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December 30, 1942  
8:52 a.m.

HMJr: Cliff Mack?

Clifton  
Mack: Yes, sir.

HMJr: I got your memo and it's what I want, but the only thing - I see you needed an additional \$27 million out of the \$100 million program.

M: That's right.

HMJr: How long has W.P.B. been holding you up on this?

M: Well, they were working on - we've been working with them for two days on it. Not long.

HMJr: Yeah, well....

M: Not long, and they may have an answer. Al Walsh is right here.

HMJr: Yeah.

M: (Talks aside: When will we have an answer on W.P.B. - clothing?) He says today, he thinks.

HMJr: Well, let me know when you get that twenty-seven cleared.

M: I will.

HMJr: Now the stuff - let me know because I'm interested - this stuff that's at the ports, you don't know how long that's at the ports?

M: Well, the stuff that's at the ports that's been there -- well, since we got in it -- about two to three weeks, I'd say, without getting the exact number of days.

HMJr: Well....

M: About two to three weeks.

HMJr: I wish you could break that down and let me know how many days the stuff has been at the ports.

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M: I'll be glad to. A lot of that stuff....

HMJr: Yes.

M: ....there's about six thousand tons, I think....

HMJr: Yeah.

M: ....was scheduled for sailing on two boats....

HMJr: Yes.

M: ....and then it was decided at the last minute that those boats were too slow for the convoy....

HMJr: Yeah.

M: ....and they pulled them out.

HMJr: Oh.

M: So I'll break it down and give you the - give you the dates on it.

HMJr: Yeah, I'd like to know how long they've been there.

M: All right, sir, I will.

HMJr: Thank you.

M: Yes, sir.

December 30, 1942  
10:00 a.m.

HMJr: Hello.

W.H.  
Operator: Mr. Wallace - just a minute.

HMJr: Hello.

W.H.  
Operator: Secretary Morgenthau. The White House,  
please.

HMJr: Hello.

Operator: Yes, sir. He'll be right on.

Vice Presi-  
dent Wallace: Hello, Henry.

HMJr: Yes.

W: Everything's all set for the meeting this  
morning at eleven.

HMJr: Good.

W: I think the office in the Capitol will  
probably be a little warmer this morning.

HMJr: (Laughs) Shall I bring the whiskey?

W: (Laughs) Yes, you might bring the  
whiskey.

HMJr: Now....

W: And the other recip.. - reciprocatory basis,  
it may be necessary. (Laughs)

HMJr: All right.

W: As you were saying....

HMJr: That was a grand speech of yours, Henry.

W: I hope it helps some.

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HMJr: I say that was a grand speech of yours.

W: Yes, I say I hope it helped some.

HMJr: Yeah, well, it will. It will take time to soak in.

W: Nothing that I particularly need to know about the meeting this morning that you know of?

HMJr: Would you like White to come up fifteen minutes earlier or ten minutes earlier? Or he and I can be up there five minutes earlier, how's that?

W: Well, that would be fine.

HMJr: White and I will be up there at that place - the same place....

W: Five minutes of ten, that's....

HMJr: Five minutes - that will be plenty of time.

W: Good. Now....

HMJr: I mean five minutes to eleven.

W: You remember I was talking about eating lunch with this Texas friend?

HMJr: Right.

W: Are you going to be in town Saturday?

HMJr: Yes.

W: Shall we plan it for Saturday at twelve-thirty?

HMJr: Good.

W: Okay?

HMJr: Be delighted.

W: All right, sir.

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HMJr: Where will that be?  
W: In the Capitol.  
HMJr: At the Capitol?  
W: That's right.  
HMJr: Saturday at twelve-thirty.  
W: Good.  
HMJr: Thank you.  
W: All right.

December 30, 1942  
10:00 a.m.

WAR BONDS

Present: Mr. Graves  
Mr. Gamble  
Mr. Odegard  
Mr. Kuhn  
Mr. Callahan  
Mr. Murray  
Mr. Rainey  
Mrs. Klotz

H.M.JR: Mr. Odegard suggested that I see you gentlemen. He thought maybe you would feel either better or worse if you got it from the horse's mouth - how I felt about these programs. I simply listened to the last two - last Saturday and the one before. Odegard was with me. I wanted to call you but Odegard didn't want me to.

But to go back before that, I just wanted to say this before I get into criticizing the program. I want to tell you that I appreciate tremendously what you have done for us the last couple of years, and I don't want you to think that I haven't. I know you have given a great deal of your own time, for which I have thanked you before, and I thank you again, now. But I simply felt that these programs - I can't remember the names - the one that is on from seven to eight--

MR. MURRAY: It is called "Over Here."

H.M.JR: Thinking of myself as the head of the Treasury, I just couldn't sponsor it any longer because it did things to me - my insides. So that is the long and the short of it. I was told that this last Saturday would be better than the Saturday before, and I thought it was worse. So I thought we had better postpone it until we could turn around and see what we could do with it.

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MR. MURRAY: Mr. Secretary, before I discuss the matter with you I just want to read - because I am always better at preparing something - I want to read you the history of my case so far as the Treasury is concerned.

H.M. JR: Have you a case?

MR. MURRAY: I have a history, yes; and I think I have a case.

H.M. JR: All right.

MR. MURRAY: This is not too long a report. It is a report to you.

(Reading) "Preliminary: On the invitation of Mr. Howard Deitz I accepted membership on the committee set up to organize the original 'Treasury Hour' starting July 1st, 1941. I performed this work throughout the first thirteen weeks. I resigned when the show was moved to the Blue Network because I found the committee's operations cumbersome and devoid of showmanship."

H.M. JR: You were with it for thirteen weeks and then got off and weren't with it again?

MR. ODEGARD: Mr. Murray was not with the second one.

MR. MURRAY: (Continuing) "The Hooper reports which are appended herewith tell their own story:

October, 1941	4.4
November, 1941	6.8
December, 1941	7.1

"Lowest of all full hour shows.

"In November I went to Washington - for the first time - at Mr. Kuhn's and Mr. Callahan's joint invitation."

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(Mr. Kuhn entered the conference.)

MR. MURRAY: (Continuing) "I discussed the question of my returning to the committee. I outlined in the conversation and later confirmed my conditions in a letter to Mr. Kuhn. Because of the shortness of time the 'Treasury Hour' was to remain on the air, we dropped all negotiations.

"Treasury Star Parade:

"Sometime in February, Mr. Callahan proposed a series of these transcriptions to be paid for by Treasury and released to all stations. I assembled an organization, put it to work under close surveillance, and with telegraphic assurance from Mr. Kuhn that except for matters of policy the operation would be left entirely in my hands.

"The success of the effort needs no repetition at this time. There is, however, one point I must insist upon: I, and none other, controlled the preparation and performance of scripts, arranged for the appearances of all stars, and carried out all instructions of policy as given to me first by Mr. Kuhn and later by Mr. Odgaard.

"Other Shows: Special shows for special occasions on networks were given me to do -- the two-hour bond show on the Blue Network and the 'Women At War Week' show on CBS among them. These specials were entirely put together by me and with the help of my Coast office, not without considerable personal expense. The staff was told what to do and how to do it; all network arrangements were made without disturbing the production staff with details which can well be arduous.

"Also, the very successful 'Paul Whiteman' show on July Fourth - done by my personal office staff in Hollywood without benefit of the Treasury staff. Incidentally, from these shows we were able to build - without cost - at least ten transcriptions and this was made possible through my insistence that the network shows be so constructed as to make this secondary operation possible.

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"'Over Here': Late in October, Mr. Callahan suggested to me the possibility of doing an hour show on network. In Washington we agreed on all preliminaries, including budget.

"The next step was getting the time through the Office of War Information. In a meeting with the Office of War Information members Mr. Callahan asked me to present to them an outline of the show we planned to do and to demonstrate to the Office of War Information how this show might be made to contribute to the entire war effort.

"We proposed a program that in our opinion was designed to further the sale of bonds on the following sound principles of radio presentation:

"(1) Wide 'listener-appeal', based upon the use of 'star' names and, in a measure, 'escape' entertainment.

"(2) Tie-in between the people here and their loved ones abroad in the armed forces.

"(3) Use of such material as the army authorities considered sure-fire material for re-broadcast overseas. The Army definitely distinguished between material which can be sent overseas and that which cannot.

"The idea of the show 'Over Here' was worked out months ago by George Faulkner and was about to be purchased by Camel Cigarettes when a quietus was put upon the whole idea by the government's taking over all short-wave facilities, thereby making impossible a rebroadcast overseas under commercial sponsorship."

"Sometime ago, Treasury was considering seriously the rebroadcast of the Army's 'Command Performance' programs. However, this fell through and we thought so highly of the idea that we felt it expedient to put the idea in reverse -- that is, to broadcast first to the people at home and then overseas to their boys, thereby building a liaison between 'Over Here' and 'Over There' with a resultant gratitude of listeners and their resultant faithfulness to the program.

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"Certainly, results have justified our faith. A Hooper report on the second show was 4.7; on the fourth show 6.5 -- a remarkable record in view of the original time of 8:30-9:30 and outstanding for any government show. The big 'Army' show on the Red Network has only 2.5, which should convey some idea of the 'Over Here' show's potentialities.

"I grant there is nothing highbrow about 'Over Here', but in these days especially, 'Over Here' possesses the entertainment values both the armed forces and the people back home want. That is my honest opinion and I will back my reputation as the most successful producer of commercial shows that it will sell bonds as it will sell any other product:"

H.M.JR: When you say "commercial shows" do you mean theater or radio?

MR. MURRAY: Radio.

H.M.JR: What other ones would you refer to that you produce?

MR. MURRAY: For example, I have the Maxwell House with Fanny Brice; Amos and Andy--

H.M.JR: You have?

MR. MURRAY: Certainly. (Continuing) "... first, by reaching an enormous audience to whom bond messages can be delivered; second by presenting an over-all picture both here and overseas of what goes on in America's entertainment and in our news connective, Office of War Information commercials, and Vandercook's news spot an overall picture for the boys of what the people back home are doing and thinking, and third, by giving your salesmen of bonds -- 370,000 of the rank and file -- a show they will listen to, enjoy, and be stimulated to action thereby.

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"In other words, the show has wide and favorable reception by the great majority and therefore the sale of bonds can be implemented and stimulated. Further, it is the kind of show everyone I talked to in Kansas City asked for."

H.M.JR: Well, let me say this: you state a very good case. The trouble has been that up to the time that Odegard happened by accident to drop in to my house Saturday night a week ago for supper, nobody told me anything about this show.

MR. ODEGARD: You remember, Mr. Secretary, it went on just as you left for England. That was the first.

H.M.JR: I know, but I mean I wasn't consulted in any way, and my first attention, somehow, was drawn to it when I learned about the expenses - which were never cleared with me. The budget - I mean, I don't know whether Harold Graves cleared it, but--

MR. GRAVES: I did.

H.M.JR: But it was never cleared with me, and the expense of that is so great that after the experience that I went through on "Donald Duck" - for me to go up and explain these budgets - I just couldn't do it. I might be able to do it if I believed in the show the way I believed in "Donald Duck." I thought "Donald Duck" was master showmanship on the screen, and I was perfectly willing to go to town on "Donald Duck." But I just could not go to town on "Over Here" and explain sixty-one hundred dollars - around five thousand dollars - you told me it was to be five thousand dollars.

MR. GRAVES: On the average.

MR. MURRAY: No, it was six; the original budget was six.

H.M.JR: You told me five.

MR. MURRAY: At least twenty percent under.

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MR. ODEGARD: Actually it is running about five.

H.M.JR: Anyway, from your standpoint you could say, "I can't help it if it wasn't cleared with Morgenthau; that isn't my fault" - which is correct. On the other hand, when the criticism comes, it is always Morgenthau and nobody else.

MR. MURRAY: I quite understand that.

H.M.JR: I mean, I have to go up and appear before the committee. On "Donald Duck" I had to appear before the committee, and I had to take it. When the criticism comes because our two-percent issue just squeaked by, they didn't mention Mr. Allan Sproul, the president of the Federal Reserve Bank of New York, or Mr. Marriner Eccles, the chairman of the Federal Reserve Board; it was always Henry Morgenthau, Junior. You can't say it is the Treasury and the organization that conceives the thing - they don't know who Peter Odegard, or Ted Gamble, or Vincent Callahan is when there is criticism; but they know who I am, and I am the butt for the criticism, so I have to take it.

MR. MURRAY: In reference to the cost--

H.M.JR: Let me just finish - one second.

Now, there is nobody here - Graves, Gamble - I haven't asked Kuhn because he is moving on - Odegard - Odegard didn't hear it. He heard the one at my house. But there isn't any one of these people that disagreed with me when I asked them what their opinion was about the show. You see, there isn't one of them that thinks--

MR. CALLAHAN: I am the exception, Mr. Secretary.

H.M.JR: I am not trying to be rude. I didn't include you because I didn't ask you. I am not being rude - it sounds brusque - I didn't mention your name. I am not trying to be rude. I didn't ask you, so Murray knows that you are not included in it. I mentioned Odegard and Gamble and Graves. I mean, it sounds as though I didn't ask you - as though it was rude.

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MR. ODEGARD: Of course I didn't hear the show, Mr. Secretary.

H.M.JR: You heard it at my house and you didn't disagree with me then.

MR. ODEGARD: I thought that was a weak show.

MR. MURRAY: Did you hear all the show, Peter?

MR. ODEGARD: I didn't hear all of it. We heard about the last half of it.

H.M.JR: So I am just saying that these men - I am excluding Kuhn because I didn't ask him, and I am not trying to be rude to him. So here you have got a situation that it is the Treasury.

Your argument - you can say, "Well, Mr. Morgenthau, I can't help it if the people that I do business with don't tell you" - and that is correct. But you also can't help it if I listen to the show and, as Secretary of the Treasury, say, "Now, what is this?" Do I think from my standards that this is going to help me as a sustaining thing, or something that is going to make people buy bonds - put people in a good humor, and they are going to go home and say, "This is fine. We think the Treasury is a great organization," and so forth and so on. And of the three people that I asked, there isn't one of them that feels that way.

MR. MURRAY: Well, you have discussed two things and I want to answer you.

H.M.JR: Please.

MR. MURRAY: Number one - on the cost of the show. I might preface that by saying that I look upon this thing as a commercial show. The purpose of this show is to sell bonds. Anybody in the advertising business will tell you that a Crosley or Hooper point is worth, in their opinion, about a thousand dollars. In four

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weeks' time, starting from scratch - not after any preliminary work - this show has reached a level of six point five. It has been costing you about five thousand dollars, so if you were in the oil business or you were in the cereal business, you would say that this is a very successful operation, particularly in view of the time.

H.M.JR: May I interrupt you? According to what he gave me here on this Hooper business, it is four point seven.

MR. MURRAY: That was the first. They have taken a second one since. One was taken on the second show and one on the fourth.

MR. CALLAHAN: We don't have that.

H.M.JR: The second is what?

MR. MURRAY: Six point five.

MR. KUHN: That covers the first two weeks - the figures you have?

MR. MURRAY: They take them every other week.

MR. ODEGARD: This covers the first two weeks.

MR. MURRAY: The four point seven. As a matter of fact, let's take similar shows; let's take a show like the big Camel hour which was set up as of July first and was produced by Mr. Bacher. It took that show three months to get to a seven-point rating. This show has got practically that rating in one month.

Now, so far as the agreement here between these gentlemen is concerned, all I can answer to that is this. On every commercial show I have ever sold, there has always been this kind of a meeting in the fourth or fifth week, in which none of the directors liked the show - both the advertising agency and the sponsor. So this is not a new experience for me.

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It has been my job, based upon my experience and my knowledge of talent, and my knowledge of show values, to fight for those shows. I started a little show one time for General Foods, called "The Aldrich Family." We started the show the first of July - the middle of June, as a Benny replacement. The first of August I went down there and the show was stumbling around with a five or six rating. Seventy-five people in the Young and Rubicam and General Foods organization told me that the show was a failure; Clifford Goldsmith couldn't write; Ezra Stone couldn't act; the production was bad. They had a thirty-nine week firm option coming up as of August 15, so I said to them, "Gentlemen, look, if you all feel that way about it, give me back the show; do that out of kindness to Mr. Goldsmith, the writer, and Mr. Stone, the actor. Let me resell the show; give me the extra two weeks to resell it."

On August 13, two days before the deadline, the new Crosley came out and had a jump of four points, and the show was renewed. You know the story today; it is one of the five ranking shows on the air. It is a show that costs about - well, the actual price is seventy-five hundred. It has a rating of thirty-four point five. General Foods people will tell you it is the best buy they have got on the air - per dollar spent. Incidentally, this is rather illuminating. Every one of those seventy people came to me later saying he alone liked the show.

H.M.JR: Let me interrupt you. You see, this happens to be the United States Treasury - it is not Postum. The people here who have been with me the longest - Graves and those that I have mentioned - know I have a sixth sense on these things.

My relationship with Congress and with the public, sitting here in the chair as an appointed officer, is not a secure position, because I have often said there are a half a dozen people who would gladly put up a million dollars to get me out of this chair. It is true. It has happened time and again.

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It isn't that I want to be Secretary of the Treasury.

I want to serve my country in time of war, and I want to serve my friend, Franklin D. Roosevelt.

If it weren't for those two things, believe me, there isn't enough money in the world to keep me here, and let me go through, each day, what I am doing, because it just isn't worth it. If you want to talk in money, fifteen thousand dollars to run a job like this--

Now, I have gotten so - these old walls and these fine pictures, and so forth and so on, have a certain meaning to me.

We were just talking about commercial - we have just completed a month where we will have raised and borrowed fifteen billion dollars, a thing that has never been done before in the history of the world. And we have done that in a clean, honorable, and businesslike manner, in cooperation with the businessmen in this country.

Now I just can't cheapen this thing. I can't have a fellow get on like that mouth-organ fellow that they may love, and that may sell Campbell Soups or cigarettes, but it can't represent the Treasury. I just can't get to that level.

You answer me, "O.K., then you had better not have a radio program." And that may be the answer. But I can't put the United States Treasury on the level - using that mouth-organ fellow - on that level. I just can't do it.

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MR. GAMBLE: It might even sell bonds, but the Secretary's point, I think, is, Bill, that the Treasury can not afford to be identified with a variety show or sponsor that type of show.

MR. MURRAY: Then I don't know what you are going to do. It seems to me that if you take this position--

H.M.JR: Just so you don't think I am walking out, I have to leave at twenty minutes of eleven to go to a meeting in Vice President Wallace's office.

MR. MURRAY: Then I had better jump right ahead to what I wanted to say at the end. Mr. Callahan called me on Monday and said, "Suspend the show."

Now, unfortunately on Monday - I can suspend the show as of tonight or as of tomorrow. I have not done it yet.

H.M.JR: I gave Graves my orders on Monday.

MR. MURRAY: I realize that.

H.M.JR: It is up to him to carry them out.

MR. MURRAY: But here is the situation we face. First of all, the Blue Network has given us the time, and they have publicized this program as of next Saturday evening. They are going to be embarrassed.

Secondly, a thousand-odd tickets were already sent out on Monday morning to people, inviting them to attend the show. It is impossible to recall those tickets, because no record is kept.

In the third place, our actors have signified their willingness to go on, and they have prepared for it.

In the fourth place, there is a certain number of people, little people, who are engaged particularly for this show, and I don't know how to pay them off unless we run the show.

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H.M.JR: Just one show?

MR. MURRAY: Yes.

H.M.JR: How about the week from Saturday?

MR. MURRAY: If you want to cancel as of this Saturday, that is up to you, Mr. Morgenthau. My earnest belief - my earnest hope was - I was given a thirteen-week operation - I set up a budget of six thousand dollars which was presented to Mr. Graves.

H.M.JR: Mr. Graves told me five.

MR. GRAVES: I think I gave you my impression without verification.

MR. CALLAHAN: We presented the six thousand dollars.

MR. MURRAY: It is seventy-eight hundred dollars.

MR. CALLAHAN: That was an outside figure.

MR. GRAVES: That was a ceiling figure.

H.M.JR: As far as the people involved and engaged, as far as I am concerned, one week more or less isn't going to make any difference.

MR. MURRAY: I tell you what I would like to do. We have had five; I would like to run three more shows, and then call it off.

H.M.JR: Why three more?

MR. MURRAY: I would like to get one more report.

H.M.JR: The reports have no effect on me.

MR. MURRAY: No, no, Mr. Morgenthau, but they have an effect on me. You must remember this, Mr. Morgenthau, this is something I have got to impress upon you, that

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from the very beginning in my connection with the Treasury Department I had only one thing in mind. There was no money; there was only the taking up of a lot of time on my part, away from my business. I was very anxious to do that, because I felt I had a contribution to offer in radio. I have seen every other Government agency make mistakes; and I have not seen one of them come through.

H.M.JR: Come through what?

MR. MURRAY: With a successful program. They have all tried it.

Now, I have a reputation of my own to sustain. Ninety percent of the shows that I have sold commercially stay on the air. This thing can do me great harm if it flops. Now, I don't mind its flopping after a certain length of time, after eight shows. Then you can say, "All right, the Treasury has changed its mind." They have other - I can get around it. I don't want to go through, nor do you, the business of having to combat newspaper men; because the moment it breaks that this thing has gone off the air, I am going to be the object of an inquisition. Now, Mr. Morgenthau--

H.M.JR: What is the word you used? (Laughter)

MR. MURRAY: Inquisition. You know, there is such a thing, and I would rather - if we can run the thing three weeks more, we can ease out of the whole situation very nicely. We will have no unfortunate publicity, and that is all I ask of you.

H.M.JR: Would that make you happy?

MR. MURRAY: Not only will it make me happy - the only thing that makes me happy is doing a job, and I can do it.

H.M.JR: Well, Mr. Murray, I started out by saying that I appreciate what you have done. Right?

- 15 -

MR. MURRAY: Yes.

H.M.JR: I am not trying to hurt anybody. I can't--

MR. MURRAY: I don't question your motives for one moment.

H.M.JR: I am not trying to blame you that I wasn't told about the show. God knows I am bothered with many things less important each day. I spent days on the Donald Duck thing, days and hours with Disney. When the thing came out it was a show I was willing to show anybody and stand behind, and I did stand behind it. I made public statements in order to help Disney, and everything else, and I never let Disney down publicly. Now that, and the show world told me--

MR. MURRAY: Walt told me that.

H.M.JR: I saw him through. The last thing, whether it is a clerk or a man important in the business world who helps me, I never let him down publicly. I never have; I never will; I don't want to let you down publicly. There is no reason to. You can't help it if you are producing the kind of show which you cleared with these people and they never told me. If I had known about it, I never would have O.K.'d the budget. I never would have O.K.'d that kind of show. I don't like the OWI thing in the middle of it. It distracts you. You don't have to pay bribe money to the OWI to get on the show by having that thing about the oil in the middle. I don't think the public wants to be scolded any more. I don't think they want to be lectured any more. I told you that when I saw you a month ago. Do you remember? I accept your proposition - three weeks and then--

MR. MURRAY: Thank you, sir.

H.M.JR: Just what I did for Disney - I don't want to hurt you, certainly after what you went through. I don't want to hurt anybody else. All I ask in return is, please make it a little more high-brow.

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MR. MURRAY: All right.

H.M.JR: Please don't give me any more mouth organs.

MR. MURRAY: I--

H.M.JR: The thing between those two comedians at the end - did you like what those two men did, that song they sang? I mean, here you brought these two outstanding comedians together, I take it, for the first time in the seven years, and the skit they did - I am sure you weren't proud of it.

MR. MURRAY: There was only one comedian. That was Jack Benny and his company.

H.M.JR: No, Jack Benny and the other man.

MR. MURRAY: They were all part of Jack Benny's regular company.

H.M.JR: No, the other man--

MR. GAMBLE: The song you are thinking of was on the other show, "Command Performance."

MR. MURRAY: That is, any two vaudevillians get together for a benefit--

H.M.JR: It was on this one.

MR. GAMBLE: No, "Command Performance." You have that last bad number that Benny and Allen did confused with this.

H.M.JR: Weren't they on this program?

MR. GAMBLE: No, that was the Christmas Eve show.

H.M.JR: Weren't they? You would know.

MR. MURRAY: No, I just asked Jack to come in and give me a spot on this. He not only wrote it and rehearsed it, but he brought his whole company in.

- 18 -

H.M.JR: I am not going to listen to it. I did it two weeks, and it spoiled my evening. It ruined Peter's supper that night, and Mrs. Morgenthau had to listen to me stomping around all evening. There was only one time when Peter felt worse, and that was when he tried to listen to the unveiling of this statue at the Grand Central. (Laughter)

MR. MURRAY: Long before this thing came along - this hour's show came along - increasing difficulties had arisen with OWI. It was the more difficult in getting time, because, after all, OWI gets the time. But beyond that a demand to see our scripts and a demand that these scripts be kept within the OWI directives on the war effort. We have today, so far as this operation is concerned, the closest liaison with OWI. Everything is sweetness and light. This is the first show ever to go on the air that has managed to involve more than one Government agency and keep them all happy. Captain Vander of the Army is delighted. He was particularly delighted with last week's show, because that could all be sent overseas.

H.M.JR: Now, one other thing - you say you are going to be crucified. When we shut off the show for three weeks, see that I don't become the butt of the publicity.

MR. MURRAY: I never give stories to the newspapers.

H.M.JR: But you say--

MR. MURRAY: Three weeks after--

H.M.JR: And the variety show, and all the rest of it - you know what I am talking about. I am going to play fair with you; and you see that when the thing is written up that I don't become the butt of the thing.

MR. MURRAY: What I want to do, frankly, is, some time in the course of the next three weeks I want to sit down with Mr. Odegard and Mr. Callahan and prepare a good publicity release which will cover the matter thoroughly.

- 19 -

H.M.JR: The sooner the better, because then if it is three weeks - I am going to have to stop now.

REPORT TO HENRY MORGENTHAU, JR.PRELIMINARY:

On the invitation of Mr. Howard Dietz I accepted membership on the committee set up to organize the original "Treasury Hour" starting July 1st, 1941. I performed this work throughout the first thirteen weeks. I resigned when the show was moved to the Blue Network because I found the committee's operations cumbersome and devoid of showmanship. The Hooper reports which are appended herewith tell their own story:

October, 1941	4.4
November, 1941	6.3
December, 1941	7.1

Lowest of all full hour shows.

In November I went to Washington - for the first time - at Mr. Kuhn's and Mr. Callahan's joint invitation. I discussed the question of my returning to the committee. I outlined in the conversation and later confirmed my conditions in a letter to Mr. Kuhn. Because of the shortness of time the "Treasury Hour" was to remain on the air, we dropped all negotiations.

TREASURY STAR PARADE:

Sometime in February, Mr. Callahan proposed a series of these transcriptions to be paid for by Treasury and released to all stations. I assembled an organization, put it to work under close surveillance, and with telegraphic assurance from Mr. Kuhn that except for matters of policy the operation would be left entirely in my hands.

The success of the effort needs no repetition at this time. There is, however, one point I must insist upon: I, and none other, controlled the preparation and performance of scripts, arranged for the appearances of all stars, and carried out all instructions of policy as given to me first by Mr. Kuhn and later by Mr. Odegard.

OTHER SHOWS:

Special shows for special occasions on networks were given me to do -- the two-hour bond show on the Blue Network and the "Women At War Week" show on CBS among them. These specials were entirely put together by me and with the help of my Coast office, not without considerable personal expense. The staff was told what to do and how to do it; all network arrangements were made without disturbing the production staff with details which can well be arduous.

Also, the very successful "Paul Whiteman" show on July Fourth -- done by my personal office staff in Hollywood without benefit of The Treasury staff. Incidentally, from these shows we were able to build -- without cost -- at least 10 transcriptions and this was made possible through my insistence that the net-work shows be so constructed as to make this secondary operation possible.

"OVER HERE":

Late in October, Mr. Callahan suggested to me the possibility of doing an hour show on network. In Washington we agreed on all preliminaries, including budget.

The next step was getting the time through the Office of War Information. In a meeting with Office of War Information members Mr. Callahan asked me to present to them an outline of the show we planned to do and to demonstrate to the Office of War Information how this show might be made to contribute to the entire war effort.

We proposed a program that in our opinion was designed to further the sale of bonds on the following sound principles of radio presentation:

- (1). Wide "listener-appeal", based upon the use of "star" names and, in a measure, "escape" entertainment.
- (2). Tie-in between the people here and their loved ones abroad in the armed forces.
- (3). Use of such material as the army authorities considered sure-fire material for re-broadcast overseas. The Army definitely distinguished between material which can be sent overseas and that which cannot.

The idea of the show "Over Here" was worked out months ago by George Faulkner and was about to be purchased by Camel Cigarettes when a quietus was put upon the whole idea by the government's taking over all short-wave facilities, thereby making impossible a rebroadcast overseas under commercial sponsorship.

Sometime ago, Treasury was considering seriously the rebroadcast of the Army's "Command Performance" programs. However, this fell through and we thought so highly of the idea that we felt it expedient to put the idea in reverse -- that is, to broadcast first to the people at home and then overseas to their boys, thereby building a liaison between "Over Here" and "Over There" with a resultant gratitude of listeners and their resultant faithfulness to the program.

Certainly, results have justified our faith. A Hooper report on the second show was 4.7; on the fourth show 6.5 -- a remarkable record in view of the original time of 8:30-9:30 and outstanding for any government show. The big "Army" show on the Red Network has only 2.5, which should convey some idea of the "Over Here" show's potentialities.

I grant there is nothing highbrow about "Over Here", but in these days especially, "Over Here" possesses the entertainment

values both the armed forces and the people back home want. That is my honest opinion and I will back my reputation as the most successful producer of commercial shows that it will sell bonds as it will sell any other product; *is here* first, by reaching an enormous audience to whom bond messages can be delivered; second by presenting an over-all picture both here and overseas of what goes on in America's entertainment and in our news connective, Office of War Information commercials, and Vandercook's news spot an overall picture for the boys of what the people back home are doing and thinking, and third, by giving your salesmen of bonds -- 370,000 of the rank and file -- a show they will listen to, enjoy, and be stimulated to action thereby.

In other words, the show has wide and favorable reception by the great majority and therefore the sale of bonds can be implemented and stimulated. Further, it is the kind of show everyone I talked to in Kansas City asked for.

1942 DEC 31 AM 9 10

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HENRY MORGENTHAU JR

WASHDC

DEAR MR MORGENTHAU BEFORE TALKING WITH YOU THIS MORNING I HAD A  
FIRM BELIEF IN YOUR SENSE OF FAIR PLAY NOW THAT WE HAVE TALKED AM  
EVEN MORE COVINCED OF THAT FACT YOU HEARD MY SIDE OF THE CASE AND  
ONLY THEN MADE YOUR DECISION IT IS REASSURING TO DEAL WITH A  
TREASURY DEPARTMENT PRESIDED OVER BY SOME ONE SO EMINENTLY JUST  
AND FAIR MY WARMEST REGARDS

WILLIAM B MURRAY.

910A

## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE

December 30, 1942.

TO Secretary Morgenthau  
FROM Ferdinand Kuhn, Jr.

Fred Allen did not appear on that radio program with Jack Benny last Saturday. I heard the last twenty minutes of the program to make quite sure. Benny did a Cinderella skit in which he called himself "Cinderallen". Maybe that's how you got the idea that Benny and Allen appeared together.

F. K.

December 30, 1942  
12:04 p.m.

HMJr: George?

George  
Haas:

Yes, Mr. Secretary.

HMJr: That part of your memorandum that you sent me over the week-end which said that the price of food in this country was going up and the price of food in England was going down?

H: Yes, sir.

HMJr: I'd like to extract that - extract it, and send it with a letter which you can dictate for me to the Vice President and to Mr. Acheson  
....

H: Yes.

HMJr: ....and to Mr. Knollenberg, who is Senior Deputy of Lend-Lease. You can get his title from Lend-Lease.

H: Knollenberg.

HMJr: Yeah, you know, he used to....

H: He used to be here, eh?

HMJr: What?

H: He used to be over here.

HMJr: That's right. Those three and you might send also one to Harry White.

H: Okay.

HMJr: Now in discussing this with the Vice President, he suggested that you get in touch with Tolley.

H: Tolley?

HMJr: Of the Agricultural Department....

H: Yeah, H. R. Tolley, I know him.

- 2 -

HMJr: ....who's now loaned to State Department to do this very thing.

H: Oh, he is? I see.

HMJr: Yeah.

H: Uh huh.

HMJr: This sort of thing.

H: All right. Shall I send him a copy too?

HMJr: No.

H: Well....

HMJr: You can tell him about it.

H: Tell him about it.

HMJr: But just the part where you say food's going up in this country and down in England.

H: Fine. And I'll - I'll....

HMJr: I want....

H: ....have those in this afternoon.

HMJr: ....accompanying letters this afternoon.

H: Yes, fine.

HMJr: I thank you.

H: You're welcome.

DEC 30 1942

**Dear Henry:**

I thought you would be interested in a statement comparing recent changes in food prices and living costs in the United Kingdom, Canada, and the United States, which I am enclosing.

Sincerely,

(Signed) Henry

Honorable Henry A. Wallace,  
Vice President of the United States,  
Washington, D. C.

Copy in Diary

Copies to Haas direct

Sent by Bundy 4:35  
12/30/42

GCW:am 12/30/42

DEC 30 1942

**Dear Deans**

I thought you would be interested in a statement comparing recent changes in food prices and living costs in the United Kingdom, Canada, and the United States, which I am enclosing.

Sincerely,

(Signed) Henry

Honorable Dean G. Acheson,  
Assistant Secretary of State,  
Washington, D. C.

Cony in Diary

Copies to Haas direct

Sent by Bundy 4:35  
12/30/42

905:en 12/30/42

DEC 30 1942

Dear Mr. Knollenberg:

I thought you would be interested in a statement comparing recent changes in food prices and living costs in the United Kingdom, Canada, and the United States, which I am enclosing.

Sincerely,

(Signed) H. Morgenthau, Jr.

Mr. Bernard Knollenberg,  
Special Assistant to the Administrator,  
Lend-Lease Administration,  
515 22nd Street, N. W.,  
Washington, D. C.

Copy in Diary

Copies to Haas direct

Sent by Bundy 4:35  
12/30/42

GCH:ca 12/30/42

British food costs decline under subsidies

Changes in living costs and in retail food costs in the 12-month period to October 1942, in the United Kingdom, Canada, and the United States, are shown below:

(In percent)

	<u>United Kingdom</u>	<u>Canada</u>	<u>United States</u>
Cost of living	40.5	+2.0	+ 8.6
Food costs	-1.8	+5.4	+16.1

It will be noted that in the United Kingdom, food costs have declined in the past year, while living costs as a whole have risen slightly. This is in direct contrast to the trend of food prices in Canada and the United States. It should be kept in mind, however, that living costs had shown a much greater increase in Great Britain than in either of the other two countries previous to 1942.

At the beginning of 1942 the British system of subsidizing production of consumers' goods, together with lendlease shipments, was instrumental in bringing down food costs. Various British foods have been subsidized in order to stabilize food prices, which constitute 60 percent of the cost-of-living index. Subsidized foods account for about 75 percent of the food price index, with subsidies being paid at the rate of approximately £102 million a year, excluding the pre-war cost of cattle and sugar beet subsidies which have been continued. (Data from U. S. Department of Labor.) The total of war-time subsidies is divided as follows:

Flour, bread, oatmeal and feedstuffs	£50 million
Meat.....	£23 million
Milk, tea, eggs and potatoes.....	£29 million

In addition, a subsidy of £20 million annually is paid by the Ministry of Food toward the cost of transport of foods.

The heavy weighting of food costs in the British cost-of-living index reflects in part the disappearance from the markets of other goods and services available for consumer purchase. In the United States, the Bureau of Labor Statistics already has begun to note similar changes, and now weights food costs in our own index at 35.9 percent of the total, as compared with 33.9 percent in the base period of 1935-39. The weight of the clothing index also has been increased.

The cost-of-living indexes of the three countries are not wholly comparable. As one example, certain taxes on cigarettes and tobacco are not included in computing the official Canadian cost-of-living index, but in this country excise taxes and real estate taxes are reflected in the BLS index.

## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE DEC 30 1942

TO Secretary Morgenthau

FROM Mr. Haas

Subject: Possibility of using Government surplus foods for halting the rise in food prices.

This memorandum is in response to your request of December 24 as to (1) what might be done to hold down the rise in food prices by releasing surplus Government stocks, and (2) what would be the effect of removing the tax on oleomargarine. Certain suggestions made by Miss Elliott are incorporated in this report.

Summary

1. There are no real surpluses of foodstuffs in this country. While the Government is buying huge quantities of foods, practically all are earmarked for lend-lease, the armed forces, and other specific uses. The only important surplus quantities of food or feed in the hands of the Government are the 309 million bushels of wheat and certain quantities of corn, barley, and rye owned by the CCC. By next year, these are likely to be needed for export, for domestic food and feed, and as protection against a possible short crop.

2. The release of wheat to millers from CCC stocks (or from 263 million bushels owned by farmers but held by the CCC as loan collateral) appears necessary if an increase in the selling price on flour is to be avoided. The use of subsidies to effectuate such release, however, is strongly opposed by Congress.

3. Similar political difficulties hinder the use of surplus grains as livestock feed, which in any event would not have a large effect in controlling food costs, since the production of livestock and livestock products is limited by other important factors. Furthermore, farmers have not taken full advantage of an existing provision allowing 125 million bushels of wheat to be sold for feed at 85 percent of the parity price for corn.

4. The removal of the Federal tax on oleomargarine ( $\frac{1}{2}$  cent a pound on uncolored and 10 cents on colored) would have relatively little influence on prices or production, since state taxes in 22 states ranging up to 15 cents a pound are a more important restrictive factor.

Government stocks of food products

Actually there are no real surpluses of foods in this country. The Government is buying huge quantities of food-stuffs, but practically all of these are earmarked for specific purposes, such as for lend-lease, for the armed forces, etc. Certain products have been bought from time to time at price-support levels as part of the program for stimulating the production of foodstuffs, but these likewise have usually been worked off through lend-lease and other channels. The distribution of surplus foods through the food stamp plan has been largely abandoned through lack of surpluses.

The only stocks of surplus food or feed products owned by the Government (or held as collateral for loans) in any important volume (excluding those bought for the armed forces, for lend-lease, etc.) are wheat, corn, barley, and rye. The last quarterly report of the Commodity Credit Corporation, as of September 30, shows the following amounts of each of these grains:

	Owned by CCC (bushels)	Held as collateral for loans (bushels) <sup>1/</sup>
Wheat	309,220,223	262,919,400
Corn	48,165,474	149,405,071
Barley	419,698	6,193,056
Rye	278,792	1,386,215

(The next quarterly report, expected around the middle of January, may show lower figures for barley and rye.)

Wheat supply may be needed next year

Although wheat appears as a surplus crop, the stocks now on hand may be needed next year for export to European countries, for domestic food and feed, and as a reserve against a possible short crop following two good crop years. The supply of "free" wheat, outside the CCC and loan stocks, is not quite sufficient for domestic requirements during the rest of the current season. The wheat in loan stocks will not be released by farmers until prices rise somewhat above the loan level plus carrying charges. While this provides a supply from which mills may draw later in the season, it can be made available only by a further rise in wheat prices or through subsidies.

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<sup>1/</sup> The Government has not acquired title to this grain.

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Present legislation requires that the wheat held by the Commodity Credit Corporation may not be sold at less than the parity price unless it has substantially deteriorated in quality, is used for feeding (with a limitation of 125,000,000 bushels) or is used for specified industrial purposes. Farm prices of wheat on November 15 were only 76 percent of parity.

The release of wheat from Government stocks for direct food uses, assuming this were politically feasible, would probably have little immediate influence on the cost of living, since increased prices of bread and flour have not contributed much to higher food costs during the past year. Retail bread prices, having the relatively high weight of 6.5 percent in the BLS index of retail food prices, have advanced only 1.2 percent between November 1941 and November 1942. The retail price of wheat flour has had a larger increase in that period--14.2 percent-- but this item has a weight of only 1.7 percent in the BLS food index.

#### Wheat release needed to avoid further rise in flour prices

The release of wheat to millers at relatively low prices, nevertheless, has an important place in the campaign to hold down living costs. The OPA announced yesterday a 10 percent increase in flour prices, since millers were being squeezed between ceiling prices on flour and uncontrolled prices on wheat, which threatened to curtail the production of wheat flour. Wheat being our most abundant food commodity, any restriction on the output of flour would be unfortunate in that it would divert demand to less abundant food items.

The original plan of the Department of Agriculture to meet this situation by making wheat available to millers (through use of subsidies) at less than the parity price, following a directive of the President to the OPA on October 2 to fix ceiling prices on flour, met a storm of protest from Congress. Even though wheat growers would have been fully reimbursed under the subsidy plan, the farm bloc objects to subsidies because a subsidy program implies a stabilization of farm prices, to which it is opposed.

Nevertheless, a further rise in flour price ceilings seems likely unless wheat prices are stabilized or wheat is made available to millers under a subsidy program. A statement submitted by the Secretary of Agriculture and the Price Administrator in a joint letter to Director Byrnes on October 12 mentioned the prospect of a shortage of "free" wheat available to millers, and said that "the amount of the eventual increase

- 4 -

which may be required in ceiling prices on flour, or the amount of the subsidy which may eventually be required on flour or wheat sales (depending upon which alternative is followed), probably will reach 14 to 18 cents per bushel of wheat before the end of the season."

#### Use of surpluses for feed

A second possibility lies in the use of Government wheat and other grains as feed grains, to help keep down prices of meats and dairy and poultry products. The Agricultural Appropriation bill approved by Congress last summer, after extended and bitter controversy on this point, permitted the Commodity Credit Corporation to make available 125,000,000 bushels of Government-owned wheat for feed, with the provision that no Government grain could be sold for feed at less than 85 percent of the parity price of corn. During the four-month period through October 31, however, a total of only 35,100,000 bushels of wheat and 21,788,000 bushels of corn were sold by the Commodity Credit Corporation for feed purposes under this program, although they were available at the minimum permitted prices.

While the release of Government-owned grain would undoubtedly have an effect in increasing production and stabilizing prices of meats and of dairy and poultry products, depending upon the amount released, the cost of feed is but one of the factors limiting the present production of those products. A shortage of manpower on farms is an important limiting factor, particularly for dairy products. It is significant that the increase in butter prices contributed more than any other single item to the rise between November 1941 and November 1942 in the BLS index of retail food prices, accounting for 8.3 percent of the rise.

#### Relative importance of foods in food price rise

As a basis for attacking the rise in food prices, it is of interest to know which foods have accounted for most of the rise in food costs during the past year. A list of the basic food products having individual weights in the BLS food price index of 2.0 percent or more is shown in the attached table, together with (1) the increase in price for each item from November 1941 to November 1942, (2) the weight in the BLS index, and (3) the percentage contribution of each item to the 15.9 percent rise in the index during that period.

- 5 -

It will be noted that the rise has been a general one, with such diverse items as butter, potatoes, eggs and oranges high on the list of percentage increases. It is significant, also, that these major items, comprising 62.5 percent of the total weight in the index, account for only 53.3 percent of the rise. This is probably because prices of most of these basic items are subject to control. Minor items, such as canned goods, fresh fruits and vegetables, etc., many of which are uncontrolled, have accounted for a relatively larger proportion of the rise.

Considering the diverse nature of the increase in food prices, and the fact that livestock feed costs are only one of a number of important contributing factors, it would seem that little can be done to control the price rise by releasing Government stocks.

#### Removal of the tax on oleomargarine

The Federal Government levies a tax of  $\frac{1}{2}$  cent a pound on uncolored oleomargarine (the principal form in which it is marketed) and a tax of 10 cents a pound on the colored product, in addition to certain occupational taxes on retailers, wholesalers, and manufacturers, ranging from \$6 a year on retailers of uncolored oleomargarine to \$600 a year on manufacturers. Collections from the combined taxes in the fiscal year 1942 totalled \$2,244,000, of which \$976,000 was from the tax on oleomargarine. In the first 5 months of the current fiscal year we have collected \$1,348,000 from the combined taxes, of which \$443,000 was collected from the tax on oleomargarine.

In addition to the Federal taxes, 22 states (as of January 1, 1942) levied taxes on the product, with 16 states requiring license fees of various kinds. In 18 states the tax on uncolored oleomargarine is 10 cents a pound or higher, the maximum being 15 cents in Wisconsin, Washington, and Nebraska. In 10 of these states, however, where the object of the tax is principally to discourage the use of imported fats and oils, exemptions are sufficiently liberal as to make manufacturers largely exempt from the tax, at least for sale outside the more rigidly restricted sections.

Repeal of the  $\frac{1}{2}$  cent Federal tax would apparently have little influence on oleomargarine prices or production. Repeal of the various state taxes, if it could be accomplished, would undoubtedly help to divert demand away from butter, and would tend to stimulate the production of oleomargarine. In view of

the general shortage of fats and oils, however, an increased production of such raw materials as cottonseed oil, peanut oil, and soybean oil would be required for full effectiveness of such a move.

Suggestions for aiding lower income groups

The rise in food prices affects most seriously those in the lower income groups, who spend a large proportion of their earnings for food, and particularly those in communities or occupations where incomes have not appreciably increased. Miss Elliott suggests that much could be done through subsidies and other means to enable these families to maintain good nutritional standards despite higher food prices.

Such aid might be given in the form of consumer subsidies for school lunches, factory lunches, special aid to mothers and babies, and milk subsidies. The British plan of requiring nation-wide use of a standard high-extraction flour, having high nutritive value, might be adopted. Great Britain has been successful during the past year in stabilizing prices of staple foods through use of subsidies. Something could probably be accomplished through educational campaigns. To reduce the high cost of butter, an important factor in living costs, for example, an educational campaign is needed to combat the idea that oleomargarine lacks the nutritive qualities of butter.

Retail price increases for selected food items,  
and their respective contributions to the 15.9 percent  
increase in the BLS index of retail food prices,  
November 1941 to November 1942

Food item	: Increase : in price (Percent)	: Weight in BLS: : retail food : : price index : (Percent)	Contribution to increase in price index (Percent)
Butter	26.1	5.1	8.3
Chickens, roasting	34.7	3.2	7.0
Potatoes	32.0	3.2	6.4
Eggs	13.8	5.9	5.1
Pork chops	19.4	3.7	4.5
Oranges	17.5	3.7	4.1
Rib roast	11.6	4.8	3.5
Round steak	13.2	4.1	3.4
Sugar	12.5	4.1	3.2
Ham, whole	20.3	2.2	2.8
Milk, fresh, delivered	2.7	11.5	2.0
Veal cutlet	12.4	2.0	1.6
Coffee	5.6	2.5	.9
Bread, white	1.2	6.5	.5
Total		62.5	53.3

Source: Based on retail price data of Bureau of Labor Statistics.

## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE December 30, 1942

TO Secretary Morgenthau  
 FROM Mr. Haas *HAAS*  
 Subject: Increase in flour prices.

This is in response to your request of this morning for an explanation of how the squeeze between wheat and flour prices might have been solved without an increase in the ceiling prices on flour.

Background: The OPA, on December 29, raised ceiling prices on flour 40 to 75 cents a barrel, or 10 percent above temporary ceilings established on October 8 pursuant to a directive from the President. The move was designed to relieve a squeeze between wheat and flour prices without recourse to subsidies, following severe opposition in Congress to a previously-announced subsidy plan approved by Director Byrnes, the OPA, and the Department of Agriculture.

The intention is to maintain retail bread prices, despite the increased price of flour, through savings in manufacture, packaging, and distribution expenses under a program to be announced by the Department of Agriculture. A rise of 1 cent a pound in the price of bread is normally associated with an increase of 40 to 60 cents a bushel in wheat prices.

Wheat prices, however, remain uncontrolled, and they rose 1 to 1½ cents yesterday on rumors that the flour ceiling would be raised. If this trend continues, another squeeze between wheat and flour prices will develop.

Possible solutions: An increase in flour prices could have been avoided only by reducing the cost of wheat to millers, since Department of Agriculture studies show no opportunity for absorbing increased wheat prices by reducing mill margins.

Three possibilities exist for reducing wheat prices, if statutory restrictions and political opposition could be removed: (1) release of wheat owned by the Commodity Credit Corporation; (2) release of farmer-owned wheat held as collateral for Government loans; and (3) importation of wheat from Canada.

- 2 -

(1) The simplest possibility would be for the Commodity Credit Corporation to sell wheat to millers at prices in line with selling prices on flour. As of September 30, the date of the last quarterly CCC report, the Corporation owned 309 million bushels of wheat. This wheat cannot be released, however, because of a statutory provision which prevents the Corporation from selling wheat for milling at less than the parity price. The farm price of wheat on November 15 was 76 percent of parity, or 32.6 cents a bushel below the parity level.

(2) The release of loan wheat offers the most practical opportunity under present statutory restrictions for making wheat available to millers at lower prices, and this was the plan originally decided upon in the program announced on October 23 by the OPA and the Department of Agriculture. This plan was not put into operation and was later abandoned because of Congressional opposition.

The difficulty to be overcome is that farmers will not release their loan wheat until prices rise high enough above the loan value to cover accrued carrying charges and allow some additional profit. Under the original plan, the situation would have been met by a subsidy, whereby farmers would be paid approximately 6 cents a bushel for redeeming their wheat and placing it on the market, and carrying charges would be waived. Congress strongly opposed the use of subsidies for stabilizing prices of farm products, and the alternative of raising ceiling prices on flour was finally adopted.

(3) The importation of milling wheat from Canada is subject to an import quota of 795,000 bushels, proclaimed by the President under Section 22 of the Agricultural Adjustment Act of 1933, amended and re-enacted, and to an import duty of 42 cents a bushel. No further importation of milling wheat is permitted in this quota year, which ends May 28, 1943, since the quota was filled by early July 1942.

December 30, 1942  
3:42 p.m.

HMJr: Hello.

Operator: Secretary Hull is coming on.

HMJr: All right.

Cordell  
Hull: Hello.

HMJr: Cordell?

H: Yes, sir.

HMJr: We missed you this morning. It was seventy  
up there.

H: Oh, it was?

HMJr: And I brought a pint of bourbon along for you.

H: My goodness, I'd have been there waiting for  
you if I'd have known that. (Laughs)

HMJr: So it was nice and comfortable and I had this  
pint of good liquor.

H: Well, suppose you just hold onto it.

HMJr: (Laughs) All right.

H: Yeah.

HMJr: Now the reason I'm calling you is this - I  
had a telephone call and then a follow-up  
letter from Henry Stimson....

H: Yeah.

HMJr: ....in which he says, "I'm enclosing herewith  
a paraphrase of an extract from a cable from  
Eisenhower."

H: Yeah.

HMJr: And he said, "I hope - as I told you this  
morning over the telephone, I hope your inter-  
vention with the British can afford us some  
relief in this matter for it's very embarrassing  
as you can see."

- 2 -

H: That's on the....

HMJr: Madagascar.

H: Oh, yes, about the difference in the....

HMJr: In the rate.

H: Rate, yeah.

HMJr: Now I thought if it was agreeable....

H: And then they complain grievously about the local situation.

HMJr: That's right.

H: Yeah.

HMJr: Now would you like me to sort of handle that....

H: Yes, go right to it, and I'll send my fellows over there anytime you want to.

HMJr: All right. Well, now I thought I'd have a little meeting tomorrow about two-thirty.

H: All right, you - you....

HMJr: And Fels has already been in on it with Bell....

H: Yeah.

HMJr: ....and General Carter has been in on it.

H: Yeah.

HMJr: Would it be all right to have Acheson come so that....

H: Yes, yes.

HMJr: And - or anybody else that you want, but if those....

H: Well, sometimes I send fellows less agreeable just to keep - keep order here at home, you know?

- 3 -

HMJr: (Laughs) I see.

H: Yeah.

HMJr: Well, it'll be for....

H: I'd rather have them over there than over here for part of the time.

HMJr: (Laughs) Well, I can take them part of the time. (Laughs)

H: Yes.

HMJr: I can't take them all of the time.

H: Well, you might want to keep them if I send them over too much.

HMJr: No, I don't think so. All right.

H: Yeah.

HMJr: And then there's a little - there'll be a little meeting on that at two-thirty.

H: Yes. Well, thank you....

HMJr: And you'd like me to - to sort of - this is straight foreign exchange rate.

H: Yeah, all right.

HMJr: I - I'm going to be tough with the British on this, because I tell you what I think they're doing, Cordell....

H: Yeah.

HMJr: ....I think they're looking towards the post-war when they're going to have something like a \$3 pound, the way they....

H: Yes, I....

HMJr: ....they....

- 4 -

H: ....think some of them are getting the idea that -- of course, this is private -- some of them are getting the idea already that we are not going to be backed up politically on these foreign matters, you know.

HMJr: You remember in '32-'33 they - that crowd that went over there to the London Economic, they had us all ready for a \$3 pound, you know?

H: Yes, yes.

HMJr: And I wouldn't hold them up - beyond them to try to do it again.

H: Well, they'd do that or worse if you give them a chance.

HMJr: So....

H: Yes.

HMJr: ....I - I'm - I'm going to be kind of tough with - with Phillips.

H: All right. Go to it.

HMJr: Thank you.

H: Yeah.

HMJr: Thank you.



## TREASURY DEPARTMENT

52 ✓

PROCUREMENT DIVISION

WASHINGTON

OFFICE OF THE DIRECTOR

December 30, 1942

## MEMORANDUM TO THE SECRETARY:

Supplementing my memorandum on December 29, which shows various tonnages on hand at New York City waiting vessels - these tonnages have been on hand since the following dates:-

Used Clothing	408 Tons	December 10
Cotton Piece Goods	1710 Tons	December 10
Refined Sugar	3071 Tons	November 27
Raw Sugar	245 Tons	November 27
Powdered Whole Milk	8 Tons	December 27
Matches	310 Tons	December 22
Copper Sulphate	675 Tons	November 27

*Cliff Mack*  
Clifford E. Mack  
Director of Procurement



December 30, 1942.

Dear Ed:

Your letter of December 22nd has given me a great deal of pleasure, and I appreciate it very much.

As you know, it has been one of the deepest satisfactions of my work here to have helped in the establishment and the operation of the Lend-Lease system. We have come a long way since the earliest days of Lend-Lease, yet the results, I think, have justified the President's faith in you and in the program.

My best wishes to you for the New Year.

Sincerely,

(Signed) Henry

Mr. E. R. Stettinius, Jr.,  
Lend-Lease Administration,  
Washington, D. C.

FK:eg

File in Diary

LEND-LEASE ADMINISTRATION  
WASHINGTON, D. C.

54

E. R. STETTINIUS, JR.  
ADMINISTRATOR

December 22, 1942

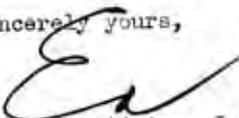
Dear Henry,

I wish to express to you my deep appreciation for the splendid cooperation the Lend-Lease Administration has received from you and the members of your staff during the past year.

The contribution that you and the members of your organization have made toward Lend-Lease affairs is very great and no small part of the credit for the satisfactory flow of goods to the United Nations at this time is due to the fine efforts of your Department.

With the Season's greetings, and with best wishes,

Sincerely yours,



E. R. Stettinius, Jr.

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

December 30, 1942

My dear General Marshall:

Your letter of December 23rd was one of the nicest Christmas presents that I received, and I cannot begin to tell you how deeply I appreciated it.

I appreciated especially your generous words about the Treasury's part in the war, but I wish the Army could know how directly its own work in the field is helping our financing operations here at home. For example, I am quite sure that the success of your African campaign had a great deal to do with the public response that brought us more than twelve billion dollars of borrowed funds in this month of December. Our success would not have been possible without yours.

My own belief, which I think you know by now, is that we are all most fortunate to have you as the head of our Army in this greatest of all wars. It is largely because you are in charge of the Army that I look forward to 1943 with such confidence.

My best wishes will always be with you.

Sincerely yours,

(Signed) Henry Morgenthau, Jr.

General George C. Marshall,  
Chief of Staff,  
War Department,  
Washington, D. C.

FK/cgk

Hooper's Draft

53

My dear General Marshall:

Your letter of December 23rd was one of the nicest Christmas presents that I received, and I cannot begin to tell you how deeply I appreciated it.

During the month of December, we will borrow from the public well over \$12,000,000,000 through the Victory Fund Drive. I am quite sure that the great success of your African campaign had a great deal to do with the public response to our request for funds.

I believe that we are all most fortunate in having you as the head of our Army in this greatest of all wars. I look forward to 1943 with confidence, due in a great part to the fact that you are in charge of our Army.

Wishing you continued success and the best of health,  
I remain

Sincerely yours,



*File with [unclear] 57  
12/28/42*

WASHINGTON

December 23, 1942.

Dear Mr. Secretary:

Just a note of Christmas greetings and best wishes for the New Year with congratulations on the outstanding performance of the Treasury Department in 1942. Your work is a very vital part of our war effort, and I speak for the entire Army in thanking you for your strong support.

May the New Year bring you even greater successes.

Faithfully yours,

Honorable Henry Morgenthau, Jr.,  
Secretary of the Treasury.

December 30, 1942

Dear Marriner:

Your letter of New Year greeting has given me a great deal of pleasure. I appreciate it all the more because of the immense help which you and the Federal Reserve Board have given me in connection with Treasury financing during the past year.

The Victory Loan, in particular, could hardly have achieved its great success without the assistance which you and the Federal Reserve Board gave us. I feel that it was a good example of what real cooperation can accomplish, and I am very grateful to all of you.

My best wishes to you for the coming year.

Sincerely,

(Signed) ~~Henry~~

Hon. Marriner Eccles,  
Chairman, Board of Governors,  
Federal Reserve System,  
Washington, D. C.

FK/cgk

File in Diary



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON

OFFICE OF THE CHAIRMAN

December 18, 1942.

Dear Henry:

As the year draws to a close, I want to take the occasion to express to you again my appreciation of your friendship and the opportunity I have had to be associated with you.

May you be given in the new year health and strength, and the satisfaction that comes from the loyal and devoted service which you are privileged to render to the country in these times.

Sincerely yours,

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

December 30, 1942.

Dear Mr. Skouras:

Your letter of greeting has given me a great deal of pleasure, and I appreciate it very much.

I appreciate it especially because you have shown yourself to be such a good friend of the Treasury in the past year, and such a source of strength to the war effort generally. It has made my work here easier to know that I could call on you for help at all times, and to know that your help would always be cheerfully and willingly given.

I hope that the New Year will be good to you, and I hope, above all, that it will lead to the liberation of your native Greece and to victory for all free men.

Sincerely,

(Signed) H. Morgenthau, Jr.

Mr. Spyros Skouras, President,  
Twentieth Century Fox Film Corp.,  
444 West 58th Street,  
New York, New York.

FK:eg

File in Diary



WYNDON J. SMOULAN  
PRESIDENT

December,  
1942.

444 WEST 80TH ST.  
NEW YORK

My dear Mr. Morgenthau:

Your inspiration to the Nation and your untiring efforts in behalf of all mankind have indeed been as a beacon light to the enslaved peoples of the world.

May the day be not far distant when Freedom and Liberty shall again reign throughout the earth, and the evil forces of tyranny and aggression be destroyed.

We, in this industry, thank you for your untiring efforts on our behalf and for your sympathetic understanding of our problems in these troublesome times.

To you personally and your family may I take this occasion to express the wish that Christmas will be restful and joyful, and the New Year be filled with success and fruitage.

Faithfully yours,

The Hon. Henry A. Morgenthau,  
Secretary of the Treasury,  
Washington, D.C.

NEW YORK  
Herald Tribune

62  
New York,  
Dec. 30, 1942.

Dear Mr. Secretary:-

Many thanks for the  
kindly note concerning me which you were  
good enough to send to Mrs. Reid. This  
seems to be only one of the many reasons  
why I owe you thanks. The principal  
one is that you permitted me to be more  
widely useful in our war effort than I  
might otherwise have been. I hope  
sincerely that I will be able to serve  
again, and more effectively, under the  
Flag and for the Treasury.

Meanwhile, may the  
New Year be a pleasant one for you, and  
may it realize for all of us our hopes  
for a speedy and complete victory.

Sincerely,

*George Wanders*

Hon. Henry Morgenthau, Jr.,  
Washington, D. C.

STANDARD FORM NO. 14A  
APPROVED BY THE PRESIDENT  
MARCH 10, 1925

# TELEGRAM

OFFICIAL BUSINESS—GOVERNMENT RATES

Miller McClintock  
Advertising Council  
60 East 42nd Street  
New York City

## TREASURY DEPARTMENT

WASHINGTON

CHARGE TREASURY DEPARTMENT, APPROPRIATION FOR  
War Savings, Expenses of Loans

(The appropriation from which payable must be stated on above line)

December 30, 1942

MAY I TAKE THIS OPPORTUNITY OF THANKING THE COUNCIL THROUGH YOU FOR THE TRULY WONDERFUL HELP YOU HAVE BEEN GIVING THE TREASURY IN OUR WAR FINANCING CAMPAIGNS. THE COUNCIL'S ADVICE AND ASSISTANCE CONTRIBUTED A GREAT DEAL TO THE SUCCESS OF THE DECEMBER VICTORY LOAN WHICH WENT OVER THE TOP BY MORE THAN THREE BILLION DOLLARS AND ALSO TO THE GROWING SALES OF SERIES E WAR BONDS WHICH ARE REACHING RECORDBREAKING VOLUME THIS MONTH. YOUR WORK HAS NOT ONLY BEEN COMPETENT IN EVERY WAY BUT I APPRECIATE ESPECIALLY THE WILLINGNESS WITH WHICH YOUR HELP HAS BEEN GIVEN AT ALL TIMES. IT HAS MADE MY TASK HERE MUCH EASIER AND THE SAME IS TRUE I KNOW OF OTHER GOVERNMENT DEPARTMENTS. MY BEST WISHES TO ALL OF YOU FOR THE NEW YEAR.

Henry Morgenthau, Jr.,  
Secretary of the Treasury.

cgx

UNITED STATES SAVINGS BONDS - SERIES B

Comparison of December sales to date with sales during the same number of business days in November and October, 1942

(At issue price in thousands of dollars)

Date	December daily sales	Cumulative sales by business days			
		December	November	October	December as percent of November
December 1942					
1	\$ 4,116	\$ 4,116	\$ 5,164	-	79.7%
2	4,489	8,605	9,272	-	92.8
3	10,042	18,647	20,460	\$ 5,045	91.1
4	39,690	58,337	31,309	42,285	186.3
5	16,648	74,984	53,076	52,984	141.3
7	46,424	121,408	62,326	73,919	194.8
8	11,887	133,295	96,366	98,490	138.3
9	17,857	151,152	111,002	117,077	136.2
10	13,607	164,759	146,494	131,593	112.5
11	38,664	203,42	161,929	169,859	125.6
12	17,480	220,903	181,120	179,232	122.0
14	52,056	272,959	188,497	194,811	144.8
15	15,530	288,488	230,083	222,243	125.4
16	22,764	311,252	241,624	239,891	128.8
17	24,848	336,100	262,274	254,201	128.1
18	25,260	361,359	287,409	290,282	125.7
19	17,907	379,266	314,568	312,386	120.6
21	45,716	424,982	327,418	327,928	129.8
22	18,083	443,065	371,750	355,719	119.2
23	16,686	459,751	390,176	382,332	117.8
24	18,942	478,693	410,473	396,458	116.6
26	54,198	532,891	429,168	434,661	124.2
28	48,034	580,925	456,184	445,071	127.3
29	23,554	604,479	482,830	467,612	125.2

December 30, 1942.

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

Source: All figures are deposits with the Treasurer of the United States on account of proceeds of sales of United States savings bonds. These figures have been adjusted on the basis of wire reports and therefore will not agree with the Treasurer's accounts.

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

## UNITED STATES SAVINGS BONDS - SERIES F AND G COMBINED

Comparison of December sales to date with sales during the same number of business days in November and October, 1942

(At issue price in thousands of dollars)

Date	December daily sales	Cumulative sales by business days			
		December	November	October	December as percent of November
December 1942					
1	\$ 197	\$ 197	\$ 303	-	65.0%
2	329	527	1,115	-	47.3
3	2,688	3,214	7,846	\$ 2,218	41.0
4	13,947	17,161	14,720	20,322	116.
5	12,303	29,464	31,425	24,325	93.8
7	17,522	46,986	34,030	31,922	138.1
8	2,872	49,858	43,940	46,695	113.5
9	9,576	59,434	49,326	55,998	120.5
10	5,651	65,085	58,842	59,711	110.6
11	14,274	79,359	64,157	74,275	123.7
12	7,135	86,495	71,352	76,430	121.2
14	15,430	101,924	73,989	83,857	137.8
15	7,719	109,644	83,246	91,884	131.7
16	5,146	114,789	88,888	98,457	129.1
17	11,654	126,443	97,154	101,252	130.1
18	6,466	132,909	104,487	110,052	127.2
19	7,992	140,901	113,191	115,757	124.5
21	13,451	154,352	116,880	124,610	132.1
22	12,077	166,429	131,041	133,767	127.0
23	8,253	174,682	136,798	142,141	127.7
24	7,854	182,536	145,126	146,525	125.8
26	20,516	203,052	151,824	159,973	133.7
28	19,576	222,629	161,542	165,364	137.8
29	11,179	233,807	172,044	180,250	135.9

December 30, 1942.

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

Source: All figures are deposits with the Treasurer of the United States on account of proceeds of sales of United States savings bonds. These figures have been adjusted on the basis of wire reports and therefore will not agree with the Treasurer's accounts.

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

DEC 30 1942

MEMORANDUM FOR THE PRESIDENT:

In accordance with the request contained in your note of December 28, 1942, I am attaching a draft of a letter for your signature to Mr. Russell Leffingwell, in reply to his letter of December 18. His letter is also returned for your files.

*12/1 H. M. J.*

DWB:NLE  
December 29, 1942

Photo file in Diary

Sent by Manus 2:35 12/30  
(Attn: Miss Tully)

DEC 30 1942

Dear Mr. Leffingwell:

I have your letter of December 18, 1942, referring to our previous conference at which time I suggested that you come down again to talk with me and Secretary Morgenthau on the subject of Government finance.

Right at this time I am completely swamped and would like to postpone the conference until late in January or early February. In the meantime I have asked the Secretary of the Treasury to see you for the purpose of discussing whatever immediate problem you have in mind. He is much interested in the subject to which you refer in your letter, and I am sure he will be more than pleased to discuss it with you.

With best wishes for the New Year, I am

Sincerely yours,

Honorable Russell G. Leffingwell,  
23 Wall Street,  
New York, N. Y.

DWB:NLE

Photo file in Diary

Sent by Menue 2:35 12/30  
(Attn: Miss Tully)

Bill

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THE WHITE HOUSE  
WASHINGTON

December 28, 1942

MEMORANDUM FOR  
THE SECRETARY OF THE TREASURY

Will you be good enough to prepare a reply for my signature, telling him that I am so jammed that I cannot see him just now? Tell him I want to see him toward the end of January and, in the meantime, will you be good enough to see him?

F. D. R.

Enclosure

23 Wall Street  
New York

R. C. LEFFINOWELL

December 18, 1942

Dear Mr. President:

You'll remember last time I saw you (a couple of months ago) you told General Watson to get me down again, to see you and Secretary Morgenthau together, perhaps at lunch, upon the latter's return. I know what a lot you have had to do since, and I have been awfully proud and happy about the great achievements of our arms under your command on land and sea and in the air. So I haven't wanted to remind you too soon of the sordid business of public finance. Yet in matters of broad fiscal, economic and social policy, affecting several arms of our Government, you are concerned as President and Commander-in-Chief; and I guess you have just got to bother about it.

At the end of November currency in circulation was more than \$110 for every man, woman, and child and baby in the country against \$79.70 a year ago. That is an increase of 10% since I saw you in October and of 38% in a year. Reporting member banks' deposits had increased 24%; their direct holdings of Government securities had increased 67%; and Federal Reserve Banks' direct holdings had increased 120%, within the year.

That is monetary inflation pure and simple. If it goes on it will blow the lid off some time, though not yet.

My friend, Bernie Baruch, has spent years preaching price-fixing, but Mr. Byrnes and Mr. Henderson's successor might just as well sit down on Old Faithful in Yellowstone Park in the

interval between eruptions, and try to hold the geyser in with the seat of their pants, as try to control monetary inflation like that, by price-fixing and rationing, when the hour of eruption comes.

A swell job is being done selling the nine billion dollar loan this month. It is a tough task. They are doing it and doing it well; and will succeed. Then a lot more loans have got to be sold soon again, and again, for which preparations must be made promptly.

Secretary Morgenthau is a devoted public servant of long experience, for whom I have warm regard. He has been unfailingly kind to me, and I should think he'd be glad of such a talk as you suggested.

I am, my dear Mr. President, with great respect

Faithfully yours



The President  
The White House  
Washington, D. C.

DEC 30 1942

Dear John,

Under date of December 18, I received a communication from Mr. Colston E. Warne of Amherst, Massachusetts, attaching a letter signed by a group of American educators expressing, as the letter put it, "a deep concern over the waste of man-power and resources and the inflationary stimulus resulting from the Treasury policy toward advertising."

I have not been able to give the matter any serious thought nor have I as yet replied to the letter.

I am attaching a copy of the communication signed by Mr. Warne.

Elinor joins me in sending our best wishes for the New Year. *to you and Anna.*

Cordially,

(Signed) Henry

Mr. John Beettiger  
Seattle Post-Intelligencer  
Seattle, Washington

Photo file in Diary  
Orig. File to Odgaard

*Sent "air mail"*

Arthur, Massachusetts  
December 18, 1948

72

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

Dear Mr. Morgenthau:

The undersigned economists, political scientists, psychologists and other educators, wish to direct your attention to the overwhelming waste involved in the continuation of the full peacetime volume of advertising when the scarcity of raw materials, power, transportation, and skilled labor should dictate drastic curtailment in this field. We are not here depicting the peace-time services of advertising. We are nevertheless aware that there is now little present need to stimulate current consumption. To the extent to which advertising agencies present buying, it is running in direct opposition to the effort of the Treasury and the War Agencies to check inflation.

According to a reliable advertising index (Fide Magazines) the total volume of ads in now some 81 per cent above the level during the years 1935-39. Newspapers and magazines are filled not only with ads designed to stimulate immediate purchasing but with patriotic affirmations indicating the successes of particular companies in fulfilling their war quotas or otherwise associating the company's name with the war effort. Much other advertising stresses the post-war potentialities of industries now working on war orders. Other appeals are for the conservation of materials and the purchase of war bonds.

We fully appreciate that among these are advertising messages that the government needs to carry to the public. Where those exist, let them be paid for directly by the government rather than associated with the private trade names of commercial companies. We urge, therefore, that, through administrative order, commercial companies be permitted to include as a deductible cost (for tax purposes) only that minimum of advertising absolutely essential to secure the sale of actual current output.

Such a ruling would make it unnecessary for the Federal Government, as at present, to be paying the bulk of the advertising cost of those companies now subject to high excess profits taxes. If in highly competitive fields all concerns which advertise are, for the duration, silent with respect to their trade names, their relative competitive position will be maintained fully as well as if they were all to be rewording questions of their existence.

Undoubtedly such a restrictive program would bring sacrifices in particular cases and would lower the income of advertising media. We would urge that, in all-out war, essential sacrifices must be made; furthermore, that the freedom of the press may well be enhanced if newspapers are less dependent upon advertising and more dependent upon collecting the true cost of publication directly from the readers.

Sincerely,  
W. Colston E. Harris  
Secretary of the Group

\* Fide Magazine, Nov. 1, 1948, p. 72

12-29-42 *via Boettiger*

# SEATTLE POST-INTELLIGENCER

1 8 6 3

1 9 4 2

OFFICE OF THE PUBLISHER

December 23, 1942

My dear Henry:

I have been advised that a group of 100 alleged economists have signed a petition addressed to you, asking that a ban be placed on all newspaper advertising for the duration.

Could you favor me with a copy of the petition, and the names?

Our best to you as always.

Sincerely,

*John*  
John Boettiger.

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



Established 1863

December 30, 1942.

Mr. Otto Frankfurter,  
Heyden Chemical Corporation,  
50 Union Square,  
New York, New York.

Dear Mr. Frankfurter:

At the suggestion of Secretary Morgenthau I am writing to tell you of the action we have taken in connection with the Chicago Tribune Press Service story by Chesley Manly, which appeared last Friday in the Washington Times-Herald.

After receiving from Director Mack the facts in the case as they related to the Procurement Division, I called upon Mr. Manly to correct his misstatement. He expressed great surprise that he had been so completely misinformed as to your activities in the Procurement Division, arguing that he had received his information from a man who was "in a position to know" and who had proved reliable in the past. He promised, however, to forward the information from our records to his office in Chicago with a request for a correction.

In addition, I advised the news correspondents who regularly cover the Treasury and those of the weekly magazines of the true situation so that they would not carelessly pick up the story as carried by the Tribune service. All of them assured me that they considered the Tribune story "a deliberate smear" and that they did not want any part of it.

Sincerely yours,

Charles Schwarz,  
Director of Public Relations.

CS:rc

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

75

DATE

December 30, 1942

TO Secretary Morgenthau

FROM Mrs. Forbush

The final batch of Victory tax correspondence from Internal Revenue was, like the previous collection, almost entirely concerned with the technical details of collecting the tax. There were a few scattered letters from firms, churches, etc., but none that added anything to the points of view expressed in the letters for your reading yesterday. It is interesting that out of 180 communications, 54, or just about one-third, dealt with the question of the first pay period. The fact that New Years day comes on a Friday, and that final salaries for 1942 cannot always be calculated and paid within the calendar year, has created a great deal of confusion; and in addition to the inquiries, there are many protests implied by the form the inquiry takes. A copy of one telegram is attached in this connection.

General questions covering types of compensation covered, methods of remitting, etc., account for more than one-half the total. The difficulty of computing the tax for certain pay-rolls now assembled on a punch-card system is mentioned several times. Various firms report that to collect the Victory tax, they will have to use new forms or install additional equipment, and complain of the waste of time and the difficulty of securing trained employees to handle additional work.

Another difficulty frequently reported is that covering transient or seasonal employment, especially in firms which have both full-time employees and occasional workers drafted from the "drifters" of labor. It is interesting to see the wide range of occupations covered in the letters of inquiry. Among those mentioned for a clarification of the regulations are variety artists, tow-boat workers, drug store rush-hour clerks, drivers of laundry trucks, shrimp pickers and oyster shuckers; and at the other end of the scale, life insurance salesmen and a puzzled board of education with a small paid staff which has to work out the problems for regular teachers, substitutes, medical consultants, student cafeteria workers, janitors, etc.

The second letter attached was received in the regular mail this morning, it comes from the minister of a Baltimore church.

Gabriel E. Forbush

C  
O  
P  
Y

Telegram sent by Loup River Public Powder District, by Harold Kramer, Secretary, General Management.

We pay on January 15, 1943 for money earned in period from December 16 to 31st, 1942. The local income tax office is trying to tell us what this January 15, 1943 payment is subject to withdrawal for Victory Tax. As we read the law the tax does not apply to 1942 earnings regardless of payment date. Moreover, we are advised by the Union Pacific Railroad Company at Omaha that you have made a special ruling for railroads to that effect, and we cannot understand why you would make fish of one and fowl of another. Will appreciate your wiring collect the exact status. May I add that it is physically impossible to collect time sheets from all over the state and have board, which is a public body, approve them and get out the checks for 1942 earned salary by December 31. Moreover, our employees are pleased to a man with our system because it gives them a nice nest egg, a sort of enforced little savings account when they leave or go into the army as so many now are doing. As a strong new dealer and interventionist, I hope you are not going to make a ruling that will upset accounting systems throughout the country. Too much of these irritating procedures rather than the tax itself is what is making Washington unpopular in the Hinterland.

Columbus, Nebraska  
December 21, 1942

December 29, 1942

Hon. Henry J. Morgenthau, Jr.  
Treasury Department  
Washington, D. C.

Honorable Sir:

I am writing you in behalf of the Official Board of the Mount Vernon Place Methodist Church, Baltimore, Maryland, to secure further information about the responsibility of churches to collect the Victory Tax. We are not raising the question of whether the recipients of salaries from the Church should be taxed by civil government in this or any other way. As citizens of the United States our obligation is clearly to do what other citizens are asked to do, so long as it does not conflict with conscience based on religious scruples.

The points on which we seek clarification are these:

1. Does the Federal Government require churches to deduct the Victory Tax from the salaries of their employees?
2. Does the Federal Government contemplate levelling legal reprisals against churches which, feeling that the plan for collecting the Victory Tax is a violation of the principle of separation of Church and State, will not comply with the Law?
3. Would not any legal reprisal for this reason be a definite infringement on the American tradition of separation of Church and State?
4. Is the Federal Government contemplating special provisions which would require the employees of the Church to comply with the Victory Tax, but exempt the Church from the obligation to collect it?

Assuring you of our unswerving loyalty to God and country, I remain

Sincerely yours,

(s) Harold Bosley

## TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE

TO Secretary Morgenthau

December 30, 1942

FROM Frances McCathran

HIGH-LIGHTS OF THE WAR NEWS  
(11:00 A. M.)

## Russia

1. The capture of Kotelnikov (90 miles southwest of Stalingrad), the pivotal town on the Stalingrad-Caucasus railroad, is the first big prize of the Russian winter offensive. Kotelnikov (or Kotelnikovski) had served as a main supply base for German armies at Stalingrad and its capture virtually sealed the doom of 22 German divisions trapped at the latter city.
2. Russians report major gains on the southwest Stalingrad front and in the city proper.
3. The Russian pincers heading toward Rostov (one along the Moscow-Voronezh-Rostov railroad and the other from the Kotelnikovski area) are now 40 miles from each other, according to Russian reports.

## North Africa

1. Tunisia - The Allied withdrawal from the hill 6 miles northeast of Medjez-El-Bab is considered largely a discretionary tactic, with even the Germans not emphasizing the operation in their reports. Although the Allies had taken most of the ridge, the Germans held the crest of the hill, making the Allied position dangerous. French troops from central Tunisia and U.S. forces from the south advanced in a triple threat to cut the coastal road linking Tunisia and Tripolitania while mud still bogged down main forces. Other French forces around Pichon and Kairouan, driving toward the port of Sousse, have improved their positions. Allies continued their air attacks on Axis-held ports. Radio Vichy (rarely accurate) reported various Allied repulses around Tebourba and Pont-Du-Fahs.

2. Libya - The British Eighth Army has reportedly broken across the Wadi Bei El Chebir area, 55 miles west of Sirte and about 180 east of Tripoli. This is the first of the remaining 3 possible lines of defense on the Libyan coast.
3. An I.N.S. correspondent in Tunisia reports that some units of the Afrika Corps have crossed from Libya into Tunisia and joined the Axis around Pont-Du-Fahs.
4. Allies continue to damage Axis shipping on the Sicily-Tunisia supply line.

#### The Pacific Area

1. Two Allied wedges in the Jap beachhead near Buna, New Guinea, threatened to isolate enemy forces still holding out near the western end of the main Jap air-strip.
2. In eastern New Guinea, where less than 6 months ago the Japs had a free hand to drive nearer Australia, they now have left only a strip of jungle and swamp  $1 \frac{3}{8}$  miles long and 1,300 yards at its widest point.

#### Burma

1. The R.A.F. attacked the Jap airdrome at Monywa along the Chinwin River, Toungoo airdrome, and the Mayu River district.
2. No further news has been received from ground forces which yesterday had reached Rathedaung, 25 miles from Akyab.

#### Europe

1. The Allies now have the initiative on all fronts, the British War Office claimed in their year-end review.
2. Anti-Axis sabotage is reportedly increasing in Europe.

## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE

TO Secretary Morgenthau

December 30, 1942

FROM Frances McCathran

AFTERNOON SUMMARY OF THE WAR NEWS  
(3:00 P. M.)

## North Africa

1. Allied artillery shelled enemy positions on the hill about 6 miles northeast of Medjez El Bab in northern Tunisia which was captured by Allies Christmas Eve but lost yesterday, the War Department announced in a communique. Allied aircraft again attacked Sousse and roads leading to Tunis, despite bad weather.
2. U.S. troops were reported in a Reuters dispatch today to have advanced to within 40 miles of Gabes, strategic Tunisian port which lies approximately midway between Axis-held Tripoli and Tunis. Direction of advance was not stated, but delayed field dispatches received last night disclosed an American task force was operating on southern Tunisian front and told of a recent raid on Maknassy, 55 miles northwest of Gabes and 40 miles from coastal road and railway.
3. Front dispatches reported a heavy flow of German and Italian supply columns from Tripoli, hinting strongly that Axis would not attempt a defense of Tripoli which already has been smashed up by Allied air attacks.

## The Pacific (Navy Communique on the Solomons)

1. American aircraft carried out 2 attacks on enemy cargo shipping in Wickam anchorage on the southeast coast of Vangunu Island (about 120 nautical miles northwest of Guadalcanal) in the New Georgia group on December 29 (South Pacific time), sinking 2 enemy craft.
2. Guadalcanal - Army and Marine Corps troops in 2 engagements on December 27 killed between 155 and 165 Japs with the loss of only 4 Americans killed and 1 wounded.

BRITISH MOST SECRET  
U.S. SECRET

OPTEL No. 451

Information received up to 7 A.M., 30th December, 1942.

1. NAVAL

Reference OPTEL No. 449, para. 1. Now known that 13 or 14 ships in this convoy have been torpedoed. 5 promising counter attacks reported.

2. MILITARY

LIBYA. 28th. Enemy patrols withdrew from southern end WADI BEI EL CHEBIR and were followed up to a point about 25 miles southwest of MOUERAT.

TUNISIA. A successful attack was launched by French at DJEBEL FOIRINE (50 miles northwest of SOUSSE). About 100 Italians captured. Enemy attack at PICHON was repulsed, prisoners and material being taken.

RUSSIA. On 29th KOTELNIKOV was captured by Russians with important booty, including 17 aircraft and a train with tanks.

3. AIR OPERATIONS

WESTERN FRONT. 29th. Mosquitos and Spitfires (one missing) attacked railway and canal targets in North FRANCE and BELGIUM. 2 enemy aircraft crossed SUSSEX coast damaging houses at EASTBOURNE. 29th/30th. Aircraft despatched - seaming 19, RUHR 3.

FRENCH NORTH AFRICA. 27th/28th. Heavy bombers from LIBYA attacked SOUSSE, hitting a ship and 2 tankers. 28th/29th. Wellingtons from MALTA successfully attacked TUNIS dock and SOUSSE Harbour.

MEDITERRANEAN. 28th/29th. A 4,000 ton enemy ship was torpedoed off the Tunisian Coast and blew up.

BURMA and CHINA. On 26th and 27th, U.S. medium bombers attacked LASHIO and on 28th U.K. fighter bombers attacked MAGWE airfield. 26th. YUNNANYI airfield was attacked by 18 enemy aircraft, which suffered 6, 10, 1 casualties at the hands of 17 U.S. fighters (2 missing).

December 31, 1942  
9:30 a.m.

GROUP

Present: Mr. Bell  
Mr. Ruffington  
Mr. Kuhn  
Mr. Blough  
Mr. Thompson  
Mr. Schwarz  
Mr. Paul  
Mr. Graves  
Mr. Gaston  
Mr. Haas  
Mr. Gamble  
Mr. Odegard  
Mr. Sullivan  
Mr. White  
Mrs. Klotz

H.M.JR: Mr. Gaston?

MR. GASTON: Carl Shoup was in yesterday and suggested something which seems possibly a very good idea and that is to make up a book of speeches on inflation and taxation made within the last six months or so, including one or more of your speeches, and speeches by Mr. Paul and Mr. Blough and others, and print them. He thinks they are quite a remarkable series of speeches on this whole subject. We might make up a little dummy for you, if you like, and show you what might be included in such a publication.

H.M.JR: Let's take a look at it.

MR. GASTON: Mr. LaGuardia made a suggestion that we have a retail liquor store check-up in New York. Elmer Irey and Dwight Avis went up to talk to him about it because they did not think it was necessary and we

- 2 -

haven't the personnel to put on it. Recently the Alcohol Tax Unit completed a floor-stock check-up, which almost amounts to the same thing, and they succeeded in convincing the mayor it was not timely to go ahead with such a general check-up as we did in other years when there were unemployed people available for it.

I have nothing else.

H.M.JR: Dan, have you that group of letters, that cable?

MR. BELL: The letter from Mr. Stimson?

H.M.JR: Yes.

MR. BELL: I just dictated the letter.

MR. SULLIVAN: One morning last week I showed you a book containing the work which Outdoor Advertising did last year under Mr. Buffington's direction. You said you did not care to write them. Do you care if I write them?

H.M.JR: No, I said it would be all right for you to write them.

MR. SULLIVAN: I think they would also like a request from me to do the same thing this year. They are willing to do it, but they would like to have us ask them to do it.

H.M.JR: That is a request that should go to Gaston, which would come up before this Public Relations Policy Committee which I have set up.

MR. SULLIVAN: Fine.

H.M.JR: So if you will submit that to Gaston - that is the kind of thing which he takes up on Friday and then submits to me on Tuesday. I have this new committee.

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MR. SULLIVAN: We have three hundred and fifty thousand copies of this new poster printed up. You remember, we had a similar one last year. (Poster on simplified tax form exhibited.)

H.M.JR: Where is Harold? We were in the Mayflower Hotel last night visiting some friends, and their poster there is still "Defense Bonds" - at the Mayflower Hotel. How old is that?

MR. GRAVES: That is eight months old.

MR. BELL: A little far removed from the Treasury. (Laughter)

H.M.JR: What did you say, Mr. Bell? I couldn't hear you. Say it again.

MR. BELL: I said the Mayflower was a long way from the Treasury. (Laughter)

MR. WHITE: That reflects the Mayflower appropriately. (Laughter)

MR. BELL: Yes, the management.

H.M.JR: Harold doesn't think it is funny. (Laughter)

Now, listen, I was at my dentist's last night, and he does not know what he does about the couple of people he employs as an employer. He says the other dentists don't.

Will this speech, for instance, go into that?

MR. SULLIVAN: Yes.

H.M.JR: Is it eight or more?

MR. SULLIVAN: No, the eight has nothing to do with it.

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H.M.JR: What does he do?

MR. SULLIVAN: What does he do?

H.M.JR: Yes. He may employ two or three people on his pay roll.

MR. SULLIVAN: He will have to withhold for them.

H.M.JR: He will?

MR. SULLIVAN: Yes. The two main exceptions are agricultural labor and domestics.

H.M.JR: The point is, how little is known about it.

MR. SULLIVAN: I think that is right.

H.M.JR: And the other thing I would like to suggest is that if this is a good speech - who is working on it?

(The Secretary held a telephone conversation with Mr. Herbert Lehman.)

H.M.JR: What I was thinking about was this - and again, this committee could help on it. I don't know whether Herbert wants to be bothered or whether you should go through Crampton, but we will work that thing out. I was thinking, we have a method of sending radio discs to various radio chains - after all, there is one broadcast for one system, but if this went out they might play it over and over again.

So if you people - if Schwarz would consider that - will you (Schwarz) check? I mean, if it is a good speech, have them make a record of it.

MR. SCHWARZ: As soon as we get the draft, we can start working with the radio stations.

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H.M.JR: Send it out to the eight hundred stations we are now sending records to.

MR. ODEGARD: Is that Mr. Helvering's speech?

H.M.JR: That is right, Peter, you are on that committee. If they want to play "White Christmas" before it and "Over There" after it-- (Laughter)

MR. SULLIVAN: You ought to write a new one, "The Ides of March." (Laughter)

MR. ODEGARD: You need soft music. (Laughter)

H.M.JR: I think just one speech won't hit it. I think there will have to be a little bit more.

MR. SULLIVAN: That is right. The Victory Tax has to be broken up into two or three different talks.

H.M.JR: I think this system they have of circulating these discs to the radio chains is good.

MR. SULLIVAN: The ones we did last year on the--

H.M.JR: You have printed material on this, haven't you, that would apply?

MR. SULLIVAN: Yes.

H.M.JR: Would you furnish Mrs. Klotz with some so she could send it over so it won't hurt me too much tonight. (Laughter)

MR. SCHWARZ: Before press conference, there is still some confusion as to what is--

H.M.JR: Heavens, Harry, aren't you and I going to this ten o'clock meeting?

MR. WHITE: Yes.

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H.M.JR: I don't want any press conference today. I thought it would be a good way to get out of it. I want to go up and see Wallace's fight. I can't go up to New York so I have to see the Wallace fight here.

We have to go fairly quickly, haven't we?

MR. WHITE: If it is like some fights, it may be over before you get there.

MR. ODEGARD: Mr. Secretary, there are two things on the Victory Tax, since this is the topic, that might be mentioned.

I asked to have a survey made of the attitude of workers and employers toward the Victory Tax. We have those returns in, although the full report will not be here until tomorrow or Saturday. From that report it appears that only about fifteen percent of the workers have heard anything about the Victory Tax.

H.M.JR: Well now, how come - I think it is a good idea, but how come you asked them to do that?

MR. ODEGARD: We asked because there was great concern by those administering the pay-roll saving.

H.M.JR: Did Sullivan know about this?

MR. SULLIVAN: No, I had not heard about this.

MR. ODEGARD: I told John we were going to make the survey, but he had not heard the results.

MR. SULLIVAN: That is right.

MR. GRAVES: That had to do wholly with the impact of the Victory Tax on the pay-roll savings.

H.M.JR: In the future, that kind of a thing, like a survey, ought to be cleared through this weekly committee, Peter.

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Only fifteen percent?

MR. ODEGARD: Only fifteen percent. I ought to add that we have prepared - I will have the proofs today - materials, in collaboration with Mr. Cann and in collaboration with Roy Blough's shop, to go out to all labor papers and all the papers in the western newspaper union, with supplementary material for distribution in plants.

H.M.JR: On the Victory Tax?

MR. ODEGARD: On the Victory Tax.

H.M.JR: Did you know about that?

MR. SULLIVAN: Yes. It was at my request that Mr. Cann sat in on that.

MR. WHITE: Is there any value or possibility - possibly you are contemplating this already - of devoting the Treasury Hour for the next two months to interesting questions and answers and other forms of discussion about filing the income tax returns, and the reason for the income tax?

MR. SULLIVAN: We do that every year.

MR. WHITE: How much time do you spend?

MR. SULLIVAN: A great deal, and that is done by the collectors over their local stations. All of that material is already prepared for this year.

MR. THOMPSON: Also through the newspapers.

MR. SCHWARZ: There is a regular series that will start in the next couple of days.

H.M.JR: Has anybody anything important this morning that they want to ask me about? If they haven't--

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MR. BELL: I wanted to raise the question as to whether you want to see it. We have some question as to whether it ought to go before we see Phillips' memorandum on it.

H.M.JR: All right. Has anyone--

MR. WHITE: Have you decided to hold that up?

MR. BELL: Yes.

H.M.JR: This will be the last one that Mr. Kuhn sits in on, is that right?

MR. KUHN: Yes.

H.M.JR: I am sorry to see you go.

MR. KUHN: Norman tells me that I can have a roof over my head for two more days if I pay rent for that big directors' table in my office. (Laughter)

H.M.JR: I hope you will not be sorry that you have gone.

MR. KUHN: No, but in lots of ways I will be - this group here.

MR. WHITE: I hope you will be sorry.

H.M.JR: We will miss you, in many ways - more ways than one.

MR. DEGARD: I hope you are at least as sorry as we are that you are going.

H.M.JR: I will see you all before I go home tonight, if any of you are still sober by the time I go home. (Laughter)

December 31, 1942  
12:04 p.m.

HMJr: Hello.

Harold  
Thomas: Good morning, sir.

HMJr: How are you?

T: Pretty good. The weather has changed for the better, so I feel better.

HMJr: Good for you.

T: In regard to your radio program...

HMJr: Yes.

T: We have in the Council a Radio Advisory Committee composed of producers.

HMJr: Yes.

T: We have got them working on the plans....

HMJr: Good.

T: ....for a show for you.

HMJr: Yeah.

T: In addition to that, I am trying to get one of the top men in Young & Rubicon to act as the head man in the - in the handling of the thing.

HMJr: Good.

T: I'm particularly anxious to do that if I can because Bill Murray has a high regard for Young & Rubicon and they for him.

HMJr: Yes.

T: And I think Murray has a lot to offer for this program which we should keep.

HMJr: Good.

- 2 -

T: May I suggest to you that when you talk to Murray....

HMJr: Yeah.

T: ....that you hang this thing largely on the point of a producer. In other words, he had this fellow, Bacher....

HMJr: Yes.

T: ....who, as I understand it, is no longer available to him now for some reason or other.

HMJr: Well, the only reason he isn't available is that they got rid of him, and which I think was a mistake from what I've heard.

T: Well, I think probably you're right, but in any event - just why they got rid of him I don't know. I didn't learn that he had gone until after I'd talked to you.

HMJr: Well, they tried to hang it on the question of the labor unions.

T: Yes.

HMJr: So I sent a man from Washington up to talk to that particular labor union....

T: Yes.

HMJr: ....and with the exception of one incident where the man lost his temper, they admire him greatly.

T: Yes.

HMJr: There's no trouble there, but there's a - was a - I think a trouble as to who was getting the most publicity, Bacher or Murray, I think that was the trouble.

T: Well, that's unfortunate if it is the trouble.

HMJr: There's nothing the matter with Bacher. They just booted him out after he did these Star Parades which are either going to get the first

(cont.)

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HMJr: or second award and will be the first time in  
(cont.) history that a recorded program ever got an  
award.

T: Yeah, yeah. Well, now when you talk to Murray,  
let's - let's think in terms of the....

HMJr: Well, I....

T: ....producer angle of it.

HMJr: Well, I have talked with Murray.

T: Oh, you have?

HMJr: And he put it on the basis of his reputation  
and everything else, so I agreed to three more  
shows and then through.

T: Oh.

HMJr: Hello?

T: Yes.

HMJr: Because he said his reputation and everything  
was at stake and I wanted to be fair. Hello?

T: Yes, I'm listening.

HMJr: I just got this telegram now from Murray, which  
I'll read to you. It just came in.

T: Yes.

HMJr: "Dear Mr. Morgenthau: Before talking with  
you this morning (that was yesterday) I had a  
firm belief in your sense of fair play. Now  
that we've talked I'm even more convinced of  
that fact. You heard my side of the case, and  
only then you made your decision. It is  
reassuring to deal with the Treasury Department  
presided over by someone so eminently just and  
fair."

T: Good enough.

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HMJr: "My warmest regards."

T: Good enough.

HMJr: So I think what we should do is if there's - we - if you could keep it from getting around too much, you see?

T: Pretty hard to do.

HMJr: Well....

T: I think we can save face on it. I tell you what I would like to do....

HMJr: Yes.

T: ....I would like to talk with Bill Murray about this thing.

HMJr: Well, that would help me.

T: And maybe I can put it on the basis that "Bill, you go ahead and - and help us on the program and nobody will know anything about it, and we'll just take over the production end of the thing."

HMJr: How do you mean nobody will know anything about it?

T: Well, I mean we won't make any - any public statements or anything.

HMJr: Well, I - I think I would - if you don't mind, I'd put it a little bit differently.

T: Yes.

HMJr: I would say that you're coming down here for a couple of months to coordinate the whole thing....

T: Yes.

HMJr: ....for the Advertising Council.

T: Yes.

HMJr: That I want it worked closer and closer with the Advertising Council.

- 5 -

T: Yes.

HMJr: That you're doing all the other advertising except radio.

T: Yes.

HMJr: Now I've asked the Advertising Council to sit in on that....

T: Yes.

HMJr: ...and, therefore, you want him to tell us what's happened so far and so forth.

T: And work with it.

HMJr: And work with you.

T: Yeah.

HMJr: How's that?

T: I think he'll be glad to do that.

HMJr: How's that?

T: I think it's a very good suggestion.

HMJr: And then - then that you talked to me this morning and that the Advertising - I've invited the Advertising Council to be in on all Treasury publicity.

T: Yeah.

HMJr: And you can't leave radio out by itself.

T: That's right. And that we will be in a position to help him in the production of the show.

HMJr: That's right.

T: Now I might say to you that in planning we may recommend to you an entirely different kind of a show than the one you've had.

HMJr: Well, I'm stopping this show....

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T: Yes.

HMJr: ....because I can't take it any longer, if....

T: Yes.

HMJr: ....I can talk about the Treasury as having dignity  
....

T: Yes.

HMJr: ....and leaving me out.

T: Yes.

HMJr: It's so far below the dignity of the Treasury I can't stand it.

T: Well, we may - we may recommend a show to you that - that may be quite different than the thing that you've got.

HMJr: All right, now there's....

T: The thing is.... Yes.

HMJr: There's one other person that I want to have sit in on this from the music standpoint.

T: Yes. .

HMJr: I have Professor Roy Welch with me....

T: I know him, yes.

HMJr: ....who's the head of the music department at Princeton....

T: Yeah.

HMJr: ....and on matters concerning music, I want him in on it.

T: Yes.

HMJr: Very much.

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T: Well, I think we'd be very happy to have him, but, of course, we can't have sixteen bosses, that's one sure thing.

HMJr: No, but the point is this - they sang - put on a record for me which they did -- it was Holy Night....

T: Yes.

HMJr: ....and they had a cafe singer do Holy Night.

T: Oh, well, that's - that's just wrong.

HMJr: Now if Welch had been there, he would have - could have gotten us a good singer.

T: Yeah.

HMJr: But to hear a cafe singer do Holy Night and jazz it I think is outrageous.

T: I think it's terrible.

HMJr: And I want Welch in on that angle.

T: Yeah, yeah.

HMJr: See what I mean?

T: I do.

HMJr: And....

T: I do, and if he's in there in an advisory capacity, it's all right, but you can see, particularly in radio, you can't have sixteen people working on it. The time element just won't let you do that.

HMJr: No, but you can have a man like Welch to say, "Now wait a minute, in the first place the orchestra that's playing Holy Night is - doesn't know how to play it."

T: That's right.

HMJr: "You got to get a different kind of orchestra."

T: Yeah.

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HMJr: "And you're going - you got to - you can't have a jazz singer singing Holy Night."

T: I agree with you. I didn't hear the program. I'm glad I didn't.

HMJr: Well....

T: (Laughs)

HMJr: Anyway it's that kind of thing and - but I - I - when you get this thing - until this thing is off the ground, I'm going to - I'm going to give it enough time to have it the way I want it....

T: All right.

HMJr: ....myself.

T: And next week we'll hope to have some people down there with a plan and sit down and talk with you about it.

HMJr: With me personally.

T: That's right.

HMJr: And I don't know whether I want to do any program. It's - but it's got to be something - now, for instance, in talking - in talking to Murray, I - they've made a check on the payroll deduction plan and they only find 15% of the people know about the Victory Tax. Hello?

T: Yes.

HMJr: Now I had to tell them, "Well, I want John Sullivan to go on the regular Treasury Hour Saturday night and explain it."

T: Yes.

HMJr: And the - the whole - the whole question of Treasury publicity has to be melded. What is the most important thing right now? Well, for the moment it's to explain the Victory Tax.

T: That's right.

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HMJr: And it's more important than Victory Bonds.

T: That's right.

HMJr: And therefore the Advertising Council in helping me has to sit in on the whole picture....

T: Yeah.

HMJr: ....and Murray can't be off on the side....

T: That's right.

HMJr: ....not knowing what the rest of the Treasury is doing.

T: That's right. Well, now let me say in that respect -- and this isn't said in a critical sense at all....

HMJr: Yeah.

T: It's my effort to be constructive.

HMJr: Yeah.

T: That these things that you're talking about are simply the outward evidences of lack of proper internal organization.

HMJr: That's right.

T: And that's the very thing that I'm so interested in to try to help you with if I possibly can.

HMJr: And you explain to Murray what - you're coming down, what you're going to do, and it's a part of the tightening up process.

T: Yeah.

HMJr: The Advertising Council is going to help me on all public relations in advertising.

T: Yeah.

HMJr: And we....

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T: Between you and me, which I will not say to Murray, we're going to try to recommend to you an organization for both your advertising and selling which can see you through the year '43.

HMJr: Wonderful, and....

T: That's a big score. Now I don't know whether I can deliver, but that's what I want to do.

HMJr: Well, I'm counting on you.

T: Now I might tell you that I've secured one man to work with me, Henry Stevens, the vice president of the J. Walter Thompson Company.

HMJr: Good.

T: And when I get down there, we'll tackle Bathrick, and then we'll see about the fourth man.

HMJr: Good.

T: I'll see you Tuesday morning.

HMJr: Right.

T: Righto, thank you. Merry New - a Happy New Year to you.

HMJr: Same to you.

T: Righto.

December 31, 1942  
4:36 p.m.

HMJr: Hello.

Operator: Paul and Sullivan. Go ahead.

HMJr: Hello.

Randolph Paul: Hello.

John L. Sullivan: Yes, Mr. Secretary.

HMJr: At Cabinet the President said he was going to ask Chuck Palmer to look into the question of the contracts on all the various housing projects in this country.

P: He was going to ask whom?

HMJr: Chuck Palmer of Atlanta. That part of it's unimportant.

P: Yeah.

HMJr: So then I said, "Well, if you're going to look into contracts, Mr. President, why don't you look into some of the contracts..." - oh, he said that we could take over the housing after the war was over. So I said, "Well, why don't you look into some of the contracts with the factories?" He said, "What's the matter with them?" He said, "I always said that they should be written so that when the war is over the Government can take them over." Well, I said, "Mr. President, if you'd look into them, you're going to be surprised."

P: Yeah.

HMJr: So he said, "What do you suggest?" I said, "Well, I'd like to write you a brief." Well, you ought to have seen Nelson and Frank Knox and Stinson. They all bristled, and Harold Ickes said, "Yes, Henry's right."

P: Yeah.

- 2 -

HMJr: "And I'll help him." So the President said, "Well, you all..." - they all bristled, so they said they were all going to write him a brief, so...

P: Who said that he'd - that you were right? Who was your supporter?

HMJr: Harold Ickes.

P: Oh, yeah.

HMJr: And he said he would instruct his Under Secretary to give us all the help we wanted, and the principal place to look was in the - Jesse Jones' organization. Now the point is, beginning next year I want you fellows to collaborate and let's go into some of this thing, and I'll talk to you about it, see?

S: I have an appointment with the War Department on Monday, Mr. Secretary. They're coming over here.

HMJr: Well, the President said that he's always laid down the rules that any Government finance plant, it should be solely the - at the option of the Government to take it over after the war.

P: Well, of course, that isn't what's been done.

HMJr: I know, but he doesn't know it.

P: Yeah.

HMJr: And he asked us to give him a brief. Now Frank Knox turned to me - he said, "Well, we only had one like that, and John Sullivan spoke to me about that and we - we've fixed that one. We've taken care of that one." I don't know what he meant.

P: Yeah.

HMJr: But anyway....

P: Well, we had a long meeting this morning with War - yesterday with the War people.

HMJr: Well, put your heads together and let me have something early next week.

- 3 -

S: I don't think it will be early in the week,  
Mr. Secretary.

HMJr: Well, anyway whenever....

S: We'll start to work on it.

HMJr: That's right.

P: I'll see you, John, on it.

HMJr: Okay.

S: Happy New Year.

HMJr: I'll be seeing you unless you're leaving early.

S: Okay, sir.

HMJr: All right.

December 31, 1942  
4:39 p.m.

HMJr: ....and I told the President the thing was in the process and that the Vice President and Hull and Stimson and I and Lend-Lease were all going to sign it and send it over to him.

Harry White: Yes.

HMJr: So he said he'd like to have it as soon as possible.

W: I see.

HMJr: So....

W: All right, we'll get it out tomorrow then.

HMJr: So will you get on it and see that it gets to him as soon as possible?

W: All right.

HMJr: And Wickard - he - he does the dumbest things. He brought up the - he was so worried about how was he going to explain that the English people took our Lend-Lease food and sold it. Well, it's about time he began to worry about that, see?

W: Yeah.

HMJr: So....

W: That isn't anything that we handled.

HMJr: No, no, no.

W: Yes.

HMJr: But everybody said that they - Wallace and all - well, the President is anxious to get this memorandum of ours.

W: All right. We'll get it out tomorrow.

HMJr: Then Wallace said that this fellow from the Budget as the head of the subcommittee is doing the same work we're doing?

- 2 -

W: Well, not the same work. It's quite different. Coy was going to take care of the - the allied questions of whether the ex. - the Lend-Lease shall skip the exporters and what subsidies are being given in other areas, and after you had left this morning Rockefeller dropped the word that he thought that committee arose as the result of an - an oral order by the President. Was that brought up?

HMJr: No, no, they....

W: And nobody else seemed to know of any such oral order. They all thought it was a - a creature of the committee.

HMJr: An oral order on what?

W: An oral order by the President creating - establishing that committee.

HMJr: Oh. Well, they better look into it.

W: Well, they - they are, but no one knew about it, and it kind of upset the - it disturbed State.

HMJr: And look into the English balances?

W: No, no, no.

HMJr: All right.

W: No, but just on - on commercial policy.

HMJr: Okay.

W: Goodbye.

HMJr: Thank you.

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Note: Original of this is in  
President's folder.

Letter to Pres and Cabinet -  
Dec 31, 1942

THE UNDER SECRETARY OF THE TREASURY  
WASHINGTON

December 31, 1942

TO THE SECRETARY:

Figures as of December 29 on Victory Fund Drive are as follows:

From Banking Sources:

Treasury bills .....	\$ 900 M	
7/8% Certificates .....	2,117	
1-3/4% Treasury bond .....	2,058	
		<u>\$5,075M</u>

From Non-banking Sources:

7/8% certificate and 1-3/4% Treasury bond .....	\$2,684	
2-1/2% "tap" bond .....	2,830	
Tax notes .....	973	
Savings bonds (E, F, and G) .....	838	
		<u>7,325</u>

→ \$12,400M

We are fairly certain that when the final figures for the end of the month are in for Savings Bonds and Tax Notes, we will exceed \$12,500,000,000.

D. W. B.

**INTERGOVERNMENTAL FISCAL RELATIONS**

**MAJOR CONCLUSIONS  
AND RECOMMENDATIONS**

---

**Submitted to the  
Secretary of the Treasury**

**by**

**The Committee on Intergovernmental Fiscal Relations  
Treasury Department, Washington, D. C.  
December 31, 1942**

## DEPARTMENT OF THE TREASURY

## Committee on Intergovernmental Fiscal Relations

oOo

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

Sir:

In June, 1941, the Secretary of the Treasury took steps to reexamine the problem of Federal-State Local fiscal relations. Study already given the subject by the Department over a period of several years made it clear that a vigorous and comprehensive inquiry was called for by a staff freed from all other responsibilities within the Department. Accordingly, a small temporary research staff was assembled under the direction of the undersigned committee. The chief of staff has been Dr. Harold M. Groves, who was released for this undertaking by the University of Wisconsin. The work was carried out partly in Washington in the Treasury Department's Division of Tax Research and the Bureau of Internal Revenue, and partly in the field in cooperation with State and local governments. The project was financed in part by special funds provided for this purpose by the Congress. The committee was fortunate in having at its disposal the aid of the Institute of Public Administration, made possible by a grant to the Institute by the Carnegie Corporation to carry through such parts of the work as could not appropriately be financed from Federal funds.

The committee wishes to express its appreciation first of all to you and to your responsible officers who organized, supervised and encouraged the inquiry in every possible way. Mr. Roy Blough, Mr. L. László Ecker-Rácz and Professor Carl Shoup of the Division of Tax Research counselled and assisted the committee during the several stages of the project. Next our appreciation is due the able and devoted staff which took part in the study. We are also indebted to other Governmental agencies, particularly the Department of Commerce and the Federal Security Agency.

While this study was made within the Treasury and with the extensive help of responsible officers of the Treasury, the report itself represents the findings and recommendations of the committee and must not be taken in any way as presenting the views of the Department.

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The conclusions of the committee are presented in summary in our "Intergovernmental Fiscal Relations - Major Conclusions and Recommendations" and in more extensive form in our "Final Report." In addition the committee is issuing a number of special studies prepared for the committee by selected authorities. The conclusions presented in these studies are those of the authors alone and do not necessarily reflect the views of the committee. The committee is, however, indebted to these authors for their contributions and is issuing their reports so that others may have the benefit of their valuable work.

In common with everything else this study has been deeply affected by the war. Anticipated researches which would have enriched our knowledge were dropped or never initiated primarily to free manpower for the war. And in certain areas war problems have doubtless deflected our attention from what is, after all, a permanent aspect of the American federal system. For these reasons our report concerns itself both with the intergovernmental fiscal problems of the war and with the underlying permanent problems.

Respectfully submitted,

Harold M. Groves  
Luther Gulick  
Mabel Newcomer

October 15, 1942.

PREFATORY NOTE

This report was well under way before the United States entered the war. It is based on the assumption that the United States will be on the winning side of the war and that the struggle will not be so long and exacting that all our institutions will need to be revolutionized to conform to military necessity. Considerable attention has been paid to the modifications in intergovernmental regulations which have grown out of or which can be foreseen as likely to grow out of the war. But the report is not primarily concerned with these problems. It has taken cognizance of the war up to the present, but it is conceded that rapidly changing military events may make any long-range program propounded in the summer of 1942 quite antiquated soon after it is formulated.

Plans for a more comprehensive study with more original research were abandoned because of the war.

In the following statement of major conclusions and recommendations, the first main section is concerned with the general approach to the problem. The remainder of the statement contains the more specific recommendations. These recommendations are summarized in terms of action programs for each level of government at the end of the statement.

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## I. EMPHASIS AND APPROACH

1. Emphasis Upon Cooperation

Coordination and cooperation rather than subordination and coercion is the answer to intergovernmental fiscal problems in the United States.

Our Federal system with its present division of power and responsibility is supported not only by tradition and legal precedent but also by widespread recognition of the very real values of decentralized government. The system permits adaptation of legislative programs to widely divergent conditions, interests, and points of view, which is very important in a large country; it provides room for experimentation in government; it encourages participation in government, and with it the development of sounder civic attitudes and better trained leadership; and it narrows the scope for the inefficiency and red tape that often occur in a huge bureaucracy. Coordination has become a major problem in the operation of the Federal Government.

The superior strategic position of the Federal Government in the control of large-scale business, in the stabilization of employment and production, and in the maximization of national income has justified aggressive Federal leadership and the expansion of Federal activities in recent years. But this expansion need not be at the expense of the States and the municipalities. The major consideration is how best the States may participate in this expansion, and how best they may facilitate rather than retard it. The States still continue to retain large responsibility for many governmental services close to the welfare of the citizen. The Federal Government has a vital interest in maintaining and strengthening both State and local governments. Much valuable energy has been wasted unnecessarily in quarrelling over the proper spheres of the Federal Government and the States, when the seeds of solid achievement lie in the scantily tilled field of intergovernmental cooperation and coordination. Progress in this field requires some willingness to compromise, to surrender vested interests, and to forget jealousies on the part of both the Federal Government and the States.

A change in attitude of revolutionary proportions seems to be needed. The American governmental system has not been viewed as a unit by most public officials, with loyalties evoked and encouraged for the entire system. If the mayor of a municipality believes that a change in the Federal income tax would embarrass his own government, he is likely to feel a great concern as to whether the change is needed to equalize the Federal system of personal taxation. Federal administrators show equally unfortunate blind spots. Very often they lose, in addition, a proper sense of proportion, and conclude that all wisdom and authority are concentrated in Washington. State officials who object to this frequently show the same attitude in dealing with municipalities. Some of this is but the inherent limitation of human beings. But much of it could be eliminated by more conscious effort.

Recent decisions of the Federal Governments of Canada and Australia to federalize a large part of state tax systems for the period of the war place proponents of our overlapping tax system on the defensive. Conditions in these two federal systems differ somewhat from our own. These countries, in contrast to our own, have a highly developed tradition of allowances (fixed grants) from the central government to the divisions. State tax rates, particularly in the income tax field, were substantially higher for at least some of the foreign states than for our own. The tradition of local and state autonomy was probably less highly developed. Certain coordination devices, notably income tax deductibility were more highly developed in this country than in the British federations, but others, such as joint administration, were much less developed. Of course, even if there were no difference in conditions, it could not be concluded from these examples that the States should be excluded, in effect, from important tax fields even during the war emergency. Fiscal independence is a large sector of general independence, and the latter a large part of local self-government which, in turn, has important democratic values. It has been suggested that another major war might put an end to federal systems everywhere. Whether or not this be true, it appears that a large degree of State and local fiscal independence does carry values of a very high order, and that they should not be sacrificed until the necessity is clearly demonstrated. It is not believed that such is yet the case.

That State rights should yield to military necessity will be generally conceded. That the war effort would be served by federalization of State revenue systems is, however, very doubtful. The Federal Government has enough on its hands for the present without assuming the responsibility for State finances unless this course would yield very important advantages in ordering its own financial program. That there would be some advantages may be conceded, but at present and in the near future these advantages seem outweighed by the disadvantages.

## 2. The Pragmatic Approach

An analysis of the history of the fiscal coordination movement in the United States, and of the experience in other countries, suggests that a pragmatic approach to the problems of intergovernmental fiscal relations is likely to be the most fruitful. The pragmatic approach does not exclude the necessity of some analysis of "long-run" principles and interests. However, hopes for a solution of the fiscal coordination problem, or for a comprehensive single plan for immediate adoption, are doomed to disappointment. Some scholars have rejected the idea of "nibbling" at the problem, bit by bit, as entirely inadequate, but it is this unspectacular method that promises most in the way of progress in what must be a cooperative venture. Indeed the preoccupation of the critics with grandiose plans for fiscal coordination may account for the rather low score of achievement to date.

A federal system involves at least two layers of government, which necessarily draw upon the same economy for support. It is almost inevitable that no matter how carefully drawn a Constitution may be,

some overlapping and conflict will ensue. Each authority tends to guard its own sphere of activity jealously, and to resent encroachment by the other.

Under these conditions there can be no completely logical and clear cut solution of fiscal problems. The united and uniform fiscal system of which some administrators dream is possible only in a unitary state. The best that can be achieved in a federal-state is a working compromise, even as the federal-state itself is, in its origin, a compromise.

It needs always to be remembered, also, that all movements toward coordination involve, to some extent, a choice of values. Coordination aims at uniformity, and finds one of its principal causes for action in the compliance costs and irritations associated with diversities of State laws and practices. But these diversities can be defended, too, as experiments in new and different techniques or adaptations to different conditions. Those who dislike centralisation think of uniformity as vicious rather than beneficent; they apply the adjective "deadly" to what the centralizers seek. Here, as in many other matters of social policy, it is not possible to have one's cake and eat it too. It may be possible, however, to achieve some results without great loss of values. There are areas in which diversity serves no useful purpose.

A survey of foreign experience indicates that no Federal form of government has developed an entirely satisfactory method for coordinating its fiscal system - much less a single panacea. Examples of almost all the coordination devices can be found in foreign experience, the selection and pattern depending considerably upon historical accident. What has worked well in one country has not always been successful in another. Australia has achieved notable success in cooperative administration, one of the less spectacular approaches to the problem, but there is no certainty that this would be equally successful under other conditions.

In short, the problems are presented and the recommendations are made in such manner that any one part is only a short step forward on the road of advancement; but if progress is likely to be slow and difficult, it is not on that account necessarily less important.

### 3. The Coordination Movement

The history of the fiscal coordination movement is characterized by much frustration, wishful thinking, and rationalization, but the efforts expended have brought to public attention a set of problems that are real and urgent. The movement has been led mainly by State officials, with less active participation by scholars and business men. It has not been supported by any groundswell of popular interest, and the lack of participation of farm and labor groups is conspicuous. There has been no crystallization of opinion concerning the problems involved, even among the experts. The movement has often failed to come to grips with fundamentals; a customary procedure has been to endorse the word "coordination," hand it to a committee, which also

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endorses it, delivers a few generalizations, and recommends "further study." (It must be conceded that as to some of these limitations the present report is no exception.) There has also been a conviction that a group of specialists could draft a formula or set of specifications to satisfy all parties when, as a matter of fact, many of the issues involved are beyond the province of the expert. If the time should ever arrive when Congress would feel it necessary for the Federal Government to take over the major strategic revenue sources of the States and put these governments on an allowance, no extensive study would be required to tell it how or why.

But this is not to say that the movement has failed to accomplish a useful purpose. It has called attention to real and urgent problems growing not only out of the overlapping tax system, but also out of the increasing national economic integration and interdependence. The development of huge corporations, only a little if at all less powerful than the States which charter them, and the growth of interstate trade, travel, communication, and migration, have intensified problems of multiple taxation, allocation, interstate competition, and costs of administration and compliance. One writer goes so far as to express the view that "commerce renders the mere convenience of uniformity (in laws) an almost imperious necessity." Tendencies toward instability and insecurity, coupled with increasing economic capacity, have developed an interest in over-all fiscal planning. These are only a few of the many reasons for concern about a revenue system that has developed piecemeal and is largely uncoordinated.

In the course of the history of the coordination movement, most of the principal devices for coordination have been recommended for adoption or extension. These include separation of sources, joint administration, State supplements to Federal taxes, credits, sharing of revenues, Federal and State grants-in-aid, and reallocation of functions. All these devices have been tried either in this country or abroad. Experience suggests that no one of them will achieve desirable results under all conditions. The means must be adapted to the nature of the problem for each tax or expenditure, and for each country.

#### 4. General Position of this Report

This report seeks a middle ground in the coordination problem. On the one extreme are the strong centralizers, who feel that State and local fiscal independence has served its usefulness and is no longer compatible with modern economic facts. The Report of the Canadian Royal Commission goes far in this direction. At the other extreme are those who are satisfied with what we have and who argue that the frictions and wastes of uncoordinated taxation are the necessary price which we wisely pay for our Federal system with its large measure of local freedom. Both of these groups are more realistic than the hybrid school which hopes for a completely coordinated fiscal system with no shift in the division of governmental powers.

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The centralization of all the major taxes in the hands of the Federal Government would provide a simple, logical, orderly, and well-coordinated tax system. The centralization of the major service functions would avoid the confusion of transfers of money and would enable the application of receipts where they are most needed. Together these steps would enable us to dispense largely with some 165,000 units of government. They would give the Federal Government quite ample fiscal powers to deal with our unstable private economy. But there is no assurance that the resulting unwieldy machine would not have worse internal incoordinations and inefficiencies than the external ones so apparent in our present makeshift arrangements. And the loss in intangible values might be even more serious.

But we think that there is another and sounder middle ground, which accepts the framework of the American governmental system and seeks no large shift in the division of power. This view starts with the observation that Federal-State relations have been marked with coolness, distance, suspicion, and jealousy. Governmental problems in our modern era have become so large and vital, and participation in a united attack upon them is so essential, that a new attitude, facilitated by new institutions, should be the minimum acceptable program of fiscal modification. While much weight needs to be given to the values associated with autonomous local government, these have to be balanced against the advantages, such as reduced confusion and wider perspective, which attend central control. A priori generalizations concerning centralization are of little use. Each specific problem has to be considered on its own merits. In some cases federalization of a function may (by a balance of the interests) be warranted; in others, retention of the function by States and municipalities may be called for; and most often joint participation, in one way or another, may be the best solution. Decentralization within the sphere of Federal activities may also have a place in the picture. The presumption should probably favor decentralized control but it is by no means a final or conclusive presumption.

This approach to the problem calls for a high degree of genuine mutuality. State suspicion that intergovernmental cooperation will be mostly Federal domination must be dispelled. A program of full and genuine mutuality is entirely possible.

The middle way which we have sought to follow has some claim to acceptance as the American way. American belief in the dispersion of initiative and in safety of numbers is very deep. The pragmatic approach, adapting machinery to the necessities of time and place, is also American in tone. Finally, the views here taken - that private enterprise should be encouraged, not hampered, in carrying as large a share of the future economic load as its performance will justify; that government, nevertheless, must be relied upon to insure an end-product in security and well-being compatible with a developing social conscience - these too, are a part of the American tradition.

## II. PLAN FOR A FEDERAL-STATE FISCAL AUTHORITY

### 5. Federal-State Fiscal Authority

It is recommended that a Federal-State Fiscal Authority be created. This is in line with the general approach here taken, namely, that the problem is not likely to be settled all at once, but that constant study of and readjustment in intergovernmental arrangements will be necessary; also, that the keynote in intergovernmental relations should be cooperation rather than subordination.

A Federal-State Fiscal Authority could be expected to perform the following functions:

(1) Promote close collaboration among State and Federal administrators with the objective of joint administration of selected overlapping taxes. Administrators have made some progress toward coordinated tax administration, notably in making Federal income tax information available to the States. Also in the liquor tax field, collaboration of State and Federal officials is highly developed and has proved mutually satisfactory. However, efforts to devise and inaugurate a joint return for Federal and State income tax reporting have proved abortive. Recent experience with the Federal automobile use tax warrants the conclusion that effective Federal-State cooperation in administration cannot be improvised, but requires extensive negotiation and preparation. A Federal-State Fiscal Authority would be admirably suited for this role.

The administrative approach to the problem of coordination is likely to prove the most fruitful one in the case of net income taxes, business taxes, sales taxes (if the Federal Government enters this field), and possibly death taxes. Joint returns, joint audits, and joint use of administrative personnel offer possibilities for future development.

Much could be said for an Authority which would administer overlapping taxes directly. The experience of Australia, which has made greatest progress in the administrative approach to the coordination problem, points toward a joint administrative agency. But Australia's problem is simpler than that of the United States. The Commonwealth has only six states and their revenue systems are more important relatively than those of our 48 States. (The latter factor creates a more even balance of power than that which exists in the United States.) Eventually a Federal-State Fiscal Authority of the type here recommended might be given power to administer some taxes in its own right. But at the outset its role had best be confined to that of mediation between Federal and State officials. It should be observed, however, that joint administration is not Federal administration; a large factor of mutuality is implied.

(2) Facilitate interstate cooperation. For example, working with existing agencies, the authority could promote reciprocity legislation, as in the licensing of out-of-State trucks.

The Council of State Governments, among others, has perceived for some time that a much greater degree of interstate cooperation is required to maintain our Federal system in a healthy condition. Some of the gravest problems in the field of intergovernmental relations might be solved if there were a sufficient degree of interstate cooperation. Of all the remedies for these many problems, interstate cooperation ranks first in its promotion of the prestige and independence of the States. But interstate cooperation, to function most efficiently, needs a "friend at court" within the Federal Government. And it needs an easy vehicle of transition from the field of interstate to that of Federal-State cooperation. A Federal-State agency should supply the factors needed to lift interstate cooperation to a much more active and more useful plane.

(3) Act as a clearing house for proposals relating to Federal payments in lieu of property taxes on Federally owned property. In the past, legislation in this field has followed no consistent principles, and an unduly complicated pattern of procedure has developed. The Authority might also serve as a "board of appeals" to hear complaints regarding Federal payments in lieu of taxes, and the use of taxation or other instrumentalities as trade barriers.

(4) Conduct research. Evidence of high costs of excessive tax machinery, both to governments and to taxpayers, is sufficient to warrant much more intensive study than the subject has thus far received. It is surprising that almost no evidence is available concerning the compliance costs of our social security system with its substantial reporting requirements. Similarly, only scattered and inconclusive evidence is available concerning the effects on firms engaged in interstate business of diverse apportionment formulae applied under income and business taxes. Little convincing evidence is available concerning differential tax burdens as a factor in industrial location and re-location. These fields could be cultivated to excellent advantage, either directly by, or through the stimulation of, a Federal-State Fiscal Authority.

(5) Create public interest in intergovernmental relations. Public apathy does not signify that the problem is unimportant. That the public (excepting certain classes of taxpayers seriously inconvenienced by duplication) has never been much interested in the "frictional expense" involved in taxation (cost of administration and compliance) is evident enough from the paucity of data concerning these costs. Public concern in these matters, however, can and should be developed.

(6) Disseminate among the States information on Federal taxes and economic trends as they affect the States.

(7) Promote better governmental reporting, accounting, and statistics.

As to organization, it is suggested that the personnel of the Authority consist of one member appointed by the President, one selected by a conference of delegates named by State Governors, and one named by these two, all to be suitably qualified in the field of intergovernmental fiscal relations. Terms might be staggered, and of four years duration; offices should be located in Washington.

This commission of experts should be assisted by a representative council. Intergovernmental cooperation is not likely to develop very far except through the process of a meeting of a large number of minds. Representation and conference are the essence of this procedure, and either by legislation or working rule, a Federal-State agency program should include an advisory and supervisory Council. The Council would provide a means of getting a consensus. It should afford direct representation of Congressional committees, and recognized organizations of State and local and Federal officials. Further representation for municipalities might also be secured by a provision requiring that one of the three experts be especially informed on municipal affairs.

It is proposed that \$150,000 to \$200,000 be authorized as the initial budget of the Authority and that half of this fund be appropriated by the Federal Government without any contingent (matching) provision, the other half to be raised from State legislatures through the Governors and their delegates. It is recognized that the process of raising financial support in the States will involve delay and uncertainty. The Federal share should be sufficient to enable the Authority to make a showing.

It may well be contended that the Council of State Governments is the appropriate agency to represent the States in this new program. During the seven years of its existence, the Council has scored notable successes in the field of interstate cooperation. The Council and its allied organizations have a record of interest and activity in the fiscal coordination field and have continuously sought Federal cooperation. The Council offers a mechanism for expeditious selection of a State representative. But the Council is unofficial in status, is supported in considerable part by philanthropic funds, and has only nominal recognition and influence in a considerable number of States. On the whole, it seems better to go directly to the State Governors and solicit their cooperation in a new plan of Federal-State organization. Needless to say, the Council would be expected to assume the major responsibility in promoting and organizing this program from the States' end. The Council itself will probably feel that its participation can be most effective if unofficial.

The plan of organization here proposed contemplates that as soon as the Authority has been authorized by Congress and the Federal appointee has been named by the President, the latter should call upon the Governors to name delegates to attend a conference. At this

conference the States' representative should be chosen, and a plan of State financing adopted. A fair method of distributing the States' share of the Authority's cost would be in proportion to the amounts of State and local taxes raised. This outline of procedure is suggestive only. An alternative method would be to provide for the selection of the States' representative by the Governors, the choice of a method of selecting being left to the Governors and the selectee to become official as soon as the President has satisfied himself that the selectee truly represents the wishes of the Governors.

The impression should not be conveyed that the development of administrative collaboration is impossible without a Federal-State agency. Much cooperation could be achieved without any institutional changes. New interest and a new cooperative attitude would be sufficient. But a Federal-State agency should help to develop this new outlook, and the latter might not be forthcoming without some new factor of the kind suggested.

The idea of a Federal-State Fiscal Authority is not new or original. It has been endorsed by a large number of organizations and individuals, and as an antidote to interstate trade barriers has received strong support from high ranking Federal officials. In our opinion it would go far toward assuring that continual progress in this field of intergovernmental fiscal relationships which, under modern conditions, is becoming more and more necessary.

### III. INDEPENDENT SOURCES OF LOCAL REVENUE

#### 6. Independent Sources of Local Revenue

It is recommended that major attention be given to a reorganization of the sources of local revenue, particularly city revenue, in such manner as to preserve and restore local autonomy, and to enable local governments to tax their own resources, according to their own discretion, without the development of more overlapping in taxation. This, in our opinion, calls for a bold attack and some fundamental changes in a time-honored institution - the general property tax.

There can be little doubt that local governments, particularly city governments, are "in a bad way" from the fiscal standpoint. The recent depression caught them ill-prepared; many were obliged to borrow heavily to meet current expenses, and the refunding of maturing obligations was common. The spectacle of a city like New York, popularly regarded as the "gold coast" of a rich country, going through one financial predicament after another, obliged to adopt a sales tax, which its mayor had successfully attacked in Congress, and frankly conceding its future dependence on Federal revenues, is evidence enough that something is lacking in local revenue institutions. New York's financial problem is not unique. Most cities have been living from hand to mouth in the hope that something would turn up.

And the attitude of municipal officials has grown increasingly pessimistic. One of them writes that "in the field of taxation the city is practically powerless" and has been placed in a "financial and administrative strait-jacket"; another deplores the fact that "municipalities are facing a post-war period when local governments will find it necessary to more and more go to the central government for Federal assistance with its resulting placing of control."

No doubt much of the blame for these predicaments can be placed at the door of the States in whose legislative councils cities have for years been under-represented. Cities have often shared very inadequately in newly developed State revenues, particularly in motor-vehicle tax revenues. More important, the States have undermined and strait-jacketed general property tax expansion, both with exemptions and with ceiling limitations.

The cities in some instances have their own mismanagement to blame for part of their financial troubles. But the generally rising competence of officials in posts of municipal responsibility has been one of the bright spots in the recent evolution of American Government. It may well be that "the best managed of our cities are ahead of the Federal Government in the quality of their administration."

The cities have claimed the privilege, and some have found it possible, to develop some diversification of revenues. And so we find, for example, municipal sales taxes in New York and New Orleans; a flat earned income tax in Philadelphia; a license tax based on volume of business in Louisville and Richmond; a one-cent gasoline, one-cent bottle beer, and two-cent cigarette tax in Birmingham; and gasoline, automobile-license, and cigarette taxes in Kansas City. But these developments involve piling taxes three deep in a number of cases, and they represent at best additional complications in a revenue system already highly complicated.

A major cause of the failure of municipal revenues on the score of adequacy is the unpopular general property tax. Although this tax proved the mainstay of local support for many years, it broke down badly during the recent depression and is under incessant political attack by State and local leaders. Beside many traditional faults, which need not be recapitulated here, the property tax, like the income tax, is attacked because its base is too narrow. The property owning lower middle class resent what they regard as the tax-free status of the "proletariat." This attack gains strength because of the traditional interest in widespread home ownership. Finally, the property tax is resented because of its regressivity, the fact that it falls with greatest weight on relatively poor taxpayers.

The narrow jurisdiction of the municipality makes it essential to depend on a relatively immobile tax base for the major part of local revenues, and this points to the continuance of the largest

part of the local tax burden on real estate. But there are important possibilities of redistributing this burden among individual owners of real estate and their tenants.

What is needed, apparently, is some new source of local revenue which will (1) not overlap existing Federal and State taxes, (2) enable the localities to tap their own resources without running hat in hand to central governments, (3) cover all or a vast majority of the interested citizenry, and (4) not be regressive. This is no easy assignment but the following suggestions are recommended for consideration.

The property tax might well be broken down into its elements and its uniform application to all owners on the basis of holdings be abandoned. One way of reconstituting the fragments would contemplate a collection from landlords in the nature of a service charge for local benefits to property, and a further collection, more personal in character, from occupants on their rental value of occupancy. The occupancy tax could be added as either a replacement or a supplement to the general property tax; and it might be introduced step by step on a gradual and experimental basis.

The property tax has suffered from notoriously weak administration. But the best possible assessment would fail to reach the shortcomings of market value as a measure of tax paying ability. It may be conceded that the owner of real estate producing no current income has some tax paying ability. But it may still prove awkward to obtain the necessary cash for tax payments; and more important, the expected future income on which the market value is based may never be realized.

In view of these limitations a good case can be made for shifting a part of the burden from real estate to current income, that is, the gross rental value of occupied premises. It may not be desirable to reduce current levies, in view of the fact that these may be partly capitalized, and that there is no certainty that the owner would reduce rentals to his tenants if such a change were made. But where there is need for more municipal revenue, a city might well give consideration to a tax on rentals, collected from the occupier. One advantage of such a tax is that, being in proportion to current income rather than expected future income, it will spread the burden over the various parcels of real estate in a different manner from the tax on capital values. Unused properties would be exempt. Also, the distribution between tenants and landlords would vary, since there is always some friction in the process of shifting. Finally, a rental tax could make some allowances for individual ability to pay. The tax on home rentals might be adjusted to take account of size of family, and a progressive rate might be imposed. This would tend to offset the regressive tax on capital values. A business rental tax would be levied, of course, at a flat rate.

Among the objections to a supplementary rental value tax would be the necessity for two valuations - rental value as well as capital value. This is not a simple matter, since many properties

are assumed by their owners, and in other cases the actual rent paid must be adjusted to allow for special circumstances.

There are other objections to a rental tax. For instance it would offer no answer (except in its possible feature of graduation) to the criticism that much of the weight of the local tax system falls on housing, an area of expenditure in which the nation is trying to improve standards. Some concessions to housing, probably confined to the philanthropic element in housing, may be necessary. It is quite possible too, that an occupancy tax might increase the cyclical fluctuations in city revenues. Nevertheless, the frequency with which such taxes have been used by other countries suggests that they have possibilities that may well be explored.

Other ways of reaching the property base are the use of unearned increment taxes and the further development of special assessments. The latter have sometimes been used to excess, and the record of administration is not encouraging, but many cities have failed to develop their possibilities adequately. Many municipal services yield special benefits, and the cost might reasonably be covered in this way. Some municipalities could revise their public utility charges, also, to cover costs, or even to contribute to the general treasury.

While the retail sales tax as a local revenue source is quite objectionable because of its overlapping of central sources, its regressivity and its jurisdictional complications, nevertheless it may be worth considering as a last resort. Exemption of food might reduce regressivity and some city might test the practicability of a personal exemption under this form of tax. As against the steady and extensive surrender of local fiscal independence, the city sales tax might merit further consideration.

In any event, the municipality should be given greater freedom in the application of the general property tax. Rate limitations offer no constructive solution to the problem of financing local government or improving the property tax. Their proponents are indifferent to fiscal crises and counsel a resort to any action other than an immediate increase in real estate taxes. The right of the cities to tax their own citizens as they please within the property tax area, primarily suited for local exploitation, should be generally restored, subject only to rules supplied by the State as to the general framework. Administrative assistance from the central units need not be precluded by such a development.

Property tax exemptions have been too freely granted and too generously interpreted. Effective State supervision of property tax administration, or State assessment if such central assistance cannot be developed, is needed to offset the pressure of special local interests.

The widely prevailing notion that the general property tax, except for new exemptions and rate limitations, is a crystallized

institution and fixed for all time should be exploded. Whether or not these specific proposals are received with favor the whole subject of independent local revenues should be given fresh and bold reconsideration.

The Federal Government is in the best strategic position to cope with cyclical emergencies and should, even with a strengthening of local financial independence, continue to finance employment-creating improvements during such periods. Moreover, as subsequently elaborated, the Federal Government should enlarge the number of functions in which, because of a national interest, Federal support is given through grants-in-aid. Federal payments in lieu of property taxes on Federally owned property, such as housing, should be more generous and dependable. A Federal market for municipal bonds might be helpful in time of depression, but the major need is for a source of revenue which will enable the localities to tax their own resources independently. Much of the vitality of local government in the United States depends upon the development (discovery and utilization) of such a source.

#### IV. COORDINATION OF SPECIFIC TAXES

##### 7. Income Taxes

Coordination in Federal and State income taxation is of first-rate importance for it is in this field that multiple taxation, threatened (and perhaps actual) interstate migration, and high compliance costs are particularly prominent.

Substantial coordination in the net income tax field has been achieved through the device of allowing the State income tax as a deductible expense in calculating the Federal tax, with mutual deductibility in some States; more can be achieved by the development of cooperative techniques in administration, with the State tax becoming more and more a supplement to the Federal tax. The States should not be asked to surrender the income tax; unless interest in State and local government is to be discouraged some access by the States to progressive, personal, and direct levies is exceedingly important. But the States should surrender exclusive control of jurisdiction (that is, the determination of what is within the territorial province of each State to tax), and mutual adjustments should be made to attain more uniform State and Federal laws. The fear of migration of taxpayers, which has impeded the development of State income taxes, might be checked by an income tax credit (permitting a part payment of Federal taxes with State tax receipts) but this is hardly politically feasible with only about two-thirds of the States levying income taxes. The deductibility provisions perform the same service to some degree. Spotty State administration could be strengthened under the cooperative program outlined above.

The State net income tax encounters serious impediments of conflicting jurisdiction, multiple taxation, high compliance costs,

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uneconomical administration, and interstate competition. There are antidotes for all these limitations and none is so serious as to warrant a death sentence verdict for the State income tax. It is true, of course, that the State income tax does less to "correct" geographical maldistribution than the Federal. The Federal tax coupled with a well ordered system of Federal aids would be most effective as a corrective for geographical maldistribution. This device is now being applied to some extent, but imperfectly; it can be further developed and improved to relieve the pressure for new revenue for State and local tax systems. But this does not mean that the States need to be ruled out of the income tax field.

The present provisions, which permit income taxes paid to States to be deducted in computing net income for Federal tax purposes, and the reciprocal practice, in more than two-thirds of the income tax States, allowing Federal tax payments to be deducted in computing net income for State tax purposes, exclude the ordinary possibility of the combined Federal and State tax rates becoming confiscatory except in cases where incomes or tax rates have fluctuated greatly from year to year. These practices have the further effect of reducing substantially the differentials in burdens among taxpayers living in different States. This acts as a curb to tax avoidance by migration, a fact which has received little recognition. For example, if each government allows the deduction of taxes paid the other, the combined load of an 80 percent Federal and a 15 percent State rate is only 80.7 percent (77.3 percent Federal and 3.4 percent State). Even in the absence of State provision 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 less conspicuous, the same general relationships apply. At the \$5,000 income level, the differential in total income taxes between a New York and non-income tax State taxpayer (1942 rates) 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 and post-war income tax schedules without much regard to the present State levies or possible changes in the latter.

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 most taxes and may be supported, in addition, on the ground that it encourages the States to maintain progressive elements in their tax systems. It is true that State provision for deductibility of Federal taxes tends to make the State income tax less progressive, but the resultant combined Federal and State tax liability may more closely represent popular intent than would be the case were deductibility disallowed by the States.

Much can be said for an amendment to the Federal law requiring reciprocity by the States as a condition of Federal deductibility for State taxes. However, at present levels of taxation such a program would involve the risk, were States to fail to meet the condition, of a confiscatory combination of rates. For this and other reasons, the reciprocity condition is not recommended for adoption. It is recommended that, as soon as revenue needs permit, States which do not now allow reciprocal deductibility change their statutes, to allow it.

While deductibility is a fairly effective protection against an excessive combination of State and Federal rates, it is by no means perfect. It gives less relief to corporations than to individuals. It works quite badly in the case of irregular income and in years when the tax rates are changed. To mitigate the difficulties arising from these changes, it is recommended that taxpayers be allowed to report taxes on an accrual basis even though other expenses are on a cash basis. This would mean that the taxpayer in his Federal return could report his State income taxes due and payable at the time of reporting rather than the cash outlay for income tax purposes during the previous year.

The most promising approach to further coordination of net income taxes is in administration. A sound precedent for delegated administration has evolved in both Canada and Australia, and the development of joint administration has been suggested as an improvement upon these successful experiments. Utilization by the States of Federal income tax information is already developed to some extent and some informal cooperation between administrative staffs now occurs. But the field has scarcely been scratched. Joint returns, joint audits, joint use of personnel, and more uniform laws are a few of the possibilities. As previously suggested a Federal-State Fiscal Authority could be of immense usefulness in paving the way for this program.

The possibility of State supplements (or additions) to the Federal income tax is one that has frequently been proposed. The supplementing program contemplates a high degree of uniformity

and joint or delegated administration. It is a goal toward which it is possible to work by degrees.

Multiple taxation is a serious problem in the income tax field. It occurs in the case of the corporation tax because of diversity in States' procedures of apportionment. Here fairly well recognized standards of fair practice have been worked out and the problem is to secure wider State acceptance. In personal taxation the problem is not so serious, but there is no generally accepted basis of proper procedure. Almost any generally applied standard would be a great improvement over the present situation and would largely remove multiple taxation. Jurisdictional conflicts constitute a problem in which the Federal Government is most strategically situated to make decisions. The rules that should be applied and the means of promoting them must remain somewhat vague for the present. But the outlines of a desirable procedure are fairly clear. They call for (1) conference and consultation between Federal and State officials as to acceptable uniform jurisdictional rules; (2) joint promotion of the adoption of these rules; (3) acceptance of Federal arbitration in cases of dispute; and (4) Federal development of incentives for State compliance. The Federal Government should gradually develop techniques to purchase compliance with such rules regarding jurisdiction as it may establish, in consultation with the States. The price might take the form of free access to information and other administrative services for States that are willing to cooperate. Perhaps stronger economic incentives would prove necessary and could eventually be developed.

There is no easy solution of this difficult problem, but the above approach has the advantage that it offers a way for gradual progress toward the desired goals by the use of democratic tools; negotiation, persuasion, and compromise. A mutual attack on the problem can be carried on without the bitterness which Federal imposition of standards might entail. Here again the Federal-State Fiscal Authority would be almost a condition precedent to worthwhile accomplishment.

### 8. Death Taxes

Federal and State death taxation is frequently cited as a field in which some coordination has already been achieved, particularly through a credit to the taxpayer against his Federal tax for death taxes paid the States. Inaugurated in the middle twenties, this device consists of an allowance up to 80 percent against the Federal tax as computed under the 1926 Federal estate tax. The Federal law has since been amended several times, and the rates

revised upward and the exemptions downward, but the credit is still tied to the now antiquated 1926 law. The credit does not apply to the Federal gift tax, inaugurated in 1932; a similar tax is now included in the inheritance tax systems of 11 States. At the very least the credit should be adapted to the most recent estate tax statute, with applicability in terms of the present rates, and exemptions, and to the taxation of gifts. Better still, the entire estate tax system should be overhauled; Federal exemptions should be reduced to at least the average level of State exemptions (the present Federal estate tax exemption is \$60,000; the gift tax exemption \$30,000) the estate and gift taxes should be integrated, and the crediting program should be brought into accord with current Federal practices. Going further, the credit as explained later, should be broadened in an effort to eliminate dual administration and multiple taxation.

On strictly logical grounds a very strong case could be made for separation of sources as a coordination device in the death tax field. If this were recommended, the Federal Government would be the choice as the taxing unit. The State tax is plagued by interstate competition and multiple taxation, and especially by the fact that estates are highly concentrated in a relatively few States, though the wealth represented may have been accumulated over a much wider area. On the other hand, the States, with one exception, have a proprietary interest in this field and any proposal for surrender would rouse intense antagonism. Moreover, any method of getting the States out of the field, short of a constitutional amendment, would involve a distribution of revenues not very different from the present. The credit is now the accepted device for coordination in the field, and it can be remodeled to accomplish much wider objectives than were contemplated in the original effort.

The credit has been fairly effective in the elimination of interstate competition, but it has largely failed to mitigate the conspicuous problems of dual administration, multiple taxation, and excessive diversity that characterize our overlapping system of death taxation.

In modernizing the credit, the law might be changed to allow the taxpayer a 50 percent credit (1941 tax) in case of estates up to \$100,000 and a 25 percent credit for estates above \$100,000. This would enable the States to enact minimum estate tax laws to cover their entire inheritance tax schedule. Most of them would gain by such action in all brackets of the tax. (This is on the assumption that the Federal Government would also substantially reduce its exemptions.) Perhaps the greatest weakness of the present credit is that it requires dual administration. States are required to build up the taxpayer's liability to the State before the Federal credit is applicable.

But the Federal Government could and should assume the task of determining the taxpayer's liability to the States. Or better still, this matter could be handled by joint administration. The main embarrassment in this program is the question of State jurisdiction to tax. But this is a matter which the Federal Government ought to arbitrate in the interest of all concerned. The right to determine jurisdiction might well be imposed as a condition under which the Federal Government would offer its administrative services to the States. Going further, it might also be imposed as a condition for the credit itself.

State death taxation has long been harassed by dispute concerning the taxpayer's domicile and the courts have failed to assist in clearing the field of "double domicile." Other cases of multiple taxation, particularly in the taxation of intangibles, are fairly common and destined to become more so. The Supreme Court, in recent decisions, has shown an inclination to reject the role of arbitrator in these disputes. It is doubtful whether this multiple taxation is helpful to anyone, and it provides an indefensible penalty from the point of view of the cosmopolitan taxpayer. The Federal Government, through the use of persuasion, sweetened with the advantages that it can offer the States, should seek to clear the field of these vicious anomalies. A liberal tax credit could be used effectively toward this end.

State administration of the inheritance tax is spotty, and in general the field is one of neglect and confusion. Legal and lay authority, and State and local responsibility, are mixed in a variety of patterns. The administration is frequently relatively expensive and otherwise unsatisfactory. Administrative collaboration with the Federal Government would probably improve the product considerably.

It has long been recognized that in spite of some very stiff rates and occasionally onerous burdens imposed by the Federal estate tax law, the results of the death tax system are fiscally disappointing and its incidence highly capricious. For example, the owner of an estate of \$100,000 can still make a 90.8 percent tax saving by disposing of half of his estate through inter vivos gifts. The death tax field needs a thorough overhauling along lines previously suggested. If the job is done thoroughly, death taxes can be made to assume a place of prominence in the tax system commensurate with their inherent merits.

#### 9. Tobacco Taxes

The taxation of tobacco products has gradually become heavily involved in our overlapping tax system. The Federal Government has been in the field uninterruptedly since the Civil War and 29 States are now included in the tobacco tax family, the number having more

than doubled in the last eleven years. (However, it should be observed that State taxes on tobacco are very largely cigarette taxes; for example, only 9 States tax cigars.) In addition, a considerable number of municipalities tax tobacco. The tax is becoming increasingly popular as a source of State revenue, and it seems but a matter of time before the tax will be universally applied at the State level. The tax is admirably adapted for Federal collection and State sharing, and while this device is open to general objection in its curtailment of State independence, its application in this instance would have so many advantages that it is recommended at least as an experiment.

State administration of the tobacco tax has important inherent limitations. In the first place, such administration is necessarily decentralized and considerably more expensive than Federal administration. The use of stamps applied to the outside of cigarette packages is relatively expensive. The States, in addition, give discounts to the tobacco merchants as an allowance for expense of affixing stamps. These discounts often run to 10 percent or more of the value of the stamps. More important is the substantial avoidance of State tobacco taxes by interstate purchase. This leakage is prevented only to a limited extent by the use tax. Extensive cooperation by Federal postal authorities in the case of parcel post shipments does not appear feasible as a corrective. Joint administration in this instance is not practical, for the two governmental levels mainly involved make their collections from different distributors, the Federal from the manufacturers, the State largely from the wholesalers. When all the leaks and costs are considered, administration of State tobacco taxes is probably only from 70 to 80 percent effective. This is surely a situation which calls for some kind of action.

The sharing device is well adapted to application in the tobacco tax field also because the diversity in State laws, while substantial, is not as great as in most other State taxes. The State rate of 2 cents per package on cigarettes, for instance, is preponderant. Moreover, a formula of distribution should not be too difficult to agree upon. A per capita distribution, with perhaps a one-hundred-and-fifty percent weighting to urban population, would approximate relative amounts of consumption and could be simply applied. The field is not one in which the maintenance of State discretion as to rate and administration should be regarded as of great significance.

As is usually the case in sharing proposals, the problem arises as to the loss of revenues of States and municipalities now employing rates above the average. To meet this, it is recommended that all States be allowed their present collections (including municipal

collections) of their pro rata share of the distribution, whichever is higher. Provision might be made for a gradual transition to general sharing on the formula basis, the transition to cover a period of perhaps 10 years. The entire program would not involve a very difficult adjustment for either the Federal Government or the States.

More specifically, it is recommended that the Federal tax on cigarettes be increased to the extent of 2 cents per standard package and that the share of Federal revenues represented by this portion of the tax be distributed to the States on a per capita basis (with due regard to the urban factor as indicated above.) The distribution would be conditional upon State and municipal withdrawal from the field. Similar arrangements should be made with regard to other tobacco products. A minimum but gradually vanishing guarantee should be included to safeguard State and local revenues. If this program were inaugurated in an era of declining Federal tax rates, State distribution might be substituted for an otherwise contemplated rate decrease for the Federal tax.

#### 10. Liquor Taxes

No new major coordination devices are here recommended for the liquor tax field except the continuation and extension of that general forbearance and due regard for each other's taxes that the Federal Government and the States should practice at all times. The liquor tax field is characterized by such diversity of legislation and administration, based upon geographical differences of opinion as to proper taxation and regulation of liquor traffic, that it would be unwise to attempt a uniform national program. Our experience with uniformity under national prohibition was not a happy one. Moreover, the opportunity to establish a uniform system with Federal collection and State sharing came squarely before the country in 1934 and was quite definitely rejected. It can be said, however, that the considerable use by the States of their wide regulatory powers over liquor importation, to establish barriers to interstate trade, is an unfortunate development. This phase of the problem can and should be attacked by State reciprocal legislation, and by educational work sponsored by the proposed Federal-State Fiscal Authority and the Council of States. Abandonment of Federal license taxes (as distinguished from excises) would relieve to some extent the complexity of the present pattern of overlapping levies and is recommended. The license itself is useful for administrative purposes and should be retained.

## 11. Gasoline and Motor Vehicle Use Taxes

For the motor vehicle tax field the coordination device here recommended is separation of sources, the Federal Government to withdraw from the field as much and as soon as its financial exigencies will permit. While a plausible case can be made for Federal taxation of motor fuel to finance Federal highway aid, the connection between the tax and the aid is a loose one and might well be severed to eliminate the overlap at this point and to allow the States the exclusive occupation of this field. The basis of this recommendation is that this tax field forms a lucrative and badly needed source of revenue for the States, and one which they are exploiting or might exploit adequately and satisfactorily. Federal collection and State sharing, and other coordination devices, would create more problems than they would solve. The motor vehicle taxes at the State level are devised mainly as benefit taxes, and the diversities in rates and other special features which occur are mainly adaptations to special needs and other conditions in each State. The Federal automobile use tax offered an opportunity for Federal-State administrative cooperation but the impediments, suddenly confronted, proved too difficult. This is an excellent example of the necessity of developing the implementation and close working relationships which are the condition precedent to joint administration. Even with present limitations, however, there appear to be no insuperable or even impressive difficulties in a program which would require a Federal automobile use tax receipt as a condition for the issuance of a State license. The issue might also be disposed of by enforcing a requirement that evidence of payment of the Federal tax be offered as a condition for rationing privileges.

Looking to the future, it is suggested that Federal and State separation of sources in the motor fuel tax field might take the form of exclusive Federal taxation of fuel used in aviation, and exclusive State taxation of other motor fuel. This recommendation presupposes that aviation gasoline will remain a product separate from motor vehicle gasoline. If the two products were to become interchangeable, separation of sources might not be administratively practicable. Two-thirds of the States now exempt aviation fuel from State taxation, and the remainder either have special aviation tax provisions or do not receive much revenue from this source. Potentially, however, the field is promising. It is appropriate for the Federal Government, since aviation is essentially an interstate enterprise and the licensing of airplanes and the regulation of air travel are already national. If the Federal Government so desired, it might use the yield of the aviation fuel tax to finance the construction and maintenance of free public airports, the laying out and maintenance of beacon systems, the provision of weather information, and the regulation of pilot licensing.

A troublesome aspect of the motor vehicle tax system is its application to trucks, particularly the excessive license fees required of trucks by States outside of the State of the owner's domicile. While much can be said for Federal action to eliminate what in some cases amounts to a trade barrier, it is believed that State reciprocity and persuasive mediation by a Federal-State Fiscal Authority would constitute the best means of attacking the problem.

### 12. Retail Sales Taxes

The retail sales tax is not an overlapping tax at present but if it becomes such, by virtue of Federal entrance into the field, the coordination device to be highly recommended is joint administration. Even with some diversities in State laws, dual administration in this field would be wasteful and otherwise undesirable. The Federal Government, especially in war-time, should draw upon the experience and personnel in retail sales taxation developed by the States.

Facilities of State and municipal sales tax administrators could be utilized to obtain a list of vendors of tangible personal property. Mutual exchange of information in such matters as the opening of new businesses, discontinuance of old businesses, and changes in ownership would prove helpful in reducing tax loss. The development of a joint auditing program, with an amalgamation of field forces, would amount to almost doubling the field forces of each organization. A pool of the highly important sorting and tabulating equipment would avoid unnecessary duplication and reduce costs. Development of joint return forms would reduce administrative and compliance costs. Going further, it would seem desirable that an opportunity be left open for experimentation, either in State collection of the Federal tax, Federal collection of the State tax, or even the collection of both taxes by a joint administrative agency (as recommended in Australia).

Other coordination devices, such as Federal collection and State sharing, are objectionable because they would in effect universalize, by Federal compulsion, reliance by the States upon a regressive tax source. The use of the sales tax by the States is none too satisfactory on the administrative side; difficulties arising from the interstate nature of much trade have been only partially eliminated by the use tax and liberal court interpretations of the States' power to tax. But the remaining difficulties are by no means intolerable.

### 13. Business Taxes

Business taxes probably offer the most difficult problem of coordination to be found in the overlapping tax system. However, the need for correlation of business taxes is very great. The confusion

in this sector of the tax system is impressive and the possibilities of repressive effects upon the economy are considerable. The Federal system of business taxation is itself uncrystallized and is at present ordered considerably by the exigencies of war finance. The absence of a Federal policy renders the development of plans for Federal-State coordination doubly difficult. Unfortunately, no generally accepted objectives of sound business taxation are available. The following are suggested in this report:

- (1) If indeed there is any valid reason for taxing business as such at all, it seems that the relative place of business taxation in our tax system is too large and that this form of taxation should be "deemphasized."
- (2) An important present justification for business taxes is that considerable income is short-circuited within corporations and reaches the stockholder only after considerable delay, if at all. New techniques should be devised for subjecting this short-circuited income to the same scale of personal income taxation as is applied to distributed income.
- (3) The present combination of heavy taxes on corporate net income and additional taxes on dividends as part of the base of the stockholder's personal income tax places an unwarranted differential strain on equity financing. Either the deduction of bond interest should be disallowed (with appropriate limitations) in the computation of the corporate tax base or, better still, a partial credit should be given the corporation for dividends paid out.
- (4) There is considerable support for the view that corporations should pay some taxes, in addition to property taxes, for the benefits received from governments. This would mean the utilization of bases which would reach businesses with or without net income. Indications regarding the proper type of corporate taxation may perhaps be derived from interpretations of the relationship between the government and the corporate entity. On one hand, the government may be considered a partner in the corporate enterprise, to share in the profits through a tax on net income. On the other, it may be considered a cost factor of production, to be compensated through a cost tax (on gross income, value added, or the like) regardless of the profitability of the business. However, it seems probable that applying taxes to income above cost is likely to be less regressive

than making taxes a universal business cost. Moreover, the incidence of taxes on business, based on factors other than net income, is uncertain and confused. A retail sales tax, aimed at the consumer and close to him in its application, is more dependable in its effects. A tax system consisting of a personal and corporate income tax and a retail sales tax would be preferable to one consisting of the first two and business taxes based upon gross income, value added, or capital stock. Accordingly, it is recommended that no attempt be made by the Federal Government to extend its business tax system to corporations operating at a loss, and that the tendency of States and cities to levy such taxes be discouraged.

- (5) Whether partnerships and individual proprietorships should be included in the scope of a business tax system is a difficult question, especially since there is no clearly defined province for the term "business" and it can easily be stretched to include all productive activity - even that of wage earners. Probably only more confusion would result from an attempt to tax individual businesses and occupations generally.
- (6) The excess profits tax, whether or not it is to be used beyond emergency periods, requires Federal perspective for its successful application and need not concern us further here.
- (7) Whether or not special treatment is required for the taxation of insurance companies, banks, and public utilities is another troublesome problem. Probably an effort should be made to integrate so far as possible all these special classifications under a general business tax. An exception in the case of insurance companies is probably warranted so far as the States are concerned, but even here the Federal Government should continue its experimentation with the difficult task of integrating insurance and net income taxation.

A good case could be made for the exclusive taxation of business by the Federal Government, with the States sharing in the revenues. Probably our complicated, highly diverse, highly arbitrary system of business taxation, with its high cost of compliance, capricious and extraterritorial incidence, and uncertain economic effects; with its double and triple-deck application; and its penalties through unjust apportionment upon cosmopolitan business, should be replaced by a new streamlined uniform centralized system.

This might be accomplished by distribution of a portion of the Federally collected tax, on condition that States and municipalities retire from the use of capital stock taxes, gross income taxes, corporate net income taxes, insurance taxes, and other taxes on business. This program would involve heavy complications, including the separation of business taxes from property taxes, Federal apportionment, and the adaptation of the program to the needs of the States. Against these must be balanced compliance costs resulting from diversities, injustices, and losses of revenue owing to jurisdictional confusion, and the repressiveness of State forms of taxation. A quantitative appraisal of what these causes for action add up to is not possible without research that cannot be attempted in an emergency period like the present. The results might support a recommendation for complete federalization of business taxes by application of a Federal sharing program. Were this recommendation made for the present it would have academic significance only, for public opinion is not prepared for such drastic action. In any event, pending a quantitative appraisal concerning the matters above discussed, the practical coordination program that can now be recommended must be confined to the following:

1. Better integration of the personal and corporate income tax at the Federal level as explained above.
2. State use of a system similar to the Federal, with resulting possibilities of joint administration; mitigation of multiple taxation, and State supplementation.
3. Research and education in this whole field. Particularly important is a quantitative appraisal of the impediments to business resulting from diverse State business taxation practices.
4. Federal incorporation of corporations engaged in interstate business.

This offers one solution for the problem of interstate competition for the corporate tax base. It would not prevent the States from taxing some appropriate share of the business when the corporation operates within their borders, but it would prevent them from taxing the entire capital stock of a corporation even when its activities are almost exclusively in other States. Federal incorporation would hardly be justified merely to remedy tax inequalities, but the importance of this measure for the regulation of interstate business is generally conceded.

Consideration might be given to the proposition that in the interest of a better balanced Federal tax the use of alternative basis be inaugurated. Net income would remain the major basis for the tax but alternative levies would also be provided: One, a flat minimum tax to cover the cost of administration or to exact a small charge for the privilege of corporate existence; a second, based on either "value added" or capital stock, preferably the former, to exact a payment on the benefit theory from corporations showing no profit. The taxpayer would be liable for the highest of these alternative taxes; rates would be so adjusted that the average business would normally pay the net income tax as the highest of the three alternative levies. But even the unprofitable businesses would have some taxes to pay, and in times of depression the alternative levies might add stability to the revenues. However, for reasons already stated we are not prepared to recommend this program at this time.

#### 14. Stock Transfer Taxes

The stock transfer tax is unique among the overlapping taxes in the degree to which the State tax revenue is concentrated in one State, New York, and the degree to which the incidence of the tax falls on the nation outside of the taxing State. The New York Stock Exchange is peculiarly a national institution. According to informed opinion, well over half of the transactions on the exchange originate outside of New York. The case for coordination in this field rests mainly upon the contention that the Federal and State taxes are levied without much regard for each other, and that the combination is excessive. Proposals for coordination have been confined largely to the idea of applying a credit for State taxes against the Federal tax. But the credit would tend to stimulate State taxation of stock transfers, and might lead to many multiple taxation problems now largely dormant. Only five States other than New York attempt to tax stock transfers now, but others could assert a claim on the basis of the domicile of the parties to the transfer, or of the corporation whose stock is transferred. It may be doubted that the present load of combined stock transfer taxes is excessive, but if this be so the load could be considerably eased by eliminating some of the crudities in the present stock transfer tax laws. The stock transfer tax, because of its incidence, is best suited for national exploitation, and on this ground separation of sources, with the tax to be levied by the Federal Government, might be recommended. But New York has a strong proprietary interest in its stock transfer tax and is not likely to surrender it except under considerable pressure. The revenue from the tax is relatively much more important for New York State than for the Federal Government. Under the circumstances, the best recommendation appears to be that of forbearance, with most of the restraint to be exercised by New York State.

15. Payroll Taxes

Coordination problems as to payroll taxes center principally around efforts to reduce costs of administration and tax compliance. While compliance costs here as elsewhere have been left largely to guessing, the view prevails that they are very substantial. However, excessive reporting and other inconveniences result as much from the two Federal as from the overlap of the Federal and State taxes. Very little can be done in the way of coordination until the Federal unemployment compensation law is amended to cover employers of one or more, thus making the coverage similar to that under old-age and survivors insurance. Efforts to coordinate the two Federal taxes and the coordination of State forms and procedures for unemployment compensation with Federal forms and procedures for old-age and survivors insurance would be expedited. Twelve States had already taken this step on their own initiative by 1941. It is true that if the State tax were eliminated, the integration of Federal taxes would be made easier and administrative and compliance costs might be considerably reduced. This, however, would involve complete centralization of the unemployment compensation system, and many implications broader than the issue relating to taxes.

There is a substantial case for the transfer of payroll tax administration from the Bureau of Internal Revenue to the Social Security Board. This would be in the interest of better coordination at the Federal level. The coordination of benefit and tax raising functions has already been adopted by the States and is the method used by practically all foreign countries. Issues of benefit rights and tax liability should be settled simultaneously by one agency, and Social Security taxes cannot be thought of in the cost-as-against-returns sense more appropriate to ordinary tax administration. This change is not now recommended because the prospective inauguration of collection-at-the-source in income taxation may change the balance of advantages in favor of collection of income and payroll taxes by the same agency as at present. The matter merits reconsideration later.

The crediting device was incorporated into the unemployment compensation system partly to counteract interstate competition. However, the threat of interstate competition has reappeared in the operation of merit rating systems under which, in States that apply them, concerns with good employment records are granted a payroll tax advantage. If all States adopted similar merit rating schemes, this might be unobjectionable. Advantages would represent only the incentive which the merit rating system is designed to supply.

Where only part of the States adopt merit rating an element of unfair competition appears, and if merit rating is used (as alleged) as a pretext for general undermining of standards, the competition begins to involve States as well as firms. Imposition of Federal minimum standards, as to tax rates, benefits, or reserves, preferably the latter, might mitigate this problem. But it would go far toward undermining State responsibility and independence. Pending a further opportunity for States to demonstrate their competence in the field of unemployment compensation, no change is recommended except that the Social Security Board assume an educational role, privately and publicly informing States when reserves or benefits are thought to be substandard.

Many suggestions have been made for various changes in the present credit grant combination which constitutes the coordination scheme of unemployment compensation. Increasing the Federal credit from 90 to 100 percent is a possible innovation that merits attention. This would go far toward the elimination of the Federal tax and the administrative and compliance costs which attend it. The change would, of course, involve some loss of revenue for the Federal Government. The 100 percent grant for collection of State payroll taxes and the administration of State unemployment compensation systems has worked well in most respects (particularly in its salutary effect on State personnel standards) but it has sacrificed the safeguards against waste which attend State budgetary supervision. Some recasting of the program to give the States an equity in the administrative outlays, perhaps variable in degree, depending on the financial ability of the States, is worth further consideration.

## V. TAX IMMUNITIES

### 15. Payments in Lieu of Taxes

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 relations. The problem has been aggravated by the Federal acquisitions of large tracts of land for reservations, cantonments, air fields, arsenals, transport facilities, ammunition depots, and other defense facilities. These acquisitions often create difficult local financial problems because they deplete the local tax base, and because in many instances Federal properties make it necessary for local governments to expand governmental services. 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. Some public housing projects pay nothing to the municipality which provides them service; others make moderately substantial payments. Local dissatisfaction with payments in lieu of taxes is very great, and the resulting irritation in Federal-local fiscal relations imperils worthwhile Federal projects and encourages resistance to the Government's efforts to improve the tax system. Those opposing the discontinuance of tax exemption for the interest on State and local government bonds 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.

A legal aspect of this problem, not usually understood, is that many Federal properties involve Federal jurisdiction, and this may mean the absence of State and local obligation to provide services.

More important by far than any single set of rules and principles for guidance in determining payments in lieu is the development of some machinery whereby such rules can be established, revised, and used effectively. In other words, what is needed is a clearing house for payments in lieu proposals. An agency of the sort suggested could also play a useful role in hearing complaints - particularly local complaints - concerning payments in lieu of taxes. A Federal-State Fiscal Authority could function most effectively in these two roles.

A better correlation of programs for payments in lieu of taxes might also be promoted were Congress to establish a special joint committee (perhaps temporary) to consider the large volume of new legislative proposals which fall in this field.

It would be presumptuous for any person or group of persons with limited experience to attempt to state a set of principles applicable to all the myriad situations which call for judgments as to payments in lieu. Nevertheless, a few generalizations can be offered.

- (1) It is more desirable to promote dependability and intelligibility in this field than to insure the most perfect balance of interests in specific situations.
- (2) Some recognition should be given to the benefit bestowed on a community by the location of a Federal function. The location of all functions, private and public, is usually beneficial, but it does not follow that the functions should be tax-exempt. There may be exceptions, however, where Federal programs assume functions which might otherwise have

to be performed by State or local public agencies such as public works projects financed from general tax funds, or as special improvements financed by special assessments. Flood control and reclamation activities are examples.

- (3) Property that has long been owned by the Government, and new properties of the same class, should ordinarily be exempt with no compensation from Federal funds. The affairs of all concerned have long since been adjusted to the exemption status. No useful purpose would be served, for instance, by subjecting the United States Post Office property and general administrative buildings to local taxes. The extensive holdings of public domain have never been taxed and probably should also be placed in this category. Although revenue-sharing devices of long standing are in operation and will probably have to be retained. Also where properties recently acquired, notably military areas, have caused sudden and serious local tax loss, payments covering actual loss should probably be provided although the properties are of the same order as those long owned and exempt.
- (4) Where services are sold by governmental agencies on a more or less commercial basis and in competition with similar private activities, as in the power and housing projects, the commercial element of the property involved should ordinarily be valued by the Federal Government with primary consideration to a capitalization of the rental or other income. The Federal Government should then pay sums on the value derived corresponding to the taxes that would be paid if the property were privately owned.
- (5) Other Federal property that is utilized ordinarily by or designed for sale to private individuals, such as farm and resettlement properties or additional Indian lands, should pay the equivalent of levies on similar privately owned property. For this and other Federally owned property on which in-lieu payments are made valuation should remain subject to Federal control.
- (6) Property acquired for conservation purposes (such as submarginal and cutover forest lands) might well pay a low flat acreage rate on value as of the time of acquisition. This would constitute a minimum guarantee, pending larger local receipts from a distribution of revenue when the property becomes revenue-producing. The flat rate would represent a rough adjustment to average effective tax rates

on this type of property. The percentage of revenue shared would resemble a severance tax. This plan is considered feasible, not only for ease of administration in the case of large holdings of low value, but also as an approximation to what is considered to be good property tax practice on depleted lands.

- (7) Although in the main full local services should be supplied the Federal property and its residents, there are cases in which the Federal agency is obliged to supply directly public services and facilities customarily financed out of local property tax funds. The Federal agency may even make the facilities available to local residents. In these cases there is room for adjustment of the payment to local units, particularly when the amount otherwise payable is the full equivalent of local taxes on land and improvements.

The above list represents an oversimplification of the problem, and is submitted in the hope of focusing attention on fundamental issues.

It is recommended that the Federal Government provide the facilities for a continuing inventory of public property. This is desirable not only for its own sake but also to facilitate the development of balance sheet accounting for the Government.

Unless something is done to improve Federal-local relations concerning payments in lieu of taxes valuable programs such as those in the field of housing may be imperiled. It is hoped that steady improvement might be made under a program such as that outlined above.

#### 17. State and Local Taxation of Government Contracts

The controversy involved in the taxability of Government contracts under State and local sales and use taxes has been aggravated by the war program. The United States Supreme Court recently held that in the absence of Congressional declaration to the contrary, purchases by cost-plus-fixed-fee contractors engaged on Government contracts are subject to State and local sales taxes. The matter is now being reconsidered by Congress.

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. 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." A distinction between sales taxes and other taxes applicable to Government contractors appears unwarranted. 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 continuation of tax-exempt securities.

If the Government were to assume ownership of the railroads few would contend that the States should go uncompensated for the loss of such a lucrative tax base. It seems doubtful if the preemption of the business of the automobile industry for war purposes differs in principle.

It is argued that permitting the States to tax purchases by Government contractors creates great embarrassment in Federal administration and a large additional load for the Federal budget. Tax compliance, whether by public or private parties, is always troublesome but not less necessary on that account. Considering the facts that the total yield of State sales taxes in 1941 was only \$671 millions and of the gasoline tax \$800 millions, the cost of these payments is not likely to loom very large against the enormous sums expended on the war effort. Cost determinations are difficult but at the current rate of expenditure on contracts, the annual cost on a very generous estimate does not exceed \$162 millions. It is probably substantially less.

It is concluded that at the very least Congress should 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.

#### 18. Tax-Exempt Securities

Whatever may be concluded as to the merits of the argument concerning tax exemption of government bonds, there can be no doubt that the effort to eliminate this feature of our tax laws has met with constant, general, and bitter opposition from many State and municipal officials. It is the proposal to include the interest on State and local bonds in the base of the Federal income tax which is most in conflict.

That States and municipalities would find this a fatal impediment to credit operations or other State and municipal fiscal interests seems quite unlikely. These units managed very well without this advantage before the income tax was developed. State and municipal bonds commanded an excellent market and a considerable advantage

over other bonds in this earlier period. Moreover, governmental units manage quite successfully to obtain credit in Australia, Canada, and many other countries without immunities.

The balance of gain and loss from the intergovernmental exchange of immunities is very obscure and depends upon many of the notorious vagaries and uncertainties in calculating the effects of tax exemption. While the advantage to States and municipalities in reduced interest costs as a result of tax immunities for their bonds is not subject to clear demonstration and has been categorically denied to exist by some critics, it has been quite generally conceded that the exemption might cause a difference in interest rates ranging up to one-half of one per cent. During recent years, State and local bond issues have amounted to \$1 billion per year and if the volume should continue, extra interest payments might amount to \$5 millions in the first year and eventually to as much perhaps as \$100 millions per year. Against this loss, of course, would have to be offset any gains which the States might realize if the States and their subdivisions were allowed to tax Federal bonds.

The argument that the elimination of tax exemption would involve a dangerous shift of power to the Federal Government is rebutted by the proposition that no authority is sought to levy a discriminatory tax. But it is said that if Congress has the power to tax State and local securities it could tax some and exempt others. Of course, Congress already has the power to subsidize some local functions and not others through its subvention system. But if a shift of power is at issue, the Supreme Court could take care of the matter by declaring the power to tax governmental instrumentalities (without discrimination) to be reciprocal. It is also alleged that if the door is opened to tax the interest on State and local securities, this will make municipalities liable to taxation on their public enterprises. But this does not seem to follow. There is a wide difference between the taxation of private individuals who own government securities and the taxation of government enterprises where no private parties are involved. Centralization of power is not part of the purpose of those who seek to eliminate exemptions from the income tax.

It is quite unfortunate that the two issues involved in the elimination of tax-exempt securities have become so badly confused. The proponents of exemption elimination are not "out to deprive the municipalities of such limited fiscal advantages as the latter now possess." Nor do most State and local officials take any pleasure in serving as a "front" to protect the patently unfair privileges of rich taxpayers. Some hope is entertained that these two groups might get together on some kind of a program which would meet the objectives of both.

Many suggestions toward this end have been made. One proposal worth serious consideration is that the Federal Government might establish a Federal bank for States and municipalities. The lending operations of the Reconstruction Finance Corporation in recent years have been of substantial assistance to debtor States and municipalities, and such arrangements might be continued on a permanent basis. Another proposal worth considering is a crediting arrangement whereby the differential advantage in tax exemption of large income recipients would be wiped out. More promising politically, perhaps, is the suggestion that the Federal Government grant a direct subsidy to units which borrow in the future. The equivalent of one-half of one per cent on the outstanding principal of new bond issues could be paid to the issuing units annually. This would have the effect of eliminating the inequities in the income tax created by tax exemption, and would convert a hidden and indirect subsidy into an open and direct one. If a compromise is necessary to secure action and promote better governmental relations, and such seems to be the case, this solution is recommended.

## VI. EXPENDITURES, FUNCTIONS AND AIDS

### 19. Reallocation of Functions and Powers

Had this report been written in 1930 more attention would have been necessary to the inadequacy and inflexibility of the constitutional and statutory division of functions and powers. At that time it appeared that the Federal Government was quite inadequately endowed with power over interstate corporations and to cope with the business cycle, powers which it alone had the perspective and size to exercise effectively. Since 1930, revolutionary changes have taken place with regard to Federal functions and powers. The legal boundaries of "interstate commerce" have been and are still being broadened; a new element of flexibility in the interpretation of the Federal Constitution has appeared; and precedents for the use of the Government as an instrument for dealing with depressions and unemployment have been established.

Nevertheless it would be rash to leave the impression that the present division of functional responsibility is in any sense crystallized or beyond criticism. The division is and probably should remain in a state of flux and constant adaptation to changes in conditions. In some instances increased Federal participation is warranted, and whether this should be direct or through the grant-in-aid mechanism is to be weighed in each case in terms of the advantages

and disadvantages. To choose a few examples, the Federal Government almost certainly should provide a larger portion of the cost of education. Most of this increased support should probably take the form of a revised and more generous grant-in-aid system. But direct provision of scholarships to insure the full development of talents (on the order of the National Youth Administration allowances) may also have a place in the program. The Federal Government should probably extend its participation in outlays for direct relief. The present program, under which Federal support is confined to a limited number of work relief projects, is properly criticized on the ground that it tends to distort the welfare budget of the municipalities. Whether work relief should take the form of grants or direct participation is also a moot point, although the evidence seems to warrant no change from the present practice. Greater Federal outlays for public health seem to be overdue; however, there is conflict here between the proponents of health insurance, a direct Federal health program, and grants-in-aid. Probably the latter are preferable. Much the same problem arises in the case of nutrition, in which some participation has occurred through a direct Federal program (food stamps) approaching the problem from the supply side.

At the State and local levels, division of financial and managerial responsibility for schools, highways, and welfare is also in flux with some trend toward centralization, usually quite justified. Unfortunately there is a great scarcity of evidence concerning the relative efficiencies of different levels in the provision of services, a scarcity which suggests another pioneer field for research.

Controversy continues over the State sponsorship of the unemployment compensation system. Here the Federal Government has already asserted a very large measure of control, but the existing arrangement is criticized because of the limited scope of State programs. Unemployment is a national problem, and important advantages would result from changes which would put the Federal Government in a position to develop its social security system as a whole. On the other side, the interests in experimentation, participation, and adjustment of programs to local diversities may be cited. A law suited for New York may be badly adapted to Nebraska. Were the program to be inaugurated now, it is probable that a national system would have the preponderance of advantages. Since the States have been granted the leading role in the system, they should be given time and Federal assistance to demonstrate whether they can handle it successfully. Constant threats to federalize the function will only interfere with cordial Federal-State relations.

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A very strong case for a functional transfer can be made to require corporations doing an interstate business to secure a Federal charter. State incorporation has been plagued by the factor of interstate competition resulting in the States with the weakest regulation getting most of the business. Data gathered by the Securities and Exchange Commission show that one State has issued charters to 29 percent of the corporations whose securities are listed with the Commission. This has tax as well as regulation aspects, for the State of incorporation has wide powers of extra-territorial taxation over the corporations it charters. Although the Securities and Exchange Commission has eliminated some of the grounds for a shift of the important incorporation function, and although a shift would cause considerable temporary business compliance cost, it is strongly recommended that as soon as the time is propitious, the Federal Government exercise its power to require corporations engaged in interstate commerce to secure a Federal charter. This implies, of course, that the conditions for the issuance of such charters will become a matter for the Federal Government to determine. This is another change that is long overdue.

#### 20. Federal Grants-in-Aid and National Minima

Regarding improvements in the aid system, it is observed first that while the scope of Federal aid developed very rapidly under the pressures of the recent depression, it is a mistake to call the existing practices a system. In many States, certain Federally supported functions, such as old-age assistance and vocational education, have tended to get the lion's share of Federal, State, and local support at the expense of such locally supported functions as relief and general education. The system should be revised and brought into balance by an extension of its scope to include additional functions in which there is a clear national interest.

The aid system has developed no concept of a national minimum, that is, of functions of such strong national interest that the Federal Government should underwrite a minimum program and insure that the minimum standard be everywhere provided without an undue strain upon local resources. It seems that the strongest claimant for preferred position in this respect is elementary education, followed by aid to dependent children. Although agitation for differential aids for old-age assistance has been persistent, minimum standards here are not so clearly of national interest and all welfare outlays are more or less relative to the standards of wealth and income enjoyed by the general population in particular States. The conclusion is that differential aids should be

inaugurated, and that they should start with elementary education. (This is discussed further in Section 21 following.)

A desirable technique for aid distribution in the welfare field that would offer some advantage to the poorer States is that suggested in the Connally Amendment, a graduated bracket system of distribution. For example, for the old-age program, the Federal Government might match on a  $66\frac{2}{3}$  percent basis up to the first \$15 per month of aid given eligible recipients; 50 percent from \$15 to \$25; and  $33\frac{1}{3}$  percent from \$25 to \$40. By this sort of a program in the welfare field, a strong Federal interest in bare minimum standards would be asserted, difficult measurements of fiscal capacity would be avoided, and intrastate equalization programs would be encouraged.

The control features of an aid program can be a very salutary influence and ought to receive more rather than less emphasis in the future. In addition to the traditional control devices, such as audit and inspection, and approval of State plans, educational aids should give attention to internal equalization, redistricting, and division of funds between whites and negroes. All the aids should seek to improve standards of local government personnel. It is probable that more can be done in most cases with persuasion than coercion. Some outside criticism has a salutary effect on almost any government, and it is unfortunate that the Federal Government is not in a position to get the benefit of similar criticisms from the States and municipalities.

The last word has by no means been written on the techniques of cost sharing applied in aid programs. Local interest in standards rather than expenditure, due concern for economy, reasonable but not excessive local effort - these are interests to be considered. If cost sharing is a necessary feature of equalization aids, it should be on the basis of an inverse ratio to ability, the latter gauged mainly by per capita income.

## 21. Expenditures for Education

Education is a function which is traditionally and legally a responsibility of State and local government. In Canada this local responsibility is included as a constitutional guarantee. Although the Federal Government has had one finger in the educational situation for a long time, its present financial contribution runs to only 2 percent of the total cost, and local control is jealously guarded. The movement for more general and more generous Federal aid is not of recent origin, but it is becoming more and more insistent. The movement has been restrained thus far by the fear of Federal control.

sectional disputes over the equalization principle, opposition of religious groups, and the condition of national finances.

A strong case for national interest and support has been built up by the proponents of Federal aid. With elaborate statistics wide differences in per capita expenditure and educational opportunity among the States have been demonstrated. With few exceptions, the States lowest in financial ability are making the greatest relative effort to support public education. The poorer areas usually show the highest birth rates and the underprivileged individuals frequently migrate in later life to areas of greater economic opportunity. The importance of public education in raising the level of consumption and production in sub-average areas and its possible effect in reducing future outlays for relief, health, welfare, and rehabilitation are also stressed. Citizenship interests in minimum standards for education are obvious. Consideration of local tax relief also enters the argument.

Any program of Federal aid for education confronts major issues of the degree and manner of central controls which should be included. Division between whites and negroes can hardly be neglected. For 17 States and the District of Columbia, average expenditure per pupil in average daily attendance (1935-36) was \$20 for negroes and \$50 for whites. The existence of these differentials raises serious questions as to the effectiveness of Federal financial aid alone in equalizing educational opportunity. Latitude for Federal-State consultation and advice on this subject should be provided.

Lack of proper equalization procedure in State-aid laws is another aspect of the educational situation with which a Federal-aid program must be concerned, particularly if it is to involve equalization features. States differ widely in the degree of State support for education, and the assistance in many cases involves little equalization. Obsolete State-local administrative organization, including small school units, is also involved. Federal aid for school construction with a view to district reorganization might play an important role in the initial stages of Federal support for general education. While Federal control of school curriculum in the direction of uniformity is to be avoided, there is need of a general review of educational objectives, and closer integration of vocational training and guidance with other school programs. It would be a serious mistake merely to raise the level of school expenditure without tangible improvement in the quality and usefulness of the educational offering. Just how much coercion, as contrasted with persuasion, should be involved in

Federal control is a debatable point, but it is suggested that the latter in most cases would prove more effective.

Much weight needs to be given to the view held by many people that education is a part of their way of life, and that national participation means regimentation and the loss of important minority rights and interests. Concessions can and should be made to this feeling, but considering also the overwhelming national interests in the maintenance of minimum standards of educational opportunity, the concessions should not extend to a veto of Federal aid for general education with equalization features. Nor should it block a control program necessary to secure the Federal objectives. It is not an acceptable feature of our way of life to keep large sections of the population in ignorance. Of all the functions of government which might be candidates for national minimum status general education has the strongest claim.

In the field of secondary and higher education a conspicuous fact is the amount of latent talent in the population which is never developed. Many of the most promising youths discontinue education long before the opportunities for profitable investment, both from the personal and social points of view, have been exhausted. Better exploitation of talent would help to increase the national income and to diminish differences in its distribution.

As to higher education, the program had best be confined to aid to individuals rather than institutions. This might take the form of Federally supported scholarships of various sorts, including loan scholarships and work scholarships on the order of those offered by the National Youth Administration. Scholarship loans to be repaid through the return of a percentage of the beneficiary's income (like a special income tax) over a certain period of time in the post-school period might also be considered. The amount granted on these conditions should be generous, but the selection should follow rigorous standards of fitness.

Wise Federal leadership with regard to educational development in the United States can make an impressive contribution to the economic, political, and cultural life of the country.

## VII. FISCAL POLICY

### 32. Fiscal Policy and Public Investment <sup>1/</sup>

Fiscal policy is a new phrase in the vocabulary of many people, but it has rapidly assumed a central place in governmental planning. Fiscal policy is concerned with both public expenditure and taxation. The taxation aspect will be discussed in the next section.

The resurgence of private business and the release of deferred consumers' demand may leave no problem of unemployment after the war. Private business should be given every reasonable encouragement to provide abundant opportunity. But taking the generally accepted view that unemployment and idle plant capacity will become a problem, what should be contemplated as a program to meet such a contingency? Without attempting to outline the program in detail, one can make a few comments concerning the proper approaches.

The Government will and should underwrite the maintenance of a high level of economic opportunity and full use of resources and plant capacity in the United States. It should do so by public investments, selected and budgeted, as far as possible, so that they will pay for themselves during their period of usefulness. This means that the expenditures must be highly creative in the economic sense. Through direct collections from the beneficiaries of the investments, and indirect collections through the tax system, each item of outlay should contemplate a closed circle of outgo and intake.

One of the big problems of the post-war era will be that of maintaining confidence within the private sector of the economy. This cannot be done with slogans such as "Let us spend ourselves into prosperity." Such slogans might create more unemployment than they alleviate. The psychology and accounting of sound public investment as a necessary and sensible program to cope with unemployment should be much more acceptable to private business.

Two views of the public debt have engaged attention during the last decade. One view is that large and mounting debt, unsupported by productive assets, is the sure road to bankruptcy.

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<sup>1/</sup> This section deals with the over-all financial problem more than with intergovernmental fiscal relations. The former is considered as included to some extent within the province of this study, and, of course, it has important implications for intergovernmental fiscal relations.

The other is that a deficit in itself is a beneficent influence creating employment and enhancing national income. It is hoped that these two views might be amalgamated in a future public investment program.

A "sound" public investment program contemplates a split budget with an operating portion regularly balanced, or at least balanced over the business cycle. The other portion - the capital budget - need never be balanced, but each item in the budget must itself be self-liquidating over a given period. A precedent for this procedure has been established in Sweden. The details are not easy to manage and require much political discipline - perhaps more than can be expected. The dual budget system is very easily abused. But alternatives to a program of the character recommended are not very attractive. A perpetually mounting dead-weight public debt and the issuance of non-interest-bearing obligations involve greater problems and a far greater departure from past traditions than the program here recommended. Of course, if no program at all is necessary, so much the better. But the situation is not so reassuring that we can afford not to be ready.

It is not difficult to find fields well adapted for public investment of the kind here proposed. Public health, regional development, public housing, and nutrition are familiar examples. There will be vested interests that would prefer to see public money invested in lines that are strictly "non-competitive." These vested interests must be either dissuaded or pushed aside. It is partly to retain a large part of our traditional private economy that plans like the above are proposed, and they should have the united support of those who are interested in sane and orderly progress and in preserving traditional values.

The implementation of a public investment program involves many problems of intergovernmental relations. Reallocation of governmental functions, the use of governmental corporations, the application of Federal loans or grants might be chosen. The proper choice will depend upon the specific situation but it seems probable that a combination of loans and grants will be most propitious - particularly if State and local government can be somewhat invigorated in the process. Apportionment should give major weight to the relative productiveness of alternative projects.

Local governments, like individuals, will have a considerable inventory of deferred construction needs after the War. But they may not have the financial capacity to meet these needs. They

can to some extent insure this capacity by paying off debts and building reserves during the war. Possible Federal encouragement of this policy will be considered later.

### 23. Fiscal Policy and the Tax System

It is said that our over-all tax system is regressive for the low income groups and that this and insufficient progression for the high income groups makes it ill-adapted to the needs of an economy with chronic tendencies toward under-consumption and over-saving. Assuming this diagnosis of modern economic tendencies to be correct, what should be done about it in modifications of the tax system?

First, it may be asked if it is necessary to centralize the tax system in order to achieve a workable fiscal policy? The answer, it seems to us, is in the negative. The Federal tax system, according to the available data, is only a little less regressive for the low income groups than that of the States and municipalities. <sup>1/</sup> If the Federal Government wishes to make the tax system less regressive, in the interest of more desirable economic effects, it might begin by working on its own segment of the system. Moreover, as previously explained, there are possibilities of developing independent local sources of revenue which are less regressive than those now employed. It will be necessary for the Federal Government to assume the major responsibility for emergency unemployment, but it is not necessary for it to encroach further upon local financial independence. The remedy for a regressive tax system is increased reliance upon progressive taxes, and the Federal Government has plenty of scope for the application of this remedy in its own tax system.

It is also alleged that the tax system is regressive - that it throws too many wet blankets on the "economic incentives." This contention to some degree contradicts the first, but perhaps something might be done to relieve regressiveness without adding to regressivity. Some relief for equity financing under the corporate income tax, the elimination of tax-exempt securities, a more orderly and logical and "deemphasized" system of business taxation - problems previously considered - should help to mitigate tax regressiveness.

<sup>1/</sup> The data represent conditions before the recent sweeping expansion in coverage in the Federal income tax. Some regressivity (due to Federal consumption taxes) continues at the bottom of the income scale, however, and the pre-war situation may be largely restored after the war.

### VIII. COST OF ADMINISTRATION AND COMPLIANCE

#### 24. Administration and Cost of Compliance

The frictional costs of the tax system - cost of administration and tax compliance - deserve far more attention and study than they have hitherto received. A pioneer study of tax compliance cost was undertaken and completed in 1934, but limitations in the scope and method of the study made the results somewhat inconclusive even for 1934. Since that date the social security system has developed. Early in the development of the present study, the United States Department of Commerce agreed to sponsor a survey of tax compliance costs but because of the war emergency the project had to be abandoned. The Commerce Department's proposed study contemplated a wide coverage of taxpayers and careful supervision of the cost accounting procedure by which data could be obtained. These conditions are essential to insure reliability in the results. As soon as circumstances permit, this survey should be undertaken and its results carefully studied.

Increased attention to compliance costs in framing all tax legislation can be recommended. The simplified Federal income tax return was a step in this direction. The recent removal of the requirement that Federal returns must be notarized is another.

Table 1 presents estimates concerning the cost of administration of Federal taxes for fiscal year 1941 prepared for this study by the Bureau of Internal Revenue. The Bureau does not maintain a cost accounting system by which accurate figures could be obtained. However, every effort was made to allocate properly the total cost of the Bureau to the various classes of collections.

The estimates follow:

Table 1

STATEMENT SHOWING BY CLASSES OF TAX THE TOTAL INTERNAL REVENUE RECEIPTS,  
THE TOTAL AMOUNT EXPENDED AND OBLIGATED, AND THE COST OF  
COLLECTING EACH \$100 OF REVENUE

<u>Class of tax</u>	<u>Internal Revenue Receipts, Fiscal Year 1941</u> (thousand dollars)	<u>Expended and obligated, Fiscal Year 1941</u> (thousand dollars)	<u>Cost of Collecting \$100 of taxes</u>
1. Income and profits taxes:			
Individual	1,418,383	23,875	\$ 1.68
Corporation	1,860,356	13,233	0.71
Excess profits	192,385	1,880	1.00
Total income and profits taxes	3,471,124	38,988	\$ 1.12
2. Employment taxes	925,856	6,329	0.68
3. Capital stock tax	166,653	842	0.51
4. Estate and gift taxes	407,058	2,100	0.52
5. Alcoholic beverage taxes	820,056	13,641	1.66
6. Tobacco taxes	698,077	1,241	0.18
7. Stamp taxes	39,057	245	0.63
8. Manufacturers' and retailers' excise taxes	617,354	590	0.10
9. Miscellaneous taxes	224,874	1,314	0.58
TOTAL, all taxes	7,370,108	65,290	\$ 0.89

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Available data on the cost of administration of State taxes are notoriously fragmentary, ill-defined, and unreliable, but such evidence as is available (much of it collected directly in this study) indicates that in few if any cases can the States collect taxes as economically as can the Federal Government; that the State taxes which tend to be expensive to collect are the tobacco tax, automobile license tax, and alcoholic beverage taxes; that costs of administration even at the State level rarely amount to more than 3 percent of the tax yield. The picture presented is one in which margins of cost permit substantial savings, though hardly greater than in many other phases of government. However, administrative efficiency is not only a matter of ratios of costs to collections but also of the effectiveness of collections.

It is commonly observed among tax administrators that the first 90 percent of any tax is likely to be forthcoming to the public treasury with little outlay for administration. Moreover, tax administration is a policing job as well as a means of collecting revenue, and the justice of effective tax collection has value in terms of public morals and may even be an end in itself.

Administrative staffs, both Federal and State should be on a merit system from top to bottom. The Federal Government has not always set the States a good example in this respect. The Collectors of Internal Revenue and, until recently, their staffs have been outside the civil service system. As to the Collectors - appointed by the President - this involves problems of coordination and integration within the Bureau, as well as the usual considerations of personnel administration. Both the Federal Government and some of the States are making progress in this field.

If the fiscal independence of the States is to be maintained at even its present level, the proposition "Tax administration like any other function of the government should be assigned on the basis of efficiency of performance" cannot be accepted without qualification. Moreover, collection is inevitably associated with expenditure or distribution and questions of efficiency in the latter processes must also be considered. But relative administrative efficiency should be an important consideration in weighing all coordination proposals. As previously stated, greater Federal-State collaboration can do much to reduce administrative costs and improve the effectiveness of performance. The transcript service now generously provided by the Commissioner of Internal Revenue provides a method by which States get almost the full benefit of Federal income tax audits. Kentucky, for instance, gets something like the equivalent of 20 auditors' work at a cost representing the salary of one investigator for less than a month. Much more of this kind of collaboration is possible and very desirable.

## IX. PROBLEMS OF INTERSTATE RELATIONS

### 25. Multiple Taxation

Multiple taxation in the form of two collateral jurisdictions imposing the same tax on the same tax base is a phenomenon of considerable and growing importance in our modern tax and economic systems. This field, too, deserves much more study. The problem is emphasized by recent court decisions which indicate that judicial limitations on multiple taxation are very substantially reduced. Multiple taxation is serious in the fields of personal and corporate income taxation, death taxes, railroad taxes, and capital stock taxes. While the States can and should do something through reciprocal legislation to reduce the amount of multiple taxation, the main impetus for improvement will probably have to come from the Federal Government. This means some interference with State and local fiscal independence but in the long run it will support such independence. It is a case of amputating a finger to preserve the arm. The Federal Government should seek to acquire the right of determining State jurisdiction to tax by means of favors and subsidies extended to the States. It may be questioned that Congress and administrators are wise enough to perform successfully a role which is now gradually being abandoned by the Supreme Court. But there is fair agreement concerning many matters of jurisdiction - a proper allocation formula for corporation income, for instance - and the States, with one or two exceptions, have no very high stake in jurisdictional vested interest. Some jurisdictional problems will have to be settled by compromise. Increasing multiple taxation acts as an unfortunate penalty upon cosmopolitan ownership and business, a sort of trade barrier, which it is the natural role of the Federal Government to prevent. It should not shirk its proper task in this matter.

### 26. Other Problems of Interstate Relations

The States are much concerned with the geographic maldistribution of wealth and income of which substantial evidence is submitted in our main report. Variations are so great that the average income in one State is not even an acceptable relief standard in another. To illustrate, the average old-age pension in California in 1939 was \$345. This exceeded the per capita income in ten States in this year; it exceeded the per capita income of the poorest State by 70 percent. In general, the report shows that wealth and income tends to gravitate to large cities, particularly certain residential centers and those that specialize in financial functions. The States and cities engaged

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in the production of raw materials seem to fare badly in the distribution. Both on philanthropic grounds and because the distribution system may not reflect relative real contributions to the national product the facts of geographic maldistribution are of national concern. The Federal tax system and the Federal grants to the States might be used to mitigate geographic inequalities. Studies of the geographic incidence of the present Federal tax system and of the distribution of Federal aids leads to the conclusion that at the present time neither instrument functions very effectively toward this end and the aids in some instances are so distributed as to aggravate the maldistribution.

Recently many critics have become quite alarmed by the growth of trade barriers. State legislation, such as the special levies on oleomargarine, taxes and restrictions on liquor importation, and registration fees and regulations which apply to trucks and busses moving in interstate commerce are examples. Closely related are the problems growing out of special inducements offered to industry to locate in a certain city or State. The latter practice has been growing and has serious potentialities. While several minor suggestions have been made for dealing with these problems, they are best handled by interstate cooperation working through education and, in some instances, reciprocal legislation.

An ideal Federal system in our modern era contemplates a group of semi-independent democracies held together by a constitution and a common tradition, and functioning smoothly through a statecraft that includes a large factor of cooperation. This cooperation must be partly in the field of interstate and partly in that of Federal-State relations. The true spirit of the Federal system is sustained by efficient voluntary relationships, which make the compulsions of the unitary state unnecessary. The Federal Government must be a partner in this cooperative interplay in more ways than one. It must be a direct partner, of course, in Federal-State cooperation, which must go hand-in-hand with interstate cooperation; it can assist the States in their efforts to work together; and it should assume the role of arbitrator in interstate conflicts (as in tax jurisdiction), where it is in a strategic position to balance opposing interests. (The double-domicile fiasco in the inheritance tax field illustrates the wide open gaps that now exist in the present operation of our Federal system.) The techniques and machinery of government which we have inherited from the past were adapted to an economy and a fiscal system in which cooperation could be minimized without critical damage. But cooperation is the lubricant that, under modern conditions, makes a federal system go. To develop enough of this lubricant to keep the machinery moving smoothly in the still more interdependent economic era that lies ahead is a major challenge.

## X. MISCELLANEOUS PROBLEMS

27. Community-Property

A unique phase of the problem of intergovernmental fiscal relations arises from the diversity of State laws concerning property ownership, which precludes the uniform application of the present nation-wide system of taxation. This is the problem of community-property arising because of the laws of 9 States under which husband and wife have joint ownership rights in the earnings of either, or from the property resulting from the earnings of either, after their marriage. At death one-half of the community-property becomes the separate property of the surviving spouse without transfer and escapes the State death taxes and until this loophole was closed by the 1942 Revenue Act, also escaped the Federal estate tax. In the case of the income tax each spouse may report half of the income from community-property or activity for both State and Federal income tax purposes. This results in deplorable discrimination against the taxpayers of non-community-property States. <sup>1/</sup> At least one of the 9 States has deliberately amended its statutes in an attempt to give its citizens the advantage of this discrimination but the Bureau of Internal Revenue has refused to recognize the amendment for Federal income tax purposes. The income tax discrimination could be removed by amendment of the Federal law to require joint returns. This result might also be accomplished by requiring all members of the family to sum their income, divide by the number of members, compute the tax, and multiply by the number of members. Territorial discrimination in the income tax law could be largely eliminated by providing that State community-property modifications of the common law shall not apply in the operation of Federal taxes. While it is not entirely certain, the probabilities are that Congress has the power to do this. It is recommended, accordingly, that Congress enact further legislation which would disregard these major differences in State property-ownership laws for purposes of Federal taxation and thus seek to establish the uniform application of its tax system.

<sup>1/</sup> This discrimination is increased by the provisions of the Victory tax which grants a fixed exemption of \$624 to each income recipient. Since all married couples in community-property States automatically share their income they in effect receive a \$1248 exemption while most married couples in other States receive only \$624.

## 28. Impact of the War

The finances of State governments have thus far improved considerably as a result of high economic opportunity incident to the defense and war programs. The fiscal affairs of local governments also appear to be improving, but the situation is spotty and some cities have been adversely affected. None of the State and local governments has as yet experienced the full effect of defense taxes and rationing upon its revenues. The possible effects of inflation and post-defense readjustments are also important.

The effect of the war upon automobile traffic is certain to involve a very important loss of revenue from motor vehicle taxes (particularly gasoline taxes) to State and local governments. While the loss may not be great in 1942 (even in this year it will be substantial in the rationed States), an estimate of a 35 percent reduction for 1943 is probably conservative. <sup>1/</sup> Motor vehicle taxes are the most important single source of revenue for States, and of considerable importance for local governments. On the other hand, highway expenditures are being and (except where such expenditure is for servicing debt) can be further curtailed. States diverting motor taxes to general governmental expenditures (15 percent diverted) cannot thus escape the impact.

Proposals for Federal reimbursement of State motor fuel tax losses are considered premature. Improvements in other revenues, reduction in highway expenditures, rate increases in some States and diversification of tax systems in others hold promise of offsetting much of the adverse effect. Impairment of debt service on highway bonds is not considered imminent, although highway aid to local governments will undoubtedly be curtailed.

Much of the financial responsibility for defense-created activities must of necessity fall to the Federal Government because of the extensive interstate migrations of population and the concentration of war activities in some areas as the result of Federal decisions, and because adequate local public facilities and services are essential to the effective prosecution of the war. Congress has recognized a large measure of Federal responsibility by making several appropriations for defense public works to be apportioned among local units to meet these needs.

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<sup>1/</sup> Written in the summer of 1942.

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The Federal 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 the tax resources of these governments are more fully utilized than in 1917, and there is 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.

As a result of improved economic and fiscal conditions, some State and local governments are accumulating surplus revenues. It is probable that these surpluses will be increasingly required as a cushion for revenue declines and to finance emergency State and local expenditures. Further disposition of these surpluses has an important bearing on the Government's effort to prevent an inflationary price rise. These efforts would be facilitated if State and local governments used these surpluses to reduce indebtedness or to build up reserves. The latter might be used to purchase United States War 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. <sup>1/</sup> Conversely, if improved State and local financial conditions resulted either in tax reduction or expenditure increases, the Federal Government's anti-inflation program would be handicapped. State governments can facilitate the war effort also by providing assistance to defense affected cities, which are required to provide essential governmental services to defense industries and their workers. Unreasonable requests for Federal aid should be avoided; States and municipalities as well as the Federal Government should show an interest in local independence. The States' position with regard to their own claim to exclusive use of motor vehicle taxes will be stronger if request for Federal assistance on account of revenue losses involved in gasoline rationing is delayed until genuine need is evident.

If all local governments were to cut taxes simultaneously, and the Federal Government were to increase its taxes by the same amount because of the local tax reduction, inflation would be largely

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<sup>1/</sup> This was written before the announcement of the recent security issues in the Victory Fund program which goes considerable distance in meeting the needs of the States.

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unaffected and the revenue would accrue to the jurisdiction with the greatest current need. This would also enable the Federal Government to keep its debt at a minimum. The weakness in this solution is that not all the States are likely to act simultaneously, nor is Congress likely to take their action into account. Consequently, the less States disturb their tax systems, the better for the counter-inflation program.

States and municipalities can meet three objectives by surplus financing. This procedure not only will facilitate the anti-inflation program in which these governments have a direct interest. It will also build a reserve to cope with post-war contingencies, including deflation. In the third place the reserve might be useful in the event that Federal tax and control programs lead to a drying up of present revenue sources. The second objective needs further implementation in the development of plans (including blue prints) for post-war public works. Moreover, surplus financing is a new experience for many States and cities and needs legislation to safeguard reserve funds against misapplication. This is no simple problem. Terms of State and municipal officials are often so short that surplus financing is reasonably feared as a possible boon to political rivals of those in power. On the other hand funds must not be so tied that they could not be used in a genuine emergency. Several States and cities have passed legislation implementing a surplus financing program successfully. This experience might well be studied and copied. In addition, if local interest and available surpluses are sufficient to warrant, the Federal Government might implement the program quite successfully by offering the States and municipalities a non-negotiable bond, redeemable after the emergency or upon a showing of a war created need. The program might provide that if the bonds were retained and the funds used for approved post-war public works, the Federal Government would match the savings.

Probably the simplest and most practical solution of the surplus problem is the use of available funds to reduce indebtedness. In case of non-callable serial bonds an effort can be made to induce existing owners to tender their holdings. Very often, too, it is possible to reduce the lag in State and local financing and thus eliminate short term borrowing. New indebtedness can be avoided by financing current improvements out of current revenue.

#### 29. Governmental Reporting

In this day of interdependence and planning there is a strong public interest in adequate information concerning the finances of Federal, State, and local governments. Governmental reporting is

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badly neglected in many parts of the country. Complete reporting and acceptable accounting practices are the exception rather than the rule, and such reports as are gathered are often not strictly comparable. A cooperative attack on the problem, initiated by the Census Bureau and with the participation of State officials, has begun. Further promotion in this direction is definitely in order. The Federal Government could well afford an appropriation to enable the Census Bureau to assume half of the cost of installing approved accounting and reporting systems in the States. Such expenditure might be a good investment from the Federal viewpoint; it would save the Government considerable sums required because of the necessity of going directly to subdivisions for information. A precedent for Federal expenditure of this sort can be found in the outlays to facilitate State and municipal reporting of vital statistics.

The Federal Government leaves important gaps in its own reporting and collecting of financial data. For instance, it does not regularly compile data on the total public revenues and expenditures. Surely in this day of important governmental operation authoritative public information of this kind should be an annual product.

A Federal-State Fiscal Authority could play a vital role in improving our knowledge of intergovernmental relations. It could stimulate research concerning State and local government by State and municipal universities. It could maintain a library and information service in the field of intergovernmental affairs. This might help to counteract the growing idea that only what happens in Washington has any importance.

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**XI. SUMMARY OF RECOMMENDATIONS IN TERMS OF AN ACTION PROGRAM FOR EACH LEVEL OF GOVERNMENT****i. Federal Government.****A. For immediate action.**

1. Negotiate with State representatives and pass legislation to create a Federal-State Fiscal Authority.
2. Amend the income tax law to make State income taxes deductible on an accrual basis even though other expenses are reported on a cash basis.
3. Revise, modernize, and broaden the death tax credit.
4. Give the Federal estates tax a thorough overhauling, integrating death and gift taxes, substantially reducing exemptions and coordinating the Federal and State taxes.
5. Eliminate tax-exempt securities in a manner to secure States and municipalities against loss arising from the taxability of their securities.
6. Defeat discrimination resulting from State community-property laws by providing that they shall not apply in the operation of Federal tax laws.
7. Provide a clearing house and "board of appeals" (Federal-State Fiscal Authority) for more careful and consistent treatment of payments in lieu of property taxes on Federally owned property. Such payments should be generous, especially during the war.
8. Provide a special joint committee of Congress to consider legislative proposals for payments in lieu of taxes; provide facilities for maintaining a permanent inventory of Government property.
9. Allow State sales tax application to contractors working on Government orders.

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10. Modify and improve the coordination and efficiency in unemployment compensation by increasing the Federal credit from 90 to 100 percent and requiring the States to furnish part of the cost of administration.
11. Disallow sales taxes as a deduction in Federal income tax practice; if the deduction is retained, make it general and not conditioned upon certain technicalities in the tax law.
12. Pay more heed to cost of compliance in framing tax laws.
13. Extend the Civil Service coverage to include all personnel engaged in Federal tax administration.
14. Consider the provision of a suitable bond instrumentality for the investment of State and local surplus funds during the war. This might take the form of a non-negotiable bond redeemable after the emergency or upon a showing of war-created need, and to be matched by the Federal Government if used for approved public works. <sup>1/</sup>
15. Continue and enhance cooperative efforts to improve State and local accounting and reporting; provide annual compilation of cost of government and total taxes.
16. Expend more effort on Federal-State collaboration in the administration of overlapping taxes.
17. Repeal the automobile use tax, or, if it is retained, require receipt as a condition for obtaining a State license.
18. Further promote better uniform governmental accounting and reporting.
19. Assume the responsibility of annual calculation and publication of the over-all cost of government and other fundamental fiscal data.

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<sup>1/</sup> Written before recent developments which cover, to some extent, the needs of the States.

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20. Cultivate an attitude which regards States and localities as partners in a joint enterprise.
- B. For immediate or future action.
21. Develop in consultation with the States, standard rules for income and death tax jurisdiction; develop suitable rewards for State compliance with these rules and other suitable procedures so that the Federal Government may serve as an umpire in multiple taxation disputes.
  22. Develop in consultation with the States rules of uniform income tax procedure; promote the adoption of such rules looking toward single administration of a relatively uniform State and Federal income tax.
  23. Adopt a Federal-Collection-State-Sharing program for the tobacco tax.
  24. Enact legislation providing for Federal incorporation of corporations doing an interstate business.
  25. Provide distribution of welfare grants to the States through a graduated bracket system as suggested in the Connally amendment.
- C. For future action.
26. Abandon motor vehicle taxes to the States reserving the right to tax motor fuel used in aviation.
  27. Inaugurate a thorough study of the cost of tax compliance and the burden of multiple taxation on interstate companies; reserve action on centralization of business taxes until this evidence is available.
  28. Use a public investment technique (if necessary) to cope with post-war deflation and unemployment; dual budget; creative public works (health, housing, nutrition, and regional development); full liquidation of outlays.
  29. Reduce repressiveness of the tax system by deemphasizing business taxes and by equalizing burden upon equity-financed companies compared with those financed by means of indebtedness (through a partial credit to the corporation for dividends paid out).

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30. Broaden Federal aid to include relief and elementary education.
31. Broaden the Social Security program to include uncovered groups under old-age insurance and unemployment compensation. This would not only provide more equitable coverage but would also make possible some simplification of payroll taxes.
32. Recognize a national minimum status for elementary education by provision of a differential (equalization) grant.
33. Provide controls which will insure improvement in the division of educational revenues, local districting, and the quality of the educational product, at the same time insuring against coercive interference with local autonomy and minority views concerning education.
34. Provide for Federal scholarships to insure the adequate development of talent through higher education.
35. In the interest of simplification, repeal Federal liquor license fees retaining licenses where needed for administration.

D. Contingent action.

36. If a Federal retail sales tax is enacted, provide legislative implementation and administrative action to insure the fullest cooperative use of State personnel and machinery.

II. State Governments

1. Negotiate with Federal representatives and collaborate in the development of a Federal-State Fiscal Authority.
2. Negotiate with Federal officials and Congress to inaugurate a program for the elimination of tax-exempt securities in such manner as not to embarrass States and municipalities fiscally.
3. Tighten property exemption provisions; relax ceiling and uniformity requirements as to local property tax levies; develop more adequate supervision of property tax administration.

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4. In collaboration with municipalities, refrain from demanding unreasonable war time aid from the Federal Government, thus recognizing the importance of local independence.
5. Apply surplus revenues, where possible, to the elimination of debt and the development of a reserve against war time loss of revenue and post-war need for public works.
6. When revenues will permit, allow Federal income taxes as a deduction in calculating State income taxes.
7. Redouble attack on trade barriers, multiple taxation, and special inducements for the location of industry; use of education, reciprocal agreements, and interstate compact toward these ends; pass legislation allowing credit to new residents for automobile license taxes paid in the same year to other States.
8. Collaborate with the Federal Government looking toward Federal arbitration of jurisdictional disputes and joint determination and promotion of uniform practices in income and business taxation especially with regard to questions of jurisdiction.
9. Further collaborate with the Federal Government in the joint administration of overlapping taxes.
10. Adopt legislation on their own initiative that would make payment of Federal automobile use tax a condition for the receipt of a State license.
11. Mitigate the rotten borough system by providing more adequate representation for cities in State legislatures.
12. Give more consideration to cities in the distribution of shared taxes, particularly motor vehicle taxes.
13. Adopt enabling legislation that would permit cities to supplement the general property tax with a rental tax on occupiers.
14. Adopt enabling legislation that would facilitate surplus financing during war time.
15. Adopt legislation requiring more adequate and more uniform governmental accounting and reporting.

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16. Cultivate an attitude that regards all governments as partners in a joint enterprise.
17. Collaborate with the Federal Government on a broader and more generous program of Federal aids, accepting controls, but insisting that they be cooperatively applied rather than dictated.

### III. Municipal Governments

1. Negotiate with Federal representatives and collaborate in the development of a Federal-State Fiscal Authority.
2. Negotiate with Federal officials and Congress to inaugurate a program for the elimination of tax-exempt securities that will not fiscally embarrass States and municipalities.
3. In collaboration with States, refrain from demanding unreasonable war time aid from the Federal Government, thus recognizing the importance of local independence.
4. Apply surplus revenues, where possible, to the elimination of debt and the development of a reserve against war time loss of revenue and post-war need for public works.
5. Broaden the property tax program by supplementing the property tax with a rental tax on occupiers.
6. Strictly interpret property tax exemptions.
7. Inaugurate a thoroughgoing study of possible new sources of independent local revenue.
8. Study successful procedures for safeguarding reserve funds, and enact legislation needed for this purpose.
9. Develop more metropolitan cooperation and the use of large metropolitan districts for financing functions of common interest.
10. Emphasize raw material producing districts' claim upon aids and shared taxes because their tax base does not represent their contribution to the national product.
11. Demand more equitable representation in State legislatures.

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12. Demand more equitable distribution of shared revenues, particularly motor vehicle taxes.
13. Provide for more adequate governmental accounting and reporting.
14. Cultivate an attitude which regards all governments as partners in a joint enterprise.
15. Prepare for collaboration with the Federal Government in a post-war public investment program.
16. Collaborate with the Federal Government on a broader and more generous program of Federal aid, accepting controls, but insisting that they be cooperatively applied rather than dictated.

December 31, 1942.

My dear Mr. Secretary:

I have your letter of December 30th enclosing a paraphrase of an extract from a cable which you received from General Eisenhower concerning the subject of the rate of exchange between the pound and the dollar and the franc in North and West Africa.

At a conference yesterday morning between representatives of the State, War and Treasury Departments it was agreed that a cable should be prepared by the Treasury giving to General Eisenhower a full justification for the 75 rate. This has been done and a copy of that cable is enclosed herewith. The original has been sent to General Carter for despatch to General Eisenhower.

I have called a meeting for two thirty this afternoon at which Assistant Secretary McCloy and General Carter of your Department will be present, as well as representatives from the State and Treasury Departments and Sir Frederick Phillips of the British Treasury.

Very sincerely yours,

Wendell H. Willkie

Secretary of the Treasury.

Honorable Henry L. Stimson

Secretary of War.

P. S. On account of Cabinet this meeting had to be postponed until next (Jan. 1) year at ten o'clock.

Enclosure.

DWB:ew

December 31, 1942

To Eisenhower

The exchange rate of 75 francs to the dollar was set after careful study of all the facts and after the fullest discussion by interested departments of this Government. The objectives were to fix an exchange rate that would be in the interests of the people of French North and West Africa, that would be fair to American troops stationed in these areas, and that could be expected to be maintained. It is our considered judgment that the rate of 75 francs to the dollar is more likely to achieve these objectives than any rate that sets a higher value on the franc, particularly the former rate of 43.90 francs to the dollar.

It appeared to us wholly unreasonable and impracticable to fix and maintain in French North and West Africa the exchange rate of 43.90 francs to the dollar which prevailed before the war and which was confirmed by the French exchange control regulations of September 3, 1939. In view of the changed conditions, particularly in the past two and one-half years, the economic basis for this rate has entirely disappeared. French North and West Africa have undergone a very considerable inflation which makes the former exchange rate completely untenable. Because of the close monetary ties with continental France, all of the areas of French North and West Africa have been affected by the extreme inflationary forces operating in continental France. The exploitation of the economy

of French North and West Africa for the benefit of the Germans contributed further to the inflation in these areas. Other local conditions of an inflationary character have also tended to reduce the value of the franc in French North and West Africa.

A rate that would have set a higher value on the franc than 75 francs to the dollar would have increased immeasurably the difficulty of maintaining stability of the exchanges and the administration of exchange control. Black markets would inevitably have developed to take advantage of the disparity between the official rate and the real value of local currency. The wider the disparity between the official rate and the rates prevailing in the black market, the greater the incentive to evade the established controls and to deal in the black market. It is clearly preferable to establish an exchange rate that can be maintained without the use of unnecessarily repressive measures. With an exchange rate of 75 francs to the dollar, the controls recently instituted in French North and West Africa should succeed in reducing black market operations and other evasions.

It is not in the immediate or future interests of the people of France and the French Empire to establish an exchange rate that does not reflect the real value of the franc and which cannot be maintained without severely disturbing the economic balance. It is important to stress that after hostilities cease a rate of 75 francs to the dollar can contribute more actively to industrial, financial and business recovery in France than a rate of 43.90 francs to the dollar. A grossly overvalued franc will inevitably pave the way for serious depreciation after the war, at the very time when France would be most eager to manifest strength in her currency rather than weakness. It would appear

that if a further adjustment of the franc rate becomes necessary after the war because of basic disequilibria, it should then be possible for France to make the requisite adjustment, either upward or downward, from a rate of 75 francs to the dollar with less disturbance than from a rate of 43.90 francs to the dollar.

It is possible that economic conditions in some of the smaller French colonial areas could justify a higher value for the local franc in such areas than 75 francs to the dollar. We are not fully enough informed on this point to express a definite view. However, it is hardly likely that during the past two and one-half years these areas have been subjected to any considerable extent to the inflationary forces resulting from German occupation of continental France. Some of these areas have been covered by the credit and financial agreements with Great Britain which have added to the strength of their currency. Under any circumstances, the rate of exchange in such colonial areas cannot be a significant factor in the determination of an appropriate rate for French North and West Africa. Because of the great role of French North and West Africa in the economy of the French Empire, it is of the utmost importance to set the exchange rate for the franc on the basis of economic and monetary conditions in these central areas rather than on conditions in colonial areas of small economic importance.

Moreover, an additional factor which the Army would probably wish to consider is that it would be wholly unfair to American troops stationed in French North and West Africa to require them to accept and use a local currency considerably overvalued in terms of the dollar. In justice to

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these men, the established rate must reflect as far as possible the real value of the local currency in which they are paid and with which they must make their purchases. If the rate of 43.90 francs to the dollar were in effect, an American soldier receiving any part of his pay in French North and West Africa would get for it little more than half of its real value. It would not be long before the American soldier would become aware of that fact. He would feel that he was being unfairly treated by his own Government, and he would tend to lose confidence in those responsible for such arrangements. The difficulties of an overvalued currency, the hardships imposed on American troops using such a currency, and the ill-will engendered under such circumstances are clearly evident in other countries where that situation prevails.

The determination of the exchange rate for French North and West Africa was made with the fullest consideration for the well-being of the French Empire whose cooperation we seek and whose interests we defend. We find it difficult to understand how any one fully cognizant of all the factors in the situation could regard a rate of 43.90 francs to the dollar, or any other rate that places a higher value on the franc, preferable to the rate of 75 francs to the dollar.

MHW/EMB/GRS  
12/31/42

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SECRET

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WAR DEPARTMENT  
CLASSIFIED MESSAGE CENTER

INCOMING MESSAGE

AXWAR 2  
filed 30/1709Z  
am

December 31, 1942

PRIORITY

From: Algiers  
To: AGWAR - USFOR (action)  
No 3561 December 30 1942

After considerable discussion the French are issuing following notice (to AGWAR for Combined Chiefs of Staff and to USFOR for British Chiefs of Staff NAV seventy and to Fiscal Division State and Treasury signed Eisenhower from Murphy and Bernstein from Freedom), our three three five one of two eight one three zero three 3, "In modification of the Avis au Public of November fourteen one nine four two and until further notice all American coins and banknotes bearing the yellow seal on the front right hand side and all British coins and special banknotes bearing the inscription British Military Authority shall continue to be accepted in payment in North Africa and West Africa. They will be exchanged at the offices of the Treasury and those of the Banque de L'Algérie the Banque D'Etat du Maroc the Banque de L'Afrique Occidentale and at all authorized banks on the terms fixed in the Avis au Public of November fourteen one nine four two." Girard is writing following letter to General Eisenhower "Je vous confirme notre entretien d'hier au sujet des taux de change dollar livre franc fixes en Novembre. Seventy five francs le dollar et a three hundred francs la livre jusqu'a revision d'un commun accord. Je demande instamment qu'on reconsidere de toute urgence cette question pour aboutir a une solution definitive et mutuellement equitable qui aura la plus heureuse influence sur l'avenir des relations Franco Americaines."  
(TRANSLATION - "I confirm to you our understanding of yesterday on the subject of the dollar-pound-franc rates

of exchange fixed in November, 75 francs to the dollar and 300 francs to the pound, until a revision by mutual agreement. I earnestly request that the question be reconsidered with great urgency in order to lead to a definitive solution mutually equitable, which would have the happiest influence on the future of Franco-American relations.)

We have just learned that Giraud is adding a sentence referring to rate of exchange fixed for other French colonies. The specified American and British currency and coins will thus be authorized to circulate until sufficient reserves of franc currency are made available in all French African areas. It is also fully understood that as originally agreed to in November negotiations the rate of exchange remains fixed until changed by mutual agreement and the rate of exchange is completely independent of the length of time such American currency is authorized to circulate. We have consistently pointed out that the rate question had received lengthy study in Washington and London and had been carefully considered by the senior officials of State Treasury and War Departments and that Washington was prepared to reconsider fully the problem with French officials in an effort to arrive at a fair solution. Iron who is in charge of Finance Section of High Economic Secretariat submitted a rather inadequate memorandum dealing with the matter which he asked be treated not as an official document but merely as a basis for discussion here. We indicated that any decision would have to be made in Washington and we gave him a memorandum requesting certain detailed information bearing on the problem. Both memoranda were mailed to Washington some days ago. It was agreed that Iron would supply us with this additional information which would then be forwarded Washington for consideration. The additional information has not as yet been received and data and discussions thus far held have not persuaded Treasury officials here as to need on monetary grounds for lowering rate. It is believed that one of the most important considerations influencing present attitude of Giraud is the recently announced British De Gaulle rate of one seven six francs to the pound for Madagascar. We believe that no final decision concerning the rate should be made now but that Iron or any other official designated by the French should be promptly invited to Washington to discuss all angles of the problem with a view to reaching a final decision.

We would at the same time send someone to Washington from here to participate in the discussions. We are also airmailing copies of office memoranda of discussions on financial matters with French officials. Please cable immediately your reactions to the foregoing.

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WAR DEPARTMENT  
WASHINGTON

December 30, 1942.

Honorable Henry Morgenthau,  
Secretary of the Treasury.

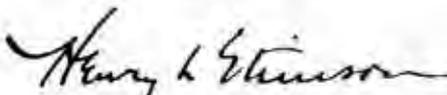
Dear Mr. Secretary:

No. 3351, Dec. 28, 1942

2:30 p.m.

I am inclosing herewith a paraphrase of an extract from a cable which we have received from Eisenhower. As I told you this morning over the telephone, I hope your intervention with the British can afford us some relief in this matter for it is very embarrassing, as you can see.

Very sincerely yours,



Secretary of War.

Incl.

*copies to Mr. White and  
Mr. Lufford*

SECRET

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Algiers  
December 28, 1942.

\* \* \* \* \*

Giraud insists that in the economic field we should give him immediate support in a study and reconsideration of the rate of pound and dollar exchange as against North and West African franc currency. He said that the business world here is in an uproar over the news today that the British authorities have granted to the DeGaulle administration in Madagascar official rate of 176 francs for the pound and 43 for the dollar. He asserts there is no justification that can be found for such discriminatory treatment, neither in the political nor economic field. Giraud recalls that similar discrimination exists in favor of French Equatorial Africa. His advent to civil authority, he maintains, should be coupled with some action on our part which will inspire confidence in his administration. He then said that he has never agreed that the rate of 300 francs for the pound, nor 75 for the dollar was justified in North or West Africa. In the hope that we may give him some encouragement and support, I urge that immediate study be given to this feature.

Although Bernstein is being requested to make a thorough review of this problem from this end, I would like a clear statement of the reasons actuating the decision to insist on the rate of 300 francs for the pound and 75 for the dollar in this area. It is remembered that this question was the subject of long discussion in the weeks preceding Torch. It is becoming an issue here which we must be prepared to meet, and I feel that it should be remembered that North African economy, relieved of the European drain which has existed since the armistice, justifies a more favorable rate from the French point of view than 300 francs to the pound and 75 to the dollar.

Great appreciation was expressed by Giraud of the President's courtesy in sending to him the message transmitted by the State Department on December 24. He reciprocates fully the President's good wishes and expresses fervent desire to prosecute the war to a victorious conclusion.

\* \* \* \* \*

*Paraphrase of Cable No. 3351.  
Dated December 28, 1942*

SECRET

○  
TO LT. COL. BERNARD BERNSTEIN  
U.S. ARMY

VERY HAPPY NEW YEAR  
BEST REGARDS

IS MORGENTHAU

Phoned to Major Hurley  
A.C.S. War Department -  
at 5 P.M. - 12/31/42. He  
promises delivery.

S. Stephens.

12/31/42.

1942 DEC 31 PM 3 00

WU58 (A) CABLE

SANSORIGINE

EFM SECRETARY AND MRS MORGENTHAU

TREASURY DEPT

A MERRY CHRISTMAS AND A HAPPY NEW YEAR ALL WELL

BERNARD BERNSTEIN.

259P

To: Secretary Morgenthau

Date: December 31, 1942

From: Joseph Gaer

Walter Freese of Hastings House came in to see me about a book on war and post-war financing. What he had in mind was a clear and authoritative book which would abandon the generalities of "a people's war" and "a people's peace", and would be devoted to a lucid discussion on how the foundations of a lasting peace can be built. Such a work would involve the appraisal of existing natural resources, population, and skills, and how they are distributed in the world; the place of science and engineering in post-war planning; the engineering developments needed to bring skills and materials together toward the raising of living standards everywhere; and how we ought to finance the war and the immediate post-war period to make such a plan or plans realizable.

Because of its many implications, Mr. Freese felt that such a book should be prepared by someone high in the Administration. Wallace's name was first suggested. But the book we visualize would have to deal with specific facts and concrete recommendations to which Mr. Wallace may not freely subscribe. It seemed to us that the one person to do this book in a forthright manner which would command respect and attention would be yourself.

I have tried to find out how great a task it would be to gather up the needed data on natural resources, population, skills, etc., and I am assured that these can be readily assembled. Mr. Alexander Taub, Chief Engineer of the Board of Economic Warfare, and men like him will be very helpful in getting the data and in outlining the place of the engineer in a post-war world. I am not myself sufficiently conversant with finances to be of great help in such a task and, also, I am at present preoccupied with the work I am doing for the education press and the youth organizations. But if the idea appeals to you and you should wish to consider to do such a book, I am certain you can find able assistance to do the research for you and to help you whip the book into shape.

I should also mention that should such a book be written, it will not necessarily have to bear the Hastings House imprint. Mr. Freese would, of course, like to be the publisher but, as a New Deal liberal, he is primarily interested in seeing such a book printed in a way that it will receive the widest attention and the largest audience.

**SECRET**

Minutes of the Meeting of the Board of Economic Warfare  
Held December 31, 1942, at 10:00 a.m.

A meeting of the Board of Economic Warfare was held in the Vice President's office in the Capitol Building at 10:00 a.m. on December 31, 1942.

Those present:

The Vice President, Chairman of the Board  
 Mr. Dean Acheson, representing the Secretary of State  
 The Secretary of the Treasury  
 Mr. Robert Patterson, representing the Secretary of War  
 Mr. Charles Fahy, representing the Attorney General  
 The Secretary of the Navy  
 Mr. Leslie Wheeler, representing the Secretary of Agriculture  
 The Secretary of Commerce  
 Mr. Nelson Rockefeller, Coordinator of Inter-American Affairs  
 Mr. William Batt, representing the Chairman, War Production Board  
 Mr. Bernhard Knollenberg, representing the Lend Lease Administration

In addition, the following persons were present:

Mr. W. L. Clayton, Department of Commerce  
 Mr. Harry White, Treasury Department  
 Mr. Herbert Feis, State Department  
 Mr. J. D. McCron, Office of Coordinator of Inter-American Affairs  
 Mr. Emilio Collado, Department of State  
 Mr. Lawrence T. Duggan, Department of State  
 Mr. John E. Lockwood, Office of Coordinator of Inter-American Affairs  
 Mr. Adlai Stevenson, Navy Department  
 Mr. Harold H. Neff, War Department  
 Mr. John Clark, Office of the Coordinator of Inter-American Affairs  
 Mr. Milo Perkins, Board of Economic Warfare  
 Mr. Arthur Paul, Board of Economic Warfare  
 Mr. Frank Coe, Board of Economic Warfare  
 Mr. E. J. Gaumnitz, Board of Economic Warfare

The meeting was opened by the Vice President who indicated the first subject was Bolivian tin. He summarized the United States tin position briefly, indicating that there was on hand approximately a two years' supply of tin and that while previously a large percentage of our tin had come from the Far East, at the present time our supplies were coming from Bolivia and Africa, with approximately 20,000 tons or half of our importations coming from Bolivia. With a limited tin supply and reduced importations every effort had been made to decrease domestic usage through such efforts as substitution of glass for tin, and to decrease the quantity of tin used for canned goods for domestic consumption, there being approximately 40 per cent of usual canned goods supplies available for domestic consumption. These facts indicate that consumers are going to become more interested in tin and

The Vice President stated that he anticipated that tin would be one of our most serious problems. The total Bolivian production is around 20,000 tons per year. The recent strike at the Patino Mine was therefore of importance. The Patino Mine produces approximately half of the Bolivian total production. The United Kingdom secures 15,000 tons of tin from Bolivia, all of it from the Patino Mine. It is unlikely that the United States will secure any tin from the Patino Mines in 1936 due to the strike.

The Vice President indicated that he had been going over some of the documents on tin. He referred to a letter to Mr. Bridgman of Metals Reserve written by the second largest Bolivian mine owner in which there was reference made to a labor clause which the writer thought inadvisable. The letter also indicated that miners commonly chewed coca because there was insufficient food and that labor was perhaps about one-sixth as efficient as might be expected. Upon question the Vice President indicated that Coca is a leaf which upon chewing apparently deadens feeling and therefore gave the effect of no hunger and of increased endurance. Therefore, workers were likely to work until exhausted and then would leave the mines, and go back to the farms where they got food and rest. He pointed out that the importance of the strike was its effect on tin production, but that in addition the President had expressed concern over a situation of this kind developing which would be reported as evidence of United States exploitation, thereby aiding Axis propaganda. The Vice President stated that other correspondence indicated that the Board of Economic Warfare staff had knowledge of the labor situation, and should have brought it to the attention of the Board earlier or taken corrective action.

The Vice President asked whether Mr. Acheson had any additional information. Mr. Acheson indicated that it was his understanding that a proposal had been advanced by the Ambassador from Bolivia and referred to Mr. Duggan. Mr. Duggan said that about two weeks ago the Bolivian Ambassador had expressed privately his concern over the situation in the mines and suggested that an investigation should be made jointly to get the facts, but that no formal proposal had been made at that time. Yesterday in discussing the matter further with the Bolivian Ambassador, the Bolivian Ambassador said he was prepared officially to ask for a joint study on labor conditions. The Bolivian government is suggesting that the United States send two or three people to work jointly with an equal number of people representing the Bolivian government, the committee to report back to the two governments. There had been some discussion of this proposal in the Department of State and it was State's opinion that the proposal gave the possibility of determining the facts and should be accepted.

The question having been raised by Mr. Morgenthau as to what the committee instruction should be, Mr. Duggan stated that there were a complexity of factors involved, such as the amount of food available locally, and transportation facilities between Bolivia and Argentina (an important source of food).

Mr. Morgenthau stated that his question was what was the objective of

the committee, i.e., to determine whether it was possible to have a decent standard of living, the desirability of labor clauses, or to whitewash the situation. His understanding was that previously laborers were paid ten cents a day, now they were paid 20 cents.

The Vice President said that he assumed that Bolivia would like to see standards of living raised. He drew attention to the fact that the United States had raised the price of tin last June from 48 1/2 cents to 62-3/4 cents per pound, the increase being retroactive to January 1. It was alleged, however, that of this increase in price less than 2 cents per pound had gone to the workers. He had no information as to how much of the increase was necessitated by taxes, etc. He indicated that some available data led him to believe that the tax situation was rather bad. Other reports indicated that Patino profits had increased materially. It was quite possible of course that the Patino mine which was reported to be an efficiently operated mine would have a profitable operation when other mines less efficient might show losses. The increase in prices therefore might easily enable unprofitable mines to operate at the same time resulting in large profits for Patino mines.

Mr. Clayton said that the 20 cent wage statement was contrary to his information. Mining people had informed him that wages were around a dollar a day and further that since the increase in the price of tin that wages had been increased 30 per cent. He also indicated that the Bolivian taxes were on the product, not income, and therefore bore heavily on owners of inefficient mines. There was no question but that owners of the Patino mines and perhaps two or three other mines were making large profits. It was his thought that the Bolivians could correct the situation themselves. He stated that the Bolivian government could secure facts, and it was clear that those who control the mines probably also control the Government.

Mr. Clayton also said that the level of tin production had been fairly good until the strike, although poorer mines were being worked. Actually production this year would be a little less than last year, though better than in 1936. He indicated that the price had been increased last summer because of an increase in costs which had taken place after the original price had been negotiated.

Mr. Rockefeller stated that he had very few facts, but his information was that wages ranged from 15 cents to 65 cents a day in the mines, though a mere statement of money wages was not significant by itself.

Mr. White said that the workers in striking apparently asked for a hundred per cent increase in wages and were objecting to the way the company stores were being handled--undoubtedly the workers wanted better conditions. It was his thought that the United States would be blamed for the labor conditions.

Mr. Rockefeller stated that he thought the case against the United States was not very good and that the strike was partly political. Mr. Acheson thought that to determine the facts it would be necessary

to send people to Bolivia. He indicated that any figures that could readily be secured were probably not reliable.

Mr. Perkins stated that his information indicated that the transportation situation was in need of improvement. Recently two locomotives were licensed to be shipped to Argentina, but of course there was no certainty that the locomotives would be used on the railroads between Argentina and Bolivia. The company store deal he thought should also be checked rather carefully. He stated further that the possibility of working directly with the mine operators and workers should be explored. He also pointed out that the United States exports of food to Bolivia were unimportant and that even though wage rates were important, a mere increase in wage rates wouldn't guarantee supplies of foods. He favored the mission idea. Apparently it was necessary for the Indians to go back to the farms in order to get something to eat, the result being to decrease the labor supply. He suggested that the mission study particularly the food and company store situation. If the situation were not improved, it was clear that we would get reduced volumes of both tin and tungsten.

Mr. Perkins also pointed out that mine owners were aware of the fact that in normal times it was possible to produce tin more cheaply in the Far West. Undoubtedly mine owners were afraid of high labor costs. He thought there might be a point in the United States subsidizing food and in relating food prices to wages.

Mr. Rockefeller stated that in October of 1941 a mine man mission had been sent to Bolivia. That mission's report indicated that food valued at around 25,000,000 was imported into Bolivia and recommended an increase in domestic food production. In July 1942 representatives of the Coordinator's Office had again recommended that steps be taken to increase domestic food production. However, in the latter part of 1942 reports from the American Ambassador indicated that the food situation was satisfactory.

Mr. Rockefeller suggested the necessity of an action program for increasing food production. He stated that the Bolivian Development Corporation has the funds to do the job. He thought that two steps might be taken; first, an attempt to get food production started under the Development Corporation and secondly, have a mission study the labor situation.

In response to a question by Mr. Knox, Mr. Clayton said the Bolivian Development Corporation funds came from the Export-Import Bank and that Reconstruction Finance Corporation controlled as long as the loan was outstanding, expenditures being subject to Reconstruction Finance Corporation approval.

Mr. Perkins stated that increased agricultural production was a longer term program and if we were to get increased tin production, it would be necessary to determine what was necessary at this time. If those steps involved better living standards, then proper steps should be taken.

Mr. Rockefeller said that his office was prepared with its health, sanitation, safety, and disease control program which could be extended to

Bolivia.

The Vice President again raised the question as to the general theory that if workers were too well paid they wouldn't do any work. Mr. Jones indicated that the theory was probably the same as that was mentioned elsewhere.

Mr. Rockefeller stated that if the problem was that of utilizing food so as to get increased production, possibly the serving of lunches at the mines might be considered.

Mr. White stated that he thought the whole problem was much broader, and referred to the Vice President's statement. He pointed out that whatever happens in Bolivia is undoubtedly going to be known in other areas. If the situation were badly handled in Bolivia, the United States would be held responsible and action there would be taken as an expression of the United States' attitude toward labor. If we permitted bad labor conditions to continue in Bolivia, we would be permitting a thing which we were not subscribing to publicly. Certainly workers would raise the question as to what we were fighting for. Workers in Bolivia apparently were asking for the right to organize. It was his thought that any report that was made should also clearly state the United States stands with reference to general social advances.

The Vice President thought that Mr. White's point had merit. The United States should attempt to see that justice was obtained, so far as it was possible without stirring up internal Bolivian affairs. However, if Bolivia is asking for United States cooperation, then it would seem there would be no difficulty in taking action.

Mr. White thought the committee should bring out the facts of the situation clearly and stated that if the report indicated a liberal labor policy on the part of the United States it would undoubtedly have a good effect within the United States also.

The Vice President said also that in the correspondence which he had reviewed it was indicated that one of the Mexican labor leaders, now the C.T.A. head, Leonardo Toladano, had indicated his concern over the Bolivian situation.

Mr. Jones stated that he thought the committee idea was merit, but instructions to the committee should be clear. It seemed to him that representatives of State, Coordinator's office and of the Federal Bureau of Investigation should be able to get the facts very quickly prior to the sending of any mission. He suggested further that if it were possible to secure a fair statement of facts prior to the departure of any mission, the mission might then be in a position to institute certain actions while in Bolivia.

Mr. Perkins said he thought Mr. Jones' suggestion in point since if the proper people were selected for the mission, it might be possible to secure action at once. For example, if the mission included representatives of the Coordinator's office, Reconstruction Finance Corporation, Board of Economic Warfare, and State, then it might be possible to have those agencies start action programs before the mission

and made its complete report. He pointed out again that the trouble in Bolivia was almost certain to spread elsewhere in the Southern Hemisphere.

Mr. Jones again stated that he thought it was a fairly delicate situation and he thought the Federal Bureau of Investigation ought to investigate. The Vice President stated that he thought that if the Federal Bureau of Investigation investigated it might possibly find that somebody connected with the strike had the idea of a Bolivian revolution. While something of that sort might be discovered on the part of a person or two, he thought that undoubtedly the real cause of the strike was living conditions.

Mr. Egan stated that he thought that there was a real labor problem, that undoubtedly there would be some improvement in conditions. However, he pointed out that there were involved primarily four sets of mining interests and suggested that an attempt be made to have a meeting with the representatives of those four groups for the purpose of securing their cooperation. If their cooperation could be secured, the chances of the mission being successful would be improved. He thought there was no question that Bolivian mines generally were high-cost mines and the only reason tin had been mined in the past was because the price of tin had been maintained under an international tin agreement.

The Vice President suggested that the mission might submit a report covering two phases. First, those factors which might result in increased tin production at once and second those factors which might involve a longer time economic program, possibly including agricultural production.

It was pointed out that the mission should include representatives of State, Board of Economic Warfare and the Coordinator's Office so that desirable actions could be instituted at once, and should also include specialists on mining, labor, and agriculture.

Mr. Anderson stated that some meetings had been held with reference to a mission, and that he would undertake to convene the agencies involved for the purpose of expediting action.

#### Dollar Balance:

The Vice President stated that at the last meeting it was decided to establish a committee to review and recommend governmental policy on the dollar position of the British Empire and related problems. After the meeting he has found that the Treasury Department had called a meeting for the following day and it appeared desirable to modify the Board committee in view of that fact. The technical sub-committee had been reconstituted for the dollar study with Mr. White as Chairman and there was also a meeting of certain cabinet officers with Mr. Stettinius and the Vice President to look at the matter from a broad standpoint.

The Vice President then asked that Mr. White review briefly the report of the committee on dollar balances. Mr. White reported that the sub-committee had directed its attention to three questions. First, criteria for determining the level at which United Kingdom dollar

balances should be held. The sub-committee had recommended that those balances should be held somewhere between 1,600,000 and 2,000,000, second, the level at which the South African dollar balance should be held. The sub-committee determined that the South African dollar balances were more than adequate at the present time and recommended remedial action. Third, whether the British Empire dollar position should be considered as a single unit, omitting Canada. The committee had recommended that South Africa, Australia, and New Zealand, as well as Canada be considered separately and that the rest of the British Empire be taken as a unit, with a reservation with reference to India, the Indian situation having certain political aspects. The Indian question had therefore been referred to State for consideration with representatives of the British Government. Mr. White indicated that colonies were not to be distinguished from the British Empire. He also stated that the final decision would be made by the cabinet committee which had not yet signed the report.

Mr. Clayton said he was concerned over the purchases which the United States was making in the British Empire. Last year for example the Reconstruction Finance Corporation had purchased goods in the British Empire amounting to around \$200,000,000. He stated that the question of government policy would be raised when it became apparent that we were supplying the British Empire with materials under Lend Lease and at the same time paying cash for the products being purchased from the Empire.

Mr. White stated that the sub-committee recommendations covered the point raised by Mr. Clayton and also included recommendations as to the steps that might be taken in the event that balances became higher than those stated. Those steps were reduction in Lend Lease exports, procurement of supplies on reciprocal aid, and receipt of sterling as reciprocal aid.

Mr. Anderson said he understood that the policy was that Lend Lease should be kept within the limits stated by the committee and that the question of how adjustments should be made was left open.

Mr. White stated that it was understood that the committee recommendations were made under present conditions and that it might be possible that the situation would change sufficiently to warrant modification of the limits proposed. However, all the members had agreed on the conclusions of the committee.

Mr. Clayton stated that some other means of increasing dollar balance should be developed rather than our paying for articles purchased from the Empire.

In this connection, Mr. Knollenberg stated that handsets and mahogany were two items the purchase of which on a cash basis would be difficult.

The question of British security holdings was discussed, and it was developed that Reconstruction Finance Corporation held a large part of such holdings, which, however, had not been liquidated. The question of forced liquidation of such holdings was not answered.

Questions other than Lead Lease:

It was indicated that a number of questions raised at the last meeting had not yet been answered. Mr. Coy had suggested that agency representatives be designated to work on certain questions not considered by the technical sub-committee headed by Mr. White. It was the consensus that Mr. Coy's sub-committee might well attack such problems as the "Criteria for Using Cash Reimbursable Lead Lease," "Subsidy Policy on Foreign Purchases and Development."

It was recognized that the sub-committee headed by Mr. Coy might wish to ask for further instructions as to the field which it was to cover.

Gold Policy in Latin America:

At Mr. Rockefeller's suggestion the Vice President raised the question of policy with reference to the shipment of supplies for gold mining in Latin America.

Mr. Rockefeller stated that the Coordinator's Office wished the information so that it could outline plans for its work, mentioning Nicaragua specifically, stating that if no gold mining equipment were shipped from the United States to Nicaragua there would be a serious employment problem.

Mr. Perkins stated that the Board of Economic Warfare's attitude on this question was clear--gold mining was useless under war conditions. However, he understood that Mr. Mellon in the case of Nicaragua had indicated that gold mining equipment should be shipped for political reasons.

Mr. White stated that it was his understanding that War Production Board's policy was quite clear--no gold mining equipment was to be sent except as shipments might be dictated by considerations other than those involving critical materials and shipping.

Mr. Batt said that War Production Board had received a letter from the State Department which according to his recollection requested War Production Board to be guided in its gold policy as follows: for Honduras, hold the present level; for South Africa, cut down; for South America, eliminate, except for Colombia and Nicaragua.

In response to a question by Mr. Patterson as to the effect of decisions as to exportation of gold mining equipment and materials, Mr. Perkins stated that the Board of Economic Warfare handles the licensing of gold mining equipment under commercial shipments, that the Board of Economic Warfare must in turn secure critical or strategic materials for this purpose from War Production Board, and that political considerations involved could originate with State.

Upon the suggestion of the Vice President that a report be prepared for the next meeting, Mr. Perkins said that he would make such a report but he drew attention to the fact that such report had been made to the Board with reference to South Africa, action decided

upon, but while that had been over two months ago, no action had as yet been taken.

Bauxite:

Mr. Batt stated that data in the hands of the Combined Raw Materials Board indicate that importations of bauxite from the Guianas would probably cease in 1943. Up to the present time we had been bringing in 250,000 to 300,000 tons per month. However, War Production Board had been attempting to make the United States independent of importations and originally it had been anticipated that the United States would be on a self-sufficient basis in June or July of 1943. It also appears that bauxite supplies in Jamaica now offer a possibility with shipping distances now being greatly in its favor. It was his information that the Canadians were ready to begin operations in Jamaica. Indications were that the United States might get as much as a million tons a year from that source.

He indicated that he had mentioned this matter to the British as it related to the British Guiana territory.

Mr. Batt stated that he was bringing it up in Board purely as a matter of information.

The meeting adjourned at 12:15 P.M.

**TREASURY DEPARTMENT**  
**INTER OFFICE COMMUNICATION**

**DATE** December 31, 1942

**TO** Secretary Morgenthau  
**FROM** Ferdinand Kuhn, Jr.

Here is a copy of my telegram authorizing Mr. Murray to go ahead with the Treasury Star Parade recordings last January.

*F. K.*

Attachment

STANDARD FORM NO. 14A  
 APPROVED BY THE PRESIDENT  
 MARCH 10, 1926

C O P Y

# TELEGRAM

OFFICIAL BUSINESS—GOVERNMENT RATES

TREASURY DEPARTMENT  
 WASHINGTON

CHARGE TREASURY DEPARTMENT, APPROPRIATION FOR  
 Defense Savings - Expenses of Loans

(The appropriation from which payable must be stated on above line)

U. S. GOVERNMENT PRINTING OFFICE 2-14117

January 16, 1942

Mr. William Murray,  
 333 East 57th Street,  
 New York City.

TALKED WITH VINCE WHO IS ENTHUSIASTIC ABOUT YOUR IDEAS.  
 DELIGHTED IF YOU WILL TAKE FULL RESPONSIBILITY FOR THESE  
 PROPOSED TRANSCRIPTIONS. BEST REGARDS.

Ferdinand Kuhn, Jr.

FK/cgk

## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE December 31, 1942

TO Secretary Morgenthau  
FROM Ferdinand Kuhn, Jr.

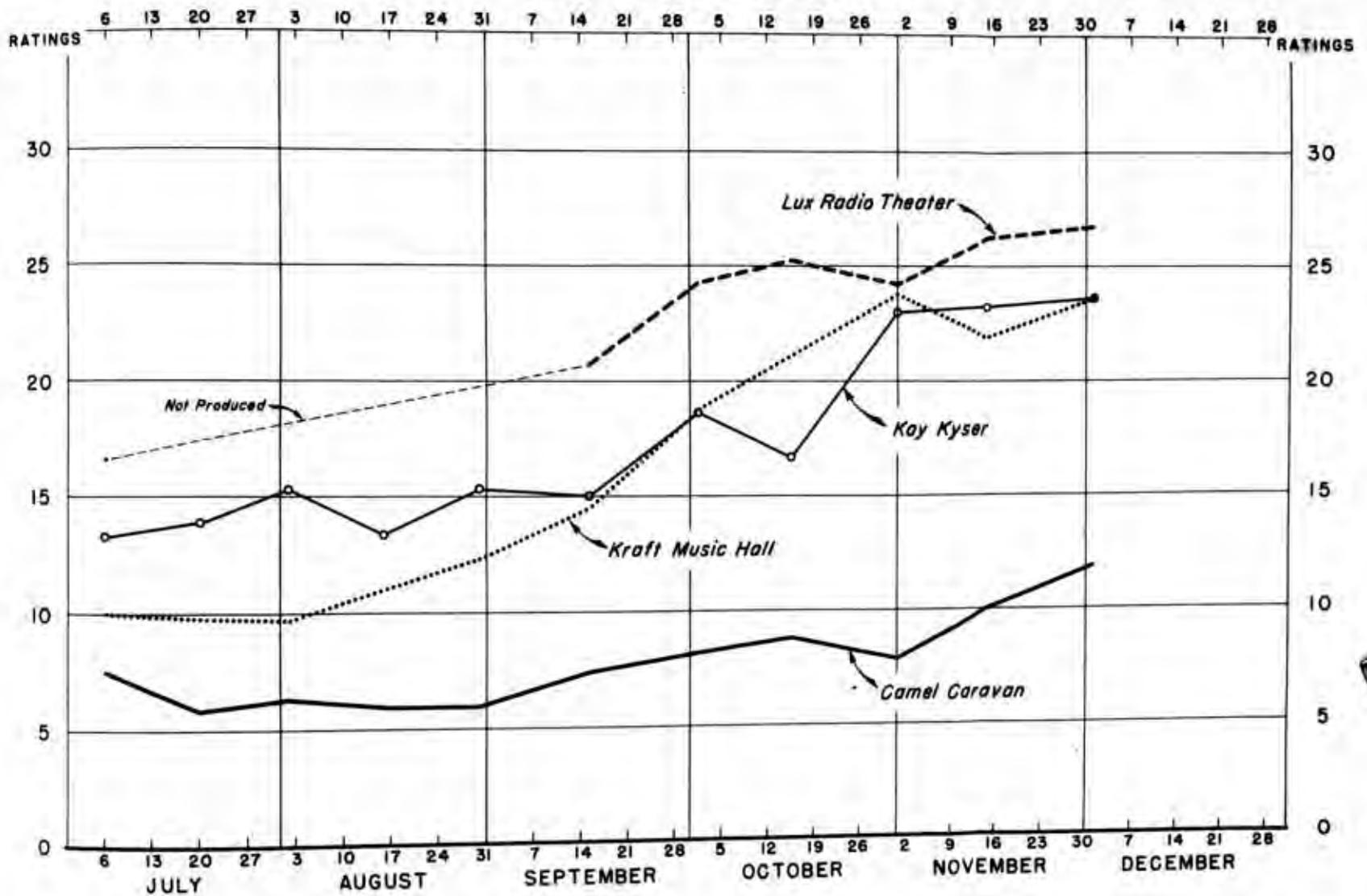
Here is Mr. Tickton's chart on the relative popularity of Mr. Bacher's Camel Caravan and other leading one-hour radio shows. There was no Camel show before Mr. Bacher began it in July, so this chart does not go ahead of that date.

*F. K.*

Attachment

# HOOPER RATINGS OF LEADING ONE HOUR RADIO PROGRAMS

## July - December 1942



## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE

Dec. 31, 1942

TO Mrs. Klotz  
FROM Joseph Gaer

I am attaching a memorandum to the Secretary and a carbon copy of "Yours for Victory". This bulletin will be printed in gravure and illustrated and will be distributed to about 4½ million junior high school and high school students enrolled in the American Junior Red Cross.

'X O H R R E O R I A O R I'

AMERICAN JUNIOR RED CROSS

A "SCHOOLS AT WAR" BULLETIN

Prepared by

EDUCATION SECTION, WAR SAVINGS STAFF,  
U. S. TREASURY DEPARTMENT

In collaboration with

THE AMERICAN JUNIOR RED CROSS

Recd. 4.21.43

(Letter from Herman Davis to come).

THE ROD OF VICTORY

Hitler, according to a popular story, stood one day on the shores at Dieppe, looking longingly across the English Channel and feeling very sad.

"I wonder", he mused aloud, "how I can possibly get across to conquer England."

"Your problem", said a wise old Frenchman who overheard him, "is really not much different from that of Moses, 3,000 years ago, when he wanted to lead his people across the Red Sea."

"How did Moses do it?" Hitler asked eagerly.

"Well, you see, Moses had a certain rod with which he separated the waters of the sea and led his people safely across."

"And where is that rod now?" Hitler demanded.

"That rod", the old Frenchman replied laconically, "is now in the British Museum."

And that is really the way it is. The rod that will enable victorious armies to cross the Atlantic and Pacific Oceans, and all the oceans, seas, channels, straits and bays uniting these oceans -- that rod is safely in the hands of the United Nations.

But the rod of victory is merely a symbol and a figure of speech.

### THE FIVE M'S

The outcome of this war depends on five M's. On their combined strength depends our victory.

The first M stands for Men. A war cannot be fought without healthy and well-trained soldiers and sailors, marines and aviators. The side that has the greater number of better trained, more determined men has the greater chance in any battle. Not only the men in the Service count but also all the people, young as well as old, who are behind our fighting men. We of the United Nations have fighters and their supporters in greater numbers than the Axis powers. The United Nations together have more than three times as many people as are to be found in the Axis countries, including the people under their domination in occupied countries. And the people in the invaded countries can be exploited only as long as the tide of battle is in the Axis favor. The people of the occupied countries are at heart our allies, waiting for deliverance, and eager to turn against their Axis oppressors.

The second M stands for Machines. Manpower alone cannot win modern battles. The men in the Service must be supplied with guns, tanks, airplanes, submarines, and a vast array of other types of fighting machines. These machines must be as modern that they can match and surpass any of the machines of the enemy and they must have them in greater numbers than the machines the enemy has. We have

these machines and we have the capacity to produce them in greater numbers than the enemy. Axis propaganda has led many gullible people to believe that the Germans or the Japanese have secret weapons endowed with invincible powers. Our military leaders know that the enemy does not use magic. The Axis belligerents had at first the advantage of the accumulation of great stores of war weapons which they had secretly accumulated during a period of several years of secret preparation. But the United Nations have already caught up with them and are now quickly surpassing them in the production of war machinery. We can and shall produce the needed machines to assure us victory.

The third M stands for Material. To send out men wherever they are needed and to keep them supplied with all their needs, we must have the food and the clothing and the necessary transportation and the raw materials to keep the production lines for weapons uninterrupted. We have a preponderant amount of the necessary natural resources such as iron and steel, oil and gasoline, and so on. The United Nations have nearly 97% of the world's crude oil; 70% of the world's coal production; over 68% of the world's steel productive capacity, and so on. If we are short in some strategic material, we can and we will develop adequate substitutes before very long.

The fourth M stands for Money. War is costly. This is the costliest war the world has ever known. In one day the United States alone spends almost twice as much as we spent on the entire Revolutionary War. These war expenses must be paid and we, the people,

must pay for them. This is a people's war and there is no one else but the people who can pay for it. One way to raise the money for the war effort, at least part of it, is through the sale of government bonds and stamps - not to just a few bankers and financiers - but to all people. The people are not asked to give this money to the Government; but are asked to lend it to our government, redeemable later with interest. The Government does not ask the people to give their money for the war effort but lend it so that, when the war is over, the people can spend it. That will assure us two things: (1) It will help keep consumer prices from rising during the war and prevent inflation now; and (2) there will be sufficient money in the pockets of every citizen to spend after the war to prevent suffering through the period of economic readjustment.

The fifth M stands for Morale. To achieve victory, in addition to Men, Machines, Material, and Money, we must also have Morale. We must have the conviction of the justness of the cause for which we are willing to give our lives, if necessary. This conviction we have. We believe in democracy which means that we believe in the rights of the common man. That includes all of us. The essence of our democratic convictions has been clearly expressed in our Declaration of Independence: "We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are life, liberty and the pursuit of Happiness."

"WE HOLD THESE TRUTHS....."

1. We believe that "all men are created equal"-- no individual or group of individuals may claim rights for themselves which they deny to others because of economic or racial differences.
2. We believe in freedom of religion -- no individual or group of individuals may prevent others from exercising their right to worship according to the dictates of their conscience.
3. We believe in freedom from fear -- no individual or group of individuals shall have the right to intimidate others through economic or political power.
4. We believe in freedom of speech -- all citizens have equal rights to express their opinions on any matter affecting their lives and the welfare of their communities.
5. We believe in freedom of the press -- the people have the right to know all the facts (excepting such facts as would be helpful to our enemies in wartime); and they have the right to publish any criticism of the Government or any institution.
6. We believe in freedom from want -- through the establishment of adequate social security legislation and administration to protect the aged, the dependent child and mother, the physically handicapped, and workers during periods of unemployment.

7. We believe in the rights of labor -- all men who are engaged in the production of goods or in useful services have the right to protect their group interests through organizations of their own which also respect the interests of the general public.
8. We believe in the freedom of opportunity -- that all people should be given equal advantages through public education and equitable laws.
9. We believe in education for living -- our entire system of education and law shall prepare the people for a richer life.
10. We believe in majority rule -- through the use of the ballot the majority of the people should determine what they believe is best for them and the minority should abide by the majority decision.

These are the beliefs we profess -- these are our democratic ideals.

THE AMERICAN JUNIOR RED CROSS MEMBERSHIP

Now more than ever before in our history we have the opportunity to prove how much we really do believe in the things we profess. High school Junior Red Cross members should show how much they believe in American ideals by supporting a maximum program of Junior Red Cross services and production. This is the time to work, serve, sacrifice, and save "until it hurts". If we do not, then the way of life we are defending is not as dear to us as we pretend.

All of you are proud in wartime to perform duties to the utmost of your abilities. Indeed you have already surprised a good many adults who were under the impression that high school students are "soft". There is ample evidence that high school boys and girls in these times are discharging their responsibilities on as great a scale as adults. In fact at no time in many years have older boys and girls considered themselves closer to adult responsibilities than now.

Some high school boys have already entered the armed forces. Others are now registering for selective service. Vast numbers are taking pre-induction training courses. Many boys and girls are training for or already engaged in direct community service, or are preparing to step into industry soon, or are doing increased farm work now. High school members of Junior Red Cross have made millions of articles for men in the armed services, as well as for government hospitals and community institutions. Hundreds of thousands are taking Red Cross

courses in First Aid, Accident Prevention, Water Safety, Swimming, Home Nursing, Canteen and Nutrition. By their present efforts high school youth are acquiring an adult understanding of their own democracy and of the issues of this war.

The understanding of the issues and aims of this war is of paramount importance. Every high school member of the Junior Red Cross should know and understand the Atlantic Charter, the "Four Freedoms", and other statements made by the United Nations on our war aims and peace aims. It is the duty of our people to gain a clear understanding of what we are fighting against and what we are fighting for in this war.

Finally there is the matter of gainful employment. A larger number of high school youth is now engaged in part-time employment than ever before. Shoulder to shoulder with adults, they are helping to do those parts of the Nation's wartime work that are appropriate to their years. The current widespread part-time employment of high school students should cause all to budget their incomes as most adults are doing in wartime. Wise management of your wartime earnings means not buying anything you do not need and spending less on ordinary peacetime amusements and attractions. Use part of your funds for real essentials; devote the balance to War Savings and donations to the Red Cross programs.

Through purchasing War Stamps and Bonds you support our fighting forces. By so doing you also conserve necessary materials. You also make an investment which is safe and earns interest for you.

Your purchase is more than a good financial investment. It is also an investment in democracy and freedom. With every stamp and bond you are buying a share in America.

Through donating to the financial needs of the Junior Red Cross program, you do not make an investment in the ordinary sense. No money comes back to you. But you are directly aiding the war effort. And your gift is an investment in a world-wide humanitarian service. YOUR Junior Red Cross money contribution is YOUR dedication to the faith that a better world for yourselves and for others is possible - for YOUR own community, for YOUR nation, and for other boys and girls in many parts of YOUR world who have suffered as you have not. For these reasons, your contribution to the Junior Red Cross Local Service Fund, the National Children's Fund, and the Red Cross War Fund, also buys for you a share in America, and in the larger world of mankind.

In your Junior Red Cross Council meetings you should discuss ways and means of encouraging every member to purchase War Savings Stamps and Bonds with regularity. Junior Red Cross members should also help promote the sale of War Stamps in their school. They can do this by making attractive posters about War Bonds and Stamps to put on school bulletin boards. They can help in other forms of publicity and education concerning this program. Capable members could speak before community service groups, explaining the War Savings Program and how Junior Red Cross members are aiding it. The War Savings Program is your own personal local program, not something far away. Its success depends on each one of you and affects each one of you, now and in the future.

Likewise include in your individual budget a fraction for donations to such social welfare programs as War Savings are not intended to support. A large number of these are financed by your Junior Red Cross. Support them by contributions from your own personal earnings and sacrifices. Let this support be over and beyond the other help that you may be giving to your own Junior Red Cross through production work, community services, or group earnings. The story of any unselfish service well done is a story of planning or organization, of service or production and of generous giving in order to make the goal ahead realizable. The first chapter of the story is necessarily money. Voluntary contributions to practical humanitarian causes are needed now more than ever. You will do your part.

### IF YOU ARE AN MAJORITY

Many high school boys and girls today have or can have part-time employment. Since the war effort absorbs practically all our manpower, and adults with needed skills must work harder and longer than ever before, there is an opportunity for young people to render valuable service in the community and at the same time earn substantial sums of money.

Those who can find regular part-time work can render the greater service. Others may find occasional tasks. Boys, for instance, can canvass the blocks in which they live and offer to clear furnace ashes away each week for a fixed fee; clear the snow from sidewalks and paths; fix leaking taps; help in the preparation of victory gardens; run errands for neighborhood stores - the list can be extended almost indefinitely.

Girls can arrange to take care of young children to relieve mothers to go shopping or to go out for recreation; they can help in various home tasks; or a group of girls can get together and decide to make and sell War Stamp coverages which are easy to make and which net the makers considerable profit.\*

The money earned by boys and girls should not be spent recklessly. If boys and girls spend their money for unnecessary things, the damage will be greater than the good they may do by their services. All earners should make it a rule not to buy anything which is not absolutely needed. They should donate some of their savings to the Red Cross programs and invest the rest in War Savings Stamps and Bonds.

\* Any girl or group of girls wishing information on material for War Stamp Coverages should write to: War Stamp Coverage Committee, War Savings Staff, 105 West Adams Street, Chicago, Illinois.

**KEEP ON LEARNING -- KEEP ON TALKING**

We are at war against Fascism and for democracy. The Fascist way of life is entirely different from and antagonistic to the democratic way of life. The first major difference between these two ways of life is: Under Fascism the citizen is expected to obey, without question and without understanding, every command issued by his superiors; in a democracy it is the citizen's right and even his duty to understand what is going on, to question, to discuss openly, and to express opinions until he clearly understands the arguments for or against anything the government does. All topics affecting the citizen's life and his future are subject to his scrutiny and approval.

Even though we are at war, young people should organize to discuss various questions pertaining to the war and the peace to follow. Junior Red Cross members should set aside a specified time in their council meetings for the discussion of topics in which they are interested. Some of the topics they could profitably consider are: The causes and aims of war; the responsibilities of all citizens and more particularly young people in a total war; rationing, price control, conservation, war savings, and other wartime measures; taxation, inflation, and how we should finance this war; our relations with the United Nations now and after the war; what we mean by "a people's war" and "a people's peace"; and the place of youth in a post-war world.\*

Never forget this: To keep freedom of speech alive - the first freedom on the "verboten" list of the Fascists - it is necessary for **EVERY** one to be as well-informed as possible, and to keep on talking and discussing.

**Keep on learning! Keep on talking!**

\* We suggest that your Council should obtain a copy of "United Nations Discussion Guide" from U. S. Office of Education, Washington, D. C. It should prove very useful in discussions.

THE FACTS ARE --

To engage in intelligent discussions about the war, you will need many facts on different topics to support your arguments. Here are a few facts which may prove helpful.

A. Line-up of Belligerents

United Nations: Australia, Belgium, Brazil\*, Canada, China, Costa Rica, Cuba, Czechoslovakia, Dominican Republic, El Salvador, Ethiopia, Free France\*, Great Britain, Greece, Guatemala, Haiti, Honduras, India, Luxembourg, Mexico, Netherlands, New Zealand, Nicaragua, Norway, Panama, Philippines, Poland, South Africa, Soviet Union, United States of America, Yugoslavia.

\* Has not yet signed the Declaration of the United Nations but fights on our side.

Axis Belligerents: Albania, Bulgaria, Finland, Germany, Hungary, Italy, Japan, Rumania, and Thailand.

B. History's most costly war

In 1943 we will spend between 70 and 75 billion dollars on the war. It is now estimated that the war will cost the United States alone approximately \$380 billions. This is close to \$3,000 for every person in the country. Why is this war so costly? Because a modern battleship costs more than \$70 millions; an aircraft carrier about \$60 millions; a cruiser from \$20 to \$30 millions; a Flying Fortress fully equipped \$350,000; a medium tank \$75,000; and so on. If you build hundreds of

ships and thousands of planes and tanks, they soon add up into billions. To train, feed, transport and equip an army of some 7½ million men -- that, too, costs additional billions of dollars.

### 9. Inflation Demons

Almost every day you hear that inflation must be avoided. What does this mean? Inflation means that all of us lose money by paying higher prices for consumer's goods than we should pay if we managed wisely the spending and saving of our money. What causes these avoidably higher prices? First, they are caused by the fact that the war decreases the total available supply of civilian goods, while at the same time the war increases our national income to the highest point in our history. This means that there is far more money to spend on goods than there are goods to buy. When the crowd at an old-fashioned auction all want a certain article, they bid against each other. When there is nationally more money than there are goods, it's the same old-fashioned auction all over again -- but on a national scale.

The second cause of inflated high prices can be the individual fault of each of us. It is our failure to save the largest fraction possible out of our earnings. It is our failure to do without everything that we do not seriously need. If we do not save far more money than ever before, we shall lose much money anyway by simply paying it out for inflated high prices.

Hence the best way to avoid inflation now, and to have money for things you will really need after the war, is to save regularly now as large a part of your income as possible. This will hold down the price

of civilian goods. It will also help to hold down the cost of our war materials. The cost to us of World War I was increased by several billion dollars because of inflated prices for war materials. Finally, you will realize that it takes much more than mere governmental controls to prevent inflation. Price control, rationing, and taxation can be only partial preventives. The chief control, however, rests in your own hands, in the way you plan the spending and saving of your money.

#### B. The Experience of Others

"I lived in Germany at the time of the famed German inflation, and I know what measure of ruin, insanity, and vice a radical inflation produces. America must not experience this. However, every war is accompanied by the danger of inflation. The general purchasing power rises, while the production of peacetime goods decreases in the face of increased demand.

"Therefore the democratic and disciplined citizen voluntarily foregoes some of the things he does not have to have, and saves for the time when there will be no war boom and excessive purchasing power, but a return of peacetime goods in ample quantities."

—Thomas Mann, world-famous writer, in  
"Why No War Bonds"

#### C. What we are fighting for

"Our own objectives are clear, the objective of smashing the militarism imposed by war lords upon their enslaved peoples - the objective of

liberating the subjugated nations -- the objective of establishing and securing freedom of speech, freedom of religion, freedom from want, and freedom from fear everywhere in the world."

—President Roosevelt in his Message to Congress, January 6, 1941.

"They (the U. S. A. and Great Britain) desire to bring about the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labor standards, economic advancement and social security."

"After the final destruction of the Nazi tyranny, they hope to see established a peace which will afford to all nations the means of dwelling in safety within their own boundaries, and which will afford assurance that all the men in all the lands may live out their lives in freedom from fear and want."

—Points 5 and 6 of the Atlantic Charter, signed by President Roosevelt and Prime Minister Churchill, August 14, 1941.

In Japan they have a Bureau of Thought Supervision. This Bureau declares that "thinking dangerous thoughts is a dangerous crime, and those who indulge in it are to be subject to very severe punishment." A number of Thought Inspection Commissioners are maintained to note out this severe punishment. We are fighting against the Bureau of Thought Supervision or any bureau dedicated to the suppression of thought anywhere in the world."

"Those who write the peace must think of the whole world. There can be no privileged peoples. We ourselves in the United States are no more a master race than the Nazis. And we cannot perpetuate economic warfare without planting the seeds of military warfare. We must use our power at the peace table to build an economic peace that is just, charitable, and enduring."

--Vice President Wallace in his "Century of the Common Man" speech May 8, 1943.

QUESTIONS AND ANSWERS ABOUT THE WAR SAVINGS PROGRAM

1. Q. How many people have so far participated in buying War Savings Bonds and Stamps?  
A. More than fifty million.
  
2. Q. How many workers participated in regular Payroll Savings Plans as of January 1, 1943?  
A. More than twenty-four million workers set aside an average of  $8\frac{1}{2}$  percent of their pay for War Bonds.
  
3. Q. How many firms instituted Payroll Savings Plans in their plants?  
A. Over 155,000.
  
4. Q. How much money has the Treasury raised through the sale of Stamps and Bonds so far?  
A. As of January 1, 1943 the total sale of War Savings Bonds and Stamps amounted to \$11 billions (\$). The sale of stamps alone amounted to \$\_\_\_\_\_.
  
5. Q. How many bonds and stamps are issued by the Treasury daily?  
A. About 500,000 bonds and about \_\_\_\_\_ stamps.
  
6. Q. How does the participation in the War Savings Program compare with the "Liberty Loan" of the last war?  
A. The total number of participants in the Liberty Loan of the last war was less than \_\_\_\_\_. The total sales amounted to less than \$\_\_\_\_\_.

7. Q. Is it true that many people redeem their bonds as soon as they can?

A. No, it is not true. As a matter of fact, the redemptions of savings bonds have been astonishingly small. From May, 1941, when the sale of War Savings Bonds and Stamps began, until January 1, 1943, nearly \$11 billions worth of bonds (cash receipts) were sold. Considerably less than 2% of all sales of bonds have been redeemed.

8. Q. Have many stamps been redeemed?

A. Yes. But 83 percent (?) of all redeemed stamps were used toward the purchase of bonds. That is really what the stamps are for -- small savings toward the purchase of bonds.

9. Q. In what way do stamps differ from bonds?

A. Stamps are very much like postage stamps. They are a variety of cash and do not increase in value. They come in five denominations-- 10 cents, 25 cents, 50 cents, \$1, and \$5.

10. Q. Why does the Government issue stamps?

A. Because some people may not be able to buy an \$16.75 bond all at once but can save up from their income slowly and make installment payments in advance for such a bond. At the same time their money is used to help pay for the war.

11. Q. What happens if stamps are lost?

A. The same thing that happens when money is lost.

12. Q. Do stamps in any amount increase in value?

A. No. Even if you should have a thousand dollars' worth of stamps

you would not get any interest. They must be converted into bonds before they can earn any interest.

13. Q. What is the maturity value of bonds in Series N?

A. The maturity value is as 4 to 3; that is, for every \$3 you pay now you will get back \$4 ten years from now. The bonds come in \$25, \$50, \$100, \$500, and \$1,000 denominations, for which you pay, respectively, \$18.75, \$37.50, \$75, \$375, and \$750.

14. Q. If a bond holder needs the money before the 10 years are up, can he get his money?

A. Yes. Any time after 60 days from the first of the month in which the bond is bought, he can get his money. The redemption value of the bond increases at the end of the first year and at the end of each successive half year thereafter until maturity. For example, a bond costing \$75 will be worth \$75.50 at the end of one year; at the end of four years it will be worth \$80; at the end of six years, \$84; at the end of eight years, \$92; and at the end of ten years, \$100.

15. Q. Can a bond be sold?

A. No. The only way you get the money for your bond is to turn it in to the Government.

16. Q. Are bonds transferable?

A. No. Bonds are not transferable and cannot, therefore, be used in any pledge or in any transaction the way people used Liberty Bonds in the last war.

17. Q. Can people speculate in bonds?

A. No. Because they are not transferable. During the last war Liberty Bonds, which were transferable, were sold in the open market. When the demand for them was low, the prices went down and people sold their bonds for 90 percent and even 80 percent of their value. That cannot happen now. The War Savings Bonds you buy now will be worth the exact amount you pay for them plus the interest for as long as you keep them.

18. Q. Can these bonds be used to provide a monthly income?

A. Yes. If you now buy a \$37.50 bond monthly, 10 years from now you will receive every month \$50.

19. Q. Can any individual or institution make a profit from the promotion of the sale of War Savings Bonds and Stamps?

A. No. Banks, stores, and all other agencies selling War Savings Bonds and Stamps do so at no expense to the Government and with no monetary profit to themselves.

EXECUTIVE OFFICE OF THE PRESIDENT  
BUREAU OF THE BUDGET  
WASHINGTON, D. C.

OFFICE OF  
THE DIRECTOR

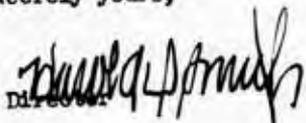
December 31, 1942

My dear Mr. Secretary:

I find that I have not acknowledged receipt of the record of the song written by two Army boys who were detailed to the Treasury in connection with the War Bond campaign. I appreciate the record very much. The children play it frequently and get a great deal of enjoyment out of it.

Best wishes for a good new year.

Sincerely yours,

  
Director

The Honorable

The Secretary of the Treasury

C  
O  
P  
Y

DEC 31 1942

Dear Mr. Watson:

I have your letter of December 28, 1942, advising that you are reducing the price of stub assemblies for United States Savings Bonds from \$8.50 to \$5.75 per thousand and also extending a credit or refund of \$200,000 on shipments already made.

We deeply appreciate this voluntary and very generous act by your company, not only because it will enable us to show a substantial saving in War Bond production costs, but because it serves to typify the kind of cooperation our Government is receiving from its industrial leaders during the present world conflict. It is the kind of cooperation that is motivated by a spirit which will assure us the victory.

I have requested the Commissioner of the Public Debt to determine whether or not the above-mentioned \$200,000 should be handled as a credit or a refund and to inform you of his determination. He has also been requested to take whatever action is necessary to reflect the unit price reduction in the records of the Department and the General Accounting Office.

Sincerely yours,

(Signed) H. Morgenthau, Jr.

Secretary of the Treasury.

Mr. Thos. J. Watson, President,  
International Business Machines Corporation,  
590 Madison Avenue,  
New York, New York.

BAR:cwf  
12-30-42

Photo file in Diary  
Orig. file to Thompson.

INTERNATIONAL BUSINESS MACHINES CORPORATION  
300 MADISON AVENUE  
NEW YORK

Mr. Broughton  
38 1/2 mg. Card Paper  
Stock # 100-100

78140

OFFICE OF  
THE PRESIDENT

December 28, 1942

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

Dear Mr. Secretary:

When we gave your Department a price on bond assemblies, consisting of a tabulating card and backing sheet, it was based on the estimates made by our Cost Department on an entirely new product with which we had no previous experience.

Immediately upon receiving the order from your Department we started our engineers to work on the development of new mechanized equipment. We gave special training to our personnel for this new job resulting in a lower cost of production. We then moved the department to our Washington plant which shows a saving on transportation.

As a result of all of this we can manufacture the bond assemblies of the present specifications at a cost which will enable us to bill you from this date forward at \$5.75 instead of \$8.50 per M, and give you a credit of \$200,000.00 on shipments already made. Or, if it is more convenient for your records, we will send you a check for the amount.

As we go along, if we can find a way to still further reduce the cost, we will give you the full benefit of such reductions.

With best wishes and kindest personal regards, I remain

Sincerely yours,

  
President

TJW:3

## UNITED STATES SAVINGS BONDS - SERIES E

Comparison of December sales to date with sales during the same number of business days in November and October, 1942

(At issue price in thousands of dollars)

Date	December daily sales	Cumulative sales by business days			
		December	November	October	December as percent of November
December 1942					
1	\$ 4,116	\$ 4,116	\$ 5,164	-	79.7%
2	4,489	8,605	9,272	-	92.8
3	10,042	18,647	20,460	\$ 5,045	91.1
4	39,690	58,337	31,309	42,285	186.3
5	15,648	74,984	53,076	52,984	141.3
6					
7	46,424	121,408	62,326	73,919	194.8
8	11,887	133,295	96,366	98,490	138.3
9	17,857	151,152	111,002	117,077	136.2
10	13,607	164,759	146,494	131,593	112.5
11	38,664	203,423	161,929	169,859	125.6
12	17,480	220,903	181,120	179,232	122.0
13					
14	52,056	272,959	188,497	194,811	144.8
15	15,530	288,488	230,083	222,243	125.4
16	22,764	311,252	241,624	239,891	128.8
17	24,248	336,100	262,274	254,201	128.1
18	25,260	361,359	287,409	290,282	125.7
19	17,907	379,266	314,568	312,386	120.6
20					
21	45,716	424,982	327,418	327,928	129.8
22	18,083	443,065	371,750	355,719	119.2
23	16,586	459,751	390,176	382,332	117.8
24	18,942	478,693	410,473	396,458	116.6
25					
26	54,198	532,891	429,168	434,661	124.2
27					
28	48,034	580,925	456,184	445,071	127.3
29	23,554	604,479	482,830	467,612	125.2
30	60,109	664,588	541,573	502,512	122.7

December 31, 1942.

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

Source: All figures are deposits with the Treasurer of the United States on account of proceeds of sales of United States savings bonds. These figures have been adjusted on the basis of wire reports and therefore will not agree with the Treasurer's accounts.

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

## UNITED STATES SAVINGS BONDS - SERIES F AND G COMBINED

Comparison of December sales to date with sales during the same number of business days in November and October, 1942

(At issue price in thousands of dollars)

Date	December daily sales	Cumulative sales by business days				December as percent of November
		December	November	October		
December 1942						
1	\$ 197	\$ 197	\$ 303	-	-	65.0%
2	329	527	1,115	-	-	47.3
3	2,688	3,214	7,846	\$ 2,218		41.0
4	13,947	17,161	14,720	20,322		116.6
5	12,303	29,464	31,425	24,325		93.8
7	17,522	46,986	34,030	31,922		138.1
8	2,872	49,858	43,940	46,695		113.5
9	9,576	59,434	49,326	55,998		120.5
10	5,651	65,085	58,842	59,711		110.6
11	14,274	79,359	64,157	74,275		123.7
12	7,135	86,495	71,352	76,430		121.2
14	15,430	101,924	73,989	83,857		137.8
15	7,719	109,644	83,246	91,884		131.7
16	5,146	114,789	88,888	98,457		129.1
17	11,654	126,443	97,154	101,252		130.1
18	6,466	132,909	104,487	110,052		127.2
19	7,992	140,901	113,191	115,757		124.5
21	13,451	154,352	116,880	124,610		132.1
22	12,077	166,429	131,041	133,767		127.0
23	8,253	174,682	136,798	142,141		127.7
24	7,854	182,536	145,126	146,525		125.8
26	20,516	203,052	151,824	159,973		133.7
28	19,576	222,629	161,542	165,364		137.8
29	11,179	233,807	172,044	180,250		135.9
30	22,732	256,539	192,976	196,322		132.9

December 31, 1942.

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

Source: All figures are deposits with the Treasurer of the United States on account of proceeds of sales of United States savings bonds. These figures have been adjusted on the basis of wire reports and therefore will not agree with the Treasurer's accounts.

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

OFFICE OF LEND-LEASE ADMINISTRATION  
FIVE-FIFTEEN 22d STREET NW.  
WASHINGTON, D. C.

December 31, 1942.

Dear Mr. Morgenthau:

Thank you very much indeed for remembering to send me so promptly the statement concerning recent changes in food prices and living costs in the United Kingdom, Canada and the United States. I have just read this with interest, and I am passing it on to Mr. Stettinius.

Sincerely yours,

*Bernhard Knollenberg*

Bernhard Knollenberg,  
Senior Deputy Administrator.

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



**TREASURY DEPARTMENT**

227

**INTER OFFICE COMMUNICATION**

DATE DEC 31 1942

TO Secretary Morgenthau  
FROM Randolph Paul

Charles A. Clark has been working with the Foreign Funds Control Field Investigative Staff for approximately a year and a quarter. In view of the nature of his duties with Foreign Funds Control, we do not feel competent to evaluate his ability for work other than that of a field investigator. Our observations to date lead us to believe that in the investigative field he is a person of definite limitations.

Clark's general background is as follows: He was born July 18, 1883, and graduated with a degree of Bachelor of Laws from Syracuse University in 1917. After working in a small bank in Dundee, New York, for approximately a year, he entered the army and served overseas as a clerk in the Office of the Auditor for the War Department. In March 1918 he accepted a position as auditor for the American Red Cross Commission to Germany with whom he worked until November 1920, at which time he returned to the United States.

He was then employed by Standard Oil Company at Albany, New York, until March 1924, when he worked abroad for a brief period with the Caucasus Branch of the Near East Relief. Upon his return to the United States in the Summer of 1924 he worked for a short time with the Veterans Bureau and for about a year with the Department of Justice as a special accountant in the Bankruptcy Accounts Bureau.

Clark began to work for the Treasury Department in May 1926, when he was hired as an Assistant Customs Attache at a salary of \$2,500 per year for service in Berlin. In November of that year his salary was increased to \$3,000 and by October 1929 he had been promoted to the position of Treasury representative in Berlin at a salary of \$4,000. In March 1931 he was transferred from Berlin to the position

- 2 -

of Assistant Customs Attache in London, at which time his salary was increased to \$5,600. Clark served in London until October 1936, when he was returned to Berlin as Treasury representative working under Erwin G. May, then Treasury Attache in Berlin. Clark remained in this position until September 1939, when he returned to the United States and was assigned to Customs work in New York. In the Summer of 1941 he was loaned to the Field Investigative Staff, then being established under Mr. May by Foreign Funds Control.

Inasmuch as Clark has worked in the Bureau of Customs since 1926, I have asked Gaston to prepare a memorandum as to Clark's ability, which will be forwarded to you promptly.

*WSP*

December 31, 1942

Dear Mr. Chiang:

Your telegram of greeting was one of the best Christmas presents that I received, and I appreciate it very much.

Please convey to your readers in China my sense of gratitude for the heroic qualities they have shown in the war against our common enemy. Their courage has been an example to all the world and to all future generations.

I shall appreciate it if you will send them my best wishes for a victorious New Year.

Sincerely,

(Signed) H. Morgenthau, Jr.

Mr. Joseph Chiang,  
Woodside Apartments,  
1900 H Street, N.W.,  
Washington, D. C.

FK/cgk

File in Diary

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*Harlow*

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~~SECRETARY AND MISS HENRY HINGENHAU~~

~~THE TREASURY DEPARTMENT WASHDC~~

MAY I WISH YOU IN BEHALF OF THE READERS OF CHINA A VERY  
MERRY CHRISTMAS AND A VERY HAPPY NEW YEAR

JOSEPH CHIANG WASHINGTON CORRESPONDENT FOR THE CHINESE NEWS  
SERVICE CHUNGKING CHINA.

426P

*Woodside Apartments  
1900 K St. N.W.*

TREASURY DEPARTMENT

231

INTER OFFICE COMMUNICATION

DATE

TO Secretary Morgenthau

December 31, 1942

FROM Frances McCathran

AFTERNOON SUMMARY OF THE WAR NEWS  
(3:00 P. M.)

The Pacific Area

American planes made additional attacks on enemy installations in the Solomons, a Navy communique said today. In one attack on Vangunu Island (120 mi. northwest of Guadalcanal) yesterday, 5 enemy barges were destroyed. Buildings and planes were also bombed in the Rekata Bay area of Santa Isabel Island.

North Africa

1. German High Command claimed their long-range bombers made a surprise raid on Casablanca, Allied Atlantic port in Morocco, causing fires which could be seen for miles.
2. Hope for an early and easy settlement of the French situation diminished today as De Gaulle's visits to Giraud and to this country were indefinitely postponed.

Europe

1. In a naval engagement still progressing "in northern waters" 2 Axis warships were damaged, the British Admiralty announced today.
2. Partial figures on the American raid on Lorient, France Wednesday revealed that at least 19 German planes were downed.
3. With the downing of 2 Axis planes over northern France today, Polish pilots with the R.A.F. brought their total of German planes destroyed to 500, the Polish Center of Information in New York said. They have dropped, too, 10,000 tons of bombs on German targets.

## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE

TO Secretary Morgenthau

December 31, 1942

FROM Frances McCathran

## HIGH-LIGHTS OF THE WAR NEWS

## Russia

1. The entire German front south and southwest of Stalingrad was in danger of collapse, as the Red Army, advancing even faster than had the Nazis, captured thousands of square miles and drove to within 9 miles of Elista (110 mi. southeast of Kotelnikovski) capital of the Kalmyk Republic.
2. Reds smashed lines between Kotelnikovski, the Stalingrad-Caucasus railroad, and the Volga-Caspian Sea area. By occupying Semichnaya station on the Stalingrad-Caucasus railroad (15 mi. southwest of Kotelnikovski) Russians were within 90 miles of Salsk, important juncture point where the Rostov railroad joins the Caucasus line.
3. In the Caucasus southeast of Nalchik the Russian armies drove across the Terek River.
4. In the rich industrial and mining district of Voroshilovgrad in the Ukraine (50 mi. west of Rostov-Moscow R.R. and 160 mi. southeast of Kharkov) the Russians liberated many inhabited districts in the northeast part.
5. In all these operations, heading toward Rostov, the Russians took huge war spoils including tanks, heavy guns, rifles, cows, horses, and even some railroad cars.

## North Africa

1. Giraud - General Giraud arrested 12 prominent Frenchmen to prevent attempts which he believed might be made to assassinate himself and American minister Robert Murphy. Some of the Frenchmen were accused of not reporting their previous knowledge of the plot to assassinate Darlan. Among them were also some who had aided the Allies in landing in North Africa. The British, who had never recognized Darlan, tacitly recognized Giraud by appointing Harold MacMillan to North Africa with the rank of cabinet minister.

2. Libya-Tripolitania - A long missing Fighting French force from the Lake Chad area of French interior Africa now has reached a point about 450 miles south of Tripoli in southern Libya. Germans admit Allied armored patrols (which they claim they destroyed) are operating south of Tripoli indicating Montgomery is planning to outflank the Afrika Korps in Tripolitania before it can reach Tunisia. Ground activity in the Libyan area still centers around Wadi Bei El Chebir (185 mi. from Tripoli), the first of the 3 dried river beds which cross the British line of advance. In the air the Allies shot down 8 German Messerschmitts without loss.
3. Tunisia - American forces have driven to within 40 miles\* of the port of Gabes as another preventive measure to keep Rommel's troops in Libya from joining Nehring in Tunisia. Since the Afrika Korps would have to pass along the coastal road running through Gabes in order to reach General Nehring, capture of this port by the Allies would force Rommel to either cut his way through or make a sea escape at Tripoli.

#### The Pacific Area

1. Using light tanks, the right arm of the Allied pincer movement against the Jap beachhead near Buna was rolling the enemy back toward Gairopa Point. On the left the American forces expanded their wedge to control 100 yards of the beach between Gairopa Point and Buna Mission.
2. Guadalcanal - The Jap position is believed hopeless, as American marines, soldiers, and planes pound them unceasingly. Meanwhile Allied aerial patrols are on the constant look-out to prevent the Japs from landing reinforcements by sea or air.
3. New Britain - Allied planes again damaged shipping in Rabaul harbor.
4. Timor Island - Australian commandos and Dutch guerillas, refusing Jap demands to surrender, continued their sniping at the enemy, blowing up bridges, etc.

#### Europe

U.S. heavy bombers flew 600 miles to attack the French port of Lorient, Nazi submarine base on the Bay of Biscay yesterday afternoon. Hundreds of Allied fighters also made sweeps over the Boulougne-Abbeville area along the Channel coast without encountering opposition.

NOT TO BE RE-TRANSMITTEDCOPY NO. 3BRITISH MOST SECRETU.S. SECRETOPTAL No. 452

Information received up to 7 A.M., 31st December, 1942.

4. NAVAL

MEDITERRANEAN. One of H.M. Submarines sank a 6,000 ton troop transport west of SICILY on 28th. Attacks on Shipping. No further attacks have been reported on the outward-bound convoy referred to in yesterday's OPTAL.

5. MILITARY

LIBYA. 29th. Our patrol engaged motor transport on AL GHEDDACHIA-UNGGA Road and destroyed some vehicles, reaching a position on this road 25 miles south of AL GHEDDACHIA (32 miles west-southwest of BIRAHAT). Area of BIRAHAT reported clear of enemy. Advanced armoured patrols resorted digging, blasting and general activity in a triangle running from a point 25 miles north-northwest of BIR EL SIDAN (60 miles west-southwest of SIRTE) to AL GHEDDACHIA to a point 12 miles south of AL GHEDDACHIA.

RUSSIA. In the Middle Don area, there has been a pause in Russian advance, and it is possible that Germans are making efforts to regain some of the lost ground. Southwest of STALINGRAD, Russian offensive is making progress.

5. AIR OPERATIONS

EASTERN FRONT. 30th. 40 escorted Fortresses dropped 78 2,000 lb. High explosive bombs on U-boat pens at KATOWICE (LOBLANT). Many hits claimed on target. Provisional enemy casualties by bombers 28, 9, 4. 7 enemy aircraft crossed South coast, some damage to residential areas at EXETER.

FRANCE NORTH AFRICA. 29th. SOUSSE attacked by 28 heavy bombers, one medium sized plane hit and fires started in docks. 6 Messerschmidt 109 approached SOUSSE, losing 1, 0, 2.

LIBYA. Enemy activity increased on 29th. Our forward troops about BIR EL SIDAN attacked.

SIAM. 26th/27th. United States aircraft bombed BANGKOK. A large arsenal was hit.

NOT TO BE RE-TRANSMITTEDCOPY NO. 13BRITISH MOST SECRET  
U.S. SECRETOPTEL No. 6

Following is supplementary resume of operational events covering the period 24th to 31st December, 1942.

1. NAVAL

GERMANY and ITALY. Air reconnaissance 23rd showed a ship probably GRAF SCHAFFLIN in floating dock at KIEL and S. IDELITZ at BREMEN with most of her guns removed. New battleship EMPEROR at TRIESTE from VANICE. Recent photographic reconnaissance of GENOA show hull of RASOLO class cruiser building there being adapted as aircraft carrier.

MEDITERRANEAN. During week three, probably four medium and two small ships reported sunk by H.M. Submarines and one medium ship, sunk and another probably sunk by naval aircraft from MALTA - all ships in Central Mediterranean. Enemy sea borne traffic still concentrated on TUNIS, SICILIA and SOUSEE. Very little to TIRPOLA.

BLACK SEA. Russian surface forces and submarines have reported the sinking of 2 enemy merchant ships and one escort in the BLACK SEA.

SUBMARINE WARFARE. During the week 26th December to 1st January 22 ships were reported attacked by enemy submarines, 6 of these were belated reports. 15 were in an outward bound convoy for AMERICA in the central north ATLANTIC. 12 British, 1 Belgium, 1 Norwegian and 1 Dutch. 4 British and 1 Egyptian ships were attacked off the coast of BRAZIL. One U.S. ship in the North Atlantic. One Spanish ship which has reached port off the coast of SPAIN, and one British and one Polish ship in the WEST INDIES area. In addition to these one British ship was mined in home waters, one Dutch ship was damaged by aircraft off the south coast of NEW GUINEA and 2 British ships previously reported overdue are now presumed lost. One British ship attacked on 16 December has arrived safely. The outward American convoy was heavily attacked and is believed to have lost nearly one-third of its complement aggregating about 60,000 tons. The attacks were made when it was out of range of home-based aircraft and contrast unfortunately with the experiences of 2 other convoys mentioned recently. Excluding counter attacks by escorts of above convoy 2 promising attacks by aircraft and one by surface craft were reported during week ending 30th.

2. MILITARY

LIBYA. Enemy movement westward continued and our patrols maintained intermittent contact with rearguard. Railway working to satisfactory capacity as far as TOBRUK. Tonnage handled through BENGHAZI again increased but results somewhat dependent on weather.

TUNISIA. Activity mainly confined to patrolling and even that restricted by boggy ground, vehicles being almost unable to leave roads. Main operation was struggle for DJERBA ABDELA feature which changed hands several times between 23rd and 26th when our troops although then in possession were withdrawn during the night owing to enemy bombardment. Some activity also in south in sector held by French who repulsed several attacks on PICHON and also themselves attacked successfully. Estimated enemy strength now 29,000 Germans and 14,000 Italians with about 140 serviceable German tanks and 50 Italian, serviceability unknown. Reinforcement of first army continuing steadily, every effort being made to improve our communications, rendered even more inadequate by deplorable weather.

FAR EAST. BURMA. Our forward troops encountered enemy resistance in MEDMUNG Area. Enemy strength north of MYA estimated at one battalion. Increased enemy patrol activity in CHEN HILLS Area.

### 3. AIR OPERATIONS

WESTERN FRONT. Our night operations on small scale owing to bad weather. Altogether only 71 aircraft operated, of which 10 over DUSSELDORF on 31st/1st, remainder sea mining and other activities. Losses 2 aircraft. By day 40 escorted U.S. Fortresses dropped 78 2,000 lb. bombs on U-boat pens LORIENT, many hits claimed.

LIBYA. Weather again restricted operations. Our fighters maintained reconnaissance and offensive patrols over the battle area and provided protection for shipping off the coast.

FRENCH NORTH AFRICA. In TUNISIA our main effort was against enemy ports. Attacks nightly by aircraft from MALTA and by day by U.S. heavy bombers and once by aircraft from LIBYA. Number of enemy ships sunk or damaged in harbor and much damage caused.

RUSSIA. German aircraft made light raids on MURMANSK. No damage to shipping reported. Russian aircraft used in support of Middle Don advance. In STALINGRAD area they continued to inflict heavy losses on transport aircraft attempting to supply German Sixth Army.

### 4. EXTRACTS FROM PHOTOGRAPHIC AND INTELLIGENCE REPORTS ON RESULTS OF AIR ATTACKS ON ENEMY TERRITORY IN EUROPE.

ROMILLY SUR SEINE. Daylight U.S. heavy bomber attack 20th. Photographs show large hangar set on fire and partly demolished, another partly wrecked by near miss, serious damage to barrack buildings by direct hits and blast. 138 craters on landing ground.

DEN HELDER. Photographs during daylight R.A.F. Ventura B-34 attacked 23rd show marked concentration in docks, direct hits on naval barracks and torpedo workshops.

### 5. HOME SECURITY

Estimated civilian casualties to 6 A.M. 30th - killed 1, seriously wounded 17.

NUMBER 64

SECRET

27

OFFICE OF STRATEGIC SERVICES

# THE WAR THIS WEEK

December 24-31, 1942

*Printed for the Board of Analysts*

Copy No. 6

*The Secretary of the Treasury*

## THE WAR THIS WEEK

*The past year has witnessed a profound improvement in the fortunes and prospects of the United Nations. The War This Week is devoting the greater part of the current special issue to a series of critical analyses of the developments of the past year and to certain probable trends for the coming year. A general analytical summary, "The War This Year, 1942 in Retrospect," (beginning on page 10), has been prepared by a member of the staff of the Office of Strategic Services who has been continuously concerned with both broad and detailed aspects of Axis capabilities. This summary is followed by a series of appendixes prepared in the Research and Analysis Branch:*

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APPENDIX I. <i>The Eastern Front</i> .....	22
II. <i>The Mediterranean Front</i> .....	29
III. <i>The Air Offensive in the West</i> .....	36
IV. <i>German Economic Prospects</i> .....	40
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VI. <i>The Pacific Front</i> .....	52
VII. <i>The Co-Prosperity Sphere</i> .....	58

This week, Russian offensives in the Don loop developed fresh vitality and may soon imperil the whole German position east of Rostov. The offensive southwest of Stalingrad captured the important supply center of Kotelnikov. The drive from Boguchar has swept around both sides of Mille-rovo, and from this point to the Volga, the Rostov offensive and the Stalingrad pincers now form a continuous front. Meanwhile, the Soviets have launched a new offensive in the

SECRET

Caucasus with the recapture of Alagir and the lifting of the Nazi menace to the Georgian and Ossetian Military Highways. Although it is too early for prediction, this recently evidenced Soviet offensive power is considered to have injected a new element of prime importance into the picture of Allied military prospects.

While relative quiet has persisted on the two North African fronts, the assassination of Admiral Darlan and his succession by General Giraud have been generally greeted as having solved a problem which was becoming increasingly embarrassing for the United Nations.

The Far Eastern theater, too, has been relatively inactive during the past week, although certain indications suggest that the Japanese are preparing for new offensive moves.

#### *The Fall of Kotelnikov*

The Soviet capture of Kotelnikov has further reduced the chances of escape for the 22 Axis divisions between the Don and the Volga. After pushing the Nazis back from the Aksai River, the Russians closed in on Kotelnikov from three sides before breaking through to take the town itself. It was from this railhead that the Germans launched their counter-offensive to relieve the Sixth Army entrapped to the east, and its fall will rob the invaders of their chief remaining supply base within striking distance of Stalingrad. As the Russians continue to broaden their hold over the Kalmyk steppe area south of the lower Don, the German supply lines to the west are likely to run increasing danger of interdiction by Red Army mobile attacks. To the north, with the practical fusion of the northern pincers offensive around Stalingrad and the more recent attack directed toward Rostov, the Russians have further consolidated their position in the Don bend. The capture of Tatsinskaya on the Rostov-Stalingrad railway

SECRET

about 50 miles east of its junction with the Moscow-Rostov line suggests that the Red Army is gradually eliminating effective communication between the German forces west of the Donets and those in the Don-Volga area.

Although the Russians have again cut the Moscow-Rostov railroad south of Millerovo and have penetrated to the west into the Ukraine, the Germans have made a strong stand at Millerovo itself. Even should the Red Army isolate this city, the enemy will probably make a determined effort to hold Voroshilovgrad and Kamensk—the line of the Donets, where two lateral railroads favor the defense. The loss of the Don-Volga area—although extremely damaging in prestige and manpower—would be one that the Nazis might accept. The loss of the Donets and Rostov, however, would threaten the enemy forces in the North Caucasus with an encirclement still more costly than that around Stalingrad, and the virtual elimination of all German gains in a year of unparalleled sacrifice.

In the Caucasus, the recapture of Alagir and the elimination of the German threat to the Georgian and Ossetian Military Highways has launched the fourth of the expected Soviet offensives. The new operation not only indicates that the Red Army has sufficient offensive power to conduct large-scale attacks in three sectors at once. It also suggests that the Soviet winter drive will not confine itself to infiltration, but may aim to liquidate the net German gains of 1942 (see Appendix I and map). The new offensive is at present mopping up valley towns on its way northwest toward Nalchik. To the north, around Mozdok, while rain has temporarily reduced the tempo of operations, the Russians will probably soon resume the attack in an effort to pinch off the tip of the Caucasus salient from two directions at once.

The remaining Soviet offensive, in the Rzhev-Velike Luki sector, has alone made no substantial progress. And in the

far north, the Germans have stepped up their bombing of Murmansk, Kandalaksha, and the Murmansk railway.

#### *The North African Fronts*

No important change has taken place in the situation on either of the North African fronts, according to the meager reports that have come from the front.

In Tunisia heavy rains limited operations, and ground conditions remain boggy even though the weather has improved. The principal fighting of the week came in a series of severe attacks and counterattacks for control of a hill area just northeast of Medjez el Bab. At some cost the Axis has now retaken the hill. Other ground operations were largely confined to patrols and consolidation, and to minor actions to the south. Allied aircraft attacked shipping and harbor facilities at Sousse and Sfax with success. Reports continue of German materiel and personnel movements southwards through the Alps, and events in Tunis are clearly building up toward the opening of large-scale fighting.

In Tripolitania Axis forces halted in the Bouerat el Soun area, apparently taking up positions in wadis running to the east and southwest of the great Tauorga salt depression. Their supply situation is assumed to be difficult, and there are indications that the enemy lacks the motor transport to withdraw all his forces simultaneously. The British occupied Syrte on December 25, and established contact with the enemy. They may shortly overcome the delays occasioned by enemy mines and their own supply problems sufficiently to be able to renew the attack. The Egyptian railway is in operation to Tobruk, and the capacity of Benghazi has been considerably increased. Meanwhile light British raiding parties have harassed the enemy's communications as far west as the city of Tripoli.

#### *Aftermath of Darlan's Assassination*

The death of Admiral Darlan and the designation of General Giraud as his successor by an imperial council that included Governors Boisson, Chatel, and Noguès, has brought expressions of relief from the British and the Fighting French, and has evoked attempts on the part of the Axis to split the United Nations by attributing the crime to English machinations. The appointment of General Juin to succeed Giraud as military commander in French North Africa has aroused little comment. (Juin is an able officer, conservative, but believed to be strongly anti-German, despite any "pledges" he may have made to the Nazis after his imprisonment in 1940).

In commenting on the assassination, British official spokesmen have indicated in confidence their gratification that the murderer had no apparent connection with De Gaulle (before his execution, the young man confessed that he acted only because he hated the Vichy regime and for the honor of France). Darlan's death, they feel, has wiped the slate clean, and improved the outlook for French unity. General Catroux, they add, would be a satisfactory representative for Fighting France in North Africa, but any effort to use the Comte de Paris (pretender to the French throne) in a provisional French government would be most inappropriate. When the Tunis campaign is over, one of these spokesmen concludes, the Fighting French might very well receive the civilian control of North Africa, while making available for the common cause as many of their troops as General Giraud might desire.

On Christmas day, the Brazzaville radio spoke out with utter frankness: "Whatever the nationality or the exact motives of the man responsible for this execution, his action expresses the indignation and rage of the great majority of

French people before the changed tactics of this traitor and the indulgence he found with Allied authorities . . . The man who shares such a large part of the responsibility for a shameful armistice in 1940, for criminal collaboration with the enemy, for Vichy, . . . for the sufferings of the French people . . . could not and should not remain unpunished." Fighting French leaders in Cairo have echoed these sentiments.

While deploring the assassination as an evil precedent, General de Gaulle has declared his intention of cooperating with Giraud, since no further obstruction to French unity exists. From Air Marshal d'Astier de la Vigerie, recently returned from a mission to North Africa, the General has apparently received a favorable report on Fighting French prospects there. Before his death (according to D'Astier), even Darlan had recognized the importance of the De Gaullists in Metropolitan France. With the future position of Fighting France in the balance, De Gaulle's talks with President Roosevelt will assume an unusual significance.

A new accretion of power for Fighting France has come with the capitulation of French Somaliland to De Gaullist forces. In resuming Fighting French broadcasts from London, André Philip, Commissioner for Interior and Labor, has explained the De Gaullist position that replacement of Darlan by Giraud does not solve the problem of creating a "provisional direction of French interests and allowing the voice of the nation to be heard at the conference tables of the United Nations." Thus far, the United States has recognized both the Vichy succession administrations in Africa and the Fighting French on a purely local basis, while President Roosevelt has declared that the choice of a future government rests with the French people alone.

### *Axis Innuendoes*

Broadcasting to Corsica, the Rome radio has called Darlan's assassin "an agent of the British police." The Nazis have elaborated on this theme by suggesting that "since the secret session of the House of Commons . . . a radical solution was to be expected." Stressing the mystery surrounding the name, nationality, and political antecedents of the assassin, Berlin has drawn attention to the cleavage between American and British views on the Darlan issue, and ascribed to the Admiral "last words" in which he foreshadowed an English attempt on his life. The Japanese have limited themselves to the assertion that "The United States was hard hit by Darlan's assassination, but nevertheless the Americans will never give up their imperialist ambition and will make strenuous efforts to maintain a puppet regime in North Africa . . ." It was "Anglo-American imperialism," according to *Domei*, which "brought about the fall of France."

### *Spain's Policy*

The Spanish Foreign Minister has again emphasized that the recent announcement of an Iberian bloc on the occasion of his visit to Lisbon was intended to inform the world that Spain and Portugal would henceforth adopt the same policy in foreign affairs. He admitted difficulties in eliminating Axis sentiments from radio and press, but asserted that he had the support of Franco and the Government in efforts to reorient Falangist elements of the press to the new foreign policy. There has apparently been no transfer of units to Spanish Morocco or southern Spain in connection with the recent partial mobilization. Nor are there any signs that the Germans intend to undertake operations in Spain.

*New Japanese Offensive Operations?*

Japanese air activity has increased somewhat, both in Asia and in New Guinea, but the Pacific front as a whole has been relatively quiet—a quiet, however, which may soon be interrupted, according to some military observers. Evidences of large-scale enemy preparations for the offensive are increasing, these sources say, although the direction an offensive might take still is uncertain. The most notable evidence pointing to a new offensive comes from China, where since early December the Japanese have been withdrawing their veteran troops. Throughout Central China and some parts of North China these men are being replaced by puppet forces and Koreans, while in the Wuhan area they are being withdrawn and shipped to the embarkation center at Shanghai.

Presumably some of these troops will be sent to the Philippine Islands for tropical training, replacing men already forwarded to the Southwest Pacific, the theater which still seems the most likely choice for renewed operations. Our local superiority in the waters around Guadalcanal now apparently has forced the enemy to attempt to supply his troops by parachute—evidence of a supply situation the Japanese can not allow to continue indefinitely, unless they intend to sacrifice these stranded troops. On New Guinea, the Japanese cling perilously but tenaciously to their Buna beachhead. Despite losses, they have evidently not yet given up hope of challenging our air supremacy in the Melanesian area, where Japanese construction of strategic airfields continues.

In Burma, where advance British units have now reached a point 25 miles from Akyab (still without meeting significant enemy opposition), British activity may have aroused the Japanese High Command to strengthen defenses, and some troops may be destined for this front. But as yet there are no reports of large-scale movements in this direction, and

little evidence of Japanese offensive intentions. Japanese patrols have clashed with the British near Kalembo in northern Burma, but enemy movements in this area appear to be for purposes of defensive reconnaissance. In India, further Japanese air attacks on Calcutta have occasioned a considerable exodus of stevedores, burlap workers, and jute balers, and a notable weakening of the morale of the laboring population.

In sum, while the Japanese are thoroughly capable of a surprise blow anywhere from India to Hawaii, the evidence as yet points only to an attempt to complete the conquest of the Melanesian "barrier," as a bulwark against a counter-attack from Australia. With this in hand, Japan might hope to secure the time to prepare for the "real war" which Premier Tojo has warned his people is just starting.

*Death of the Premier of the Punjab*

The death of Sir Sikander Hyat Khan has robbed India of perhaps the most statesmanlike of its Moslem leaders. As Premier of the Punjab, Sir Sikander, in opposition to the Moslem League's narrow insistence on Pakistan, had followed a broad policy of compromise among Hindus, Moslem, and Sikhs. His death can scarcely fail to strengthen the position of Jinnah and other Moslem extremists.

*Strikes in Bolivia*

End of the Catavi strike leaves labor tension in Bolivia's tin mines unchanged as the Government continues to delay application of a new, ameliorative labor code. Twelve hundred workers in the Patiño mines at Huanuni now threaten to lay down their tools. Instead of meeting demands for wage adjustments to offset soaring prices, the Government has decided to reply with further measures of repression, arresting "agitators" and cutting off supplies to the strikers. Meanwhile, desperately needed tin production is dropping.

## THE WAR THIS YEAR

### 1942 in Retrospect

1942 was, for both ends of the Axis, a year of large territorial gains accompanied, however, by proportionately expanded military commitments. Since neither the Far Eastern nor the European Axis partners proved capable during this period of disposing of major opponents, the problem for both had become by the end of 1942, one of (a) developing the resources of vast—but as yet unassimilated—empires to support a maximum war effort, and (b) achieving a strategic position from which efforts to dislodge them would be fruitless. The position of both has become, then, in a fundamental sense, defensive. While it is too early to say that the period of Axis expansion is over, it is becoming clear that such offensive objectives as may be within their capabilities are limited.

#### *European Axis*

The past year has, in absolute terms, witnessed little decline in the military strength of Germany or its satellite powers. In numbers of combat divisions the German Army has slightly increased. This has been accompanied by a decline in average divisional strength, sufficient probably to cause a numerical reduction in total armed strength. Disproportionate casualties have, no doubt, been inflicted upon the spear-head divisions, manned by the choicest troops. But all these losses are, to some extent, balanced by increased combat experience. Armament supplies, except for planes, have been well maintained, though there is some evidence of cumulative obsolescence in plane and tank design. The failure of plane production, however, to keep pace with

wastage has brought about a substantial decline in Germany's first-line strength. The plane position—with particular respect to combat planes—is undoubtedly the weakest point in Germany's military façade.

The over-all limiting factor to German military effort is clearly the shortage of manpower rather than a shortage of plant and equipment or of industrial materials. But there is nothing in Germany's manpower position to suggest that, in the absence of unexpectedly high casualties, the scale of her military effort must be reduced in the near future. There has been an undeniable decline in the quality of the German labor force which has made it impossible to sustain total output, but to date this has not seriously affected armament production. The food situation in Germany and her satellite powers has been well maintained, and it is within the range of possibility that sufficient tonnage may be imported through the blockade to relieve an otherwise dangerous position with respect to fats and oils. Although the supplies of civilian articles other than foods are pinched, there is not much evidence that the standard of living is sufficiently low to cause a decline in worker stamina and efficiency.

Oil stocks are lower than at the end of last year but prospective increases in production must be judged sufficient to permit a scale of military effort probably somewhat higher than in 1942. Transport conditions grew slightly worse during the year, but the program of new construction now under way will repair any deficiencies by the middle of 1943. No shortage of industrial materials will limit German output in the coming year, though it is probable that the process of substitution necessary to eke out dwindling supplies of copper, antimony and a few other materials will increase industrial labor requirements. Although, in a long view, the Axis war economy is "running down", the process is not sufficiently advanced to lower appreciably the Axis military effort in

1943. On the contrary, except in the air, the scale of military effort might—for a short period—be substantially increased, though at the expense of long-run capabilities.

The few cracks only now becoming visible in the German edifice are still too slight to impair the short-run soundness of the structure. Differences between the army and the party may develop into an important limitation on Axis military action, but there is no evidence that the cleavage has as yet gone this far. Nazi administration has proved incapable of winning the mass of the population of occupied countries to support of the New Order, but increasing acts of insubordination and sabotage are still in the nature of pin pricks. The most important of the growing fissures in the Axis structure is probably the crumbling resistance of the Italian ally. The thesis favored in some quarters that, when Germany cracks, the process of dissolution will be rapid, may be a sound one, but to date there is little evidence that the beginning of the process is in sight. On the contrary, in terms of the scale of military effort which the European Axis can sustain in 1943, there is no reason to expect a substantial diminution.

Although there has been no substantial diminution in German military strength in absolute terms, the change in Axis strength in relation to commitments has been remarkable. At the end of 1941 it appeared altogether possible that the Axis might eliminate effective Russian resistance before England and the United States could bring substantial forces to bear. At the end of 1942 Germany is faced with the war on two or more fronts that she has always feared and has striven to avoid. Not only in Russia, but in Southern Europe and in the West the Axis is vastly weaker in relation to the strength of her enemies than at the end of 1941. While Axis strength was substantially maintained in 1942, the totality of opposing forces has been greatly augmented.

### *Russia*

When Germany turned on Russia in June 1941 after the failure of two attempts to knock England out of the war—failure in the air "Battle of England" and in the less publicized, but equally important, battle of the sea lanes—the turn made military sense only on the assumption that Russian resistance could be crushed before her western opponents were ready to engage Germany in full strength. The attempt to crush Russian resistance had failed by the end of 1941, though this failure did not become clear until the campaign of 1942 unfolded. Among the many "turning points" of the war, it now seems probable that the German withdrawal from Moscow in December, 1941 was the most important. The development of the 1942 campaign made it obvious that Germany was abandoning her earlier objective, the crushing of the main Russian military force, and was pursuing a war of attrition. While in 1941 the German army sought to encircle and annihilate the enemy in his strongest concentrations, the next year saw the same army attacking only in the southern sector and neglecting the main enemy force in central Russia.

The Axis objectives in 1942, as they developed, were not so much the pursuit of economic gains as the infliction of economic loss upon Russia. While it is true that the acquisition by the Axis of surplus grain-producing areas and of oil resources represents a real gain, the Axis position in grain and oils was not sufficiently critical to make such acquisitions a prime military objective. More important was the damage to the Russian war effort which the complete attainment of the 1942 objectives would have entailed. The loss to Russia of extensive grain producing areas and the manufacturing facilities of Rostov and Stalingrad, and interference with transport on the Volga have been serious but not critical. If, however, the Axis had succeeded in occupying the North

and South Caucasus, the damage to Russia's war potential might well have been vital.

The 1942 Axis campaign of attrition must then be regarded as a partial failure. In 1943 Germany has the choice of renewing the war of attrition (attempting again to conquer the Caucasus) or of shortening her lines in Russia and assuming the defensive. (The crushing of Russian resistance in 1943 seems definitely out of the question). Whatever the choice, the Axis would appear to be faced by a Russian war potential which the 1942 campaign has not decisively reduced. Whether a renewed German offensive can sustain the scale of 1942 depends largely on how actively the United Nations push the attack in Southern and Western Europe.

#### *The Mediterranean*

The European Axis, in the war to date, has possessed two enormous advantages over its western opponents. The fact that the United Nations lines of communication have been extended sea lines, peculiarly vulnerable to submarine attack, has meant that the Axis could, with a relatively small expenditure of resources, inflict tremendous damage on its enemies. Secondly, since the only area in which the United Nations could bring ground forces into contact with the Axis was Egypt and Libya at the end of a 12,000-mile supply line, the Axis possessed an enormous logistical advantage. Four German divisions and a half-dozen Italian divisions have been able to divert continuously from 2½ to 3 million tons of shipping into the supplying of United Nations forces in the Near East. As long as the United Nations were denied Northwest Africa and their forces were held in Eastern Libya or Egypt, this advantage persisted and Germany was well content with this type of "second front". The events of the last three months have completely changed the position of the Axis in the Mediterranean. The almost bloodless

conquest of Northwest Africa has lopped 8,000 to 9,000 miles off the length of United Nations supply lines. The scanty port capacities still left to the Axis in North Africa will not permit a long continued resistance to United Nations attack in this area, unless diversion of United Nations forces is within the capabilities of the Axis. The most promising avenue for a limited Axis counter-offensive is probably Spain, but without the cooperation of the Spanish Government, which seems unlikely, this approach is beset with danger.

Possession of the whole North African coast by its enemies would confront the Axis with a second front of major potentiality. It would not only give the United Nations a supply line protected by land-based aircraft to the Near and Far East and would deny to the Axis in large part the use of this sea, but it would immediately entail extensive redistribution of Axis ground and air forces. These changes are real and inescapable. What is involved for the Axis in the Mediterranean over and above this is contingent on the forces which the United Nations devote to this area. There can be no doubt, however, that 1942 has witnessed a major decline in Axis capabilities in the Mediterranean.

#### *The West*

When Germany threw 200 divisions into the attack on Russia in June 1941, it was a gesture of supreme contempt for the offensive capabilities of her British opponent. The arc facing England from Trondheim to Bordeaux was garrisoned by a handful of divisions and protected by less than a quarter of German plane strength. During 1942 this arc continued to be held by not more than 45 divisions. In the meantime, however, the air situation has completely changed. German plane losses in Russia and elsewhere have been in excess of production rates and her effective combat plane

strength has declined from around 10,000 at the beginning of the Russian war to a present figure of not over 5,000. In the meantime an air offensive mounted from England has inflicted increasing damage on the Axis economy and war potential.

The decline in the number of combat planes is, of course, to a certain extent seasonal, and ordinarily the winter months would witness some recuperation of German air strength. The recuperation of last winter, however, was insufficient to permit the replacement of losses of the previous summer, and the pressure this winter promises to be far heavier. It is within the power of the United Nations to continue and to accelerate the downward spiral of Axis plane strength.

Appendix III points out that during the first eleven months of 1942 the RAF undertook bombing missions against Axis Europe on 135 nights with an average of 190 planes per night. This weight of air attack was augmented by high and low level daylight attacks and from August on by the precision bombing missions of the American Army Air Force. The German air effort in the west during the same period was essentially defensive. There is every reason to believe that the weight of air attack on Germany in 1943 will be greatly increased and no reason to believe that German air capabilities on this front will be augmented.

At the same time that Germany's air position in the West has become progressively worse, the United Nations have been building up ground forces based on England. To the Axis this represents a potentiality of attack which must be taken into account in its military commitments.

In summary, the capabilities of Axis Europe, *vis-à-vis* its enemies, have declined in the following principal respects:

1. There has been an absolute decline of considerable magnitude in air strength. The relative decline is even greater.
2. The probable Axis loss of North Africa will provide the

United Nations with an effective base for operations against Southern Europe.

3. The growing strength of opposing forces in the West and South has not been compensated by an appreciable decline in the capabilities of Russia.

4. There is some evidence of widening fissures in the structure of the Axis New Order in Europe.

5. The war economy on which the military effectiveness of the Axis is based is in decline in the sense that labor replacements are of insufficient quality to maintain total output and that replacement of capital equipment is inadequate.

The relative decrease in European Axis capabilities, however, should not be interpreted to mean that the scale of Axis military effort must be less in 1943 than in 1942. Germany will, no doubt, wish to keep it less if she decides to pursue a defensive war of attrition. It is, however, within the capabilities of the Axis to increase substantially the scale of activity, though at the expense of a later, more rapid, decline in military strength.

#### *The Far East*

The rapid and striking gains of the Japanese against weak opposition in the first five months of 1942 attained for the Far Eastern Axis an empire the full exploitation of which would make Japan one of the strongest powers on earth. It early became evident that immediate Japanese objectives embraced nothing less than the exclusion of the United Nations from the area bounded by the great arc from Burma and the East Indies through the Melanesian barrier to the Solomons and beyond. With the exception of New Guinea, these objectives were quickly attained. Since June, however, further Japanese efforts have been abortive and accompanied by very considerable losses.

Already in April a naval reconnaissance in the Indian Ocean

had met with unexpected opposition from British planes based on Ceylon, leading to a retirement of the Japanese force. On May 7 a Japanese approach toward Australia was routed in the Coral Sea. In June came the smashing defeat at Midway and with it the cessation of further attempts at offensive action by the Far Eastern Axis. Although Japan strengthened her already sizeable Manchurian forces during the summer, the opportunity to attack Siberia while Russia was fully engaged was not seized. In August American forces landed in the Solomons and during the last four months of the year Japan's major military effort has been devoted to the unsuccessful attempt to dislodge her enemies from these islands and from New Guinea. This lack of success culminated in the naval battles of November 12-15 off the Solomons, resulting in Japan's worst defeat of the war to date.

Japanese offensive capabilities in the near future must be judged with her naval, merchant marine, and aircraft position in mind. While this position is not such as to preclude a major offensive, it is sufficiently tight to deter the Nipponese from incurring further heavy losses unless the probable gains are of decisive importance.

Japanese naval losses have been especially heavy in aircraft carriers, heavy and light cruisers, and destroyers, that is, in those ships which are particularly useful in the amphibious operations which have characterized the war in the Pacific. As of the end of November, 6 out of 12 aircraft carriers had been sunk with an additional 2 damaged; 12 out of 19 heavy cruisers with 4 damaged; 5 out of 20 light cruisers with 6 damaged, and 45 out of 124 destroyers with 15 damaged. While these losses still leave the Japanese navy much stronger than any naval force likely to be brought against it in the West or Southwest Pacific in the near future, they represent a rate of decline in strength which can not be long sustained. Japan can not, at this juncture, afford to trade loss for loss

with an enemy who can so overwhelmingly outbuild her, unless this trading process brings with it a decisive improvement in her strategic position.

Estimates of Japanese plane strength remain highly uncertain. While it is thought that a strength of around 5,000 combat planes at the beginning of the war had been reduced to about 3,600 by the end of November, both the estimates of initial strength and subsequent loss rates are conjectural. It seems clear from recent operations, however, that the Japanese are unwilling to risk plane losses of more than 500-600 a month which argues, perhaps, that their production rate is not in excess of that figure and that first line strength is low in relation to existing commitments. It seems probable that inability to undergo a marked increase in air losses was one of the principal deterrents to action against Siberia during the late summer and autumn.

Nor does the Japanese merchant marine position—although its weakness is much exaggerated—appear favorable for a major offensive involving ground operations in areas distant from Japan. The Far Eastern Axis member started the war with a highly modern merchant marine of 6.7 million tons. Despite the capture of a few hundred thousand tons of neutral and enemy shipping, Japanese losses have been sufficient to reduce the present merchant marine tonnage to not more than 5.7 millions. After allowance is made for existing economic and military requirements, it is thought that some 600,000 tons would be available for a new military venture (see Appendix VIII). If the present estimated high rate of sinkings and low rate of new construction are accurate, even this small surplus would be wiped out by June 1943. There is reason to believe, however, that the now commonly accepted rate of 400,000 tons of merchant ship construction per year—based as it is on a pre-war estimate of Japanese shipbuilding capacity—is considerably short of present Japanese capa-

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bilities. As our own experience shows, shipways can be rapidly constructed and it seems unlikely that a shortage of ship plates, propulsion machinery, other materials and equipment, or manpower would limit our Far Eastern enemy for any long period to this rate. Furthermore, it is probable that the Japanese are substituting rapidly-built wooden ships for steel cargo carriers on every possible route. While the shipping position probably limits to some extent not only military operations but the economic exploitation of conquered territory, it would be wishful thinking to suppose that a continuation of ship sinkings at their present rate will—either in the near or distant future—have decisive effects.

While it can not be asserted with confidence that Japanese naval and air losses and lack of merchant shipping condemn the Far Eastern Axis partner to a fundamentally defensive position, it appears unlikely that it will undertake any one of the four major offensives which, if successful, might decisively improve its strategic position, i. e., offensive against India, Australia, the United Nations' South Pacific supply lines, or Siberia. Action against India or Australia would involve the transportation of large ground forces as well as the use of extensive air and naval strength. Cutting our South Pacific supply lines appears a task too large for present Japanese naval and air strength. As against Siberia the circumstances are now less propitious than four months ago.

But, if Japanese offensive capabilities do not appear to be major, her defensive position and capabilities, on the other hand, have been scarcely called in question. Four months of fighting on the periphery of the newly acquired Japanese empire have yielded a few square miles of territory and, if the air and sea losses inflicted have been heavy, it is rather in relation to the immediate objectives and to the forces involved than in relation to total Japanese strength. In the meantime, the Nipponese have been fortifying and strength-

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ening island bases further north in such fashion as to make the island-by-island approach to the citadel of Far Eastern power an extremely tough one. The engagement of Japanese forces in China and the effective use of Chinese territory for aerial bombardment will require the reconquest of Burma and the reopening of the Burma Road, a difficult task in view of the logistical problems involved in moving large forces from India. From the north, Japan remains practically impregnable as long as Russian territory is not available for United Nations' use. There remains the sea route to Japan proper from Pearl Harbor, an approach requiring overwhelming naval strength not at present at the disposal of the United Nations.

Within the area occupied by Japan are industrial materials adequate, with the principal exception of cotton and copper, for a self-sufficient military power of great strength. The factors which mainly limit the rate of exploitation of this empire are shortages of skilled labor, various types of equipment, and shipping. The principal vulnerability of the area lies in its long lines of sea communications. Information on the speed and efficiency with which Japan is developing the potentialities of its newly acquired empire is almost wholly lacking. It is probable, however, that Japan has increased her peacetime rate of industrial advance; and that the present scale of United Nations activity in the Pacific will not prevent the Japanese from consolidating their gains and adding to their power to wage sustained war.

## APPENDIX I

THE EASTERN FRONT: FROM THE RELIEF OF MOSCOW  
TO THE RELIEF OF STALINGRADI. *The Russian Winter Offensive*

The winter offensive of 1941-42 was undoubtedly the product of excellent timing and judgment of the enemy's capabilities on the part of the Russian High Command. After a summer and autumn of disasters, which had cost the Soviet Union about three and a half million casualties, and the loss in combat of at least 7,000 planes and 8,000 tanks, the defenders of Moscow chose exactly the right moment to strike back. The result was the relief of the Soviet capital, the recapture of Klin, Kalinin, Mozhaisk, and Volkhovstroi, and the creation of a salient in the Valdai Hills-Velikie Luki sector seriously threatening the flank of the German central armies. (See map facing page 26.)

There are those who assert that the final attack on Moscow was never seriously intended, and that the major part of the *Wehrmacht* was already going into winter quarters late in November of 1941. The narrow sweep of the December Panzer encirclement, and the fact that the Germans announced their withdrawal the day after their Japanese allies had irrevocably committed themselves by the attack on Pearl Harbor, have suggested to some that the last offensive was psychological and political rather than military in inspiration.

There is probably an element of truth in these assertions. The attack of late November was a desperate venture, undertaken perhaps against the advice of Hitler's most reliable advisers and conducted with predominantly mechanized forces. It is doubtless true that a large part of the German armies had already retired toward the winter barracks prepared in the vicinity of Smolensk, Vyazma, and other cities to the rear—witness the comparatively small number of troops captured by the Russians in their successful counter-advance, and the fact that once the Germans had reached their previously prepared positions they were able to bring their withdrawal to a halt.

On balance, however, it appears that the final attack was probably a serious effort to reduce Moscow. The collapse of this drive set the seal on the strategic failure of the whole German campaign of 1941. Similarly the Russian winter offensive was of profound moral sig-

nificance. It not only disproved Nazi claims about the destruction of the Red Army; it also helped to convince the doubting Thomases in the Anglo-American camp that Russia was a good risk, which in return for assistance in planes, trucks, and tanks served to tie down three-quarters of Hitler's army.

The Russian offensive actually lasted less than two months. By early February, the recapture of Mozhaisk had completed the relief of Moscow; the successful landings in the Crimea had eased the pressure on Sevastopol; and the establishment of the Russian salient toward Lozovaya had created a constant threat against Kharkov, the most important city in German hands. At this point, however, the Soviet advance came up against the Nazi winter line. In an irregular arc from Schlüsselburg on Lake Ladoga to Taganrog on the Sea of Azov, the invaders had established a series of almost impregnable hedgehog fortresses—including such advance bastions as Staraya Russa, Rzhev, Vyazma, and Orel. These strong points were prepared to hold out for weeks at a stretch without contact with the outside world and supplied only by air (as actually happened in February and March at Staraya Russa, where the Russians claimed the encirclement of the whole Sixteenth Army). To garrison these fortresses and the lonely village outposts between them, the Germans may have used no more than 40 divisions; perhaps 75-100 more were in reserve in such areas as White Russia and the western Ukraine. The rest of Hitler's army was resting and reequipping in Poland, France and Central Germany.

At the same time, with the coming of the extreme cold, the Russians began to restrict themselves to isolated, semi-guerrilla activities, the establishment of sweeping salients through lightly-held areas, and the cutting of strategic railroads around Rzhev and Kharkov. In an apparent effort to keep up the morale of a home front and of Allies disappointed at the Russian failure to capture these two cities or to liquidate the German resistance at Staraya Russa, the Soviet High Command resorted to "victory by communiqué" and took refuge in generalities. In brief, the winter offensive was unable to break the German line; it recaptured areas of comparatively minor agricultural and industrial significance.

The winter fighting imposed ghastly hardships on the Nazi soldiers who garrisoned the forward areas, and may have forced the German High Command to bring back from France eight or ten divisions whose rest period had been curtailed. These hardships, however, never

broke the Nazi armies on the Eastern Front; typhus never reached more than mildly epidemic proportions. The winter offensive was essentially an incomplete victory, but one which assured Russian participation in the war for at least another year.

## II. *The German Spring-Housecleaning*

As the thaws of April turned the Russian front into fields of mud in which all action was impossible, interest centered on the convoy route to Murmansk. By early April, Ambassador Standley was able to announce that American deliveries at last squallied our commitments, and the steady arrival of convoys from Britain—as yet with a comparatively low percentage of losses—marked the faint beginnings of an effective cooperation between Russia and the Anglo-Americans. This liaison was to increase in importance until early June when the simultaneous signature of the master lend-lease agreement with the United States and the 20-year mutual assistance pact with Great Britain marked the beginning of the protracted conflict over "the urgent tasks of creating a second front in Europe in 1942."

Ever since February, the German units that had been resting in the West had been steadily returning to the Russian front. By late April, the ground was presumably dry enough around Kharkov to permit the resumption of major operations. But the expected spring offensive failed to materialize. Until June 28, Hitler restricted himself to local attacks, aiming to straighten his lines by destroying the salients created during the Soviet winter offensive.

To explain this Fabian strategy, some observers have contended that the Nazis were so confident of a rapid victory that they felt they could afford to wait until the season was far enough advanced to permit of an attack all along the line. But the fact that the *Wehrmacht* eventually waged its campaign on the southern front alone would appear to rule out this hypothesis. Others have stated that Timoshenko's Kharkov offensive of late May disorganized the German timetable. Yet this offensive proved to be a most costly operation, in which the Russian advance became overextended, and in which Timoshenko lost perhaps 30 percent of the three armies originally committed. The most likely explanation is that the Germans were actually weaker—especially in air power—than competent American military opinion believed. With the beginning of a large-scale British air offensive in the West, the Nazis were obliged to leave about 1,000 planes in this theater. As a result the Germans had only about 3,400

first-line planes, with very low reserves, for the Eastern Front as opposed to about 2,500 in the initial establishment, plus adequate reserves, in the previous year. With allowances for routine activity in comparatively quiet areas, the invaders had available sufficient planes for major activities in only one or two sectors at a time. It was not until the last days of the month-long siege of Sevastopol, in which the Germans may have used 900 planes, that the great summer offensive began.

Meantime, the Nazis had proceeded in workmanlike fashion to eliminate the Soviet salients. By May 1, all the major dents in the German lines had disappeared except for the one south of Lake Ilmen, which remained in reduced size all through the summer. On May 19, the last Russians evacuated the Kerch Peninsula. On June 31, Sevastopol fell.

## III. *The Don-Caucasus Offensive*

The same factors which had limited German spring operations to local attacks probably dictated the organization of the great summer offensive on a relatively narrow front. Consequently, General von Bock was able to concentrate about 65 divisions—11 of them Panzer units, with about an equal number of motorized and SS divisions—for a three-pronged attack from Kursk to the Sea of Azov. The result was a heavier concentration of mechanized units than had participated in any German attack in 1941. The Russians, whose major forces remained around Moscow, had no alternative but retreat.

As to the skill of Timoshenko's withdrawal, opinions have varied. Some claim that his delay in evacuating the Rostov position forced the bulk of his army to retreat into the Caucasus where it was of no use in defending the main line of resistance at Stalingrad. Those critics concede, however, that fewer units were trapped in Rostov than those who remembered the Kiev encirclement of 1941 had anticipated, and that the one major battle of annihilation that Timoshenko suffered was in the Don bend. And even in this latter area, the defenders of Kletskaya met defeat only after postponing for two weeks the attack on Stalingrad. Furthermore, the divisions which escaped south from Rostov, far from being reduced to a disorderly mob, were able to cooperate with the Army of the Caucasus in stemming the German advance at Mozdok and south of Novorossiisk. By mid-September, both in the Caucasus and around Stalingrad, the Nazi offensive had substantially halted.

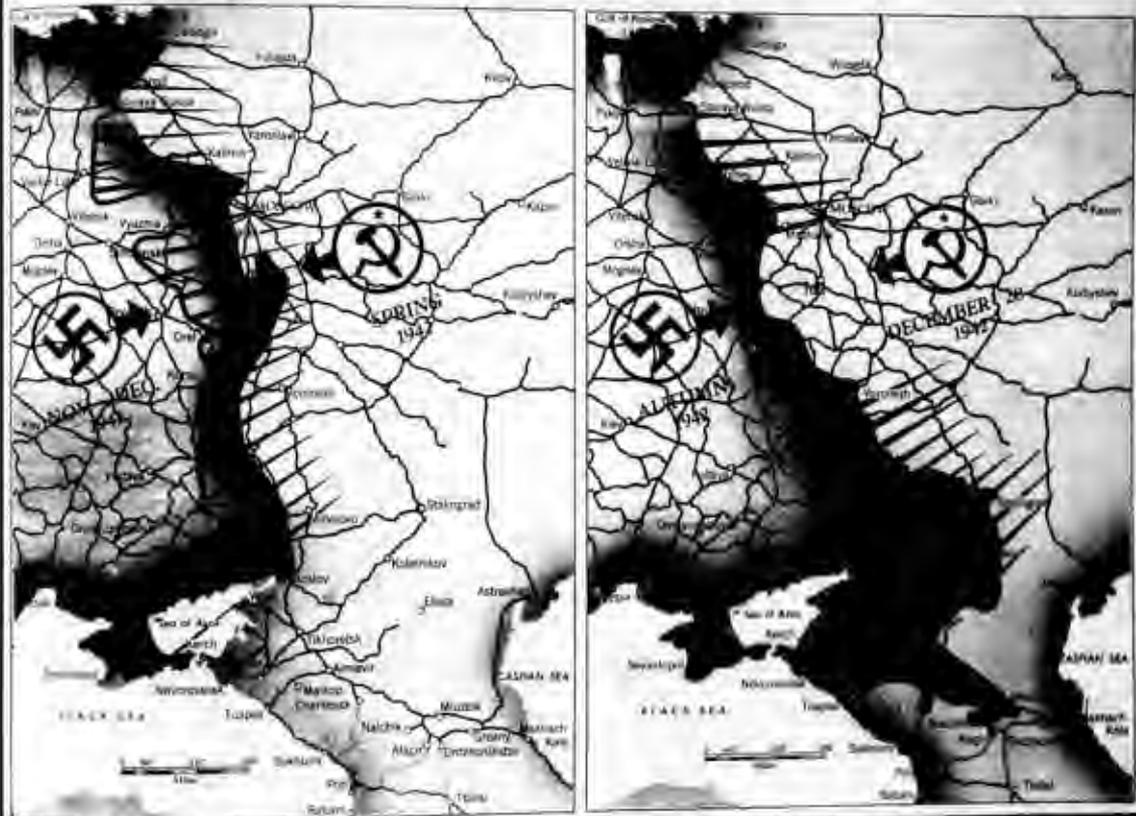
In the Caucasus, this halt was largely the result of supply difficulties. At the end of a 400-mile salient, the Germans had behind them a railway net capable of supporting only 20-30 divisions. Furthermore the terrain of the Caucasus foothills favored the Russians, and the recurring factor of air power was a real limitation in an area where the Nazis had available only about half the number of planes they had concentrated around Stalingrad.

At the Volga River city, the causes of the German failure were more complex. Here also supply difficulties were of prime importance, since the invaders could use only one single-track railway, and the dirt tracks that served as roads over the Don steppes were reduced to quagmires by a few days of rain. The air situation was likewise tight, for the Germans discovered in mid-September that they could not keep up a pace of 1,500 sorties a day. Furthermore, Panzer and hitz tactics were ineffective against an enemy that chose to resist from street to street and from house to house. The Russians, of course, faced equal supply difficulties, since the roads along the Volga and the pontoon bridges for the reinforcement of the city were constantly being interdicted by enemy air attack. But by daring makeshift and reinforcement operations by night, Timoshenko was able to supply the city and to keep contact with the Russian reserve concentration in the Saratov-Tambov area. About October 1 the arrival of 10 fresh divisions from western Siberia helped to maintain pressure on the German northern flank. Military explanations, however, do not fully account for the epic of Stalingrad. The defense of the Volga River city was an unprecedented triumph of popular courage.

One cannot gauge the magnitude of Hitler's failure without examining the purposes of the great offensives of 1942. Some commentators have maintained that Von Bock's drive was essentially a geopolitical campaign for grain and oil with its ultimate goals at Stalingrad and Baku and as such represented a radical departure from previous German strategy, which had always aimed at the annihilation of the enemy's major forces. Hitler himself has given this interpretation his implied approval. On the other hand, competent analyses of German capabilities have revealed no such crying need for oil as the American press has supposed. In 1942, oil production in Nazi-controlled areas nearly balanced consumption, and a slight rise in production, exclusive of the North Caucasus, is anticipated for 1943.

Furthermore, the Axis timetable produced by Stalin in his anniversary address last November called for a vast encircling movement

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on Moscow, coupled with a thrust toward the Trans-Caucasus, which was to have brought the Germans to Stalingrad by July 25, to Arzamas (250 miles east of Moscow) by September 10, and to Baku by September 25. This timetable largely coincides with the plan which many American military observers were attributing to the Germans as late as last June, despite the fact that the delay in launching a "spring" offensive had already suggested that Hitler might be intending something less than a victory of annihilation.

On the basis of evidence now available, it is impossible to judge the extent of the German objectives for 1942. It seems obvious, however, that a battle of annihilation around Moscow—where perhaps 40 percent of the Russian forces remained concentrated last September—represented the only way the Germans could have eliminated the Soviet Union from the war before the power of the United States became a major factor on the European continent. And it is difficult to see how under any more limited plan the Nazi leaders hoped to bring the war as a whole to a victorious conclusion. Stalin's hypothesis, then, appears the more logical. On the other hand, the hypothesis of a limited objective represents an estimate of German weakness pregnant with possibilities for 1943.

Even on this narrower basis, Hitler's achievements in 1942 fell far short of his goal. In the months of July, August, and September, the Germans may have lost 2,100 tanks, 3,565 planes, and 450,000 men (killed, missing, and permanently disabled). Stalingrad and Baku remain in Soviet hands. The Volga will probably be open to Russian traffic next spring. While the Germans have denied to the Soviet Union the steel capacity of Rostov and Stalingrad (with a 1937 production of 4,000 tons of finished steel daily in one plant alone), the complete destruction of plant, at least at Stalingrad, has left the invaders little aggregate gain. Neither the Germans nor the Russians for the present can use the crude oil output and crude refining capacity of the Maikop area, which represent approximately 9 and 11 percent respectively of the Soviet Union's total resources. The grain of the Kuban is perhaps the most serious loss which the Russians have suffered in 1942. Yet the summer harvest was almost complete when the invaders arrived, and with the evacuation of most of the tractors, draft animals, and able-bodied men, the 1943 crop will probably fall notably below that of previous years.

IV. *After Stalingrad*

By mid-November, the number of Axis divisions in and around Stalingrad, which in September had totalled perhaps 30, had fallen off sharply. Although Hitler did not publicly admit it, he had already implicitly recognized the failure of his 1942 campaign, and by sending his soldiers into winter quarters somewhat earlier than in 1941 was seeking to avert the calamities that had befallen them during their first winter in Russia. And as in 1941, the Red Army struck back at the very moment when its enemies had begun to waver. The result was the relief offensive north and south of Stalingrad, and the development of the secondary offensive which had been in progress on the Kalinin front ever since August into a considerable effort threatening the security of the German anchor at Rzhev.

The original pincers attack on the southern front apparently aimed simply to relieve Stalingrad and the Volga. The two more recent offensives—one south along the Voronezh-Rostov railway, and one against the tip of the German Caucasus salient—are more extensive in scope, strongly suggesting that the Red Army will attempt to reduce Rostov and liquidate the whole Caucasus position this winter. If the Russians could virtually annihilate the 20-odd Axis divisions around Stalingrad, and the 50-odd divisions in the North Caucasus, they would cripple the *Wehrmacht's* offensive power. In this area the weather will be suitable for large-scale Soviet operations all winter. In the center and north, however, the experience of last year would indicate that from February on, the Russians will probably concentrate on harassing and infiltration, and that the Germans may be able to hold substantially the same winter line as in 1942.

Whatever the Soviet High Command decides will depend to a great extent on the attitude of its Allies and on the requirements of coalition warfare. The "crisis of the United Nations" last summer shook relations between Russia and the Anglo-Americans to their depths, and its effects have not yet completely disappeared. After the disastrous experience of the June-July convoy to Archangel, no further convoys went through until September. And the press campaign for a second front—which reached a crescendo in October long after the Soviet leaders had learned of the Anglo-American plans for November—evidently reflected Stalin's dissatisfaction with what Churchill had told him in August—that the second front for 1942 would be in Africa and not on the European continent.

Since the African invasion, the Russian attitude toward Britain

and the United States has been somewhat warmer, and comment on the Darlan question was notably restrained. Yet the Kremlin can hardly fail to remember that the appeasers of the past were frequently advocates of conservative cooperation against the "Communist menace." While the Russians are apparently prepared to commit their ultimate reserves in the most far-reaching military and political offensive of the United Nations effort, the mutual scepticism and incomplete understanding between the Soviet Union and its Allies may well remain the major problem of the war—and of the peace to follow.

## APPENDIX II

## THE MEDITERRANEAN FRONT: 1942

The Axis position in the Mediterranean has now fallen to its lowest point since the war began. Despite various reversals of the pendulum in Libya, the total Axis position in the Mediterranean had grown steadily stronger since Italy's entrance into the war, reaching its peak last July when Rommel threatened the Middle East. Today Hitler is struggling not to control North Africa or the Middle East, but to maintain a foothold across the Sicilian narrows in order to deny the Allies use of the Mediterranean for assault on the continent of Europe.

At no time, however, has the Axis made a total effort to develop its potential position in the Mediterranean-Middle Eastern theater. Specifically, German commitments in this arena have never been large, and at each critical juncture German strategy has treated this as a theater of secondary importance.

*Attack and Counterattack in Libya*

The years 1940, 1941, and 1942 have all closed with British counterattacks driving the enemy from Egypt across the Cyrenaican hump to El Agheila. General Wavell's offensive of December, 1940, repelled the first Italian advance into Egypt; but, following the arrival in Tripoli of the German Afrika Korps in February, 1941, and the diversion of Allied forces for the Balkan campaign, the enemy again drove to the Egyptian frontier one week before Germany opened her

attack on Russia. Here Rommel halted until forced back by General Auchinleck's offensive of November, 1941, which relieved Tobruk after six months of siege. This, the "Fourth Libyan Campaign," carried the British to the El Aghella region in January, 1942, before losses, tactical errors, and problems of supply caused their withdrawal to the Gazala-Bir Hacheim line from which Rommel eventually launched his summer offensive.

This pattern of attack and counterattack in Libya was possible because—given the few divisions involved and the mobile conditions of desert warfare—a slight advantage of strength or supply, or a single tactical judgment could result in a spectacular advance. Yet none of these campaigns produced decisive results, because none annihilated the enemy's forces. Both sides, however, were slowly but steadily raising the ante. The battles and the stakes had grown apace by the time the campaigns of 1942 began.

#### *Axis Mediterranean Peak*

All during last winter Allied capitals were apprehensive lest the Axis use the period of reduced activity on the Russian front to undertake major operations in the Mediterranean. Fears were widespread of either an Axis movement into French North Africa or a drive on the Suez Canal to clear the Mediterranean and possibly the Middle East. The Axis concentrated in the islands of Crete and the Aegean a total of about 90,000 men, and stepped up its propaganda to the Arab world. The Italian Navy, having repaired much of the damage suffered at Taranto, came to enjoy a relatively better position than at any time since Italy's entrance into the war. Britain, although sending men and planes to Libya, was forced to divert strength to the Far East at this time. The British naval position in the Mediterranean, which had never fully recovered from the Battle of Crete, had deteriorated sharply, and Malta was virtually neutralized by incessant air raids. In February only five to ten percent of Axis shipping en route to North Africa was being sunk.

But the Axis made no move to use the winter months for operations in the Mediterranean. German strategy apparently called for conservation and concentration on the coming campaign in southern Russia—rather than exploitation of its Mediterranean potential. A limited flow of supplies and reinforcements to Rommel was the only exception.

By May the latter had accumulated sufficient strength to reopen

the Battle of Libya. When the Afrika Korps swept around the southern end of the Allied line at Bir Hacheim on May 26, its immediate objectives were probably only the reduction of growing British striking power and the capture of Tobruk as a basis for future operations. However, after narrowly averting entrapment east of the minefields, Rommel achieved such spectacular success against British armor on June 12-13 that the way was open to Egypt. Tobruk fell by storm on June 20, with heavy losses in men and stores. Faced with encirclement at the frontier and again at Matruh, the remnants of the Eighth Army finally fell back at the end of June to the El Alamein line. Only the coverage provided by the RAF made possible this withdrawal. Here fatigue, supply problems, and British reinforcements halted Rommel's advance at the gateway to the Middle East.

This was the high tide of Axis success in the Mediterranean. The Eighth Army had dwindled from 125,000 men to considerably less than half that number, and losses in tanks and guns had been even more severe. This situation made necessary a transfer of forces that seriously reduced the already weak Ninth and Tenth Armies in Syria and Iraq-Iran. All heavy units of the British Mediterranean fleet had to be withdrawn, and Alexandria and the French ships interned there were in peril. The Arab world appeared ready to receive the Axis in the Middle East. Turkey asserted her determination to resist any attack, but she was threatened by Axis pincers advancing through the Caucasus and Egypt. In the west Italian war morale skyrocketed, and collaborationist groups in France and Spain were notably strengthened.

#### *Berlin's Higher Strategy*

Yet even at this juncture Berlin neither gave Rommel the reinforcements needed for a break-through, nor attempted any other operation against the Middle East. Observers estimate that two armored divisions, together with adequate air power, might have been enough to turn the tide in Egypt. Yet neither in July nor again in early September (when Rommel made his last abortive attack) did the Axis make available the margin of strength needed for victory.

Primary in this turn of German strategy was the fact that both in 1941 and 1942 Rommel reached Egypt in the same week that Germany opened her offensives against the Soviet. The magnitude of commitments on the Russian front probably precluded any simulta-

neous operations against Turkey or Cyprus and Syria, and may have weighed against diversion of air or armored strength to Africa. Some observers suggest that ample forces and air power for operations in Egypt were at hand, but that supply and terrain were the limiting factors. The Axis situation in supply and in fuel and servicing facilities for aircraft was continually tight; but an ample margin of Italian (and if needed Vichy) shipping was always available, if the Axis had ever decided on major operations in the eastern Mediterranean.

The enemy's decision was rather part of its total plan of operations, and indicates that the German High Command—whatever might be Italy's stake in this theater—did not feel the war could be won here. Accordingly, beset by the two-front "lesson" of the last war and anticipating the requirements of 1943, Germany never committed more than four divisions in Africa, prior to the Allied landing in the West. Her commitments in air power have been larger, but still secondary. She has been content to maintain a force sufficient to deny the United Nations the use of the North African littoral as a bridgehead for attack on Europe; and sufficient to force the Allies to send men, materiel, and shipping 12,000 miles around Africa to check Rommel's army, supplied by interior lines only 1,500 miles from Germany.

In the last analysis the strategists in Berlin perhaps made two basic errors in judgment. First, they may have failed to appreciate the long range importance of driving the United Nations from the Mediterranean and Middle East. Second, they apparently did not assess accurately the latest growth in the power of the Eighth Army, both in material resources and in its command of the tactics and problems of desert warfare.

#### *The British Offensive*

In the months from July to October the Eighth Army increased from less than 50,000 men to more than ten combat divisions and received significant reinforcements of new equipment, including American M-3 and M-4 tanks. The RAF and Ninth Air Force were greatly expanded in size and range of operations. At the same time reinforcements brought the Tenth Army in Iraq-Iran from a "blueprint" Army to very substantial fighting strength. In August Churchill effected a change in command that turned over the forces in Egypt to Generals Alexander and Montgomery, men who had learned the lessons of Libya.

During the summer both sides awaited reinforcement. The British twice felt out enemy positions, but neither side possessed sufficient advantage for a major offensive. The scope of Allied air war mounted sharply, and told heavily on enemy supply lines. Three thousand tons of bombs were dropped on Tobruk alone in the three months after its fall. In early September Rommel made a final effort to reduce Britain's growing striking power. His forces had increased to 70,000-85,000 combat troops, over half of them German, and he probably had 400-500 tanks. He was denied any large scale air reinforcement, however, and the British won a tactical victory.

It was this force that General Montgomery routed in the offensive that began on October 23. Taking full advantage of the enemy's failure to concentrate his forces in the northern sector, the British worked their way through the fixed defenses at El Alamein, defeated the enemy's armor, and then advanced almost 800 miles in 29 days. The Axis left on the Alamein battlefield seven or eight much reduced Italian divisions that had been in the front line, several German Battle Groups, and most of the 164th German Infantry Division. The British, however, were never able to encircle the depleted Afrika Korps and other remnants which retreated to El Aghaila. Axis forces at this point, augmented by two fresh Italian divisions and other units, were estimated at 35,000 combat troops and 100 tanks.

When Berlin apparently decided to concentrate reinforcements in Tunisia, Rommel was obliged to withdraw from the strong natural defenses of the El Aghaila region. Although he thereby lengthened British lines of communication another 250 miles while easing his own fuel, supply, and transport problems, his present positions are vulnerable to outflanking movements whenever the British are able to renew the attack. It therefore seems doubtful that the enemy will be able to hold Tripoli indefinitely; but a delaying defense to the east of this port may be expected, for with Tripoli as a forward base, the Allies could close the pincers on Tunisia, moving forward by sea the extensive supplies accumulated in Egypt.

#### *Allied Operations in Northwest Africa*

On the heels of the British break-through in Egypt, American land, sea, and air forces—aided by the RAF and the Royal Navy—made multiple landings in French North Africa at 3:00 a. m. on November 8. Resistance was offered chiefly by French naval forces and coastal artillery, and by troops under Noguès' command. Algiers

capitulated that evening, and three days later Admiral Darlan gave the general order to cease firing.

Elements of the British First Army and an American armored force promptly pushed eastward into Tunisia in an effort to forestall the establishment of a major Axis bridgehead. Although lacking forward air bases, small Allied forces advanced as far as Mateur and Djedeida by November 30. Here they were halted. During December 1-6 the Djedeida column was driven back along the Medjarda Valley west of Tebourba with substantial losses in armor, trucks, and guns. This closed the initial phase of the Tunisian campaign. With the enemy established in relative force in strong positions, the Allies paused to bring forward over tenuous lines the reinforcements and supplies, and to organize the air bases and ferry-services needed for large-scale operations.

Apparently not absolutely certain of just where and when the Allies were going to land, the Axis had shifted no large forces to Africa before November 8. It had previously concentrated submarines for the attack and enlarged its air forces and air facilities in Sicily and Italy. Not until November 10, it appears, did the airborne movement to Tunisia begin. Since that time, in addition to strengthening the defenses of southern Europe, the Axis has moved to impose a maximum delay on the Allied conquest of Tunisia, for the immediate purpose of denying us both passage through the Mediterranean and air bases for sustained attacks on Sicily, Italy, and southern Europe.

Enemy forces in Tunisia, estimated at 8,000-10,000 combat troops on November 16, had increased to almost 40,000 a month later. Most of this force was concentrated in northeastern Tunisia, with small forces at strategic points southward along the coast and the east-west roads. German combat air power in the Italy-Sicily-Sardinia region has been increased by several hundred planes since early fall, though this transfer has been partly cancelled by losses in Libya.

If the Germans consider that the objective justifies the expenditure of strength, ample forces should be available. The limiting factors are transport and supply, especially the small capacity of the African ports at the disposition of the Axis.

Assuming that Russia continues to contain the mass of German strength, and that Allied tonnage continues to flow to North Africa, the United Nations should be able to isolate and eliminate this Axis toehold. But even should the enemy maintain a foothold in Tunisia into the spring, it may be possible from bases all along North Africa

to impose a diversion of strength and a rate of air attrition that the Axis can not afford in the face of 1943's demands.

#### *The Mediterranean Scene at the End of 1942*

This reversal of the Axis position from the high tide of July had important effects on all the watching, wavering countries of the Mediterranean, although only in France did spectacular consequences follow. Here Germany had maintained Laval in power since April because he offered them more in the way of security and supply at less cost than any other alternative. With the Allied landings in North Africa, Germany was compelled to occupy and fortify southern France. The scuttling of Toulon denied the Axis an important potential addition to its naval power. Our friends in France were enormously encouraged by the American landing, and a more united French front should follow the reestablishment of Giraud.

Upon Italy has fallen the full impact of the Allied offensives in Africa. After 30 months of war, Italy has lost her Empire and now faces a grim winter under heavy air attack. High Italian officials are undoubtedly bitter over Hitler's policy of playing with France, which prevented the defense of North Africa against the present developments. General morale in Italy is low, but that of the armed forces is apparently better. The Italian Navy is strong in numbers (except in cruisers) but its strategic position has been weakened by increased threat of air attack. Its commanders will probably be no more anxious than in the past to take the offensive, but in defensive operations, the Italian Navy is expected to fight vigorously. Although its conservative officer corps is traditionally tied to the monarchy, the modern Navy is a Fascist creation both in ships and function, and observers feel that it considers its fate identified with that of the present Government. In general, there is no reason to believe that Mussolini's regime is in danger, especially as long as German "influence" is present.

Germany has waged a war of nerves against Spain and against the Allies with regard to Spain's fate and Spain's position in the war; but the Franco Government, relieved by President Roosevelt's assurances, has cautiously trimmed its sails away from nonbelligerency in the direction of strict neutrality—a trend that has been under way since the eclipse of Serrano Suñer in September. The Spanish Foreign Minister has assured us "direct from Franco" that Spain will resist German pressure. Observers who even two months ago were

questioning whether Germany would disperse her strength by undertaking operations through Spain (in the face of the known difficulties of logistics, terrain, and guerrilla opposition) now feel that developments on the Russian front make any such action highly improbable.

In the Near East, our successes in North Africa halted the progressive decline of Allied prestige in the Arab world. The change of fortune has not, however, resulted in any flocking to the Allied cause. Long standing nationalist issues remain to the fore, and the wheat problem throughout the Middle East is of mounting gravity. Turkey has been elated at our success and there are indications that, if the trend of events continues, Turkey might in 1943 deviate from her past policy of absolute neutrality. Such a development might create a serious challenge to the difficult Axis position in the Balkans.

The net Axis position in the Mediterranean, then, is notably weaker than six months ago. Its enormous logistical advantage has been reduced with the establishment of an Allied front whose supply lines are about 8,000 miles shorter than the vulnerable route around Africa to Egypt. Furthermore, during the winter season, which Germany has in the past devoted to building up her war potential, the Axis must now construct defenses and divert strength to the long southern European front. Germany has had to increase her plane commitments in this theater, for example, by about 500 additional combat and 200 transport aircraft. At the same time fears that the Nazis would strike through Turkey or Spain have been substantially allayed by the absence of German preparations. It now appears, therefore, that the Axis will limit its counter-measures in the Mediterranean to a determined stand in Tunisia, conserving its forces for the land and air battles of 1943 on the continent of Europe.

### APPENDIX III

#### THE AIR OFFENSIVE IN THE WEST

Throughout 1942 the RAF maintained a strong night and day offensive against German-occupied Europe. With the *Luftwaffe* restricted largely to defensive operations, the British metropolitan air force, later joined by the USAAF, conducted extensive bomber and fighter forays against enemy objectives ranging from Norway to Italy.

#### *Night Operations*

In the first eleven months of the year, the Bomber Command of the RAF despatched some 26,000 aircraft on night raids of which the vast majority were directed against cities in Germany proper (excluded from this summary are those raids in which fewer than 25 planes participated). During this period, bombing missions were undertaken on 135 nights; an average of 190 planes was engaged on each of these nights. More than 30,000 tons of bombs, divided about equally between high explosives and incendiaries, were released on German objectives in these night sorties. French, Belgian, and Dutch targets received 3,500 tons of bombs, while 1,900 tons were released over Italy (Table I).

Increasing in scope and intensity, the bomber offensive reached its peak in June, when an average of more than 300 planes was despatched on operational nights. In the final months of the period the scale of night operations declined sharply owing, in part, to unfavorable weather conditions.

While shipping installations and German naval vessels in Occupied France were attacked frequently in the initial months, major night raids were subsequently directed against objectives in Germany. Systematic bombing of Italy, planned to coincide with military events in North Africa and designed to exploit the lengthening period of darkness, began in late October.

An outstanding feature of night operations was the initiation of 1,000-plane raids, three of which were directed against Cologne, Essen and Bremen during May and June. Two raids on Düsseldorf and one each on Hamburg and Bremen, involving 639, 476, 425, and 446 planes, respectively, took place in the three months following the 1,000-plane raids. These, and the earlier attacks upon Lübeck and Rostock, were reported to have been the most effective raids of the 1942 offensive. Essen, Bremen, and Cologne, in that order, were the most frequently and most heavily raided German cities. Essen alone was favored with 17 night attacks, while Cologne, on May 30, received the heaviest weight of attack on a single night when 1,500 tons of bombs were released over the city.

#### *Bombing Policy*

Area bombing, as contrasted with precision bombing, continued to characterize the RAF's night bombing policy. With but few exceptions, no effort was made to hit specific military or industrial objec-

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tives. The heaviest weight of attack was generally levelled against compact residential areas with the intention of maximizing indirect industrial damage through the destruction of housing, transportation, and communication facilities, etc. In some instances, however, additional bombers were directed against important plants in or near the target city, such as the Heinkel works at Rostock or the Fiat factories in Turin.

This adherence to an area-bombing policy resulted in the employment of heavier bombs, larger bombers, and a greater proportion of incendiary bombs. The use of 4,000-pound H. E. "block busters," particularly effective against residential areas, increased nine- or ten-fold between January and October. Eight thousand-pound H. E. and 4,000-pound incendiary bombs were introduced on a limited scale late in the year.

The type of plane used by the RAF Bomber Command changed markedly during the year. Four-engine Lancasters, Stirlings, and Halifaxes rapidly replaced the two-engine Manchesters, Whitleys, and Hampdens, which had constituted the RAF's early equipment. In January only 4 percent of the planes despatched were four-motor bombers; by October this figure had been raised to 68 percent and by November to 84 percent.

In a similar manner, the average bomb load of planes participating in night raids on Germany increased from 1.4 tons in January to 2.2 tons in October and November. The more extensive use of the four-engine planes with larger bomb-carrying capacities, the employment of heavier bombs, and an increase in the size of the bomb bay of individual planes, all contributed to the increased bomb-load.

Approximately 4½ percent of the planes despatched against Germany failed to return to their bases, but casualty rates among planes sent over France, the Low Countries, and Italy were considerably lower. There is some evidence of a gradual trend upward in casualty rates of planes raiding Germany. This may be attributable to quantitative and qualitative improvements in German antisircraft defenses.

The laying of sea mines and sowing of propaganda leaflets continued to play an important role in night operations. More than 4,200 planes were despatched on mine-laying flights on 160 nights during the first eleven months of 1942. They extended over a wide area from the Bay of Biscay to the North and Baltic Seas, the Helgoland Bight, and the Skagarrak and Kattegat. Six hundred planes despatched on 95 nights dropped leaflets on Germany, Occupied and

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Unoccupied France, Belgium, the Netherlands, and Scandinavia. In July, 33 million were dropped, in August, 23 million, and in November, the month of the Allied invasion of North Africa, 42 million.

#### *Daylight Operations*

More varied but less intensive were the RAF Bomber Command's daylight activities which, unlike the night operations, comprised low or high level precision bombing.

Objectives in Occupied France and the Low Countries were mainly industrial targets such as power stations, docks, shipping installations, enemy naval vessels, and airdromes. Thirteen hundred planes, mostly Boston and Mosquito Bombers, frequently accompanied by fighter escort, were despatched on 100 attacks in this area; but less than 1,000 tons of bombs were dropped on the targets. The most striking daylight raid was the long-distance attack by 88 Lancasters on the Schneider-Creusot Works.

Daylight raids on Germany and Italy were less frequent, and seldom involved forces of any consequence. Fewer than 600 planes were sent over Germany in 70 daylight bomber operations, during which not more than 500 tons of bombs were released.

On August 17, the 8th Bomber Command of the USAAF joined in the daylight sorties against Western Europe. By the end of November more than 1,000 B-17's and B-24's, usually with fighter escort, had been despatched on 21 high-altitude, precision bombing missions against harbor installations, submarine pens, airdromes, and power stations in occupied territory. Greatest of the raids was that of October 9, when 115 bombers were directed against the Fives Lille Steel and Engineering Works.

Operations of the RAF Fighter Command were manifold. They ranged from frequent escort of RAF and USAAF bombers to regular offensive sweeps of areas in which enemy fighters were concentrated but where serious opposition was rarely encountered. American P-38's and Eagle Spitfires joined in these activities. United Nations fighter planes also engaged in diversionary sweeps to draw off enemy fighters and in bombing operations aimed at railroad installations, locomotives, and military centers.

TABLE I.—RAF night bomber operations, January–November, 1943

Month	Total aircraft despatched	Number of nights of operations	Average number aircraft per night of operations	Average percent casualties		Bombs dropped (metric tons)			
				Germany and Italy	France	Germany and Italy		France	
						H. E.	I. B.	H. E.	I. B.
January	1,998	19	106	3.7	0.7	600	50	1,100	50
February	810	11	74	1.1	1.4	550	100	100	.....
March	1,780	9	197	4.1	0.7	1,350	450	500	.....
April	3,321	18	185	5.9	1.9	1,650	1,200	600	.....
May	2,160	10	216	4.9	9.7	1,000	1,350	250	.....
June	4,204	14	307	4.8	.....	1,900	3,500	.....	.....
July	3,294	11	304	4.1	.....	2,500	1,850	.....	.....
August	2,090	12	172	8.3	.....	1,050	1,550	.....	.....
September	2,078	11	270	8.0	.....	2,500	2,450	.....	.....
October	1,753	10	175	4.4	.....	1,250	1,550	.....	.....
November	1,814	10	181	2.7	.....	1,100	1,050	.....	.....

<sup>1</sup> Nights of operation where less than 25 planes were despatched are not included. The figures presented in the table are based on preliminary reports.

## APPENDIX IV

## GERMAN ECONOMIC PROSPECTS

Any estimate of the productive potential of the German economy during 1943 must be framed in terms of certain assumptions concerning the size of the forthcoming Nazi military effort. The only generalizations that appear feasible within this context are very broad ones: namely, that if the Nazis remain largely on the defensive and if they are not severely pressed in Europe itself, they should be able to strengthen considerably their productive position, whereas, if they attack in Russia or elsewhere on a scale comparable to that of 1942, or if the Allies open a continental front in Europe, the effectiveness of their forces will be perceptibly impaired by deficiencies in the output of certain military items. Moreover, military operations of these dimensions would in turn reduce Germany's economic capacity to wage war on a comparable scale in the succeeding year.

*Manpower*

Our first assumption of German defensive operations in the East and of no Allied offensive on the continent carries with it the estimate

that the Germans would thus be able to reduce safely the size of their armed forces by some 1,500,000 men in 1943: permanent losses, which might be expected to amount to some 1,000,000 men in 1943 under this assumption, could be allowed to go unreplaced, and 500,000 soldiers could be given "industrial furloughs." This would permit the disposition of 130 divisions to hold the Eastern Front, 45 divisions to man the West and the Mediterranean littoral, and 75 divisions for garrison and line-of-communications duty. Table I indicates the German labor position under these assumptions:

TABLE I.—Labor Force in Germany, November 1942–November 1943 (Assumption: Germany on Defensive, no Major Attacks by United Nations)

[In thousands]

	Total	Male	Female
<b>A. Position as of November 1942:</b>			
1. Germans, normal working population	28,280	13,510	14,770
2. Internal recruits	940	290	650
3. Disabled veterans	710	710	.....
4. Foreign civilians	2,920	2,270	650
5. Prisoners of war	1,500	1,500	.....
<b>Total</b>	<b>34,350</b>	<b>18,280</b>	<b>16,070</b>
<b>B. Net change, November 1942–November 1943:</b>			
1. Furloughed from armed forces	+500	+500	.....
2. Natural growth	+125	+100	+25
3. Internal recruits	+100	.....	+100
4. Disabled veterans	+640	+640	.....
5. Foreign civilians	+300	+200	+100
6. Prisoners of war	.....	.....	.....
<b>Total</b>	<b>+1,665</b>	<b>+1,440</b>	<b>+225</b>

If, on the other hand, Germany renews her offensive or is subjected to severe Allied pressure, she may require anywhere from 150 to 200 divisions in the East, 45 to 95 divisions in the West and along the Mediterranean, and some 75 divisions for garrison and line-of-communications duty. Moreover, activity on such a scale should boost permanent losses to perhaps 1,500,000, and, contrary to the situation envisaged under our former assumption, these losses would have to be currently replaced. Withdrawals from the civilian labor force, rather than industrial furloughs for the *Wehrmacht*, would consequently be necessary. The estimated net numerical decline in the German working force, after allowing for new entrants, would be no more

than about one percent; but in terms of "effective replacement value," the decline might total 2.5 percent, since the induction of 1,500,000 able-bodied laborers into the armed forces would lower by a good 1.5 percent the qualitative average of the remaining aggregation of German workers, disabled veterans, foreign civilians, and prisoners of war. Attempts by the Germans to compensate for these losses by increased recruitment of non-German workers from Axis Europe would undoubtedly meet with even more stubborn resistance if the *Wehrmacht* appeared to be hard-pressed on one or more major fronts and if the Reich itself came under heavy and persistent attack from the air. In Table II, the position of the German labor force under this second set of "offensive" assumptions is estimated:

TABLE II.—Labor force in Germany, November 1942–November 1943 (Assumption: Germany on offensive or heavily attacked by United Nations)

(In thousands)

	Total	Male	Female
<b>A. Position as of November 1942:</b>			
1. Germans, normal working population.....	28,280	13,510	14,770
2. Internal recruits.....	940	290	650
3. Disabled veterans.....	710	710	.....
4. Foreign civilians.....	2,920	2,270	650
5. Prisoners of war.....	1,500	1,500	.....
Total.....	34,350	18,280	16,070
<b>B. Net change, November 1942–November 1943:</b>			
1. Replacement of permanent losses.....	-1,500	-1,500	.....
2. Natural growth.....	+125	+100	+25
3. Internal recruits.....	+100	.....	+100
4. Disabled veterans.....	+640	+640	.....
5. Foreign civilians.....	+300	+200	+100
6. Prisoners of war.....	.....	.....	.....
Total.....	-335	-560	+225

### Strategic Materials

Apart from the unpredictable effects of 1943's bombing raids on Axis Europe, Germany's supplies of strategic raw materials would appear, on the whole, to be sufficient for her essential military and industrial needs. The copper position can be described as "extremely tight and still deteriorating"; chromite supplies depend to a critical degree on the Clodius Agreement with Turkey; tungsten requirements must be met in part by blockade-running. But there seem to be

sufficient supplies of rubber, coal and coke (if the ovens in the Ruhr-Rhineland area are not too severely damaged by bombs), iron, steel, manganese, magnesium, aluminum, lead, and zinc. Chemical production will apparently be adequate in 1943. If the Nazis can exploit successfully Finland's Petsamo mines, enough nickel can be acquired to meet the war economy's reduced requirements. The German position in antimony is strained but not apt to be critical in 1943; there will probably be enough tin to meet basic requirements through 1943, but after that only by blockade-running. Present and expected supplies of molybdenum will suffice; but if the Caucasus were lost, the situation would become noticeably tighter, and if both Caucasian and Norwegian sources were cut off, Germany would be left with supplies adequate to meet only 20 percent of her requirements.

As for oil, the Axis position appears to be in a tenable balance. Although stocks are low, new supplies of petroleum and its substitutes are, in fact, expected to be larger in 1943 than in 1942. More motor vehicles will be adapted to run on solid and gaseous substitutes, freeing liquid fuel for other uses. Full operation of the new hydrogenation plants at Bruex, Blechhammer, and perhaps elsewhere should bring a considerable rise in the output of synthetic oil—as should the opening in the course of the year of more plants using the Fischer-Tropsch process. Moreover, exploitation of the captured fields at Maikop may yield anywhere from one to two million tons next year.

As a result, unless Allied bombing interferes, the Axis can look forward to an increase of 2,500,000 to 3,500,000 tons in its supply of petroleum products and substitutes. Since 1942 saw no significant withdrawals from Axis oil stocks, this prospective rise in output in 1943 should provide a large margin for expanded military operations.

### Transportation

The inland transport position of Axis Europe hinges to a significant degree upon the extent of German military operations in the East. The task of supplying the Eastern Front in 1942 engaged about 13 percent of all Axis locomotives, and 10 percent of all freight cars. If, after withdrawing from their advanced positions in the south, the Nazis should merely maintain a shortened defensive line through 1943, only about half as much rolling stock would be required to supply the front. Even the opening of a "Western Front" in Europe by the

Allies might not offset such a gain, since the supply of a division on a western front would call for only a third of the locomotives and freight cars needed to supply an equally active division facing the Russians.

Under these assumptions, the 200,000 freight cars and 6,000 locomotives scheduled to be built in 1943 would, after the first half of the year, release the Axis rail-transport position from the worst of its strain. A small reserve capacity in the transport facilities of inland waterways would probably be offset by reductions in Mediterranean coastal shipping.

If, however, German military activity increased in 1943 above the scale of 1942, without any compensating shift of that activity to nearer fronts, the burden placed on inland transport would necessitate reductions in the volume of industrial and civilian freight hauled. This reduction might be further accentuated if Allied air attacks took on greater proportions than the present "locomotive hunts."

#### *Military Supplies: Aircraft*

An acute shortage of skilled labor—aggravated by the *Luftwaffe's* need for trained maintenance and repair men in the newly-extended Mediterranean air theatre—will probably prevent the Germans from expanding their output of combat planes in 1943 much beyond their present production rate of about 1,300 per month. Moreover, bombing raids by the Allies, which hitherto have had but a limited effect on German plane output, may increase sufficiently in weight and in precision during the coming year to check any rise in production, if not actually to lower it.

To these factors may be added the effects on output of a possible large-scale change-over in plane models. Basic models for the *Luftwaffe's* present aircraft were, with a few exceptions, developed in 1940-41, and many of them may now be regarded as obsolescent in relation to recent United Nations designs. If Germany in 1943 attempts to put new models into production on a major scale, the labor and machine tools available to turn out present models will be reduced, and output will, for a time, decline. On the other hand, a change in emphasis from bombers to fighters—in line with a policy of defense—might eventually allow a higher number of planes to be produced each month, since fighters call for fewer man-hours of labor than do heavy bombers.

Despite the adoption of a policy of plane conservation and the grant of "high priority" to the plane industry, the *Luftwaffe's* recent

rates of loss have somewhat exceeded its rates of production. On balance, it would seem likely that, with increasing pressure from the Allied air forces, German air operations will be limited by the dearth of reserve strength and by the difficulty of expanding production.

#### *Submarines*

Steady expansion of Germany's submarine construction capacity from early 1940 until the autumn of 1941 made possible a rise in the rate of completions in 1942, so that the monthly rate now fluctuates around 25. During the late spring and summer of 1942, however, failure to keep the rate of crews trained up to the rate of submarines completed resulted in a corresponding increase in the backlog of uncommissioned boats. Recent efforts to break this bottleneck may prevent any actual decrease over the year in the rate of submarine accretions.

Prospects for 1943 launchings depend primarily on increases in shipyard capacity effected in 1942, balanced against last summer's bombing of submarine ways. Between March and June of 1942, the number of ways apparently rose 10 percent—which would normally result in an enlarged number of submarine launchings early in 1943. But, while an exact appraisal of bomb damage wrought last year is impossible, it seems quite possible that the Allied raids may have prevented that anticipated rise in the rate of launchings.

#### *Tanks*

If Germany confines her military operations to defensive efforts or to limited offensives on the scale of last summer's campaign, the *Wehrmacht's* present tank strength—some 17,000—plus current output, should be sufficient. But if Germany anticipates either launching or having to resist a full-scale offensive, she would have difficulty in revamping her obsolescent tank models, without curtailment of even current rates of output. Further improvements in armor and armament can no longer be readily superimposed on those basic tank designs developed in 1938-39. But a thorough change-over in production would call for substantial quantities of skilled labor—at a time when submarine, aircraft, and locomotive construction are presumably to be stepped up. If, to take only one competitor, the locomotive program of some 6,000 units a year were to be pushed, it would render out of the question a significant output of newly-designed tanks.

*Guns, Ammunition, Explosives*

Although the lack of satisfactory data on holdings, wastage, losses, and production makes any estimate of the German armament position extremely hazardous, certain new demands on the Nazis' gun production that may appear in 1943 can be noted. Large quantities of all types of anti-aircraft and anti-tank guns will be needed to meet present strategic requirements. Moreover, Germany industry will have to meet increased requirements for new and improved anti-aircraft batteries for use not only within the Reich but in the Balkans and Italy. It may be necessary, too, to produce more heavy guns for fixed fortifications in France and elsewhere.

As for ammunition, it appears that the *Wehrmacht* is assured of an adequate supply in 1943. Germany's engineering industries are under increasing strain, and deficiencies may develop in lead, antimony, or high-grade steel; but apart from some technical difficulties attending the substitution of gilded or lacquered steel for brass, and the replacement of copper by soft iron or bimetallic driving bands, these factors are not expected significantly to affect the output of projectiles this year.

*Trucks*

Should Germany be allowed to remain during the coming year on the "stationary defensive," her supply of lorries will probably prove entirely adequate. If, however, Germany either chooses, or is forced, to engage in military operations in 1943 on the scale of 1942, her deficit of motor trucks will become serious enough to affect markedly the mobility of her armies.

Increased truck production is no longer possible except at the direct expense of other essential military items. The number of lorries in civilian use within the Reich has already been whittled down to its minimum, nor would it be possible to withdraw any sizeable number of trucks from civil use in occupied countries without seriously impairing the efficiency of those states in producing for the Axis.

*Civilian Supplies*

Though food supplies in the second half of 1943 will be largely determined by the unpredictable size of that year's crops, it would seem reasonable to estimate that even a subnormal harvest will leave the Germans with sufficient food supplies for a diet adequate in energy content, though perhaps deficient in relation to long-run nutritional

needs. At all events, the Nazis have themselves emphasized that as long as there is food in Europe, it will go first to the Germans; and among the Germans, soldiers and munitions workers will be the last to go without. Rations as established on October 19, 1942 apparently assured an average intake of approximately 2,450 calories per capita per day. As the rations allotted to the German population in 1917-18 allowed only about 1,500 calories, the Germans would seem to have a considerable margin as yet before a critical situation appears.

The quality of German textiles will doubtless continue to deteriorate, but the quantity allotted to consumers still appears well above minimum physical needs. In leather, however, the German position may be even worse in 1943 than during the past year. While there may be enough heavy leather for the most important military needs, industrial and agricultural consumption will have to be pared to the bone, and civilians will receive none at all. Soles for civilian footwear will be fashioned largely of substitute materials.

An increasing housing shortage in certain areas of Germany may be expected in 1943 if Allied air raids continue at the same or a higher level. Already the British estimate that these raids have required the continuous labor of some 100,000 men for repair work on homes alone. However, the fact that Germany has only now begun to consider measures for rationing dwelling space tends to indicate that no crisis in housing has yet been reached. More acute may be the persisting shortage of household equipment.

In general, civilian supplies in Germany appear to be short, but not critically so. It may indeed be asserted that further cuts in the civilian sector could be and probably are being made to the advantage of purely war production. Rationalization has already been pushed far; it can still be pushed a little further. Quite possibly, a huge increase in bomb damage inflicted by the Allies on German civilian areas might produce a progressive and cumulative encroachment on military output to sustain minimum civilian supplies. But there is no convincing evidence that this stage has yet been approached.

## APPENDIX V

## THE OUTLOOK FOR RESISTANCE IN OCCUPIED EUROPE

Perhaps no other aspect of the war is less susceptible to accurate prognosis than the question of resistance to the Axis in occupied Europe. The weighting of scanty, contradictory data on current activities is an operation hazardous enough; but estimation of what the coming year will bring in the way of anti-Nazi opposition depends to an almost prohibitive degree upon factors beyond our knowledge—particularly the extent and success of our military ventures, and the cumulative effects of near-starvation on the subject peoples.

Generalizations upon European resistance confront a further difficulty in the diversity of conditions that exist on the continent. What might apply to Poland would be irrelevant to Denmark. Sabotage in Yugoslavia occurs on quite a different scale and in quite a different context from that in Belgium; and attitudes toward the Allies vary sharply even within one country—as in Czechoslovakia.

Yet occupied Europe does present a picture of substantial unity in its hatred of the Nazis; and it is possible to draw certain conclusions about resistance in 1943 which will fit at least a majority of the Axis-dominated countries. As a basic datum it can certainly be laid down that "moral" opposition to the New Order will show little sign of slackening in the coming year, barring any catastrophic reverses for Allied arms. In Upper Silesia large numbers of Poles have accepted *Volksdeutsch* status, but their defection from the ranks of the opposition is and will undoubtedly remain a striking exception.

On the other hand, it can probably be said with as much safety that even if nutritional standards in the occupied countries fall no lower than their current levels, the progressive effects of present dietary deficiencies will seriously reduce the capacity, if not the will, to resist. In Greece, active opposition to the Axis forces is largely confined to mountainous areas, near sources of food inaccessible to the weakened, starving city-dwellers. In what was "Occupied France," the caloric average of the population's diet was clearly below the amount necessary for consistent, normal activity, and it is doubtful whether conditions in what is now fully-occupied France will be any better. In Poland, where even in peacetime a large sector of the population lived under the almost perennial threat of famine, malnutrition is now a commonplace of existence. In Belgium, too, and Yugoslavia, resist-

ance is being widely undermined by the enervating consequences of semi-starvation.

*Food and sabotage*

In nearly every occupied country in Europe in fact (with the exception of Denmark and perhaps Norway), malnutrition is tending to confine the *ability* to resist to two sections of the populace: those who can afford to patronize the black market, and those who live close to the source of food supply. The urban proletariat, in short, on whose revolutionary capacity some observers have relied, is gradually being reduced to a point of political ineffectiveness, a point where the effort required for large-scale, active revolt will be beyond its physical resources.

That sabotage of industrial and communications facilities will continue in every country through 1943 seems assured; but that it is now or will be then on a scale sufficient to affect the Axis economy significantly is extremely dubious. Direct sabotage by workers within factories is difficult at best and has become more so under the Nazis' increasingly close surveillance. The slow-down can be resorted to with more safety, but its overall effect in most countries does not seem to have been very disturbing to the Germans. In the Czech "Protectorate," for instance, sporadic sabotage and slow-down tactics have been much more than offset by enlargement of productive facilities and the labor-recruitment of the entire Czech younger generation, no longer liable to military service.

Where sabotage can be carried on by guerrilla bands, as in Greece and Yugoslavia, it is not so likely to diminish; but elsewhere there appears to be a discernible tendency for opposition groups to conserve their strength and perfect their organization, awaiting the ultimate hour of rebellion rather than exhausting their forces on day-to-day exploits. It may be significant in this connection that reports of resistance in occupied countries increasingly emphasize *agricultural* sabotage—efforts by the peasants to withhold crops, slaughter livestock illegally, damage German-owned farm machinery, etc. This is not to say that industrial sabotage has ceased or will cease; in the Netherlands alone, during June and July of 1942, some 48 freight trains en route to Germany are reported to have been destroyed. But it does seem true that such acts of sabotage are now considered even by their perpetrators as being primarily important for maintaining anti-Axis morale rather than crippling the German war economy.

*Rifts Among the Opposition: Poland*

In most of the occupied countries, hatred of the Nazis so dominates the thinking of all political groups that operational unity is largely assured. In four nations, however, divisive elements have either appeared in virulent form or threaten to do so in the near future.

Poland, for one, is showing now the effects of the Nazis' policy of "divide and rule." The mere task of keeping alive in Poland tends to generate bitterness and mutual distrust. The thousands of deportees quartered upon peasant villages scarcely able to support themselves have met with and have returned antagonism aplenty. Previous ill-feeling between peasants and landlords, and between poor peasants and rich peasants, festers anew under Nazi encouragement. Because their functions make them seem part of the ruling German machine, Polish engineers and foremen in industry are suspected by the workers of being "collaborators." Such suspicions arise the more easily because a great many Poles, for venal or other reasons, have in fact "sold out" to the Germans, accepting *Volksdeutsch* status.

Moreover, the Nazis' calculated policy of preserving many of the outward forms of private property rights, even while pursuing an actual process of exploitation, has effectively prevented large elements of the "owning" classes from allying themselves with the rebellious masses. While great sections of the poorer peasantry and factory laborers are riper than ever for a radical economic revolution, the landlords, richer peasants, and business proprietors (including some Jewish ones) would apparently in a showdown prefer Hitler to Stalin.

*Bulgaria*

In Bulgaria, too, resistance to the Nazis is considerably qualified by the contradictory aims of different classes. Much of the opposition which the workers and peasants are providing is Communist-inspired, and certain defeatist middle class groups who otherwise might hope for an Allied victory to "save Bulgaria" from the New Order are still confused by the fear of Soviet domination. More serious as a drag on whole-hearted resistance to the Nazis is a fear shared by nearly all groups in some degree that defeat of Germany would mean the loss to Bulgaria of her newly acquired Dobrudja, Macedonia, and Thrace.

*Yugoslavia*

Division in Yugoslavia has been dramatically underlined by the armed quarrel between General Drazha Michailovich's forces and the Partisans, a quarrel which has taken on aspects of the "class struggle." Michailovich, fighting under the aegis of the Yugoslav Government-in-Exile, has been orientated primarily toward the British, the Partisans toward Russia. Since efforts by the Yugoslav Government to stop this strife through appeals to Russia have failed, the Axis can apparently look forward in 1943 to the advantages of fighting a divided foe.

*Czechoslovakia*

In Czechoslovakia also it is salutary to note that though the Sudeten Germans are somewhat disillusioned over the joys of being part of the Greater Reich, the Czechs have not wholly recovered from their own disillusion over their allies at Munich. Their scepticism may well have been kept alive by the continuing output of anti-Beneš propaganda since that time. They are not prepared to go back without change to the pre-war set-up. This wait-and-see attitude reinforces an understandable tendency to make the best of things as they are; and though the opening of a continental front in Europe by the Allies would undoubtedly electrify them into action, their present urge to commit overt acts of resistance has been somewhat weakened.

Nor can reports of recent sabotage in Slovakia be taken too optimistically. Violence here seems to have been directed more against the corruption of the "independent" government, the excesses of the Hlinka Guards, and the economic distress of the country than against the Germans. Moreover, the Slovaks have continued to cultivate their resentment of the Czechs; they know that their "independence" is due solely to German help and exists solely on German sufferance. This acts as a quite effective brake on any large-scale resistance.

In summation, it can be repeated with some safety and not a little triteness that the question of effective resistance in occupied Europe is bound up in a race between Allied invasion and internal attrition. No one outside of Europe and few within it are competent to say whether postponement of the opening of a second land front in Europe during 1943 would result in a general collapse of the underground movement. But it would seem undeniable that in a majority of the occupied nations such a postponement—if it appeared to be compelled by German strength—would find active anti-Nazi elements markedly weaker at the end of 1943 than at the beginning.

## APPENDIX VI

## THE PACIFIC FRONT

The contrast between the calculated boldness which marked the opening Japanese drives in the Pacific and the restraint which has characterized Japanese military operations since the conquest of Burma, has made it increasingly clear that the strategic plan with which Japan began hostilities in December, 1941 was limited in scope. Japan hoped to take a great step toward the fulfillment of her long-standing ambitions; she did not plan to attain her final goal at one stride.

Japan has long and openly aspired to the achievement of a dominant, unchallenged, and self-sufficient position in East Asia. The Japanese, however, have never defined this ambition in precise territorial terms. They have certainly regarded China, Southeast Asia, and the Indies as regions which must come under their control. Acquisition of Eastern Siberia has also been a constant objective. Australia and probably India have been within the sphere of their ambition, and many Japanese have postulated still wider boundaries of empire. Territorially, long-term Japanese aspirations have been intentionally vague.

The specific strategic plan which the Japanese began to implement with the attack on Pearl Harbor, however, was directed toward the conquest of a well defined geographical area. Its content was dictated to some extent by immediate circumstances. Japan faced the imminent danger of a raw materials blockade, with oil already on the embargo list. Lend-lease supplies and American piloted planes were on the point of adding further difficulties to the Japanese campaign in China. British capital ships and Australian troops at Singapore, American planes in the Indies, Canadians at Hongkong, and American heavy bombers in the Philippines were evidences of a gathering military strength which threatened to multiply the cost and hazard of any future southward drive.

The immediate Japanese problem was to seize the sources of Japan's raw material requirements, to occupy the territory through which military supplies could reach China, and to capture the bases where military strength was gathering. Occupation of Malaya, the Philippines, the Indies, and Burma would achieve these ends. For the conquest of these regions Japan formulated her strategic plan. Within a few months the plan had been fulfilled (see map facing page 56).

*The Japanese Offensive*

The Japanese attacks on Pearl Harbor, Hongkong, the Philippines and Malaya initiated one of the most brilliant campaigns in military history. Surprise, timing, concentration, coordination, aggressiveness, and imagination were outstanding characteristics of the Japanese offensive.

The occupation of French Indochina and astute political maneuvering in Thailand had assured the Japanese of bases for the southward push. In a few hours, at Pearl Harbor, the Japanese sank or damaged eight battleships of the Pacific Fleet, crippled the American air force in Hawaii, and banished the possibility of an immediate American advance into the Asiatic theater. Assurance was made doubly sure with the occupation of Guam, Wake and the Northern Gilberts.

Meanwhile concentrated Japanese air attacks, by both land-based and carrier-based aircraft, secured considerable surprise and uniformly excellent results in the Philippines and Malaya. The Japanese rapidly achieved complete local air superiority. With the sinking of the *Repulse* and the *Prince of Wales* and the destruction of Cavite, the Japanese were assured of a minimum of local naval opposition. Supreme in the air and at sea, they were free to develop their land campaigns.

*The Philippines*

The Japanese left wing pushed down through the Philippines. Here the Japanese exhibited bold strategy and perfect timing. The preliminary landings in the north and the south of Luzon held the main American army in the center of the island. When the southern landing had engaged the attention of local American forces, the Japanese landed in strength, without covering forces, on the east coast. Before this threat could be countered, another strong landing force put in at Lingayen Gulf on the west coast. Our strongest opposition developed here, but despite this, the Japanese, with help from the forces which previously had been landed in the north, secured their beachhead. Threatened from north and east, the Americans and Filipinos had to evacuate Manila. The Japanese seized the key points in the other islands, and, except for the gallant defense of Bataan and Corregidor, the Philippine campaign was over.

*Malaya*

The Japanese right wing, in Malaya, gave an expert demonstration of the favorite Japanese tactics of infiltration and outflanking. Striking south in two columns, with the stronger force following the western coastline, the Japanese were frequently stopped in their frontal assaults by determined British resistance. But time and again, particularly in the west, the Japanese by infiltration, surprise river crossings at lightly defended spots, or well rehearsed coast-hopping, came up on the flank or appeared in the rear of the British positions, forcing retreat. By the end of January the Japanese had occupied the entire Malayan mainland. Battered by siege artillery and raked by bombing, Singapore was doomed. The weary and demoralized defenders surrendered February 15, after six days of desperate and confused fighting.

*The Indies*

The Japanese then closed in on the Indies. Preliminary landings in December had already given them air bases in British North Borneo and Sarawak. When the Philippine and Malayan campaigns were well under way, and naval forces were free for other tasks, the Japanese organized a series of strong landing parties with powerful naval escorts. By concentrating preponderant forces against relatively weak defenses, the Japanese were able to reduce the key points in the outer island defenses of Java as well as to fling a barrier eastward through the Bismarcks, New Ireland, and the Solomons. The fall of Singapore released ground forces for the assault on Java. Heavy concentrations of air and naval power destroyed or dispersed the local remnants of United Nations strength at sea and in the air. The enemy pincers met in Java, and by mid-March the Japanese had won the Indies.

*Burma*

Of the original Japanese plan, only the occupation of Burma remained to be achieved. Japanese forces, striking across the Thailand-Burma border, had made steady progress, and by the time of the fall of Java the Japanese were entering Rangoon. With this large port at which to land reinforcements, the Japanese set off in a two-pronged northward drive along the Sittang and Irrawaddy Rivers. Heavy fighting slowed their advance, but by the end of April the Japanese were converging on Mandalay, and shortly after-

wards the British and Chinese defenders were forced to retreat toward India and China.

*Repercussions in China*

The Japanese may have believed that the occupation of Burma might bring immediate cessation of organized resistance in China. If so, they were not alone in their belief. At least one high Chinese official confided to friends, in the early days of the Pacific War, that cutting of the Burma Road would mean collapse at Chungking. China, however, managed to weather the crisis, and, curiously, the very pace and magnitude of the Japanese victories were in part responsible for continued Chinese resistance.

In China, as in all the Oriental world, the fall of Hongkong and Singapore brought a virtual collapse of British prestige and a rise of anti-British feeling. The Chinese chose to ignore the instances of native loyalty to British arms, and judged fifth column activities in Malaya and Burma to be just retribution for imperialistic oppression. American prestige also dropped sharply. The long stand at Bataan and Corregidor, Filipino participation in armed resistance to the Japanese, and the exploits of American planes in China, served somewhat to soften the blow to America's reputation. But in Asia the white man was humbled.

The prestige of the yellow man rose correspondingly, and the Chinese, as Orientals, took new pride in their own long resistance to the Japanese. The Shanghai of 1937 was frequently contrasted with Hongkong, Manila, and Singapore. The new prestige of the Oriental seemed to promise greater importance in the post-war world. The Chinese felt assured that, if they hung on, China would emerge strong and independent in a new Asia. Despite the shock of isolation, Japanese occupation of Burma did not end Chinese resistance.

*The Search for Easy Victories*

With the conquest of the Philippines, Malaya, the Indies, and Burma, Japan completed her initial strategic plan—probably more quickly than she had anticipated. The costs had been relatively light, and Japanese capabilities were still adequate for further major tasks. Yet Japanese operations in the following months were tentative and even cautious. Japan displayed little of the willingness to accept major risks which had marked her early offensive. The

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Japanese tested and probed, sent out strong forces in reconnaissance, but withdrew when important enemy strength was encountered.

The explanation undoubtedly lay in the wealth of the resources Japan had already seized, the absence of an agreed strategy for further expansion, and an over-abundance of likely opportunities. Japan had secured her immediate raw material requirements and in the course of her campaign had opened several immediately promising possibilities. The swift campaign in Malaya and the British losses at sea and in the air seemed to leave a potentially rebellious India relatively defenceless. Australia and the American-Australian line of communications were near at hand and lightly protected. The major part of Hawaii's guardian fleet was still *hors de combat* from the blow at Pearl Harbor. An imminent German offensive in Russia might bring Japan the one opportunity she could not afford to miss—a chance to seize Eastern Siberia without the risk of indefinitely prolonged hostilities. To agree upon any one venture, and to press it home to the exclusion of other moves which might prove even more feasible, was a difficult task for Japan's leaders.

Japan, therefore, engaged in a species of opportunistic extemporizing, but undertook no all-out offensive. The Japanese fleet tested the defenses of Ceylon in April, during the latter part of the Burma campaign, ran into unexpected British fighter strength, and withdrew. In May, a Japanese task force probed the outer Australian defenses, encountered punishment in the Battle of the Coral Sea, and retired. In June, a Japanese naval force, complete with transports, struck toward Midway and Hawaii, ready to seize the American bases and dislocate American supply lines in the Pacific. The Japanese met formidable American strength and in losing four carriers suffered a severe setback. Significantly, however, most of the losses were incurred while the Japanese were retiring. Even at Midway the Japanese were not ready to press home their attack against strong resistance. In the Aleutians they gained an outpost for possible use in case of an attack on Siberia, and all during the summer they concentrated strength in Manchuria. But the German offensive in Russia slowed, and the great opportunity did not materialize.

### *The American Initiative and the Beginnings of Attrition*

The American surprise landing at Guadalcanal, in August, marked the first important United Nations' initiative in the Pacific War. It also marked the end of the Japanese search for easy victories.

# WAR IN THE PACIFIC 1942

MIDWAY\*

JANUARY 2

HAWAIIAN  
ISLANDS

FEBRUARY 15

MARCH 9

AUGUST 1

DECEMBER 30

CHINA

INDIA

GUINEA

MON IS.

SAMOA IS.

NEW  
HEBRIDES

FJI IS.

NEW CALEDONIA

AUSTRALIA

Balked in their attempts to secure great gains at little cost, the Japanese settled down to the problem of expelling the American intruders. Misled, perhaps, as to the extent of their naval victory off Savo, August 8, the Japanese underrated American strength and committed insufficient forces to the task. The Americans held their own, and the beachhead at Guadalcanal gradually developed into the focal center of a campaign of attrition.

The issue was supremacy on the sea and in the air along the supply lines to Australia. Near Cape Espérance, in October, American naval forces avenged the earlier disaster off Savo Island, when four Allied cruisers were sunk. An engagement off Santa Cruz, October 30, was indecisive, but in it we lost ~~out~~ our fourth carrier. Then, in the naval battles of November 12-15 in the Southern Solomons, the Americans established a clear lead by sinking 9 enemy cruisers with a loss of only 2 of our own, and destroying at the same time our first enemy battleships. In the the air the attrition rate favored the Americans from the beginning—on the average, about 4-5 to 1. Japanese air losses, particularly of naval planes, have assumed respectable proportions.

On land, in New Guinea and the Solomons, Americans and Australians have displayed a grim efficiency in jungle warfare. But here it is too soon to say that the Japanese warrior has been outdistanced—his fanaticism still makes him a most formidable foe. Indeed, the war of attrition on land as well as in the air and on the sea is only in its beginnings.

With the close of the first year of the Pacific War, the early Japanese successes still dwarf the gains of the United Nations. The Japanese achieved what they set out to achieve—the conquest of the Philippines, Malaya, the Indies and Burma. They assured themselves of rich resources and they isolated China. Later Japanese ventures proved abortive, and at times costly, particularly in the case of Midway. But none of these could be characterized as a determined offensive.

The United Nations have gained small toeholds in the outer fringes of the Japanese defenses and have made a beginning in the development of attrition. They have not been able to mount a large scale offensive. The United Nations have yet to meet and stop a Japanese drive launched with all the force of which the enemy is capable. Despite enemy air and shipping losses, there is no convincing evidence that the Japanese yet have been so weakened that they are incapable of such a major offensive—if they should so decide.

## APPENDIX VII

## THE JAPANESE CO-PROSPERITY SPHERE

The chief objectives of the Japanese military campaigns of the past year have been the acquisition both of strategic bases and of material resources adequate to support modern warfare on a heavy and sustained scale. It is this latter objective which most responsible Japanese leaders have had in mind when speaking of Greater East Asia, or the Greater East Asia Co-prosperity Sphere. By their recent conquests, the Japanese may be considered to have filled in the territorial outlines of Greater East Asia. Japanese leaders claim that they are well on the way toward achievement of their economic objectives and that Japan will soon be in a position to sustain indefinitely her present scale of warfare, or even to expand her war-making capacity. It is vital to Japan's enemies to know what basis there may be for these claims.

*Initial Assets*

Japan began the Pacific War with substantial resources essential to modern military operations already within her control: a steel capacity of some 8½ million metric tons (ingots and castings); an adequate coal supply relatively near at hand (coking coal in occupied North China and Karafuto and poorer grades in Japan proper, Korea, and Manchuria); an electric power capacity of more than 11 million kilowatts in Japan proper alone; a large and expanding production of light metals. Japan had a merchant marine of approximately 6.7 million tons and adequately manned industries experienced in the production of ships, ordnance, aircraft, and chemicals. She had large stockpiles of those strategic materials not produced in adequate quantities within her boundaries.

Japan also had that most important military asset, reasonable assurance of self-sufficiency in food. Eighty-five percent of her total requirements of approximately 13.5 million metric tons of the principal grains—rice, wheat, and barley—could be met from production within Japan proper. The remaining fifteen percent was covered by exportable supplies from Korea and Formosa. Imports from Indochina and Thailand permitted her to enter the war with stockpiles much larger than the usual year-end carry-overs. With Korea and Formosa, her food position was easy.

On the other hand, Japan began her campaigns in Southeastern

Asia a year ago without control over an adequate production of many important commodities. She was partially dependent upon imports from outside the yen bloc for iron ore, manganese, tungsten, molybdenum, aluminum ores, copper, zinc, and phosphates; she was very heavily dependent on such imports for petroleum, tin, lead, mercury, cobalt, nickel, chromium, antimony, cotton, wool, cordage, and potash.

*First-year Gains*

The effect of Japan's first-year conquests on her pre-war shortages has been spectacular. As long as she holds her present gains and maintains sea communications with them, Japan is assured of supplies to meet any conceivable requirements of tin (Netherlands East Indies and Malaya: 75 percent of world supply), rubber (NEI and Malaya: 90 percent of world supply), quinine (NEI: 95 percent of world supply), abaca (Philippine Islands: 95 percent of world supply), kapok (NEI: 70 percent of world supply), and petroleum (NEI: former production eight million tons). In Malaya, French Indochina, and the Philippines, Japan has won sources of iron ore which, together with those in China, Korea, Manchuria, and Japan proper, are sufficient to supply even expanded requirements. From the fantastically rich Badwin mines in the northern Shan States of Burma, Japan can meet her needs in lead, and cobalt, and complete her requirements in zinc.

As a result of her territorial gains of the past year, Japan has also become self-sufficient—potentially, if not immediately—with respect to many other materials. Nickel deposits in the Celebes and Burma will supply the bulk of Japan's annual wartime requirement of 10,000 tons. Manganese and chrome reserves, located chiefly in the Philippine Islands, can satisfy all Japanese requirements. Indochina, Thailand, Malaya, and especially China and Burma, can contribute tungsten in adequate quantities. Antimony can be secured from various minor sources, or by well-established smuggling routes from unoccupied China. Ample bauxite is available in Malaya and Bintan Island.

Japan's food position has also been still further strengthened. Thailand, Indochina, and Burma are the major world sources of trade rice. Subject only to limitations on shipping space, Japan can now supply reasonable quantities of rice to deficit areas she has occupied and still build up stocks at home against the future.

*Remaining shortages*

Not all Japan's requirements have been met by her conquests, however. Japan does not now mine enough copper to meet her requirements without far-reaching and inconvenient substitutions. The newly won areas give her little relief. Cotton and wool remain deficient in Japanese-controlled territory, as do mercury, potash, mica, asbestos, quartz crystals, and diamonds.

The existences of these shortages, however, does not primarily alter the obvious conclusion which can now be drawn with regard to Japan—namely, that the Japanese have acquired a sufficient complement of natural resources to support a substantially increased military effort, provided these resources can be effectively developed, transported and processed.

*Shipping*

The most pressing problem Japan faces in developing Greater East Asia is that of shipping. Her vital lines of communications run by sea, and the greater part of her raw materials come from abroad. Coal, iron ore, and salt are imported from China, coal, food, chemicals, and a host of miscellaneous products from Manchuria and Korea, and bauxite, oil, and raw materials of many different kinds from South-eastern Asia and the Indies. In return, manufactured goods flow back to the occupied areas. An adequate supply of bottoms, therefore, is a prerequisite to the maintenance and expansion of the Japanese economy.

Japanese shipping losses have been severe, and it is estimated that as of December 1, 1942 the 6,700,000-ton merchant marine with which she began the war had been whittled down, despite Japanese captures and new construction, to 5,685,000 tons. Generous estimates of Japanese requirements are: 3,100,000 tons for the China and the coasting trade; 700,000 tons for military and economic requirements in southern areas; 500,000 tons of naval auxiliaries. If, in addition, allowances are made for 700,000 tons of lay-ups for repairs, and 100,000 tons of captured vessels which were already used in essential trades, the total of 5,100,000 tons still leaves a theoretical surplus of 585,000 tons available for other purposes, such as for new military campaigns.

Japan's shipping position is therefore tight, but not yet dangerous. She still has sufficient shipping to maintain her economy, but her "surplus" for military adventures is dwindling. If the estimated

present rates of high sinkings and limited new construction are correct and remain unchanged, this surplus will be wiped out by June, 1943.

Japan is making great efforts, however, to solve this shipping problem by increased construction, and there is reason for thinking that she will be successful. The above shipping estimates are based on a new-construction rate of 300,000 tons a year up to November 1, 1942, and thereafter, 400,000 tons a year. Japanese preoccupation with naval building and repairs, as well as shortages of material and labor, are thought to contribute to this estimated low rate of production of merchant shipping. The Japanese, however, had in 1941 a shipyard capacity of some 800,000 tons; and in 1937 and 1938 they were building approximately 450,000 tons of merchant shipping a year. They have already given one demonstration of their ability to expand construction at a rapid rate: in 1917 the Japanese built steel, steam vessels totalling 337,716 tons (approximately the present estimated rate). The next year, 1918, under the incentive of American bonuses, they built 688,659 tons.

As a subsidiary means of easing their communications difficulties, the Japanese have begun the construction of wooden ships. Indications of the importance which this variety of shipping might attain can also be found in the World War period. Japanese production of wooden ships rose from 26,024 tons in 1915, to 45,431 tons in 1916, to 120,773 tons in 1917, and reached 186,580 tons in 1918. The Japanese regard shipping as a problem of utmost urgency, and it seems very probable that they will expand their rate of production, perhaps very notably.

*Manpower*

Japan's manpower situation is not easy, but it is far from critical. One basic reason for this is that a larger proportion of Japan's 75 million people are in the age group between 20 and 39 than is the case with most other nations. Thus, in terms of men of military age or of age suitable for employment in munitions industries, Japan is relatively better off than her total population would indicate. At present some 3,000,000 men are in the armed forces and some 4,500,000 men in munitions production (metals, chemicals, machinery, engineering, shipbuilding). It is estimated that each of these figures could be increased by at least a million within a year's time by withdrawals from less essential occupations (building, woodwork, textiles, professions, commerce) and through the normal population increase. More-

over, if the need for manpower became great enough, Japan could draw more of her food from occupied territories and release additional agricultural labor in Japan proper.

Although the general manpower situation is satisfactory, the Japanese are short of highly skilled labor. Strict and reasonably efficient occupational controls, together with a well established official program of mechanical training in elementary and middle schools, have helped the Japanese to meet their requirements in semi-skilled labor. Technicians and highly skilled laborers, however, are at a premium, and the Japanese undoubtedly suffer from this scarcity.

#### *Techniques*

Related to the Japanese shortage of technicians is the occasional lack of "know how" in such industrial techniques as advanced metal-burgy and the production of certain machine tools and heavy machinery. Japanese backwardness, however, does not rise out of any general lack of ability. The "Zero" is only one of many proofs of Japanese skill and capacity. It is a fact, however, that a large part of Japan's machine tools and heavy machinery were purchased abroad, and Japanese producers are correspondingly inexperienced.

The fact that the Japanese have heretofore not produced certain things is not, however, a guarantee that they are incapable of doing so. The Japanese had never built a battleship before the Russo-Japanese War; but during the war, when they could not buy ships abroad, they laid the keels of two battleships and in due course completed them successfully. At the present time Japan can benefit from German technical assistance, and the Japanese have always followed scientific developments in the Western countries with assiduous care. Given the need, and the necessary time, they probably can produce anything for which they have the raw materials.

#### *Liabilities Acquired by Conquest*

Japan's conquests have presented her with certain new problems, all of economic significance, but of varying importance in their relation to the immediate economic prospects of Japan. Japan is faced, for example, with the necessity of making readjustments in export industries such as rubber, tin, sugar, and copra which have been cut off from their customary markets. Japan must also meet the demand for consumers' goods on the part of the populations in occupied territories. Japan can, however, defer the settlement of both of these problems,

despite the hardships which delayed solutions will entail for the inhabitants of the "Co-prosperity Sphere."

More important is the fact that Japan has inherited the task of policing the newly occupied territories, and of establishing the political machinery required for effective economic exploitation. The material costs of an actively hostile population have already been demonstrated to the Japanese by crop hoarding in Manchuria and by railroad sabotage and cotton growers' strikes in North China. As yet, however, the Japanese appear to have met only negligible economic losses from either active or passive resistance on the part of the peoples in Southeast Asia. In the regions of occupied China such losses have apparently slackened.

The maintenance of effective machinery for economic development makes severe demands upon Japan's limited pool of trained administrative personnel. The actual policing of occupied areas, however, has as yet required but few more Japanese troops than those necessary for garrison duty alone. The Japanese have been able to restore a semblance of order within moderately brief periods after each of their successive conquests, and the burden of petty police work is largely carried by natives of the occupied areas. For the present the economic losses and the drain on manpower which might arise out of hostile activities from the inhabitants of Japanese-held regions are potential rather than actual problems.

#### *Time*

In the last analysis, Japan's only urgent need is time. The present production of "Greater East Asia" is adequate to sustain Japanese military action on its present scale and, in addition, to support Japan's recent high rate of capital formation. But "Greater East Asia's" as yet undeveloped resources and as yet untrained manpower are sufficient for the creation and maintenance of a far greater and more dangerous military and industrial power. The deficiencies are those which time can supply. With time, new mines will be opened, more blast furnaces and rolling mills will be built, and more keels will be laid. With time, Japan will find men and tools to convert her mushrooming production of aluminum and magnesium into more and better "Zeros." With time, increasing thousands of Chinese, Filipinos, and Javanese will work for Japan.

The rate at which Japan can develop new industrial power will depend wholly upon the "excess" resources of shipping, plant ca-

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capacity, and personnel skills she can devote to this task after meeting immediately pressing military needs. During 1943 Japan cannot hope to grow in strength as we will grow, but she may well entrench herself so that effective action against her will become very much more difficult and costly. She will beyond all doubt do so, unless the rate of attrition imposed upon her is sufficient to absorb in current operations all her industrial capacity. She cannot do so if relentlessly harassed by air and submarine attacks against her shipping, by organization of sabotage and sedition in the areas she has occupied, and by bombing of her industrial centers.