encouraging a rise in prices, and with that a rise not only in the cost of living for every citizen, but a wholly unjustified rise in the cost of war to the Government and to the people of this country. Therefore, it has seemed essential from the beginning, and doubly, triply essential now, that we borrow as much as possible out of the current earnings of our people. I want the purchase of Defense Bonds to come out of pay checks rather than out of bank deposits. I want every pay day to be bond day from now on, for everyone in this country who receives a regular income.

You may ask "What is the Treasury's goal? Can't the Treasury give us some figure to shoot at?" I have had such questions sent to me repeatedly, and I have answered repeatedly that I am more interested in the kind of money we raise than in the amount. But the Treasury does have a goal, and I should like you to regard it as one of your solemn obligations to your country to see that we reach that goal in the shortest possible time. That goal is to have every one of the 35 million men and women who work for regular pay put a part of that pay aside systematically every week, every pay day, for the purchase of Defense Bonds and Stamps. And when I say "a part" I do not mean a mere token contribution of a few nickels every week, or the mere contribution of one percent or two percent of the weekly pay check. This is not a token war. It

is not a two percent war. It is not a war that can be won with spare change. Each of us will have to figure out the very most that we can set aside, for our own good and for our country's good, as long as the war may last.

I suggest that each of us sit down this very evening to study our family budget; that each of us decide this very evening, not the least but the most that we can afford every week; that we then translate that amount into a percentage of our pay, five, ten, or fifteen percent, whatever we choose, and stick to it by setting that percentage aside week after week without fail. The more bonds we buy, the more planes will fly. Remember, every bond we pledge ourselves to buy will strike a blow at our enemies. Remember, also, that every dollar we pledge to set aside now will come back to us with interest on that brighter, happier day when victory is ours.

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The industrial workers of this country are making a good start. Voluntary pay roll savings schemes are now in operation in thousands of factories, and in most of our largest business concerns. Until now a very small fraction of employees have taken advantage of these plans. Since Pearl Harbor the extent of participation has been much greater, and I am receiving reports already of some companies in which 90 percent or more of the employees are setting aside a part of their pay each week and are receiving Defense Bonds as they accumulate their savings. But the response from industrial workers so far is only a beginning. The extent of their participation, and the amounts that they subscribe, must be increased sharply if we are to reach our goal.

What I am saying now applies not only to factory workers

but to accountants and teachers, to civic employees of all kinds, and above all to farmers who are receiving solid income for the first time in many years and who will be the first to suffer if inflation is allowed to get out of hand as it did in the years that followed the first World War. I should like to see all of America lined up in a vast army of 130 million, using their dollars to support and sustain their fighting men in the front line. Those fighting men are looking to us right now. They are looking to us from the Philippines and Iceland, from the silent gray ships that are guarding our shores, from all the posts of danger in all the seven seas -- they are looking to us to keep them supplied and do our part as they are doing theirs. I want those men to be able to look back home and see us standing shoulder to shoulder, with all sections, all groups, all the old divisions and dissensions swept away in our

D-A

united resolve to win this war.

I would not pretend that purchase of Defense Bonds is all we need to do here at home to win the war. We shall be called upon for all kinds of hardship and sacrifice, for the complete abandonment of our old standards of luxury and convenience and ease. But I do say that the buying of Defense Bonds is the first thing we can do. It is the first test of our willingness to back up our soldiers and sailors and airmen. Let us then resolve to be worthy of those men in uniform. Let us prove that we will lend to defend our right to be free -- and that we will pledge our lives, our fortunes and our sacred honor until victory is won.

Mr Kuhn took to  
Jays house

9 pm 1/2/41.

DRAFT OF SECRETARY MORGENTHAU'S BROADCAST  
"THE JOB AHEAD"  
January 4th, 1942

209

*2nd draft*

Tonight I can give you proof that the country remembers Pearl Harbor. I am happy to report to you that Defense Bond sales in the month of December produced more than five hundred million fighting dollars for fighting men. Actual cash deposits from Defense Bond sales reached the record total of \$528,500,000 -- ~~a total~~ *about* ~~almost~~ *twice* as ~~large~~ as the average for the previous seven months.

This ~~magnificent~~ *grand* response is just one sample ~~and~~ ~~one foretaste~~ of what our people will do, in every field of the war effort, now that they are awake and aroused to their country's danger. Let the Nazis, the Japanese and their satellites take notice.

D-B

It is especially good news to me, ~~and I think to~~  
~~you~~ that \$341,000,000 of the December total came from  
the sale of the Series E Bonds, the "people's bonds",  
that sell for as little as \$18.75. The sales of Series E  
Bonds ~~are almost~~ three times what they have been in previous  
months. I can give you no estimate as yet of the sales  
of Savings Stamps in December except that they are far  
ahead of any previous monthly figure. All this indicates  
that the American giant has stirred from his long sleep,  
~~and~~ that great numbers of people with moderate and small  
incomes have already acquired the good habit of saving for  
their country.

The rush to buy bonds was so great this month that  
there was a period, and there may still be such a period  
in some cities, when the supply of bonds ran out. We just

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couldn't supply the bonds fast enough after Pearl Harbor. In Honolulu, while the smoke from Pearl Harbor still darkened the sky, the citizens of Hawaii replied to the bombs by buying bonds ten times as fast as ever before, and we had to authorize the issuance of receipts in place of bonds to meet the demand. As a result of that superb demonstration, and many others like it throughout the country, we promptly placed the Bureau of Engraving and Printing on a 24-hour basis. We're glad that the country is pushing us. We like to be pushed. The presses are at work all night, every night. We now have several weeks' advance supply of bonds to meet the demand which has not yet slackened and which, I am confident, will never slacken until the war is won.

It is important, however, to keep a sense of proportion in figures just as in grand strategy. In December your Government spent four times as much on the war effort as you subscribed in Defense Savings Bonds. In the months to come it must spend at a far greater and ever increasing rate. Next Tuesday you will hear Budget estimates calling for such huge expenditures in the coming year that even the half billion dollar record you established in the purchase of Defense Bonds in December will seem to be ~~small and almost~~ insignificant.

Wars are never cheap, but it's a million times cheaper to win than to lose. The French, the Czechs, the people of a dozen conquered and ravaged countries, can tell us what it costs to lose. We have made up our minds to win. We have made up our minds to produce and to use such an

overwhelming preponderance of planes, of ships, of tanks, of guns and of trained and fully equipped men, that the Nazis and Japanese and their kind can never again threaten our freedom. The cost of our war effort should frighten no one but our enemies. To us, it is just a measure of the size of the job ahead.

If this were a different kind of war, I should not be speaking to you in your homes tonight about the job that faces us. But this is a people's war. Everything that the people of this and other free countries have won through centuries is now at stake. You will want me, as Secretary of the Treasury, to finance this people's war by going to the people themselves for the sinews of war. I am not going to finance this war by depending primarily on the financiers. I am depending on you, on each and every one

of you who may be listening to my voice this evening. In particular, I am depending on the 35,000,000 American men and women who earn regular pay.

You may ask "What is the Treasury's goal? Can't the Treasury give us some figure to shoot at?" I have had such questions sent to me repeatedly, and I have answered repeatedly that I am more interested in the kind of money we raise than in the amount. But the Treasury does have a goal, and I should like you to regard it as one of your solemn obligations to your country to see that we reach that goal in the shortest possible time. <sup>The Treasury's</sup> That goal is to make every pay day Bond day -- for everyone. It is to have every wage-earner and salary-earner put aside a part of every pay check, every week, for the purchase of Defense Bonds and Stamps. And when I say "a part" I do

not mean a mere token contribution of a few nickels every week, or the mere contribution of one percent or two percent of the weekly pay check. This is not a token war. It is not a two percent war. It is not a war that can be won with spare change. Each of us will have to figure out the very most that we can set aside, for our own good and for our country's good, as long as the war may last.

The industrial workers of this country are making a good start. Voluntary payroll saving schemes are now in operation in thousands of factories, and in most of our largest business concerns.

Many of you already know about these payroll saving plans. The most popular of them is a method by which you or your union can tell your company how much you wish to

set aside from your pay. Your company accumulates your savings for you, and when you have enough to buy a bond your company will deliver the bond to you, registered in your own name. That is all there is to it. Until now a very small fraction of employes have taken advantage of these plans, and a comparatively small proportion of employers have agreed to provide the facilities. Since Pearl Harbor the extent of participation has been much greater, from labor and from management alike. I am receiving reports already of some companies in which 90 percent or more of the employes are making good use of this easy road to voluntary saving. We intend to recognize such participation by giving a flag to every company with 100 or more employes in which 90 percent or more of the working men and women are saving systematically for their country.

But the response from industrial workers so far is only a beginning. If you haven't heard about voluntary payroll saving, or if the details haven't been explained to you, or if your company has refused to install such a scheme for you, I wish you would write to me at the Treasury Department in Washington. It's the Treasury's responsibility to tell you about payroll saving; our State organizations are ready to tell you all about it, and if necessary to send someone to your factory to explain it to you.

I am ~~talking~~ in dead earnest when I say that millions more must take part in these payroll saving plans, and must invest hundreds of millions of dollars more, if we are to reach our goal. Our plans at the Treasury for financing the war are based upon the assumption that the

American people will want to pay a big share of the cost of the war, of their own free will. The response to payroll saving will tell us whether that assumption is right or wrong.

~~It will tell us whether our war financing program will succeed or fail.~~ I have such faith in the American people that I believe they will want to do the job in the voluntary way -- but it is up to you to prove it, ~~to me~~. And when I say "you" I mean not only factory workers, but accountants, teachers, salaried employes of all kinds, and also the farmers who are receiving substantial income for the first time in many years.

I suggest, then, that each of us sit down this very evening to study our family budget; that each of us decide this very evening, not the least but the most that we can

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afford every week; that we then translate that amount into a percentage of our pay, five, ten, or fifteen percent, whatever we choose, and stick to it by setting that percentage aside week after week without fail. Remember, the more bonds we buy, the more planes will fly. Remember, every bond we pledge ourselves to buy will add to the weight of the bombs that will fall on Tokyo and Berlin. Remember, also, that every dollar we pledge to set aside now will come back to us with interest after that brighter, happier day when victory is ours.

*It is high time for*  
~~I should like to see~~ all of America lined up in a vast army of 130 million, using <sup>our</sup> their dollars to support and sustain <sup>our</sup> their fighting men in the front line. Those fighting men are looking to us right now. They are looking to us in our homes and factories, looking from the Philippines and Iceland, from the silent gray ships that are guarding

D-B

our shores, from all the posts of danger in all the seven seas -- looking to us to keep them supplied and to do our part as they are doing theirs. ~~I want~~ those men <sup>must</sup> to be able to look back home and see us standing shoulder to shoulder, with all sections, all groups, all the old divisions and dissensions swept away in our united resolve to win this war.

I would not pretend that purchase of Defense Bonds is all we need to do here at home to achieve victory. But I do say that the buying of Defense Bonds is the first thing we can do. It is the first test of our willingness to back up our soldiers and sailors and airmen.

Let us, then, resolve to be worthy of those men in uniform. Let us prove that we will lend to defend

our right to be free -- that we will pour out a mighty torrent of dollars "to defend life, liberty, independence and religious freedom . . . against savage and brutal forces seeking to subjugate the world." At first sight the amount of money we have to raise through borrowing and taxes may seem impossible, but we in the Treasury have struck the word "impossible" out of our dictionary. With your help we are going to do the job.

January 2, 1948  
11:50 a.m.

WJr: Hello.

Colonel  
Smith: Mr. Secretary, this is Smith.

WJr: Good morning.

S: You wanted a report on the anti-aircraft situation.

WJr: Yes, I do.

S: It is as follows. The three radio detector sets  
belonging to this regiment here are in operation.

WJr: Good.

S: Three additional, giving them a hundred per cent  
increase in their normal table of organization,  
are also here and are being tuned up now and will  
be in operation in about three or four days.

WJr: Yeah.

S: That makes them six. An experienced battery from  
Fort Monroe is en route here and will be here at  
five o'clock tomorrow night.

WJr: Five o'clock Saturday night.

S: Yes, sir.

WJr: Yeah.

S: As soon as it gets in, it will take over for one  
of the batteries here, which will then move on  
down to Monroe by rail or motor and put in its  
little firing period down there.

WJr: Would that have happened if you hadn't followed  
up for me the other day?

S: It would not.

WJr: I mean, let's be honest with each other.

S: No, it would not.

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HMJr: If I hadn't of called you - when did I call you, New Year's Day?

S: That's right, sir; it would not.

HMJr: I mean, it would not have happened.....

S: I don't think it would.

HMJr: I mean, you got them to do it after I called you yesterday.

S: I think that's the answer, Mr. Secretary.

HMJr: Well, I think it's a.....

S: I give them the benefit of the doubt; but I did it by telephone, as a matter of fact, yesterday.

HMJr: Yeah. Well, now.....

S: Of course, you've got to give these people credit. They're looking at definite military objectives.

HMJr: Well, what is Washington?

S: You see what they're up against.

HMJr: Well, what's Washington?

S: Well, they don't think much of Washington as a military objective. They think of the ships and the lading at Hampton Roads, and the naval dry dock down there, and things of that sort.

HMJr: Well, how about our President?

S: Well, that's something that probably didn't occur to them.

HMJr: Yeah. Well.....

S: However, it's done.

HMJr: Well, you and I are together, and I appreciate your getting after them. Now, let me ask you this, if I had time Sunday to run and take a look at these

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Radars and this battery - it wouldn't take more than an hour, would it?

S: I think it would be nice.

HMJr: Would it take more than an hour?

S: No, it certainly wouldn't. It would take you an hour to get around to all of them, but you don't want to see more than one or two of those Radars, do you?

HMJr: No, I'd like to see one, and see this new battery. Would it be in place by - in the morning? Sunday morning?

S: I think it will, yes, sir. I'd have to call up Hawes to verify that; but if it comes in tomorrow night, I think they would have taken over by Sunday morning.

HMJr: Well, I tell you what I'm going to do. Supposing - I'll get in touch with you Sunday morning. It won't be too early, see?

S: Well, I'll be at my office at eight o'clock.

HMJr: You will?

S: Yes, sir.

HMJr: Well, could you slip away for an hour or do you have to prepare in advance.

S: Certainly, I'll be glad to, Mr. Secretary. No, sir.

HMJr: Well, I'll see how I feel Sunday and I'll give you a ring, and then maybe we can go around for an hour.

S: All right, Mr. Secretary.

HMJr: But I'm certainly - now, let me think what else. Well, that's a good day's work.

S: I wanted - I have something here I wanted to read to you.

HMJr: Yeah.

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S: You were interested in the performance of our airplanes.

WJr: Yeah.

S: This is a report from the American Volunteer Corps in China, which is now being incorporated into the Army, on their operations.

WJr: Oh, from our friend Colonel Chenault.

S: Chenault, yes, sir.

WJr: I know him well.

S: They have in the period - I've sent this message out - but in the period that he mentioned, I think a period of about four weeks.....

WJr: Yeah.

S: .....they had destroyed sixteen Japanese four-engine bombers and I think it was twenty-one pursuit planes. They had four planes destroyed, and six damaged but capable of prompt repair.

WJr: That's wonderful.

S: That's a good record.

WJr: That's wonderful. When I see you Sunday, I won't ask you over the phone, tell me - bring me up to date on what the anti-aircraft situation is at Corregidor.

S: Yes, sir. Well, the anti-aircraft - at Corregidor.

WJr: Corregidor.

S: Oh, yes, sir. I will.

WJr: At Corregidor.

S: Yes, sir. I will.

WJr: I think I know, but I'm going to ask you when I see you.

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S: All right, sir. I'll tell you the whole story about that.

HMJr: What?

S: I can tell you a good deal about Corregidor.

HMJr: Yeah. Well, I'd like to - if it's still there, I'd like you to tell me about it.

S: Oh, it's there. It'll be there for about three months.

HMJr: I hope you're right.

S: Oh, I think we're right. We got a pretty good estimate yesterday.

HMJr: Did you?

S: I'll show you the radio.

HMJr: Thank you.

S: All right, Mr. Secretary.

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January 2, 1942

Dear Harold:

For your information I am enclosing copy of the proposed Executive Order which we discussed at luncheon today.

The order embodies an arrangement which was agreed to at a luncheon held in my office on December 13, attended by Attorney General Biddle, Leo Crowley, Ed Foley and myself.

The order which the Department of Justice has prepared does not follow the compromise agreed upon, but in effect turns over the entire administration of Foreign Funds Control to the Department of Justice.

I am also enclosing a memorandum which discusses the administration of Foreign Funds Control in the Treasury.

Sincerely,  
(signed) Henry Morgenthau, Jr.

Hon. Harold L. Smith  
Director, Bureau of the Budget  
State Department Building  
Washington, D. C.

Enclosures.

EMF:mp 1/2/42

Sent by Special Messenger at 5:00 p.m.  
1/2/42.

EXECUTIVE ORDER

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VESTING POWER AND AUTHORITY IN DESIGNATED  
AGENCIES PURSUANT TO THE TRADING WITH THE  
ENEMY ACT, AS AMENDED, AND RELATED MATTERS.

By virtue of and pursuant to the authority vested in me by the Trading with the enemy Act, as amended by the First War Powers Act, 1941 (Public No. 354, 77th Congress), by virtue of all other authority vested in me, and by virtue of the existence of a period of unlimited national emergency and a state of war involving the United States of America, and finding that this Order is in the public interest and is necessary in the interest of national defense and security, I, FRANKLIN D. ROOSEVELT, PRESIDENT of the UNITED STATES OF AMERICA, do order and prescribe the following:

Section 1. There is hereby established a Foreign Property Control Board (hereinafter referred to as the "Board") which shall consist of the Secretary of State, the Secretary of the Treasury, and the Attorney General or representatives

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appointed by each of them. The Secretary of the Treasury or the representative appointed by him shall act as Chairman of the Board. The Alien Property Custodian (hereinafter referred to as the "Custodian") shall sit with the Board, but shall not vote except as the representative of the Attorney General.

Section 2. When directed by the Board, any property or interest of any business enterprise doing business within the United States and which is a national of a foreign country designated in Executive Order No. 8389, as now or hereafter amended, and any property or interest in any such enterprise of a national of any such foreign country, shall vest in the Custodian, as, and upon the terms directed by the Custodian; and such property or interest shall thereafter be held, used, administered, liquidated, sold or otherwise dealt with by the Custodian in the interest of and for the benefit of the United States upon such terms and conditions as the Custodian may prescribe; and the Custodian may perform any and all acts incident to the accomplishment and furtherance of these purposes.

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When directed by the Board, the Custodian shall also supervise, manage or otherwise direct or control the activities of any business enterprise doing business within the United States and which is a national of a foreign country designated in Executive Order No. 8389, as now or hereafter amended; and for this purpose the Custodian shall exercise such powers and authority as are necessary in connection with such direction or control. The Custodian shall have access to all reports and other information, relating to the activities of any such business enterprise, which have been obtained by other agencies referred to in this Order; and, where deemed by him necessary, he is authorized and empowered to make investigations of the activities of any such business enterprises either before or after any vesting order.

To the extent necessary for the Custodian to carry out his functions under this section and section 3 hereof, there are hereby delegated to the Custodian all powers and authority conferred upon me by sections 3(a) and 5(b) of the Trading with

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the enemy Act of October 6, 1917 (40 Stat. 411), as amended by sections 301 and 302 of Title III of the First War Powers Act, 1941 (Public No. 354, 77th Congress).

Section 3. Subject to the provisions of Section 2 hereof, any property or interest of any foreign country designated in Executive Order No. 8389, as now or hereafter amended, or national thereof shall vest, when directed by the Board in such agency or person as may be designated by the Board; and such property or interest shall thereafter be held, used, administered, liquidated, sold or otherwise dealt with by such agency or person in the interest of and for the benefit of the United States upon such terms and conditions as such agency or person may prescribe; and such agency or person may perform any and all acts incident to the accomplishment and furtherance of these purposes.

Section 4. No property shall vest pursuant to the provisions of this Executive Order unless such property is owned or controlled, directly or indirectly by any one or more of the following:

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(1) The Government of any country with which the United States is or shall be hereafter at war;

(2) The Government of any ally of any country with which the United States is now, or shall be hereafter, at war; (3) a person situated in or doing business in a country falling within either category (1) or (2) above; (4) Any person situated outside the United States who is acting for or on behalf of any one or more of the foregoing; (5) any person who is now, or hereafter shall be, interned as an alien enemy pursuant to Section 21 of Title 50 of the United States Code; provided, however, that any finding by the Board that any person falls within any of the foregoing categories shall be final.

Section 5. Subject to the foregoing provisions, there are hereby delegated to the Secretary of the Treasury all powers and authority conferred upon me by sections 3(a) and 5(b) of the Trading with the enemy Act of October 6, 1917 (40 Stat. 411), as amended by sections 301 and 302 of Title III of the First War Powers Act, 1941 (Public No. 354, 77th Congress); provided, however, that the Secretary of the Treasury shall not extend the provisions of

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Executive Order No. 8389, as amended, to any additional foreign countries and nationals thereof. All such powers and authorities shall be exercised by the Secretary of the Treasury with the advice of the Board.

Section 6. Any outstanding order, proclamation, regulation, ruling, license or instruction issued pursuant to sections 3(a) or 5(b) of the Trading with the enemy Act, as amended, shall remain in full force and effect, unless and until amended or revoked by the Secretary of the Treasury or rendered inoperative by a vesting order, issued pursuant to the provisions hereof.

THE WHITE HOUSE,

January , 1942.

MEMORANDUM FOR THE PRESIDENTTHE ADMINISTRATION OF FOREIGN FUNDS CONTROL:  
APRIL 1940 TO DECEMBER 1941.1. Inception and rapid extension of the Control.

The Foreign Funds Control program was initiated in April 1940 by freezing the assets in this country of Denmark and Norway when Germany invaded these two neutral countries. As other countries were invaded or dominated by the Axis, the Control was successively extended during the summer and fall of 1940 to the assets of the Netherlands, Belgium, France, and the Baltic and Balkan states. In June 1941, the Control was extended to Germany and Italy and to the rest of continental Europe. Shortly thereafter Japan and China were also frozen. At present the Control covers over \$7,000,000,000 of assets and the transactions of 33 countries, including all of continental Europe (except Turkey), and China and Japan, and their nationals. The frozen assets in this country consist not only of bank deposits, gold and securities, but also a great number of business enterprises as well as merchandise, patents and other forms of property. The Control affects all financial, commercial and trade transactions in which the 33 countries or their nationals have an interest, whether such transactions are purely domestic transactions or transactions in foreign exchange or foreign trade.

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2. Purposes and shift in emphasis.

The original purposes of the Foreign Funds Control were primarily to prevent the assets of the invaded countries from falling into the hands of the invaders, and to protect American institutions from possible adverse claims arising out of the invasion. As the International crisis deepened there was a distinct shift in the emphasis of the Control from a role of benevolent protection to one of active economic warfare.

The inability of the Axis to use the dollar assets of the countries covered by the Control and to acquire other dollar assets has greatly impaired the ability of the Axis powers to finance propaganda, sabotage and other subversive activities in the United States and other areas of strategic importance to this country. The Control has prevented the Axis countries and their satellites from using the American dollar, and American banking and financial facilities for commercial and other activities in the United States and other parts of the world. Through the Control, we are taking appropriate steps to nullify or eliminate vicious and undesirable influences in business enterprises in this country owned and dominated by the Axis. The Control safeguards the interests of American creditors of blocked countries by preventing those concerns which are able to negotiate special deals with the Axis from receiving preferential payments at the expense of other American creditors.

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The Control has not been confined to the regulation of banking and financial transactions. It also is an instrument for controlling all exports and imports between the United States and a large portion of the world. For example, the Control was instrumental in effecting a complete stoppage of all trade, import as well as export, with Japan.

### 3. Operation of the Control.

The effective conduct of modern economic warfare requires a highly flexible organization, and a trained, competent, and imaginative staff capable of rapid adjustment to constantly changing problems. During the course of the past twenty months the Treasury Department has built up such an organization which is now effectively operating on a nationwide scale. The Control is centered in and directed from Washington, yet it has succeeded in delegating to its field offices, the twelve Federal Reserve Banks, major segments of the task. Since economic warfare is essentially the effective application of financial controls which can be applied only through the banking system, the Treasury selected the Federal Reserve Banks to act as its field offices in administering the Control. Through the Federal Reserve Banks the Treasury is able over night to reach the banks of the country and to put into effect new regulations as rapidly changing conditions demand. There has been established at each of the Federal Reserve Banks a competent staff familiar with the intricate problems faced by the Control,

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experienced in the handling of complex financial operations, and in constant communication with the financial institutions of its district. In the Federal Reserve Bank of New York this staff consists of approximately 500 persons, whereas in several of the other Federal Reserve Banks a relatively small group of persons has been able to handle the daily operations of the Control.

In addition to the field offices maintained in the Federal Reserve Banks, Foreign Funds Control maintains personnel in Hawaii and in the Philippine Islands, aiding in the administration of the freezing control in these areas. Foreign Funds Control has also representatives in Latin America dealing with Proclaimed List problems.

The Control, in dealing with its many increasing problems, has when occasion demanded been able to call upon the personnel and facilities of other agencies of the Treasury Department, including Customs, National Bank Examiners, Coast Guard, Secret Service and Internal Revenue.

#### 4. Organization of the Control.

Foreign Funds Control is organized along the following lines:

(a) Interdepartmental Committee.

The basic policies followed in the operation of the Control have been formulated by an Interdepartmental Committee, consisting of E. H. Foley, Jr., representing the Treasury Department, as chairman; Dean Acheson, representing the State

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Department; and Francis Shea, representing the Department of Justice. This committee meets periodically to consider the basic problems confronting the Control and the more important applications for licenses.

(b) Administrative section.

Mr. John W. Pchle, Assistant to the Secretary of the Treasury, is charged with directing the administration in the Foreign Funds Control. Approximately 650 persons are employed in the office of the Control in Washington on work of an administrative character. The administrative staff is divided into major sections, each of which specializes in handling problems relating to different types of transactions, such as Securities, Business Enterprises, Foreign Trade and the Proclaimed List, Trusts and Estates, Foreign Banks, and Remittances.

(c) Legal section.

Forty lawyers in a special section of the General Counsel's Office handle the legal aspects of Foreign Funds work, draft documents, analyze the legal implications in applications, and actively participate in the policy determination.

(d) Economic section.

The Division of Monetary Research maintains a special section of trained economists, who make studies of the many and complex economic problems confronting the Control for use in making policy decisions.

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(e) Investigative section.

An investigative staff with several field offices is headed by Mr. Erwin May, former Treasury attaché in Berlin. This section employs a large staff of competent investigators familiar with financial problems, who investigate attempted violations and evasions of the freezing control.

5. Integration with the work of other governmental agencies.

The primary medium through which the basic problems of the Control have been brought to the attention of the Departments of State and Justice has been the Interdepartmental Committee. The State Department has been more concerned with and has participated more actively in the solution of the problems confronting the Treasury Department in its administration of the Control. Through cooperation between the State and Treasury Departments, the Control has been used in an effective way to implement this Government's foreign policy, as in the case of Japan.

Other examples of the effective liaison established between the Foreign Funds Control and other government agencies are:

(a) Strategic material problems have been resolved in consultation with the appropriate defense agencies. The Control has been able to uncover and direct into defense uses millions of dollars worth of highly strategic materials, machine tools, and other materials. .

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(b) Cases involving the fueling, chartering, or sale of ships are cleared with Merchant Ship Control, the Maritime Commission, and the State and Navy Departments.

(c) Proclaimed List problems are handled by a subcommittee consisting of representatives of the Treasury, the State Department, and the Economic Defense Board.

(d) Securities problems have been worked out with the SEC.

(e) Valuable information obtained through censorship has been received by the Control for some time from the British and Dominion Governments. Confidential information is exchanged with the FBI, the Office of Naval Intelligence, the Army Intelligence, and other governmental intelligence offices.

6. Major Areas of Operation.

The far-reaching character of the Control can best be seen by considering some of the major types of transactions which can be effected only under freezing control licenses. The Control, in addition to licensing foreign exchange transactions and a wide variety of other payments and remittances, has exercised control in such significant areas of economic activity as:

(a) Business Enterprises.

Approximately 2,500 business enterprises in the United States have been operating under licenses issued by the Control. These enterprises engage in all forms of business activity,

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from long-established Axis-owned chemical manufacturing plants to the newly established American diamond industry. We have closed down a number of Axis firms whose activities have been dangerous to the national interests and whose operation was not important to the national or local economy. Treasury representatives have been placed in over 50 business enterprises which had strong Axis connections and whose continued operation was considered essential.

All firms operating under license have been required to file with the Control affidavits providing detailed information as to organization, officers and directors, capital structure, relationships with other companies, the nature of its operations and principal customers. These firms are also required to file periodic reports which provide significant information with respect to their operations. As a result of the operations of the Control in this field, the Treasury now has in its files organized information with respect to the structure, activities, and background of the numerous Axis-owned or dominated concerns, as well as concerns controlled by nationals of other blocked countries.

(b) Foreign banks and insurance companies.

As each new country was frozen, many foreign banking agencies and insurance companies were brought under the Control. Such enterprises were permitted to operate under the careful

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supervision of Treasury representatives placed in such institutions who inspected all transactions to assure that the restrictions of the Control were being strictly observed. The Treasury has obtained the full cooperation of state banking and insurance departments in administering this phase of the Control.

(c) Securities.

Security accounts of nationals were blocked, and purchases and sales of securities for such accounts could be effected only under license. Debt service and sinking fund operations of blocked countries have been controlled through a licensing system. In order to prevent the disposal of looted securities in this market by the Axis countries, the Foreign Funds Control early in 1940 prohibited the importation into the United States of securities from any foreign country except under license. Imported securities are held by the Federal Reserve Banks until satisfactory evidence as to origin and ownership is forthcoming.

(d) Foreign Trade.

The Control is one of the most important measures adopted by this Government affecting the United States import and export trade with foreign countries. Not only is trade with all blocked countries subject to the Control, but trade with much of the rest of the world is affected by it. For example, the

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blacklisting of Axis and Axis-dominated firms in Latin America by the Proclaimed List is designed to promote healthy hemispheric trade and to eliminate the undesirable activities and influence of these Axis firms in Latin America.

(e) Proclaimed List.

When the Proclaimed List was issued, the Control assumed a major part of the administrative work involved. Representatives of the State and Treasury Departments have recently visited the Caribbean countries where Proclaimed List problems, particularly those relating to coffee, required immediate action. Also, at the present time, a group of Treasury and State Department personnel is touring South America, consulting with and advising diplomatic missions on Proclaimed List problems.

(f) Census of Foreign Property.

To further the purposes of the freezing control and to assure more effective administration, the Treasury has recently taken a complete and comprehensive census of all foreign-owned property in the United States, irrespective of whether the owner of such property has been blocked under the freezing control. This census makes available for the first time precise data as to the identity of the foreign interests, and the nature and location of the property.

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The wealth of information thus obtained will be of inestimable value to numerous governmental departments and agencies, not only in dealing with problems of the immediate present but also in formulating long-range programs for the future.

7. Technique of large-scale operation.

In view of the wide areas of economic activity which are subject to the Control, it has been necessary rapidly to develop methods of operation which would allow transactions not contrary to our national interest to be effected with a minimum of interference. This has been accomplished largely through the use of general licenses. These general licenses permit well-defined types of transactions to be effected without individual licenses, provided they are consummated strictly in the manner and within the limits stipulated in such licenses. When needed, these general licenses require reports which are used to police the activities conducted under the licenses, to insure compliance with the terms thereof, and as a basis for restricting or broadening the scope of the license. Under the 75 general licenses which have been issued, millions of transactions have been effected without the necessity of individual applications being filed and individual licenses issued. The reviewing staff of the Control has thus been able to concentrate upon the more difficult types of transactions for which specific licenses

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are required, and has been able expeditiously to act upon over 350,000 specific applications. More than 80 percent of these applications are now being handled directly by the Federal Reserve Banks in the field.

8. Special comment on Axis and Axis-controlled business enterprises.

In the twenty year period between 1919 and 1939, German interests have succeeded in organizing within the United States another industrial and commercial network centered in the chemical field, but extending also to the electrical and heavy goods industries, foreign commerce, and financing. It is unnecessary to point out that these business enterprises constitute a base of operations to carry out Axis plans to control production, to hold markets in this hemisphere, to support fifth-column movements, and to hold our post-war economy to Axis plans.

One of the primary reasons for freezing Axis assets was to combat this situation. The problem with which we are now faced, is more difficult although somewhat similar to the problem faced by us in 1917. The background today is vastly different from that which existed in 1917.

For almost fifteen years the Axis business interests have been taking comprehensive steps to insulate themselves against an alien property custodianship with its seizure of legal title. As a result of their efforts only a negligible portion of Axis-influenced property in this country would pass into the hands of a custodian whose powers are limited to the seizure of "enemy" title. The

"title" concept employed in creating the office of Alien **Property Custodian** in the first World War is now outmoded. The title to some of the most dangerous of the Axis-influenced enterprises is Swiss, Dutch, or Panamanian. Other enterprises are 100 percent American, so far as title is concerned.

Under the broad definition of the word "national" the freezing order has brought under foreign funds control all those organizations which are actually American and other neutral "fronts" for Axis activities. Many of these concerns are related to the Axis powers only through contractual ties, patent licensing agreements and the like. In some cases the ties are informal, based largely on personal fealty or family relationships. The flexible procedure of foreign funds control, developed over the past twenty months, makes it possible to deal effectively with this type of situation.

By intensifying our controls over these business enterprises, within the framework of the foreign funds control licensing procedure, we can, in most cases, safeguard our national interests more effectively than could be done under the seizure technique.

9. The record of the Control. The Department has more than \$7,000,000,000 of frozen assets under its surveillance at the present time. Only by contrast with the \$500,000,000 of assets administered by the Alien Property Custodian during the last world war is it possible to gain some conception of the magnitude of the task the Treasury has been doing during the last twenty months.

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More than 350,000 applications have been handled by the Control and in addition literally millions of other transactions have been effected only on terms prescribed by general licenses. In spite of the highly restrictive character of the Control and its ruthless adherence to the principals of outright economic warfare, not one decision or ruling of the Control has been so much as challenged in the courts.

All of this has been possible only as a result of the confidence shown by the public in general and the banking and business community in particular in the reasonableness and integrity of the Control. This confidence has recently been re-affirmed in a most striking manner when both Houses of the Congress unanimously approved H.R. 6233 which greatly expands the powers of the President over this foreign property. Throughout the consideration of the bill both in the committees and on the floor of the House and on the floor of the Senate there was not one word of criticism leveled at the manner in which the Control has been administered.