July 4, 1939

(Dictated July 5, 1939)

I spoke to the President at the picnic on July 4 at about three o'clock and suggested that on Wednesday, July 5, we do nothing in regard to the purchase of silver and simply say that everything was in suspense pending action by the Senate. F.D.R. asked, "Have you a press conference Wednesday?" and I said no. He said, "Good! Then I would say absolutely nothing and do nothing." He said, "I think we are going to win in the Senate at five o'clock on Wednesday."

Last night on the train I had quite a long talk with the President. Again went over the silver situation, and the President said, "Say absolutely nothing today. Just sit tight." He said, "Keep everything in suspense" just the way he, the President, said the Stabilization Fund was when discussing it at his press conference on July 4.

Then he got on to what we might do on Thursday if the bill did not pass and here he began to get quite wild. He said that we should announce that we would accept offers at the world price and only after all the offers were in for both domestic and foreign would we decide how much we should buy. I didn't argue with him because I felt it wasn't worth while.

I brought up the question about countervailing duties on Italy and the President said that he would call Gaston because he was under the impression that they would go into effect on the first of July. He was correct in his impression as I don't believe I had advised him that we had given them until the 5th of July.

I told him that the cable had come in from Wait saying that in the case of silk cocoons that the Italian Government did subsidize and that today we would give them the 30 days' official notice. I said furthermore I could not have done anything about it on Saturday because I had given Sumner Welles a promise to let it go

until the 5th of July and he could not be reached. The President said, "Well, how about Italian raw silk manufactured in England and exported here?". I said that that was a good point. Under the present law we could do nothing, but we were introducing an amendment to take care of this situation.

The President said to announce the countervailing duties between 3 and 4 o'clock this afternoon so the Italians would get notice the first thing Thursday morning. I said, "Do you want me to delay until after the vote on the Monetary Bill in the Senate?" and the President said, "No. The two things have nothing to do with each other."

I then asked him when he expected to publicize his self-liquidating program and I gathered that he would do this at his next press conference, on Friday. I said, "You will have to have a heart-to-heart talk with Jesse Jones in regard to both the railroad situation and the foreign loans. The President said as far as the foreign loans are concerned, he's going to put it up to Barkley this morning at 9:15 and let him decide. I said we had the bill drawn both ways, with foreign loans in and out.

I said he seemed in a good humor and, therefore, I wanted to talk to him seriously about McReynolds. Did he want McReynolds? That it would be a great loss to me, because, I said jokingly, "You are taking my right arm away from me, Steve Gibbons, in September and I never know when Johnnie Hanes will make up his mind and go and," I said, "McReynolds and Bell are doing the work of Assistant Secretaries." He said he had made up his mind to take McReynolds; that he needed him as a stabilizer and counter-balance to the rest of the people that he was taking on; that Harold Smith, the new Director of the Budget, did not seem to be catching on; that he wasn't tough enough and he wanted McReynolds to act as his backbone. (This is not the exact language of the President, but this is what he had in his mind.) I said McReynolds knew nothing about the budget. Well, he said, he wanted him anyway. I said it would be a

great loss to me, but if he insisted, after all there was nothing that I could do. He asked what was McReynolds' salary and I said $9,000 and wanted to know his title. He said, "I suppose he won't want to give up his Civil Service status and, therefore, he will be unable to receive the $10,000 that the other Assistants do." So I said couldn't the President give me some idea as to how long he would keep him and finally I wheedled out of him he would keep him only for three months, or until December. He said he felt by that time McReynolds would have his office organized. I laughed and reminded him that he had promised to keep Bell only for three months and kept him four and one-half years. (I will have to get my organization ready, to fill up the gap, if possible, that is going to be left when McReynolds leaves.)

The President said he had a letter from somebody saying that our estimates on the new tax bill were inaccurate and we should recheck them. Also wants us to "go to town" on Section 102.

Somebody also had evidently been criticizing the decisions of the Board of Tax Appeals. He said that somebody sent him, every week, a summary of how the Supreme Court voted on each question and by individuals and suggested that I do the same in the case of the Board of Tax Appeals.

oOo-oOo

July 5, 1939

5 p.m.

HM,Jr called the President at 5 pm and the following is a record of their conversation.

HM,Jr: Heartiest congratulations!

President: By how much?

HM,Jr: Barkley phoned and said that it has not been finished, but that he thought it would be 43 to 39. They have announced the approval, but the count has not been announced. Isn't that marvelous! We will get the stuff ready. Ed is sitting right here.

(HM,Jr. aside to Mr. Foley: Can the President sign it tonight? Mr. Foley said yes.)

(To the President) What is the deadline?

President: Ten o'clock tonight.

HM,Jr: We will see what we can do to get it engrossed.

(The Secretary said, after the above conversation with the President had been concluded, that the President remarked, "After I am blackmailed like that, I am in no damn hurry to sign it!")

July 6, 1939

HM, Jr called the President at 9:20 this morning and the following is a record of their conversation:

President: Good morning, Henry! What is new today?

HM,Jr: Don't you feel safe and sound with the monetary authority back in your hands?

President: I did not sleep a wink all night worrying about all the responsibilities in the hands of one man!

HM,Jr: Silver in London dropped from 37.92 to 36.73 and our thought here is that quite a lot of silver is backing up on us.

Therefore, my hunch is why not put it at 35 cents and leave it there and maybe that will be the price. Why pay more?

President: How about China? Have they any silver for sale?

HM,Jr: They sent me word last week that there is 6,000,000 ounces in Chungking. The bulk of it is in Mexico and a little over 1,000,000 ounces coming out of Canada.

President: What effect will that have on Mexico?

HM,Jr: The lower the price, the more difficult for them. If you wanted to do something for them, I could always increase it one cent or two cents and show that we want to help them out. The trouble with them is that they have not appreciated the fact that we have been buying silver from them for several years.

President: In putting it at 35 cents we are establishing a new world price and I don't want to fix the price by fiat.

HM,Jr: That is right.

President: My eyes are not even open and my brain has just begun to work. Wasn't I grand yesterday?

HM,Jr: Did you go to town!

President: Did you get what was in the back of my head? The R. F. C. is going to be run by Schram, you see. You will get on beautifully with Schram.

HM,Jr: That was quite something that you handed Jesse. He was up on the Hill at 6 o'clock last night talking to Barkley.

Shall we finish silver first?

President: If it is 36.72, I would put it at 36.75.

HM,Jr: That will be 36-3/4. I have nothing very definite. I would just as leave do it that way. Let's say 36-3/4.

The bill will be down this afternoon and I take it that you will sign it and then we will get out our regulations.

President: Yes, I will.

HM,Jr: On the Jesse Jones matter, they sent over a bill last night with no comment and our boys say that it is not very good. I have been trying to get Jesse for half an hour.

President: Barkley wanted to introduce it today.

HM,Jr: Have you any suggestions?

President: No, other than carry out what we said yesterday.

HM,Jr: I will try and get Jesse and ask him to come over here this morning.

President: Will you try to get it to Barkley by one or two o'clock at the latest?

HM,Jr: As I understand it, you do not want to give up any principles, but let the R.F.C. be the pool of capital.

President: Actually there are five agencies and only one of which is under the R. F. C.

HM,Jr: And you are going to depend on Schram. If I need any help, I will holler.

oOo-oOo

July 7, 1939

9:15 am

HM,Jr called the President at 9:15 o'clock and the following is a record of their conversation.

President: Hello, Hen!

HM,Jr: Hello, Mr. President! It is too bad about Claude. It is a shame. Was it a stroke?

President: Yes.

HM,Jr: Well, I suppose it is a relief for him.

President: I don't know anything about the funeral yet. I take it it will be on Monday away down in South Virginia. We will all go down on the train.

How is silver?

HM,Jr: Yesterday it was 36.73; today, 36.61.

President: It is the same then.

HM,Jr: I would say you are a good guesser. With your eyes partly opened you are good.

On the Jesse Jones affair ....

President: ... are you all ready? I got mad again yesterday. I told Pa "For God's sakes not to bother me with that thing again."

HM,Jr: You know, he went to bed yesterday. I talked to him a little while ago and he said "I will have it ready on Monday," and I said positively no.

President: No! No!

HM,Jr: Jesse said he got up at 6 this morning and read it and he is down to a few inconsequential things. I told him that I was free to go over it at any time with him.

I was going to make this suggestion. If we

can't get together, because it is down now to fixing the interest rates and I do not want to do it and he had it in 3% or above, that we will do everything we can up to noon and then walk the bill over to you. I take it, because Lowell Mellett called me, that you do not want to do anything at your press conference this morning, especially with Claude out.

President: No, I do not.

HM,Jr: Thanks, Sir. Good-bye.

President: Good-bye.

oOo-oOo

July 7, 1939

I said to the President, "With the Secretary of the Navy vacant and with all the trouble we have been having with Jesse Jones, don't you think your idea of some months ago of putting Jones in this position would be good?" The President shook his head and said, "No; it would never do." He said, "Did I tell you what I told Jesse?" He said, "I have been good this week?" I said, "What did you tell him?" He said, "Jesse wanted to keep his Directorship in the R.F.C. I told him no. And he wanted to be ex-officio on every other one of the Corporations and I told him no." And he said, "I want you, Henry, to get close to Schram." I said, "Mr. President, you have not appointed him." He said, "I will Monday and then you get close to him."

(The President had Admiral Leahy for lunch and my guess -- just a guess -- is that Leahy goes in -- a sheer guess.)

Part 1 - Meeting With Doughton, Cooper and Harrison at White House on taxes
Part 2 - HM,Jr conversation with President on Self-Liquidating Projects

July 7, 1939

2:50 pm

Present:

Mr. Gaston
Mr. McReynolds
Mr. Foley
Dr. White
Mr. Bell
Dr. Haas
Mr. Duffield
Mrs. Klotz
Mr. Lochhead
Phil Young (For first half of the meeting)

HM,Jr: Young, I want you to hear the first part of this, which has to do with the taxes, and then you will be excused.

The President saw Harrison, Doughton and Cooper at Doughton's request to discuss how the Congress would proceed over the summer in the preparation of a tax bill. Mr. Doughton and Mr. Cooper, it seemed, had taken it up with the Democratic members yesterday before coming down and they were very emphatic in their opinion they should proceed the way they had under the so-called Hill (Congressman Hill) Committee in 1933 where the House did the original work and with the Treasury cooperating. Pat Harrison concurred and said that he felt it was much better for the House to do it and the Senate would be very glad to let it go that way and then if the House could pass a bill early next January the Senate would be glad to receive it.

The question was brought up of outside advisers and it was the unanimous opinion, particularly stressed by the President, that the Government ought to have enough tax experts without calling in outsiders. Cooper said he had yet to see an outsider who contributed anything.

Then the question came up of a letter Mr. Hanes had written asking for a $250,000 appropriation, which I don't believe I have seen. I am fairly sure I have not. And also of an Advisory Committee. And they asked me how Mr. Hanes would feel in view of this decision and I assured them I knew he would be delighted to go along with the decision which was made there this morning, namely, that the House would immediately go to work, using the staff on the Hill plus the Treasury staff, and they said they would like very much to have the cooperation of Mr. Hanes and I assured them they would have it.

(HM,Jr to Mr. Young) If you will tell him that, plus the story that's in the papers. I don't believe I ever saw that letter. So many things have happened. But Doughton kept asking me about some letter he had for a quarter million dollars and setting up an Advisory Committee. You might dig it out and give it to McReynolds.

Mr. Bell: I think it was a Committee appropriation.

Mr. McReynolds: Did not go as a Department proposition.

HM,Jr: But everybody is very happy. I am only stressing it because it seemed to bother Mr. Doughton terribly and I assured him that Mr. Hanes would be delighted to go along on this basis.

(Mr. Young left at this point.)

NOTE: THE following was dictated by the Secretary from the Farm on 7/8/39 as an afterthought to the above.

The President said that England handled their finances the best of any country in the world and that when they decided to increase their cost for armament that they raised half of it through taxes and half of

it through borrowing. That this session of Congress went overboard on his Budget between $800,000,000 and $900,000,000 on Agriculture and on Armaments and, therefore, he thought in planning over the summer the Tax Committee should think of ways and means of raising another $400,000,000.

* * * * * *

I spoke to the President and told him that I was pleased to report there was 100% agreement between the Treasury and Mr. Jones and he said that was fine and that Mr. McReynolds and Mr. Foley would walk the bill over and you (Foley) most likely thought of it, but if you haven't I think there should be a new summary, possibly underlining the things which have been changed.

Then the President, while I was over there, put in a call for Sam Reyburn, Barkley and Steagall. He only got Rayburn while I was there and I had told him Jones had only spoken to Steagall, and the President said, "The bill is here and Foley or somebody will bring it up." He said, "It most likely will be Foley."

So the President wants us to continue, I would take it from that. You see? But Mac will escort you (Foley) over there because he has a way of his own with Forster.

Then the President talked about Currie being over there to see him about the railroad proposition and I told him that we had Currie over this morning and that seemed to please the President very much that I invited Currie to sit in with those railroads fellows.

And the other thing, very much in the room, very much in the room -- (looking under the desk and saying: No, I don't see Drew Pearson) -- Jesse wanted to sit as Director of R. F. C. and the President said

no. He wanted to stay as ex-official on every one of these groups and the President said no. And then he asked me particularly to get close to Schram, beginning Monday when he will announce it.

oOo-oOo

July 10, 1939

HM,Jr called the President at 11:05 and finally got to talk to him at four minutes of 12.

President: Hello, Hen!

HM,Jr: Hello. Did Missy tell you what I just told her? I said that I would set the price of silver at 20 cents if I could not get you. That I would have to use my own judgment.

President: I forgot to call you. How are you?

HM,Jr: Fine!

President: Good!

HM,Jr: Friday silver was 36.61 cents; Saturday, 35.55 cents and today, 33.84 cents. Unless you had some other idea, I thought we would make it 34.

President: Make it 35 today. From what I see, I would hate to see it go below on account of Mexico and Canada.

HM,Jr: On Friday we paid 36-¾.

President: Incidentally, we may squeeze somebody.

HM,Jr: We have been getting very little the last couple of days anyway.

President: I hate to do it on account of Mexico.

HM,Jr: Maybe they will begin to appreciate what we have done for them during the last four years.

President: I don't think Mexico will appreciate it if we do something for them now. If we do not set it at 35, Mexico will go broke. If it goes up again we can follow it up, but I don't like this going up and down.

oOo-oOo

July 11, 1939

Saw the President at 9:30.

Told him that Wallace was over here with blood in his eye in regard to Commodity Credit. He wanted something done about the stock that we hold. I told the President that Wallace wants to get Jesse Jones and his organization out of Commodity Credit and that Bell had told me that the President wanted Jones to continue. The President said that wasn't so.

"Well," I said, "I will tell you how I feel about it and I told this to Wallace. I think that you ought to have one big agricultural lending agency, just the way you have one lending agency for the people in the cities, and put a strong man at the head of it." And I told the President, "In addition to what I told Wallace, I want to tell you, Mr. President, I think it's most important politically to have an independent agricultural agency so you can point to that and say, 'Well, maybe you did criticize the Administration program on the little pigs, holding too much cotton, etc., but look what a wonderful record we have on lending money to the farmer,' and I think you ought to do it."

He said, "I agree with you." He said, "I would have to send a message to Congress on this, wouldn't I?" I said, "Yes, after the first of January." He said, "That's right and that's the way we will do it." But in the meantime I sit tight on my stock.

I said, "I am going to suggest to Jones that he withdraw one Director and let Wallace have one more Director," and he said, "That's all right."

Then I asked him who he would want to have testify on the self-liquidating program; that Wagner had asked me to. I said I thought it was a mistake for me to start, but I was willing to do anything that he suggested. That Foley had told me they had asked Jones to start and he didn't want to and my thought was to let Wallace, Carmody and Jones do it and if they wanted me to close the hearings, O. K. That was agreeable to the President.

He did not seem to think well of my idea of getting the Independent Agencies together, but he said he would have Jones and Carmody come to Cabinet next Friday and explain the program there.

I asked him, "If you don't mind my asking, why don't you send Schram's name up?" and he said, "Thanks" and he made a note of Schram and made a note of Currie and McNutt.

Then the President went into a long talk as to why he was putting McNutt in. He said, "The political reason is very insignificant." And he said, "I am sick and tired of having a lot of long-haired people around here who want a billion dollars for schools, a billion dollars for Public Health." He said, "I want a fellow who can "talk turkey" to Aubrey Williams and tell Aubrey Williams that just because a boy wants to go to college is no reason he should finance it." I said, "Is McNutt that kind of a fellow?" He said, "Well, we will give him his chance and we will find out."

So I interrupted the President and I said, "Franklin, you don't expect me to swallow all this, do you?" Very seriously he said, "Yes, I do." I said, "You are in grand form today, but it's kind of hard for me to swallow!" He said, "Well, to show you the kind of fellow he is." He said, "He thinks that the Philippine Islands should not be given their independence. He realizes that 90% of the people of the United States want them to have it, but if it's right why shouldn't he say so? Did he have the President's permission to come out in favor of not giving the Philippines their independence?" President said "Sure, go to it." The President said, "That's the kind of a fellow he is. He's willing to go against public opinion."

The whole time the President was talking I had a broad grin on my face, which he didn't seem to object to. But he wouldn't smile himself.

On silver, the President was very much pleased that the price in London had come up to 34½ cents.

He said, "Can't we select the people that we buy from?" I said it would be very difficult. He said, "Couldn't we treat silver like any other commodity and say to Chile, 'If you will drop your duty on automobiles, we will buy silver at so much above the world's price.' Make a separate deal with Mexico; one with Canada."

I told the President that last year the world's production was about 200,000,000 ounces; that the United States Government had bought 300,000,000 ounces; that private industry in the United States had bought about 50,000,000 ounces, so that we had purchased about 150,000,000 ounces above world production. I furthermore pointed out that from now on most of the silver that we buy -- a goodly proportion of the silver we buy -- will be stolen silver that Japan would want to sell us that they had stolen from the Chinese. This "hit the bull's eye" with the President and it was after this suggestion that he asked whether we couldn't make separate treaties with each country. He said "Just the way we do trade treaties". He said, "Treat silver like a commodity."

I asked the President for suggestions as to who he wanted for poker and he suggested Noble and Louis Johnson of the War Department. I shook my head on both. I said, "How about Bob Jackson". He said, "That would be fine." I phoned Bob Jackson's office and he could not come. He's in San Francisco.

oOo-oOo

Upon my return from the White House I called General Watson and suggested that he think over the idea of my inviting Farley to the poker party on Thursday. He called back and said he had talked it over with Miss Le Hand and they had decided that they did not want to have any irritation and therefore decided that it would be unwise for me to ask Mr. Farley. They suggested Stewart MacDonald and I have invited him.

I let the President read this cable.

ADDRESS THE COMMANDANT, U. S. COAST GUARD
AND REFER TO No.

TREASURY DEPARTMENT

UNITED STATES COAST GUARD

HEADQUARTERS

[redacted]

WASHINGTON 10 July, 1939.

From: Spagent, Hongkong, China.
To : Mr. Lochhead.

Message from Mr. Nicholson.

Buck arrived Hongkong July 6th enroute for New York via the Clipper. Stated four experts had been selected for assignment to Chungking in connection with road maintenance and transportation over Burma - Lashio - Kunming routes and their expected arrival in Hongkong would be about middle of August. In my opinion this is the outstanding achievement of the Secretary on China's behalf outside of commodity loans. According to reports from reliable persons on the spot, the highway from Bhamo to Lashio road at border is in very bad condition and almost impassable. That same fact is true of the Lashio Kunming road, although wet season has only begun. Road from Bhamo as far as Loiwing, site of Central Aircraft Factory is practically washed out in places and otherwise full of ruts and holes and tractors are now being used to pull loaded trucks over the most difficult parts. Aircraft factory officials are patching road with gravel the size of golf balls taken from their quarry. This, of course, is only makeshift repair and may do more harm than good in long run. However, there is goodly quantity of this gravel on river shore around Bhamo and with proper crushing etc. may make ideal material for strong road construction.

[redacted]

Franklin D. Roosevelt Library
DECLASSIFIED per T.D. 160
RHP 7-28-71

July 13, 1939

HM,Jr called the President at 9:20 and the following is a record of their conversation.

President: Good morning, Henry.

HM,Jr: How are you, Sir.

President: What happened?

HM,Jr: Yesterday silver was 34.90 and we kept it where it was. Today it is 35.43.

President: Fine!

HM,Jr: And my thought was not to follow it up.

President: What is your price now?

HM,Jr: Our price yesterday was 35 cents. We did not follow it all the way down.

President: I think that is all right.

HM,Jr: We could see what happened. They have a very short position over there. If we left it at 35 for a day or two .....

President: That is all right.

HM,Jr: What time would you like to have supper tonight?

President: About midnight.

HM,Jr: What time would you want to have tea, then?

President: Let's get started early. Shall we say seven o'clock?

HM,Jr: In other words, you expect dinner at seven. You will have it.

President: Don't give us too much to eat.

HM,Jr: I will not give you too much. I am planning to give you lobster.

President: Oh, boy! Don't have much else besides lobster.

HM,Jr: No. A little salad, a little champagne.

President: That's fine! That's fine!

HM,Jr: Is General Watson coming? We will make him play with a fifty-cent dollar. (HM,Jr explained to Mrs. Klotz afterwards that Watson's name for himself is Old Dollar Watson.)

President: You will have to call him $2.00 Watson. It will be a grand game!

oOo-oOo

July 14, 1939

Appointment with the President at 11 a. m.

I reviewed with the President the recent history of the Bank of America case, reminding him of his suggestion of a letter that Giannini should write to the Comptroller and told him that Giannini had never done this. I furthermore told him that all negotiations we had with them expired as of June 30th. I told him about the three advisory bankers. I then let him read Folger's letter of July 13th (attached) plus the statement which Mr. Ottley had given me (also attached) and told him what we proposee to do. The President said, "That's fine!"

At the beginning of my conversation he said, "Is it you or the Department of Justice who is having hearings about the Bank of America, because I have received copies of a number of editorials from the West saying that you are persecuting Mr. Giannini and the Bank of America." I said, "The only place that has been conducting hearings is the S.E.C." I said, "All of our negotiations have been in private." I told him that I had Jerome Frank over here yesterday and had posted him and that Frank was so pleased because he said that this $8,000,000 right-off on the real estate was just what they needed in order to make their case.

I talked to the President about Joe Green of the State Department and he said that he had spoken to Hull about giving him a diplomatic post some place outside of Washington, but that Hull was very stubborn; that he liked Green; that he told the President that he supposed it was Ickes who was back of it. The President said no, it wasn't Ickes; that a lot of people were talking about it plus the Hill.

I talked to him about Aranha and Brazil and how we weren't doing anything, thanks to Francis White plus Herbert Feis and the Bondholders Committee, etc., etc., and he said to talk to Sumner Welles about it and I told the President my idea of transferring those negotiations to the Export-Import and he liked the idea immensely.

Also asked him for a date for a picnic at the Farm and he said either the 22nd or 23rd would be O.K. and I asked Steve Early which was better for the newspaper men, Saturday or Sunday, and he said Saturday night is better. They can sleep on Saturday night, but if it is on Sunday they have to prepare it for their Monday morning papers.

I found the President in excellent humor. He said he had enjoyed the evening very much and in talking to Seve he said last night was just what the President needed after the very difficult day he had had yesterday.

TREASURY DEPARTMENT
COMPTROLLER OF THE CURRENCY
WASHINGTON

ADDRESS REPLY TO
"COMPTROLLER OF THE CURRENCY"

July 13, 1939

MEMORANDUM TO SECRETARY MORGENTHAU

Examiner McLean, in making the current examination of the Bank of America N.T. & S.A. as of March 31, 1939, has tentatively listed losses totaling $13,522,598.69 and doubtful of $16,482,838.83. In addition there are classified assets in II (formerly known as "Slow") of $102,692,875.09.

Approximately $5,000,000 of the loss classification has already been reviewed with the officials of the Bank by Examiner McLean and they are substantially in agreement. An additional amount of approximately $8½ million remains to be reviewed with the officials of the Bank. Most of this results from a review of the Bank's own appraisals of its banking premises and other real estate.

The District Chief Examiner, Mr. Irwin Wright, and I are in agreement with the tentative loss classification and believe that it is completely justified by the facts developed in the course of the examination.

As agreed upon in the conference with you and the Comptroller, I am planning to return to San Francisco at once to participate in the review of this additional loss classification with the officials of the Bank. We shall endeavor to complete that review and proceed directly to the closing of the examination and the completion of the writing and typing of the report in an endeavor to return to Washington and have prepared for transmittal to the Board of Directors of the Bank by August 1st a letter summarizing the examiner's criticisms.

W. P. Folger

Wm. P. Folger
Chief National Bank Examiner

approved
Preston Delano

11-21-1938.		4-1-1939		DECREASE.	INCREASE.
SLOW.		SLOW.			
Loans	102,515,860.	Loans.	91,310,717.		
Overdrafts	14,530.	Overdtafts	6,884.		
Bonds,securities	30,099.	Bonds,securities	423,536.		
Banking House	1,363,950.	Banking House	707,651.		
Other real estate	3,437,404.	Other real estate	4,327,798.		
Other	51,550.	Other assets	1,285.		
Merchants Nat.Realty	5,055,151.	Merchants Nat. Realty	3,515,000.		
Dep'n. B.H. & F.F.	0	International Dep't.	2,400,000.		
	112,468,546.		102,692,875.	9,775,671.	
11-21-1938.		4-1-1939.			
DOUBTFUL		DOUBTFUL			
Loans	2,265,001.	Loans	8,664,222.		
Overdbafts	623.	Overdrafts	4,078.		
Bonds,securities	2,118,153.	Bonds,securities	1,445,477.		
Other assets	728.	Other assets	0		
Dep'n. B.H. & F.F.	3,200,553.	Banking Premises	1,489,666.		
		Banking Premises - O.R.	0		
		Merchants Nat.Realty	1,686,968.		
		International Dep't.	1,265.127.		
		Furniture & Fixtures	1,927,298.		
	7,585,059.		16,482,838.		8,897,779.
11-21-1938.		4-1-1939.			
LOSS.		LOSS.			
Loans	2,517,762.	Loans	1,464,748.		
Overdrafts	2,682.	Overdrafts	12,897.		
Bonds,securities	2,913,770.	Bonds,securities	1,631,482.		
Banking House	389.	Banking House	5,027,366.		
Other real estate	199,347.	Other real estate	665,895.		
Other assets	249,678.	Other assets	3,345.		
		Merchants Nat.Realty	2,100,636.		
		Same - Future & Former	1,126,991.		
		Banking House - ORE	488,643.		
		International Dep't.	1,000,591.		
	5,883,631.		13,522,598.		7,638,967.

0230

THE WHITE HOUSE
WASHINGTON

December 13, 1938.

MEMORANDUM FOR
THE SECRETARY OF THE TREASURY

Will you hold this confidential memorandum until we are ready to take it up?

F. D. R.

So B plan

July 17, 1939

Lunch with the President.

Told him we were going ahead with Section 102. I did not show him the memorandum from Graves (attached) but I told him that we were getting a Treasury Decision out in the next day or two. He said, "Fine!"

He said, "I would like you to investigate a couple of companies for me especially." He said, "Now take the New York Times, for example." He said, "Not that I have got anything against Arthur Sulzberger, but he's just plain stupid," and with that I howled.

I said, "What do you want me to do?" He said, "Well, where did they get the money from to pay their income tax?" So I said, "They got it from the Times Company. They bought back preferred stock." He said, "I know. I want you to look into it."

Then he said, "Take a look at Coco Cola." He said, "They have been paying lots of stock dividends." He said, "I was told to buy it the first year I went to Warm Springs by the Coca Cola crowd and I never did it." He said, "A very beautiful lady advised me to buy it and I never did it and I would like you to look into it."

(I am not going to carry out either suggestion of the President. I will give Harold Graves time and see how he handles it in the normal way.)

I spoke to him about Self-help Cooperatives; that I had spoken to both Carmody and Harrington, but nothing happened and he would have to get after them. He said, "Dictate a memorandum to Kannee." I said, "My suggestion is that you organze self-help coops, in the future, in the States where they have made a success of the food stamps. They had to do a lot of preliminary work with the unemployed. Let them start in Rochester, Dayton and Seattle." He said, "Fine! Write a memorandum to Kannee and I will do it," which I did.

He said, "Sometime next fall I want to get this whole question of surplus commodities and self-help all reorganized -- the unemployed -- in a very simple form. This is the way I remember it: first we ought to have our

public works, then we ought to have our self-help coops and supplement it with surplus food, and I don't remember just where WPA fits in.

The great trouble with the President is he has these ideas and throws them out to me, but he never seems to sit down and carefully plan a program for the unemployed over a period of years.

I said, "According to the ticker, Jones has come out flat-footedly in favor of the self-liquidating program. You must have said something to him Saturday." He said, "I did. I picked up the Wall Street Journal of Saturday and showed Jones where it said 'Jesse Jones Appears Skeptical on Phases of Spending-Lending." I said "Evidently it worked because now he is out for it."

The President said -- going back to Coca Cola -- "If you want to try something, when you leave the office take ten grains of aspirin and then drink two bottles of coa cola through a straw and see what it does to you." I said, "But, Mr. President, I have to go on the Hill tomorrow and testify.

"Well, take it half an hour before you go up and testify and you will go up and spit in their eyes."

The President read the memorandum on Edison and said, "If Edison thinks he can get it rhough, all right. But I would rather have him borrow the money from R.F.C. and pay it off on a pro rate basis." So I said, "Well, Mr. President, they won't do that because at the end of four years where does it leave them if they have no more orders."He said, "Then R.F.C. is out of luck." He said, "Suppose this is a good corporation and they are hooked. Let them organize a subsidiary and take care of it that way,"the inference being that they could go through bankruptcy. I said, "Mr. President, a reputable company won't want to do that." So he said, "I don't think they have to get this legislation through." " I said, "Well, supposing Edison thinks he can?" He said, "All right, but tell him I would rather have him do it the other way, to borrow the money from R.F.C. and pay it off on a pro rate basis." I said, "You toldme that on Friday and I threw out that suggestion and we got nowhere."

I asked the President whether it would be useful in testifying tomorrow to emphasize the number of skilled people who would be employed, particularly in the building industry, on account of the trouble he is having with WPA. He said it would be most useful and please to stress it.

TREASURY DEPARTMENT

WASHINGTON

OFFICE OF
COMMISSIONER OF INTERNAL REVENUE

ADDRESS REPLY TO
COMMISSIONER OF INTERNAL REVENUE
AND REFER TO

July 10,1939..

Memorandum for the Secretary:

Complying with your request of Wednesday, July 5, I submit the following information with respect to the steps to be taken by the Bureau of Internal Revenue in the application of the provisions of section 102 of the Internal Revenue Code:

Section 102 of the Revenue Act of 1938 contains a new provision, namely, that the existence of an accumulation of earnings or profits beyond the reasonable needs of the business is determinative of the purpose on the part of the corporation to avoid the surtax on shareholders unless the taxpayer proves the contrary by the clear preponderance of the evidence. The effect of this new provision is to shift the burden of proof to the taxpayer and thus materially strengthen the position of the Bureau in undertaking to defeat efforts to avoid surtax upon individual shareholders by failure to distribute corporate earnings.

With this change in the law, revised instructions will be issued to all internal revenue agents in charge and other officers and employees of the Bureau concerned, requiring that close attention shall be given to all corporation returns to determine whether section 102 is applicable. The types of corporation returns to which the instructions will require attention include the following:

1. Corporations which have not distributed at least 70 percent of their earnings as taxable dividends.

2. Corporations which have invested earnings in unlisted securities or other properties unrelated to their normal business activities and not readily convertible into cash.

3. Corporations which have advanced sums to officers or stockholders in the form of loans out of undistributed profits or surplus from which taxable dividends might have been declared.

4. Corporations, a majority of whose stock is held by a family group or other small group of individuals, or by a trust or trusts for the benefit of such groups.

5. Corporations, the distributions of which, while exceeding 70 percent of their earnings appear to be inadequate when considered in connection with the nature of the business or of the financial position of the corporation, or with accumulations of cash or other quick assets which appear to be beyond the reasonable needs of the business.

In so far as cases of the first four types are concerned, the instructions will provide that in every instance the examining officer's report shall contain a specific recommendation for the application or nonapplication of section 102.

Employees will be designated in each field office to specialize on the application of section 102, whose responsibility it will be to pass personally upon each case in which recommendations have been made by examining or reviewing officers with respect to the application or nonapplication of that section. Special attention will also be given to these types of cases in the post review of returns in Washington, and detailed data will be maintained currently in Washington in respect of all cases in which liability under section 102 is suggested so that the officers of the Department and interested committees of Congress may be kept appropriately informed.

It will be remembered that personal holding companies are now taxed under section 351 of the Revenue Act of 1934 and corresponding sections of the Revenue Acts of 1936 and 1938 and the Internal Revenue Code. The provisions of the statute establishing high tax rates on earnings held in such corporations have eliminated the largest group of cases which previously fell within the provisions of section 102, and that section now has application only to corporations other than personal holding companies.

It is believed that under the plan which is in mind, as outlined above, the Bureau will be able to provide an adequate arrangement to insure that unreasonable accumulations of current earnings in corporate structures will be taxed as directed by section 102.

Hans Schaum

Acting Commissioner.

THE SECRETARY OF THE TREASURY
WASHINGTON

MEMORANDUM FOR THE PRESIDENT:

Pursuant to your suggestion at Cabinet meeting on Friday, representatives of the Treasury conferred with Assistant Secretary of Navy Edison and representatives of the Navy Department.

Assistant Secretary Edison wants to work out some method to step up the armor production of three steel companies to meet the Navy's battleship building program.

The way Mr. Edison wants to do this is through special legislation. The special legislation proposed is of two kinds: (1) An Act authorizing the steel companies to get, under the Vinson-Trammell Act, a deduction for the cost of new plant, equipment, et cetera, required to execute the contracts for the contemplated battleships; or (2) An amendment to the deficiency appropriation act authorizing the Navy Department to spend $6,000,000 for the purchase of the new plant and equipment.

Mr. Edison feels that this end can probably only be achieved by such legislation. The Treasury agrees.

The Treasury representatives have given every cooperation in suggesting the kind of special legislation necessary to accomplish the end that Mr. Edison has in mind. A conference was held on Friday afternoon, July 14, with Navy Department representatives, at which the Treasury representatives presented their suggestions. Again on Monday morning, July 17, the Treasury Department representatives participated in a conference with the Navy Department representatives and the Director of the Budget to prepare the kind of special legislation that Assistant Secretary Edison desires. The Director of the Budget thinks that the legislation amending the deficiency appropriation act would be better.

In short, the Treasury is doing everything that it reasonably can to assist the Navy Department in accomplishing its purposes.

H. Morgenthau Jr.
July 17, 1939

JUL 17 1939

JESSE JONES SAYS HE THINKS LENDING SPENDING BILL SHOULD BE PASSED AT THIS SESSION OF CONGRESS

12,35

WASHN - JESSE JONES ADMINISTRATOR OF THE NEW FEDERAL LOAN AGENCY SAID HE WOULD LIKE TO SEE THE ADMINISTRATION-S NEW SPENDING LENDING BILL PASSED AT THIS SESSION OF CONGRESS - HE DECLARED THAT IN HIS OPINION -THE LENDING BILL IS A GOOD BILL-

MR JONES DECLARED THAT IT WOULD TAKE SEVERAL MONTHS TO GET THE VARIOUS SECTIONS OF THE BILL INTO FULL OPERATION AND SAID THAT IF ENACTMENT WERE DELAYED UNTIL NEXT SESSION OF CONGRESS A LONG DELAY WOULD ENSURE BEFORE THE OBJECTIVES OF THE LEGISLATION COULD BE ACCOMPLISHED

-0-

WALL STREET JOURNAL - July 15, 1939

Faint Praise

Jesse Jones Appears Skeptical on Phases Of Spending-Lending

From THE WALL STREET JOURNAL *Washington Bureau*

WASHINGTON — Federal Lending Administrator Jesse Jones told the Senate banking and currency committee yesterday that the new self-liquidating loan program had good objectives and that if loans were properly made the program could be made self-liquidating.

Senator Barkley (Dem., Ky.), sponsoring the bill in the upper chamber, said that it was not designed to make money and he didn't want the government to make money out of it.

To this Mr. Jones replied: "Don't worry, the Government won't make any money out of this program."

Some members on the committee took the Jones' testimony, which lacked any enthusiasm for the bill, as injuring its chances of enactment at this session, contending that it was the Jones curse of faint praise on the Mead bill for insurance of bank loans for business which was largely responsible for its failure to move toward enactment at this session.

Says RFC Now Has Broad Powers

Mr. Jones, in responding to inquiries from members of the committee, said the Reconstruction Finance Corp. already had broad powers to make self-liquidating loans and that in his opinion the new proposed fund could not be loaned out or spent as fast as advocates had estimated and certainly he did not think the rail equipment leasing program would approach the $500,000,000 mark for some long time.

Advocates of the legislation were particularly anxious to win the support of Mr. Jones, whose influence with members of the Senate banking and currency committee has brought results on many occasions. Now, friends of the legislation look for Secretary of the Treasury Morgenthau, scheduled to appear next time, to be the key witness for the measure.

Backers of the plan hope that the Secretary will strongly endorse the government lending program outside of the budget and overcome any setback the bill may have received as a result of the Jones testimony.

A highlight of the hearing yesterday was the proposal suggested by Senator Maloney (Dem., Conn.) to put into the bill as an aid to railroad carriers an amendment which would permit them to buy in their own securities at a discount with government financial assistance. Such a proposal is embodied in the Lea omnibus transportation bill which appears to have less chance of enactment at this session than the spending lending program.

Jones Seeks to Salvage Section

Mr. Jones apparently is seeking to salvage this section on government-aided security purchases by railroads and he told the committee he thought it would be very desirable. He discussed the proposal at length stating that there are roads with bonds which have never been defaulted and which had earned charges in all but the last two years and yet these bonds are selling around 30.

"Now if we had authority to lend money to railroads to buy these bonds we would require them to give to the holders the difference in the discount price and 100 in preferred stock," he stated. He declared that carrier fixed charges in some cases could be cut 50% by such a system.

Rail Equipment Leasing

With respect to the rail equipment leasing feature, Mr. Jones said some good could come of it. While railroads have a great deal of equipment, he said, much of it has little more than scrap value, therefore, they might be induced to buy or lease if the Government would give double scrap value of old equipment. A little money would be lost under the program, he thought, but it might be made up in general economic improvements.

The committee members got into a discussion with Mr. Jones over the provision of the bill which establishes a formula for fixing the rate of interest on loans at about one-eighth of 1% above cost of the money to the government. The formula provides for a calculation based on yield where government securities are selling above par. Mr. Jones said it wasn't clear and that he had asked the "figure boys" in the Treasury to explain it to him and that he still did not understand it. He urged the committee to simplify the provision by providing rates giving due regard to the cost of money to the government. He thought the Secretary of the Treasury ought to be required to approve rates fixed by the agencies because he would know what the money is costing.

A question was asked whether Mr. Jones would favor making the rail equipment features outright loans instead of equipment leasing. Mr. Jones said the RFC has tried to get railroads to buy equipment ever since the Glass-Steagall Act.

Senator Maloney wanted to know whether loans could be made to foreign railroads under the bill. Mr. Jones said it wasn't contemplated but committee members generally agreed that it wasn't prohibited under the measure. Senator Wagner (Dem., N. Y.) stated that an amendment could be added restricting the loans to domestic carriers.

July 18, 1939

2:20 pm

Present:

Mr. McReynolds
Mr. Foley
Mr. Bell (last part)
Mrs. Klotz

HM,Jr: I just got a telephone message from the President who says to me, after being very polite and "How are things going. What's the news? Now, about this Commodity Credit business" -- Wallace is having lunch with him -- "I understand you have a piece of paper.

And I said, "I don't know what you are talking about."

"Well, a piece of paper representing the stock of the Commodity Credit." He said, "I think Congress meant to transfer that piece of paper along with Commodity Credit over to Agriculture." He said, "I think you had better transfer it and have Wallace's name on it."

He said, "You have twelve directors, which is too many. Make it five." He said, "You don't want to be one." I said, "No." He said, "Make ex officio the R.F.C., Farm Credit and Treasury."

I said, "Well, you know, Mr. President, the stock belongs to you. I am simply the trustee for it." He said, "I don't own the stock." I said, "Well, you represent the United States Treasury." He said, "Well, this is a legal matter and Wallace's name should be on the stock."

So I said, "I thought, Mr. President, you were in favor of creating an Agricultural Credit Agency."

"Yes, that's a good idea, but we don't want any

city slicker at the head of it."

I said, "I did not suggest that." I said, "Once this thing goes over, it makes it that much more difficult."

"Well, I want Wallace's name on the piece of paper."

"Well, whatever you want, it's all right with me."

He said, "Well, that's what I want." He said, "It's legal matter."

I said, "It isn't a legal matter, Mr. President."

So fix it up between you and advice Bell and transfer the stock and let's ship it over to Wallace and I wash my hands. I am not going through the motions of a Directors' meeting or anything else. To hell with them! The President only last week said he wanted the other thing. Now he completely reverses himself.

Who fixes up that Executive Order?

Mr. Foley: We talked about an Executive Order and Wallace had one ready.

HM,Jr: I told the President it needs an Executive Order. Mac, in your dual capacity, see it through. I don't have to sign anything?

Mr. McR: You will probably have to sign a letter transmitting the stock.

HM,Jr: Suppose I get bullheaded and not do their financing on Monday for Commodity Credit. It's a busted concern and the stock is not worth the paper it's written on. I don't want anything to do with it. I told Wallace yesterday that we always did it. They have got to raise $200,000,000 between now and the first of August and Congress has refused to give them the $119,000,000.

Mr. McR: We can take care of it.

HM,Jr: Wallace put up a fight and he won.

(Mr. Bell came in at this point and the Secretary repeated to him the substance of the above remarks.)

Mr. Bell: The stock is in the name of the United States Government. I think under the Act the President has authority to exercise ownership.

HM,Jr: Supposing I am bullheaded and I am not interested in Commodity Credit. They are shy $100,000,000 and I don't want to sell their phony paper to the misguided public.

Mr. Bell: I don't think they will get their $119,000,000.

HM,Jr: Should I, as Secretary of the Treasury, peddle that busted concern?

Mr. Bell: Yes, I think you should continue to sell Commodity Credit paper. The fact that it changes hands in this way does not affect it.

HM,Jr: You can do it. I am not interested. I don't want to touch it. Let the President of the United States peddle $200,000,000. He takes it so easy. I am busy the rest of the week.

Mr. Bell: I don't think it's right, but there are a lot of things like that.

HM,Jr: I am busy the rest of the week. Let Wallace go in the Street and do a little financing. And I will tell the Vice Chairman of the Fed, Sproul, I will tell him it's phony and not to touch it. It's a busted concern. Deficit of $119,000,000. Congress has not acted and until it acts I won't offer it to the public. What right have I got to offer. What are their assets?

Mr. Bell: Stock isn't worth anything. They have assets of $775,000,000 of which $119,000,000 is

lost based on market prices, so they have about $650,000,000 in assets and $206,000,000 in the hands of the public.

HM,Jr: But what is the net position?

Mr. Bell: Commitments up to about $800,000,000. Capital stock is worthless.

HM,Jr: All right. Until Congress votes it, I am not going to offer it.

Mr. Bell: No, you can't do that.

HM,Jr: Well, I have a good lawyer who will give me a legal opinion.

Mr. Bell: You can't do that.

HM,Jr: Why not?

Did Wallace send his man over to talk to you?

Mr. Bell: Three o'clock today.

HM,Jr: It should be looked into by S.E.C. It's illegal, improper. I am against selling phony securities.

You are seeing them?

Mr. Bell: Yes.

HM,Jr: Well, the President of the United States before he would give Edison the right to build a dirigible made him write a letter guaranteeing against fatalities. You have to guarantee me against any loss before I offer it to the public.

Mr. Bell: I couldn't do it last year and I can't this year.

HM,Jr: Last year it was in the hands of Jesse Jones in whom I had confidence.

Mr. Bell: He lost $119,000,000.

HM,Jr: Not in his operations.

Who's coming over to see you?

Mr. Bell: Robbins and Goodloe.

HM,Jr: Mac, it's in your lap and get the stock over to Wallace or at least in the hands of the Director of the Budget today.

Mr. Bell: We have a copy of the Executive Order upstairs and we wrote we did not agree with it.

HM,Jr: Tell Harold Smith that the President has ordered me to do it.

Mr. Bell: Do you want to write a letter to the Director of the Budget?

HM,Jr: No. I won't write any letter. If I do I will say I am opposed to it.

Mr. Bell: That's on record.

HM,Jr: That's all right. Leave it there. The President has overruled me.

Mr. Bell: That's perfectly terrible!

I am in favor of stopping the thing.

HM,Jr: Suppose we don't make a loan on Monday?

Mr. Bell: They have obligations coming due. Payments to banks which can't be met. $206,000,000 public obligation coming due on July 31.

HM,Jr: Wallace is much more interested in having the stock. I am on record asking him to get in touch with you and that the next move was up to him. Of course, unfortunately, yesterday I made this pretty speech that we always did this financing for them.

Mr. Bell: I think you ought to continue to do it.

oOo-oOo

July 20, 1939

HM,Jr spoke to the President on the phone and the following is his part of the conversation:

"My parents are at Bar Harbor. I am going up to say good-bye and then go to the Farm. I just wanted to let you know that I am going.

"We are looking forward to seeing you on Saturday. Elinor thought we might better tell the men 6:30 because it gets dark.

"As far as I can tell, we are doing all right in the Senate on this Lending Bill. Steagall as Chairman is something! He had me there from 10:30 in the morning until 6:30 last night. But they are marking up the Bill on the Senate side.

"There is no Cabinet today? Oh, you are leaving this afternoon! I didn't know. That is just perfect!"

oOo-oOo

July 26, 1939

9:30 am

On my visit to the President, I told himabout Collins' reporting to me about the visit here of some Lord Riverdale and he said he did not know anything about it and wanted to be kept informed.

I told him I was going to buy my tickets for Europe and he said, Fine! He said he thought things looked a little bit better.

Spoke to him about the Lochheed plane and he gave me a memorandum to Edison.

Told him about Greenlee, of Indiana, and McHale. He suggested that I see Senator Minton and explain to him that this was just in line of duty and was not aimed at McNutt. (I am going to see Minton, but I am not going to put any ideas in his head about McNutt.)

Told the President I was going to scold him because he had not had his sinuses ex-rayed and had not seen Dr. Kroll of Baltimore. He said it was unnecessary to have his sinuses ex-rayed because due to the fact his nose was broken twice playing football that at times the passages are closed and it has nothing to do with his sinuses. I still begged him to do something about it, but he said he wouldn't.

Asked him if McReynolds could have a month off for vacation and he said yes.

Spoke to him again about Brazilian debts owed to our private citizens and told him that I had spoken to Sumner Welles and that I doubted if anything would happen until some crisis arose and then they would come running to him and asking him for help. He agreed.

I asked him for a clearance on "Policy and Purpose of Act" (attached hereto) to be used in case of emergency and he said it was all right to give it to Barkley to be used if necessary.

Policy and Purpose of Act.

SEC. 21. It is hereby declared that it is the policy and purpose of Congress that through this Act the competitive system of private enterprise for profit shall be maintained and encouraged and that wherever practicable no loan or expenditure shall be made under this Act for any work, project, or undertaking in a field now adequately supplied by existing competitive private enterprise or by existing non-competitive private enterprise at reasonable prices.

July 28, 1939

11 am

The President just called me. I told him about the silver business and he said yes, we can quote him as saying he does want the right to buy foreign silver continued, but we don't want to say we will buy how much, but we do want to continue to buy it. I told that to Ed Foley.

AR

July 31, 1939

Lunch with the President.

The President read this letter of Delano's very carefully and approved it. Said it's a good letter.

Read this Japanese material. Asked were we doing anything more about looking up subsidies on Japanese goods coming to this country. I said we were and he said to hang on to this.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE July 31, 1939

TO Secretary Morgenthau

FROM Mr. White

Subject: The recent report on the economic situation in Japan by the Department of Commerce

The report is merely a review of the economic changes which have taken place in Japan in the past two years. Unfortunately this report was a hastily prepared summary of the consular reports which have been available to us. It adds nothing new to the available information and is an inadequate presentation of the situation.

The actual situation is as follows:

1. We estimate Japan has been losing foreign exchange at at least about the same rate during the first half of 1939 as she did during the first half of 1938, namely from $10 to $15 million a month. Her trade position with foreign exchange countries has grown worse despite her strenuous efforts to improve it.

2. Her situation is becoming increasingly serious because she has less than $200 million in foreign exchange assets left. At the rate at which she is losing her foreign exchange her supply will reach within 12 months an irreduceable minimum -- unless she obtains new sources of foreign exchange.

3. To increase her source of foreign exchange Japan is trying desperately to increase exports, reduce imports, borrow abroad, and obtain control over foreign exchange assets in China. She has had little success so far.

a. Her imports have already been cut to the bone and any further reduction would be at the expense of the efficiency of her military forces and her preparedness for a possible war with Russia.

b. She is going to great lengths to substitute Chinese raw materials, for which she does not have to pay foreign exchange, in place of imported goods which have to be paid for with foreign exchange.

c. She has been trying very hard to increase her exports during the past year but with only little success. Her exports to foreign exchange countries during the first five months of 1939 increased only 2 percent over the previous year. (This was more than offset by an increase of more than 5 percent in imports from such countries.)

d. She has been successful in obtaining some short-term credits but we have evidence of only small amounts so obtained.

4. The increasing shortage of foreign exchange is one of the important reasons why Japan is making greater efforts to secure control over the foreign settlement in China.

5. The Japanese economic situation is becoming more desperate every month.

The reported wholesale prices -- despite the controls -- are 20 percent higher than in 1937. (In contrast world prices are down 12 percent.) Note circulation of Japan has been rising steadily and is now 50 percent higher than it was in 1937.

The war is being financed by budgetary deficits the size of which for Japan are colossal. The national income of Japan is estimated at about 15 billion yen; yet her public debt is now increasing at the rate of 6 billion yen a year. If the United States were increasing her public debt at the same rate as Japan in relation to the most significant figure, namely her national income, our public debt would be increasing at approximately $25 billion a year!

The Japanese Government is now completing the process of obtaining complete war time control over production, foreign trade, prices, and distribution of all commodities.

The inflationary process has already begun in Japan.

...nced, declared
...ly will take re-
...asures if there is
...on by America" after
...dies.

...ary of the Treasury Mor-
...d said here that he was
...ying means of backing up the
...tate Department's abrogation action, presumably through possible countervailing duties on Japanese exports or restricting purchases of Japanese gold and silver.

The Commerce Department, in an analysis of Japan's economy, said that nation's most pressing need "is for exchange to carry on its foreign trade," exchange it has obtained to a large extent through sale of gold here.

Secretary of State Hull indicated that developments within the next six months before the treaty actually ceases to exist will have a dominant bearing on the question of negotiating a new one.

There followed, in Tokyo, an official statement saying that if the United States desires a new treaty it must be negotiated on the basis of "the new situation" in east Asia, a condition considered entirely unacceptable to this Government.

Treaty Blocked Embargo

The treaty denounced had clearly ...ood in the way of a Senatorial-...sed embargo on American ma-...l in Japan's war on China. ...e shall be a Congres-...n embargo, ... taken

Immediate Release

DEPARTMENT OF COMMERCE
WASHINGTON

July 27, 1939

Secretary of Commerce Harry L. Hopkins today made public the following report on Japan's economic situation, prepared for him by the Far Eastern Section, Division of Regional Information, Bureau of Foreign and Domestic Commerce.

- - - - - - - -

Two years of military activity in China have brought about a radical reshaping of Japan's entire economic system. With the advent of the China Incident of July, 1937, the country definitely committed itself to a policy of planned economy -- although trends in this direction were apparent even before the outbreak of hostilities, when, by its efforts to increase productive power, expand foreign trade, and attain a higher degree of self-sufficiency, the Japanese Government subjected business and industry to some degree of State control.

Import Restrictions Have Depressed Exports

But the need to mobilize all resources to meet "emergency" requirements of the past two years has brought many additional state control measures, which have penetrated into every recess of Japan's industrial, business, financial and agricultural activity. Today Japan is operating on the basis of a purely wartime economy, with practically complete Government domination over production, foreign trade, prices and distribution. These control measures, while assisting to meet emergency needs, have, nevertheless, thrown the country's economic structure off balance. In order to safeguard yen exchange, imports have been so severely restricted that many raw materials normally entering into the production of essential requirements for export have been diverted to armament and munition industries.

Thus Japan's flourishing pre-China-incident export trade has been drastically diminished through the inability to find adequate means to finance emergency needs plus insufficient foreign exchange to purchase abroad the raw materials imperative to maintain its program of export production. Export trade has also materially suffered as a result of higher production prices -- engendered in part by the control measures -- and by a slackening demand in foreign countries for the products of Japanese industries.

Manpower Greatest of Japan's Natural Resources.

Japan has no great reserves of natural resources nor accumulated wealth such as are possessed by the United States, or by certain of the countries of Europe. Her greatest resource has been a skilled, thrifty and frugal manpower, whose earnings in the production of goods for export from imported materials have been her mainstay. Half Japan works on its farms: the bulk of the remainder is employed directly or indirectly in production for export. To purchase the raw materials which go into this production Japan must either have gold which she can export in payment for them, or foreign exchange obtained by exporting the goods she manufactures. But her exports have declined and her gold reserves have been depleted. The necessity of obtaining foreign exchange to pay for essential imports, in the face of diminishing gold reserves and declining exports to free exchange countries, is a major problem confronting Japan's leaders.

Changing Trade Position.

Export trade started its downward trend in the autumn of 1937 — or shortly after the commencement of the Sino-Japanese hostilities -- and continued to decline throughout 1938. Exports of the Japanese Empire last year totaled but 2,896,770,000 yen, a drop of 12.7 percent from 1937, while exports from Japan Proper, valued at 2,689,677,000 yen, declined more than 15 percent. Raw silk, the leading export commodity, registered a 10 percent decline in value, and notable recessions occurred in exports of cotton piece goods, silk tissues, rayon piece goods, woolen textiles, knitted goods, potteries and glass, and miscellaneous manufactured goods — all products that figured so prominently in Japan's rapid trade expansion up to 1938. The only commodities showing increases in 1938 over 1937 were canned foodstuffs, wood, paper, and machinery and parts; but the gains in exports of these products represented primarily increased shipments to yen-bloc areas, to Manchuria in particular.

Even greater declines occurred in import trade. Total imports into the Empire, valued at 2,838,220,000 yen, were 28.3 percent below the 1937 total, while imports into Japan Proper, totaling 2,663,337,000 yen, show a decline of about 30 percent. Purchases of raw cotton, wool, crude rubber and other materials essential to export industries, as well as unessential manufactured products, were severely curtailed in order to conserve exchange for the purchase of military necessities. Although statistics of imports of commodities of possible military value are not available from Japanese sources, it is revealed from export figures of the principal supplying countries that in the two years, 1937 and 1938, very substantial increases occurred in Japan's imports of those commodities that are possessed of exceptional usefulness in warfare -- petroleum products, iron and steel, machinery, automotive products, and aircraft and parts.

Heavy Import Excess in Trade With Foreign Currency Countries.

Every year since the period of the World War Japan has had an import excess in its foreign merchandise trade. In 1937 the import balance of Japan Proper reached a peak of 607,759,000 yen, while that of the Empire was 635,906,000 yen. Usually the import excess is offset in large measure by an export excess in invisible items, principally in receipts from shipping services. But over the last two years returns from shipping have fallen off drastically, largely because Japanese ships have had to be diverted from international trade to the carrying of troops and military supplies to China. Nevertheless, trade returns for 1938 showed an Empire export excess of 60,549,000 yen — the first in twenty years. But this improvement in the trade balance was far more apparent than real. The trade of Japan Proper showed an excess of but 26,340,000 yen, and this was brought about by a sharp increase in exports to the yen-bloc areas (Manchuria, Kwantung Leased Territory, and North China) — which do not yield foreign exchange — and by severe restrictions on imports. Exports to foreign currency countries dropped sharply; actually Japan Proper had an import excess of 492,390,000 yen in its trade with the foreign currency countries.[1/]

Gold Reserves Depleted by Shipments Abroad.

In order to balance its international accounts, therefore, Japan has had to export considerable quantities of gold in the last two years. The Bank of Japan's gold reserve totaled 548,000,000 yen at the end of 1936, several months prior to the outbreak of Sino-Japanese hostilities, but this amount was reduced in ensuing months by shipments abroad. On August 25, 1936, the Bank's gold stock was revalued on the basis of 290 milligrams of fine gold to the yen, as compared with a former gold content of 750 milligrams. At the same time the Bank's gold reserve was set

1/ Actual values of Japan's trade by leading countries are given in the table of foreign trade in the Appendix to this report.

at 801,000,000 yen (valued on the new basis). The surplus gold resulting from this operation was transferred to a newly created gold-fund special account. Although from that time on the Japanese Government ceased publishing figures on gold exports, it was subsequently announced in answer to interpellations in the Diet that shipments during 1937 totaled 860,000,000 yen. Virtually all of this was sent to the United States, whose imports of gold from Japan during the year were reported to be $246,470,005.

While production of gold during 1938 was speeded up considerably, it is reported to have fallen far short of expectations with an estimated output of about 220,000,000 yen. It appears that all or almost all of this newly mined gold was exported and in addition gold to the amount of 300,000,000 yen was taken from the Bank of Japan's reserves during the year for the establishment of the foreign exchange revolving fund to finance the purchase of imports under the import-export link system[1/]. As a result of these shipments it is believed that gold on hand at the end of 1938 was probably limited to the Bank of Japan's reserves of 501,000,000 yen.

1/ The shortage in supplies of raw materials for export industries, owing to import restrictions, caused the Government in 1938 to adopt an import-export link system, whereby exports of manufactured goods were linked with imports of raw materials entering into their production. The system has been applied to imports of cotton, wool, wood pulp and a number of other materials. To finance these purchases, a foreign exchange revolving fund amounting to 300,000,000 yen was set up. The specie is converted into foreign exchange as occasion requires and the foreign currency placed at the disposal of the exchange banks for financing imports. The exchange thus used is required to be repaid to the fund, within a specified period, from the proceeds of the sale abroad of the commodities into which the respective raw materials enter.

All possible efforts, however, are being directed towards bolstering gold supplies and increasing production. In May of this year the Government issued a decree providing for compulsory registration of all privately owned gold articles, except gold teeth, pen points, needles for medical use and some other articles, and prohibited the display of gold articles in shops after June 1.

Furthermore, the note issue of the Bank of Japan has been further expanded, although undue inflation has been curbed by control measures. At the end of 1938, the Bank's note issue amounted to 2,754,923,000 yen, compared with a note issue of 1,865,703,000 yen at the end of 1936 and 1,330,575,000 yen at the end of 1931.

Efforts to Conserve Foreign Exchange.

In the scramble for foreign exchange, and with a view to maintaining the value of its currency at the desired yen-sterling rate of 1s.2d. (with the dollar rate fluctuating slightly around 27 U. S. cents, according to variations in the New York-London quotations) Japan has resorted to exchange restrictions and other measures of trade control. Exchange control dates back to the summer of 1932 when laws were passed to prevent the flight of capital and to conserve foreign exchange funds. It was not until January 1937, however, that these restrictions were applied to payments for imports into Japan. Since the outbreak of Sino-Japanese hostilities, control over exchange and imports has been greatly strengthened. Imports of raw materials were placed on a licensed basis and exchange permits authorizing payment for foreign merchandise have been sparingly issued.

Exchange Control Extended to Chinese Areas.

Japan, moreover, has extended exchange restrictions to Manchuria, and even to the occupied areas of China, partly with a view to bringing under Japanese control the foreign exchange accruing from Manchuria's and China's exports to third countries. With the organization of the so-called "Federal Reserve Bank" in March 1938 -- through the medium of its puppet regime at Peking -- and the attempt to place "Federal Reserve" notes at par with the yen and the Manchurian yuan as part of the yen-bloc, Japan hoped to attain full control of all exports from the yen-bloc area and the exchange derived therefrom. The arrangement, however, has not, so far, proved successful. Japanese traders were compelled to perform all transactions in "Federal Reserve" notes at the artificially high rate of 1s.2d., while foreign traders and foreign banks continued to deal in the national (Chinese) yuan notes, and, accepting "Federal Reserve" notes only with reluctance, quoted them at a substantially lower exchange rate than that quoted by the Japanese. As a result, wherever it was possible for them to avoid military confiscation or compulsion, exports from the occupied areas flowed out through other than Japanese hands.

To meet this situation Japanese authorities in the occupied areas have resorted to embargoes on raw materials and stricter exchange controls. It was recently announced that foreign exchange derived from all exports would have to be sold to the "Federal Reserve Bank" at the official rate, without which export transactions would be prohibited.

Financial Structure Carries Heavily Increased Load.

Heavy deficits have featured Japan's Government finance since the Manchurian "Incident," of 1931, and up to 1937 annual budget deficits ranged from 800,000,000 yen to 1,000,000,000 yen. The China "Incident," of 1937, however, necessitated a broad revision of the 1937-38 budget involving the establishment of special accounts for military operations with increasingly large appropriations. The total budget for 1936-37 allowed for expenditures of 2,282,000,000 yen; but in the 1938-39 fiscal year the general accounts budget alone was set at 2,514,522,000 yen, while 4,850,000,000 yen was voted additionally for special military expenditures. Total budgetary allocations for 1939-40, including the general accounts and defense budgets, aggregate more than 9,400,000,000 yen.

nBudget deficits have been met mainly by bond flotations, absorbed primarily by the Bank of Japan and other banks. According to a report dated July 10, 1939, bonds to the value of 7,860,000,000 yen have been issued since July 7, 1937. China Incident bonds accounted for 6,300,000,000 yen of the total; Manchurian bonds, 358,000,000 yen; budget deficit bonds, 935,000,000 yen; and miscellaneous bonds, 267,000,000 yen.

As a result of heavy borrowings in 1938 the Government's bonded indebtedness increased by 4,329,000,000 yen during the calendar year, and amounted to 16,222,700,000 yen by January 1, 1939, compared with a national debt of less than 6,000,000,000 yen in the fiscal year 1930-31. The major part of Japan's national debt, however, represents internal loans, outstanding foreign loans at the end of

1938 having amounted to less than 1,300,000,000 yen.

Increased Taxes and Thrift Campaign to Aid in Financing Debt.

In order to assist in financing the increased debt, taxes have been revised upward, a substantial rise occurring in 1938 in the temporary profit tax, which was first imposed in 1935 on business profits of corporations and individuals. Furthermore, under the China Incident Special Tax Law, new taxes were imposed during 1938 on dividends, interest derived from bonds and debentures, amusements, and on a wide range of commodities. The Government also promoted a thrift and savings campaign among the people with the object of inducing the public to save 8,000,000,000 yen during the 1938-39 fiscal year. It has been reported that actual savings in that period amounted to 7,380,000,000 yen and that the goal for the following year has been raised to 10,000,000,000 yen.

Increased Demands for Capital.

In addition to financing such exceptional projects as the military operations in China, compulsory exports to yen-bloc areas, heavy contributions to the Government's expansion program for home industry, and the normal financing of domestic agriculture and business, Japanese capital must also be made available for financing the immense reconstruction schemes that have been planned for China. In none of these is Japan likely to have the assistance of foreign capital -- at least to any considerable extent -- and the history of Japan's economic activities in Manchuria affords a pattern of similar probabilities in the area now under Japanese occupation in China. While Japan's exports to Manchuria have been greatly enhanced, and are much larger than her imports from that area, they have comprised largely sales of machinery and equipment for enterprises which Japan has established there with Japanese capital. There has been nothing so far to show that developments in North China will follow a different course.

16826

0218

Program for Expanding Production in Japan and Yen-Bloc Areas. 1/

Attainment of self-sufficiency in the production of essential materials has been the goal of Japan's economic program for some years, but efforts in this direction have been greatly intensified since control over Manchuria and North China has been achieved. Japan looks to these areas for raw materials to supplement her own meagre resources, and for industrial requirements hitherto purchased from foreign countries. According to recent estimates, her rate of self-sufficiency in iron ores is only 13 percent; in iron, 65 percent (partly from imported ore); petroleum, 26 percent; coal, 93 percent (but with a considerable deficiency in coking coal suitable for industrial purposes); lead, 8 percent; copper, 62 percent; zinc, 39 percent; tin, 29 percent; aluminum, 44 percent; manganese, 30 percent; and antimony, 3 percent. Apart from these, Japan is wholly dependent on outside sources for the raw cotton, crude rubber, wool and a number of other commodities essential to its export industries.

A recent announcement of a 3-year program for expanding the production of basic commodities in Japan Proper and in Manchuria and North China, voices the conviction that an approximation of self-sufficiency will be brought about in iron and steel materials, nonferrous metals, gasoline and heavy oils, chemicals, pulp, machine tools, rolling stock, motor vehicles, and wool by the spring of 1942 sufficient to enable the yen-bloc countries to be practically independent of foreign sources of supply for these commodities. Plans are already being carried out for the diversion of wheat, cotton, tobacco and bristles from China to Japan. The industrial program also calls for increased gold production and

1/ A full report on "The Industrial Expansion Program of Japan, "Manchukuo," and North China," by Donald W. Smith, Assistant Commercial Attache, Tokyo, is available for loan upon application to the Bureau of Foreign and Domestic Commerce, Washington, D. C.

expansion of agricultural products from Manchuria as the basis of foreign exchange to be utilized for purchasing of industrial equipment.

Specific quantity goals to be attained by 1942 are not indicated, but that the plan is an ambitious one is evidenced from the following table, showing proposed percentage increases in production of leading commodities in Japan Proper, Manchuria and North China, the actual production of these commodities in Japan Proper in 1936, and the percentage of domestic production to demand during that year:

Planned Increases in Production of Basic Commodities in Japan, "Manchukuo" and North China

Commodity	Planned Percentage Increase	1936 Production in Japan	Percent of Japan's Production to Demand in 1936
		Metric Tons	
Ordinary steel.....	60%	4,264,253)	
Special steels.....	100%	75,813)	91.6%
Steel ingots.....	60%	5,223,017)	
Pig iron.....	100%	2,007,500	64.6%
Iron ore.....	150%	863,200	12.5%
Coal.....	30%	41,000,000	89.2%
Aluminum.....	"Several 100%"	6,664	40.5%
Magnesium.....	1,000%	500	100.0%
Copper.....	80% plus	78,614	61.7%
Lead.....	about 90%	8,883	8.0%
Zinc.....	about 70%	39,066	37.0%
Tin.....	100%	2,200	28.8%
Dehydrated alcohol.....	1,200% plus	5,557	
Soda.....	20%	367,205	
Caustic soda.....	40%	263,327	100.0%
Industrial salt.....	65%	518,682	29.0%
Sulphate of Ammonium.....	40%	880,000	75.0%
Pulp for paper.....	20%	747,356	82.0%
Pulp for rayon.....	220%	55,209	39.0%
Wool.....	240%	none	
Machine tools.....	100% plus	unknown	
		Cases	
Automobile gasoline, Natural.....	30% plus	2,378,000	12.0%
Heavy oil, Natural.....	40%	3,659,000	30.0%
Railway rolling stock:		Units	
Locomotives.....	30%	970	100.0%
Passenger cars.....	70% plus)	6,201	100.0%
Freight cars.....	50%)		
Automobiles.....	400%	3,500*	15.0%*
		Kilos	
Gold.....	20%	41,107	

(*) Estimated.

16826

Financing Yen-bloc Industrial Production Program A Major Problem.

Success of Japan's new industrial program depends to a considerable extent upon the availability of capital and a sufficient supply of trained labor.2/ Aside from capital needed to finance the plans for increasing production in Japan Proper, it is estimated that no less than 4,750,000,000 yen will have to be raised to carry out the industrial expansion program in "Manchukuo" alone; while present North China Industrial expansion plans involve an estimated expenditure of not less than 1,420,000,000 yen. Just how this capital is to be raised has not been definitely explained; but Japanese economic publications stated in the middle of 1938 that approximately 44 percent of required capital for the "Manchukuo" industrial program would be raised in that territory, while 30 percent would be raised in Japan, and the remainder would be obtained from foreign investors. With respect to foreign investments, however, one Japanese publication comments that "the present outlook allows for little optimism, but it is deemed essential to emphasize the readiness of welcoming foreign investors when more propitious conditions arrive."

Labor Shortage May Hamper Industrial Production Program.

The industrial expansion production planned for the yen-bloc countries is, moreover, dependent almost entirely on Japan for its trained labor supply, 3/ but at the present time Japan is hardly in a position to supply its own labor requirements. While one of Japan's greatest sources of strength has been its apparently abundant supply of cheap, docile labor, a survey made shortly before the outbreak of the China Incident, and reported by the office of the American Commercial

---

2/ "The Industrial Expansion Program of Japan, "Manchukuo" and North China," by Donald W. Smith, American Assistant Commercial Attache, Tokyo.

3/ Ibid. Page 12.

Attache at Tokyo, indicated that there was a scarcity of labor in Japan even before the present "emergency" period. The survey showed that during the period from 1930 to 1935, slightly over 2,000,000 workers were estimated to have been absorbed by industries, or 66,300 workers more than the estimated net increase in the labor supply. To some extent the heavy demand for labor during this period was met by the 1,305,000 unemployed workers available at the end of 1930, as in that year Japanese industrial activity was at a low ebb in common with the industries of other nations. On the basis of the increase in productive capacity during the period from 1930 to 1935, however, it was estimated that the demand for labor was more than twice as large as the estimated growth of the labor supply, and that even under normal conditions all of the available supply of labor, including the unemployed, would be absorbed by the fall of 1937.

At the time this survey was made there were no indications that a great demand for basic wartime materials would arise, but the productive capacities of industrial plants have been taxed to capacity since the summer of 1937, and since then many new plants have been opened. It may be assumed then -- and the present high wages for labor supports the assumption -- that shortage of labor has seriously impeded the industrial development program. Furthermore, the theory that the natural growth of the rural population, from which industrial labor is drawn, would afford a reservoir of labor for other industries does not hold under present conditions, as, according to official investigations, 43.5 percent of the soldiers enlisted in the Japanese Army are farmers.

Little hope can be entertained therefore that there will be a surplus of farm labor available in Japan Proper for the industrial expansion program. In fact, the Government is fully aware of the absolute necessity of at least maintaining the production of crops at levels which will assure self-sufficiency as regards the domestic food supply, and it has outlined a farm expansion program which will not allow the farm population to be drained of its labor reserves.

Finally, now that more workers are required in the munitions and allied industries, and a large number of men have been summoned to the colors, another serious labor problem has developed. The shortage of trained workers and technicians in Japan Proper precludes the possibility of furnishing Manchuria and North China with the trained technical workers needed in their industries. But steps are being taken by the Government to mobilize all available resources and to train technical workers to cope with the increasing demand for additional manpower.

Increases in Earnings Inadequate to Meet Advanced Cost of Living.

The greatly increased demand for labor, especially in the heavy industries, has been reflected in higher wages. In contrast to the nominal wage received in Japan's peacetime industries, usually ranging from less than 1 yen to 2 yen per day, recent reports indicate that the highest daily wage paid by munitions factories is 14.56 yen. The latter figure, however, is much higher than the average for all industries, the general wage level for factory labor in 1938 having been only 3 percent above the 1937 level -- though actual earnings were 10 percent over 1937, the result, largely, of overtime payments. In spite, however, of the relatively high wages, their increase has not been commensurate with the advance in living costs. The shortage of supplies -- engendered chiefly by control measures and some profiteering -- has forced prices upward. Wholesale prices have advanced about 10 percent since July 1937, but retail prices, on which the cost of living is based, have risen about 23 percent, with the sharpest advances in food, clothing and luxury articles.

Price Control Measures Adopted.

In an effort to combat inordinate price rises, a Central Price Commission, set up in 1938, has fixed prices at lower levels on numerous articles. Great importance is given to the control of prices in view of the bearing prices have on the maintenance of the yen exchange rate, the expansion of productivity and export trade, as well as the effect on living costs. A new price policy program was approved by the Cabinet in May of this year, specifying that commodity prices are to be fixed on the basis of international price levels, rather than on production costs in Japan. Closely related to the new price control program is the recently approved Material Mobilization Plan which will place 120 separate materials under strict control. These materials are divided into five categories -- (1) those for munitions, (2) for

industrial expansion, (3) export products, (4) Government use, and (5) private consumption -- with preference to be shown in the order named. The effectuation of this plan envisages further drastic restrictions on the use of materials for private consumption.

Production of Substitute Products Encouraged.

Over the past two years consumption for non-military purposes of iron and steel, petroleum products, copper, platinum, lead, tin, zinc, raw cotton, hides and skins, and crude rubber has been greatly restricted. In some cases consumption by the civilian population has been practically prohibited, or reduced to negligible proportions. In other cases, limited amounts of specified raw materials have been allowed, but only when used for the manufacture of export commodities.

The shortage in these important raw materials caused the Government during 1938 to focus considerable attention on the production of substitute products. Attention was directed to developments along these lines in Germany and Italy -- two other powers also with limited supplies of raw materials. A drive was made to popularize the new substitute products, and the Government rendered financial and technical aid to manufacturers. A primary consideration in the production of substitute commodities is that they should be made from domestic materials. They range from marine leathers to soybean casein, from synthetic and reclaimed rubber to noiseless gears made from raw silk. It has been found that some of the products are so useful that they may provide the bases for new branches of Japanese industrial activity when the present period of wartime economy has passed.

Imported materials may be used in the production of substitutes, provided the latter supplant articles which are much more expensive. For instance, the Government has encouraged the production of reclaimed rubber, made largely from imported and cheap scrap rubber, in order to reduce imports of the relatively more expensive crude rubber. Other productions in fairly large quantities as

substitutes include: celluloid, phenolic resins, porcelain products and glass products manufactured as a substitute for metals; imitation leather, shark leather and vulcanized fiber as a substitute for natural leather; straw pulp as a substitute for wood pulp in the manufacture of paper; and soybean products as a substitute for resins and glue. These are but a few examples of the many types of substitutes that are being produced.1/

Basic Conditions in Agriculture Unsatisfactory.

Undoubtedly, agriculture continues to be one of the weakest links in Japan's economy. Even though gross farm income has increased in the past few years, totaling 3,754,000,000 yen in 1938, net farm income has been reduced by higher production costs, heavier taxation and the general rise in the cost of living. For some time there has been a serious maladjustment between farm income and expenditures — the result of marked inflation in land values, rentals and taxes, based on values that prevailed during and immediately after the World War. Until 1928 this structure was supported by artificially high rice prices and abnormally heavy returns from sericulture. But even during this period of apparent prosperity farm income was very low, and each year since has witnessed further increases in farm indebtedness. Estimates made in 1937 place the total farm debt at between five and six billion yen, with average interest charges of at least 9 percent. This means annual interest payments of from 450,000,000 to 500,000,000 yen, or considerably more than 10 percent of the total gross farm income even at the much increased 1938 figure.

1/ A report on "Increased Production of Substitute Products," by Carl H. Boehringer, Assistant Trade Commissioner, Tokyo, is available for loan upon application to the Bureau of Foreign and Domestic Commerce, Washington, D. C.

Effect of Incident on Japan's Agricultural Structure

The shortage of labor, lack of horses, and the scarcity and high price of fertilizers -- all results of the China Incident -- are definitely unfavorable factors in the maintenance or increase of agricultural production. Total production values in 1938 showed an increase of 2.3 percent over 1937, but the three principal sources of rural income -- rice, wheat and cocoons -- have fallen off in production output by 2.3 percent, 10.3 percent and 14 percent, respectively. The decline in rice and wheat production is attributable to heavy damage to crops from unfavorable weather conditions. Sericulture, however, shows a drop of 6.7 percent in the number of households raising cocoons, and 11 percent in the amount of silkworms brushed from egg cards. The "Incident," is without doubt responsible to some extent for this decline, due to labor shortage, although anticipated lower silk prices and storm damages to mulberry trees were also retarding factors.

The importance of maintaining agricultural production to meet wartime requirements has been fully realized, and is receiving unqualified support from the farm population. Whether Government measures and farmers' endeavors will be successful in keeping agricultural income in an upward course, or whether the evils of land appreciation, higher rentals, a rising commodity price index, and Government control of prices will force agriculture into a second depression is a serious question -- in the solution of which weather and silk market conditions will play major roles. 1/

1/ A full report on "Rural Conditions in Japan," by Maeda M. Playfair, Clerk to the American Commercial Attache, Tokyo, is available for loan and may be had upon application to the Bureau of Foreign and Domestic Commerce, Washington, D. C.

Conclusion

Until some adjustment is made between agriculture and industry few believe that Japan can regain a really prosperous condition. But the most pressing need at the moment is for exchange to carry on its foreign trade. Control measures are considered essential in order to protect the currency and bring about the desired state of productivity; yet these measures are a drawback to the revival of foreign trade. The numerous trade regulations in force have tended to raise prices, and have added greatly to merchandising costs by making it more difficult for business concerns to effect the readjustments required by the changing conditions under which they must operate. Hence, export prices are less attractive to foreign buyers. While total export trade for the first four months of 1939 advanced 7.3 percent over the corresponding period of 1938, the increase was due entirely to heavier shipments to yen-bloc countries. Exports to foreign currency countries declined by 1.2 percent, but exports to yen-bloc areas gained 23 percent. It is true that this increased trade augments business in the industries producing goods for sale in the yen-bloc countries, but it does not produce the essential foreign exchange.

Apparently every effort is being made to conserve available supplies of foreign exchange. Recent reports indicate that applications are being rejected for foreign currency for travel abroad, and business men encounter increasing difficulty in securing exchange permits for the import of foreign merchandise. Additional evidence of the scarcity of foreign exchange is furnished by the efforts to obtain control over the foreign exchange derived from exports from Manchuria and North China to third countries. However, the question of increasing trade with foreign currency countries is receiving major attention from the Government and the several trade associations. Further control measures are being applied, with a view to restraining the upward tendency in commodity prices -- partly in order that Japanese export products may again be placed on a more competitive basis in world markets -- while domestic consumption of goods of possible export value is being minimized and the use of substitute articles encouraged.

#

APPENDIX

TRADE OF JAPAN PROPER BY CONTINENTS AND PRINCIPAL COUNTRIES
(Value in Million Yen)

Country of Origin or Destination	General Imports 1936	1937	1938	General Exports 1936	1937	1938
Grand Total	2,764	3,783	2,663	2,693	3,175	2,690
Asia, Total	1,060	1,295	1,023	1,371	1,646	1,665
British India	372	449	172	259	299	188
"Manchukuo"	205	249	339	151	216	316
Kwantung	34	45	60	347	396	536
Netherlands Indies	114	153	88	129	200	104
China	154	144	165	159	179	313
Straits Settlements	41	68	54	59	67	21
Philippine Islands	36	45	36	52	60	33
British Malaya	39	48	47	2	4	2
French Indochina	20	27	20	5	5	3
Other	45	67	42	208	220	149
North America, Total	921	1,374	1,007	609	660	440
United States	847	1,270	915	594	639	425
Canada	74	104	92	15	21	15
Europe, Total	330	504	376	307	356	261
Great Britain	73	106	63	147	168	135
Germany	115	176	171	35	43	33
France	20	28	14	43	47	37
Belgium & Luxemburg	16	41	15	16	21	10
Sweden	23	49	24	9	12	8
Norway	18	24	16	6	9	5
Other	65	80	73	51	56	33
Africa, Total	108	206	61	198	243	137
South Africa	23	89	10	42	54	35
Egypt	46	74	36	41	33	14
Kenya, Uganda and Tanganyika	30	24	4	31	40	23
Other	9	19	11	84	116	65
Oceania, Total	210	222	98	98	106	97
Australia	182	165	83	69	72	69
New Zealand	22	49	10	17	19	15
Other	6	8	5	12	15	13
South America, Total	112	163	91	69	110	60
Argentina	30	42	24	23	42	20
Brazil	47	63	46	9	17	10
Uruguay	10	34	4	8	10	4
Chile	10	15	11	7	11	6
Other	15	9	6	22	30	20
Central America, Total	22	19	7	41	55	29
Mexico	19	14	5	7	14	5
Panama	---	---	---	10	10	6
Other	3	5	2	24	31	18

Note: The average value of the yen in U. S. currency was $0.2902 in 1936; $0.2879 in 1937; and $0.2845 in 1938.

16826

Discrimination by Japan

against U.S. Commerce

THE SECRETARY OF THE TREASURY
WASHINGTON

12-15-38

MEMORANDUM FOR THE PRESIDENT:

The attached material, which is listed below, brings out the following:

1. You are authorized to impose new or additional duties of 50 per cent on all Japanese products coming to the United States. Such imports totaled $93 million during the first 9 months of 1938.

2. You are also authorized to deny Japan the benefit of the Trade Agreement rates as you have Germany on 14 occasions and Australia on 5 occasions. This action, however, would affect less than 2 per cent of the Japanese exports to the United States.

Attached hereto are the following:

1. My memorandum stating the law, the facts that have come to the Treasury's attention and my reason for bringing them to your attention.

2. A list of the discriminatory practices on which you are authorized to act. (Appendix A)

3. Statistical data with respect to Japanese imports. (Appendix B)

4. Memorandum on the effects of the imposition of new or additional 50 per cent ad valorem duties on all Japanese imports. (Appendix C)

THE SECRETARY OF THE TREASURY
WASHINGTON

MEMORANDUM FOR THE PRESIDENT

In the course of the Treasury Department's administration of the customs laws, there has come to my attention, particularly in reports made available to the Treasury by the Departments of State and Commerce, evidence that American trade and enterprise in the areas of China now under Japanese control are being discriminated against, directly and indirectly, by Japan through exchange control, the establishment of monopolies, the granting of special preferences and by the imposition of restrictions upon American trade and shipping, all of which operate to favor Japanese commerce and to hamper American commerce. Instances of the foregoing are set forth in the attached list marked Appendix A.

This evidence having come to my attention, I deem it my duty to lay it before you in order that you may consider its sufficiency and, if deemed sufficient, to determine whether to take that action you are authorized to take in the premises. Inasmuch as those reports show that Japan discriminates in fact against the commerce of the United States in areas of China under Japanese control, there is occasion for you to determine whether, under the authority of section 338 of the Tariff Act of 1930 (U.S.C. title 19, sec. 1338), new or additional duties should be imposed upon Japanese products imported into the United States. The Treasury Department construes this section to mean, in its applicability to the present situation, that whenever the President finds that Japan discriminates in fact in China against the commerce of the United States, directly or indirectly, in such manner as to place the commerce of the United States at a disadvantage compared with the commerce of Japan, or of any other country foreign to China, he shall by proclamation declare new or additional duties upon articles wholly or in part the growth or product of Japan if he finds that the public interest will be served thereby.

Section 338 further provides that, if the foreign country maintains or increases its discrimination against the commerce of the United States after the issuance of the proclamation authorized by section 338, the President, if he deems it consistent with the interests of the United States, may issue a further proclamation directing that such products of the foreign country or such articles imported in its vessels as he shall deem consistent with the public interests shall be excluded from importation into the United States.

In addition, it seems clear that the acts and policies of Japan in evidence tend to defeat the expansion of foreign markets for products of the United States. Therefore, there is also occasion for you to determine whether, under the authority of section 350 of the Tariff Act of 1930, as amended, (U.S.C. title 19, sec. 1351), the application of the reduced rates of duties established pursuant to the trade agreements entered into under that Act should be made inapplicable to the products of Japan. You have exercised this authority on fourteen occasions in connection with discrimination by Germany and the higher duties so imposed are still in effect. It was exercised in the case of Australia on five occasions. The discrimination in this case has been discontinued.

The suspension of the application of trade agreement rates to Japanese imports under authority of section 350 of the Tariff Act of 1930 would have negligible effects upon Japanese exports to the United States. The proportion of Japanese exports to the United States that enter under the tariff rates proclaimed under the various trade agreements constituted less than 2 percent of Japanese exports to the United States in 1937.

Confirmatory of my impression of the existence, the wide extent, and the serious effects of the practices to which I have referred is the text of the note of October 6, 1938, in which the United States protested to Japan against the direct and indirect discrimination now being applied by Japan to American commerce in the areas of China under Japanese control. The intention of Japan to adhere to the policies and practices complained of by the United States in its note of October 6 is evidenced by the Japanese reply of November 18 to that note, as published in the press.

Attached (Appendix B) is a list of:

(a) Leading items of import from Japan that would be affected if all goods imported from Japan now free of duty were made subject to 50 percent ad valorem duty under section 338 of the Tariff Act of 1930.

(b) Leading items now imported from Japan under existing tariff rates which would be subject to a duty of 50 percent ad valorem under section 338 of the Tariff Act of 1930 in addition to the duty now imposed by law.

(c) The percentage of Japanese imports that would be subject to higher rates if trade agreement rates were withdrawn from Japan under section 350 of the Tariff Act.

(d) Items imported from Japan indispensable for the United States and difficult to obtain directly from sources other than Japan.

Also attached (Appendix C) is a memorandum on the effects of the imposition of new or additional 50 percent ad valorem duties on all Japanese imports.

(APPENDIX A)

1. Japanese importers have been able to purchase cotton from the occupied areas in China without obtaining foreign exchange in the usual and more difficult manner in which prospective purchasers of American cotton must purchase foreign exchange. (Consular despatch from Osaka, February 9, 1938.)

2. Under the exchange control system enforced by the "Manchukuoan" puppet government, all transactions in foreign currencies, including transactions in United States dollars, are subject to rigorous administrative control, but the Japanese yen is exempt from this control. (Cables from Peiping, October 18, 1937 and March 16, 1938; cables from Shanghai, November 2 and 16, 1937; consular despatches from Harbin, November 29, 1937, April 7, 1938 and May 6, 1938; consular despatch from Mukden, April 25, 1938.)

3. In the conquered areas of North China, Americans are permitted to export only if they conform to regulations which force them to handle foreign exchange through Japanese banks or branches of Japanese banks and to accept blocked Japanese currency at rates specified by the Japanese authorities in exchange for the proceeds of their export sale. (Peiping consular despatch of February 23, 1938; Tientsin consular despatches of March 12 and August 6, 1938; Shanghai cables of March 16 and 25, 1938; Chefoo cable of August 26, 1938; Tsingtao cables of August 1 and 26, and September 9, 1938.)

4. The Japanese military and naval authorities in the conquered areas of North China and the Yangtze Valley have engaged in smuggling and in certain tariff practices by which products imported from Japan or elsewhere enter these areas without the payment of Chinese customs duties. In one instance it was reported that imports thus entered were sold in the Chinese market. (Tokyo cable of October 12, 1937; Tientsin cables of January 1 and 25, 1938; Shanghai consular despatches of March 28 and June 6, 1938.)

5. The military and naval authorities in North China and the Yangtze Valley permit Japanese ships to enter ports in conquered areas without payment of port and customs duties while at the same time American vessels are not permitted to do so. (Consular despatch from Shanghai, March 28, 1938.)

6. In all the occupied areas, purchases of American goods are discriminated against in favor of the purchase of goods from Japan, through monopolies and other forms of trade control under the administration of the local puppet governments or under the control of Japanese military and naval authorities. (See references under 7, below.)

7. American citizens are excluded from export trade, or export commerce is directed through Japan by the establishment of monopolies for the export of commodities from the occupied areas under the control of military and naval authorities or the local puppet governments. (Consular despatches from Mukden, April 25 and December 2, 1935; from Shanghai, November 17, 1937; cables from Peiping, December 11, 1937, March 22 and July 1, 1938; consular despatch from Mukden, December 17, 1937; Commercial Attache's reports from Tokyo, December 29, 1937 and January 29, 1938; consular despatches from Harbin, March 30 and April 12, 1938; from Mukden June 20 and July 27, 1938; from Tientsin, February 23 and July 15, 1938; cables from Tientsin, July 30, August 4 and 15, 1938; from Peiping, June 18, 1938.)

Appendix B (a)

Leading items of United States import from Japan in 1937 that would be affected if all goods imported from Japan now free of duty were made subject to 50 percent ad valorem duty under Section 338 of the Tariff Act of 1930.

(In thousands of dollars)

Free of duty	
Raw silk	$100,273
Tea	3,725
Pyrethrum flowers	1,995
Fish scrap and fish meal	1,695
Undressed mink furs	1,538
Cotton waste	1,148
Undressed coney and rabbit furs	1,076
Rags, for paper base stock	948
Tuna fish, fresh or frozen	665
All other free	7,829
Total Free	$120,892

Appendix B(b)

Leading items of U.S. imports from Japan in 1937 under existing tariff rates which would be subject to a duty of 50 percent ad valorem under Section 338 of the Tariff Act of 1930 in addition to the duty now imposed by law

	Value (In thousands of dollars)	Rate of Duty
Textile fibers and manufactures	$32,028	
Cotton cloth, bleached	4,274	13.35% to 44.5%
Silk woven fabrics, except pile	3,401	30% to 65%
Woolen wearing apparel	1,411	33¢ a lb + 45% to 50¢ a lb + 75%; 75% to 90%
Rayon filaments, not exceeding 30 inches in length	2,001	25%
Cotton floor coverings	1,798	20% to 75%
Cotton rags, except for paper making	1,729	3¢ a lb
Hat braids, plaits, laces of straw, paper and other fibers	1,439	15% to 45%
Paper hats	1,289	25%; 2-1/12¢ each + 25%
Cotton cloth, printed, dyed, or colored	1,226	16.35% to 47.5%
Rayon waste, except cellulose acetate	1,091	10%
Cotton wearing apparel	1,454	25% to 90%
Cotton pile fabrics and manufactures	784	31½% to 70%
Rayon wearing apparel	941	45¢ a lb + 5% to 45¢ a lb + 65%; 90%
Cotton household articles	1,283	25% to 45%
Other textile fibers and manufactures	7,907	-
Cotton seed oil, edible	3,522	3¢ a lb
China and porcelain ware	3,351	60% plain, 70% decorated-table and kitchen articles + 10¢ per dozen
Crab meat, sauce, and paste	2,908	15%
Dolls, toys, and parts	2,410	1¢ each + 50% to 90%
Earthenware and stoneware	2,077	15% to 10¢ a dozen + 50%
Tuna fish	1,913	45%
Bristles, sorted, bunched or prepared	1,063	3¢ a pound
Camphor, crude and refined	1,020	1¢ and 5¢ a lb respectively
Menthol, natural	981	50¢ a lb
Electric lamps, incandescent	906	20% and 30%

(Continued on following page)

Appendix B(b) - Continued

Leading items of U.S. imports from Japan in 1937 under existing tariff rates which would be subject to a duty of 50 percent ad valorem under Section 338 of the Tariff Act of 1930 in addition to the duty now imposed by law

	Value (In thousands of dollars)	Rate of Duty
Brushes	855	40% to 60% and 1¢ each + 50% to 2¢ each + 50%
Perilla oil	889	4½¢ a pound
Rubber manufactures	854	10% to 70% (combs - 1¢ + 25% to 2¢ each + 35%)
Oil cake and oil cake meal	829	3/10¢ a lb
Miscellaneous textile floor coverings	766	3¢ a sq. yd. to 12¢ a sq. foot
Glassware, blown, pressed, cut, engraved	690	20% to 60%
Manufactures of cellulose	633	60% - 1¢ each + 25% - 2¢ each + 35%
[illegible]ppers	613	66%
Ajinomoto	597	25%
Li[illegible] bulbs	585	6/10¢ each
Ri[illegible]	508	5/16¢ to 2½¢ a lb.
All other dutiable imports	14,911	
Total dutiable imports	$74,909	

Appendix B (b)-continued, 2

United States - Trade with Japan by principal commodities -
9 months ending September 1937 and 1938

(In millions of dollars)

	9 months ending Sept. 1937		9 months ending Sept. 1938	
Exports to Japan				
Principal commodities exported				
Raw cotton	57.5		37.0	
Crude petroleum	14.8		25.1	
Iron and steel, including scrap	62.9		25.0	
Metal working machinery (power driven)	6.9		17.2	
Refined copper	12.6		13.0	
Refined petroleum products	14.4		12.9	
Aircraft and parts	1.4		8.7	
Autos, parts and accessories	12.4		8.1	
Wood pulp	9.9		2.3	
Lumber	3.3		.5	
Total principal commodities	196.1	84%	149.8	87%
All other commodities	37.5	16%	22.7	13%
Total exports including reexports	233.6		172.5	
Imports from Japan				
Principal commodities imported				
Raw silk	76.4		57.6	
Silk fabrics except pile	2.6		2.0	
Crab meat	2.5		1.9	
China and porcelain ware	2.5		1.4	
Tea	2.2		1.2	
Pyrethrum flowers	1.0		1.1	
Hat braids	.9		.9	
Cotton cloth	2.8		.8	
Canned tuna fish	1.8		.8	
Cotton rags	1.3		.8	
Mink furs, undressed	1.5		.7	
Total principal commodities	95.5	63%	69.2	74%
All other commodities	57.0	37%	24.0	26%
Total imports for consumption	152.5		93.2	

Appendix B (c)

Value of United States Imports from Japan 1/

(In millions of dollars)

	Subject to rates proclaimed under trade agreements	Total Dutiable Imports	Total Imports	Percent of total imports under trade agreement rates
1937				
January	$ .2	$ 5.1	$ 17.7	1%
February	.3	7.1	18.4	2
March	.3	7.5	17.7	2
April	.2	7.4	20.4	1
May	.2	7.1	18.2	1
June	.2	7.1	18.6	1
July	.1	6.8	16.4	½
August	.1	6.0	16.3	½
September	.2	5.7	16.0	1
October	.3	5.6	15.4	2
November	.3	5.3	17.2	2
December	.3	4.1	11.8	3
Total	2.7	74.8	204.1	

1/ This table covers the year 1937. In 1938 trade agreements were concluded with Czechoslovakia, Ecuador, United Kingdom and Canada. The lower rates applicable under these agreements might raise the percentage of Japanese imports subject to the trade agreement rates somewhat, but not enough to make most-favored-nation treatment of substantial economic importance to Japan.

Appendix B (d)

Items imported from Japan Indispensable for the United States and Difficult to Obtain Directly from Sources Other Than Japan

Aside from the importation of raw silk there are two items that are indispensable to us: Agar Agar and Ho oil.

Agar Agar is used as a culture medium in bacteriological work. The amount of imports is only $600,000 but there seems to be no satisfactory substitute and Japan has a complete monopoly of the seaweed out of which it is made. There have been reports that Russia has been developing the production of Agar Agar along its Siberian Coast. This may prove to be an alternate source of supply.

Ho oil -- which comes from camphor trees found only in Formosa -- is used in the making of perfumes. Natural camphor still is a Japanese monopoly but since 1933 a synthetic camphor has been developed which we understand is interchangeable with the natural product.

Appendix C

The Effects of the Imposition of New or Additional 50 Percent Ad Valorem Duties on all Japanese Imports

Summary

The effects of the imposition of new and additional duties under Section 338 of the Tariff Act of 1930 would probably cause small economic loss to the United States, but the economic loss to Japan would be great.

Unfavorable economic effects on the United States

1. United States exports to Japan would be reduced. Japan would be forced to curtail her purchases somewhat and would wish to diminish them to an absolute minimum. But she is now importing from us only those commodities essential to her needs. We estimate that the imposition of the new duties would cause United States exports to Japan to drop from $15 to $30 million a year.

There is a possibility that Japan may for political motives retaliate against our action by imposing severe restrictions against imports from the United States either through her control of exchange or through direct measures. The nature of Japan's present imports are such, however, that she could do so only at considerable cost to herself. In addition such retaliation would invite more drastic action by us under Section 338 which would hurt Japan far more than it would hurt us.

2. It is unlikely that the duty would cause any significant unemployment in the United States. The most important American industry which might be adversely affected by the additional duties is the silk hosiery and knitting industry. Yet even in those industries our analysis of all the factors concerned leads us to conclude that there would be no substantial loss of employment.

3. The price of Japanese imported goods would be higher to the American consumer though not by the full extent of the duty. Most of the added price would, however, go to the Treasury in the form of import duties. Consumers of some Japanese goods will be forced to turn to more expensive (or less satisfactory) substitutes.

Favorable economic effects on the United States

1. The Treasury would gain through increased customs revenue from $25 to $50 million a year. A large part of that revenue would be a net national gain because the Japanese exporter would in this instance bear the greater part of the duty.

2. Domestic manufacturers competing with Japanese products for the home market would be stimulated by the higher prices of Japanese imports. The development of silk substitutes which is already under way may be particularly stimulated.

The loss to Japan from this additional duty will be great, but the loss to the United States will be small.

1. The Japanese will have to absorb well over half the new import duty by reducing the prices of their products. It is difficult to estimate how the duty on the large number of minor products will be borne, but it seems exceedingly likely that Japan will have to absorb most of the duty on the most important product she sells us, raw silk. Raw silk is the second most important of all Japan's exports and constitutes over half the value of Japan's total sales to the United States. The great elasticity of the American demand for raw silk, the fact that the United States is (aside from Japan herself) the only important consumer, together with the extreme inelasticity of the Japanese supply will combine to make it difficult to shift any considerable part of this duty on to the American consumer. It must be recalled that when American imports of raw silk fell from 97 million pounds in 1929 to 60 million pounds in 1934, price fell from $4.93 a pound to $1.30 a pound. Practically the entire cocoon output of Japan is produced as a subsidiary occupation of poor farmers. Anything received for the cocoons above the cost of the egg sheets and the rent of the mulberry land is considered as profit. Hence supply is very little affected by a lower price. Lower prices of silk have meant widespread agricultural distress. Japan is peculiarly vulnerable at this point.

2. The amount of dollar exchange which the Japanese derive from their sales of goods to the United States will probably fall 20 or 30 percent below the amount it would have been without the duty. Part of this will be due to a decline in volumes of sales but more will be due to a decline in the prices received by Japanese exporters. If Japan finds it as necessary to concentrate on war needs in 1939 as she has in 1938, her sales to the United States will be reduced from an estimated $125,000,000 in 1938 to somewhere between $85,000,000 and $100,000,000 in 1939.

3. The shortage of dollar exchange will compel the Japanese to restrict their purchases from the United States. Such restriction will endanger the functioning of their home economy and interfere with their ability to successfully prosecute the war. They have already cut all foreign purchases to the bone. They need their chief imports from the United States -- cotton, petroleum, iron and steel, machinery, aircraft and automobiles.

4. The Japanese are in a very poor position to retaliate against our export trade. The things they buy from the United States are economic and military necessities. Consequently, if Japan imposes additional duties on imports of American products, those duties will have to be borne chiefly by Japanese industries. Japan cannot produce at home desirable substitutes for goods she now imports from the United States. Nor can she compel important price concessions from the American exporters.

Japan will doubtless be able to shift a portion of her purchases from United States to other countries. But Japan's imports from the United States are of such a nature that were she to transfer any substantial portion of her purchases to other countries she would in the first place do so only at a cost of additional foreign exchange to herself inasmuch as imports of similar commodities of similar quality will be higher if she buys them elsewhere, and in the second place if Japan does buy from third countries the United States will obtain a portion of the trade indirectly.

5. The United States will also lose as the result of the duty, but our losses are not likely to be serious. The price of some Japanese articles will be higher to the American consumer. Consequently substitutes will be developed for some articles formerly bought from Japan. On the other hand, American exports to Japan will be curtailed. We estimate that our exports to Japan would not be likely to fall less than $15 million or more than $30 million in the twelve months succeeding the imposition of high duties.

There is a possibility that Japan may, for political motives, go so far as to cut off most or all of her purchases from the United States. If she were to do so, however, it would only be at a correspondingly high cost to herself.

Were Japan to take such retaliatory action the United States could invoke more drastic action permitted under Section 338, namely complete prohibition of imports of Japanese origin into the United States, and of articles carried in Japanese bottoms. So severe would be the resultant economic loss to Japan that such retaliatory act on her part is extremely unlikely. The most vulnerable part of Japan's economy at present is her lack of foreign exchange. A complete prohibition of Japanese imports into the United States would hit her in her weakest spot.