DIARY

Book 285

July 22 and 23, 1940

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July 22, 1940

TELEGRAM TO THE PRESIDENT

HYDE PARK NEW YORK (VIA WHITE HOUSE TELEGRAPH)

STRICTLY CONFIDENTIAL

VALUABLE STRATEGIC MATERIAL SLIPPING THROUGH OUR FINGERS EVERY DAY. LICENSES ISSUED BY JOE GREEN OF STATE DEPARTMENT PRIOR TO JULY FIFTH. PLEASE INSTRUCT COLONEL MAXWELL TO CANCEL ALL OUTSTANDING LICENSES ISSUED PRIOR TO JULY FIFTH BY STATE DEPARTMENT.

HENRY MORGENTHAU JR.

July 22, 1940

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HENRY MORGENTHAU JR.

July 22, 1940

My dear Mr. Hoover:

This will acknowledge receipt of the following communications which you have been good enough to send me recently:

July 15 - Operations of the I. G. Farben-Industrie Aktien-Gesellschaft;

July 16 - Information furnished by Major Van Oosten relative to penetration of Holland by Germans and Austrians prior to the invasion of that country;

July 17 - Strike to be called at Bendix Products Division, Bendix Aviation Corporation, South Bend, Indiana.

Yours sincerely,

(Signed) H. Morgenthau, Jr.

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

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Mr. J. Edgar Hoover, Director,
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Washington, D.C.

JOHN EDGAR HOOVER
DIRECTOR

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

July 15, 1940

<u>Personal and Confidential</u>

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

My dear Mr. Secretary:

Because of the World-wide holdings of the I. G. Farben-Industrie Aktien-Gesellschaft, Frankfort, and its close relationship with various chemical corporations in the United States, I have been endeavoring for some time to maintain a rather accurate and comprehensive check upon the operations of this corporation. I have today received from a source within Germany some data of a general nature concerning the operation of the parent corporation in Germany which I thought might be of interest to you.

The financial report of the corporation for the calendar year, 1939, indicates that sales were very satisfactory. The balance sheet indicates that as a matter of fact a sales record has been established probably by reason of armament orders and military preparation. Sales within Germany have increased in synthetic gasoline, artificial fibre, rayons and other substitute products for which the Reich has much need in view of its armament program. Of course, because of political developments, exports dropped particularly during the last quarter of 1939. Total exports for the last quarter of the year were however higher than for those of the same quarter in 1938. In order to replace overseas markets, exports in Europe have been pushed with Russia being the most importance purchaser. Through its far-flung and interwoven corporate structure, the parent corporation has encouraged its subsidiaries to build up stocks of merchandise in overseas countries in order to permit the subsidiary units to maintain the markets which they have established.

The production of colors and accessories has reached a record with a pronounced increase in exports particularly to Russia. The sale of by-products for use in the manufacture of textiles has been very large. Special attention is at present being given to cleaning products which reduce the use of fats. There is also an increase in the sale of chemical, pharmaceutical and photographic products; of rayon, artificial fibres, et cetera. The production of a fibre made of coal and chalk (PeCe) has commenced. The production of azote is larger than at any time in the past and the corporation has denounced its international contracts with other producers of azote in Europe.

The following figures on the balance sheet at the close of business for the calendar year, 1939, may be of some interest to you. All figures are in millions of Rm.

Assets

	1939	1938
Real Estate	624.8	605
Merchandise	186.-	203.5
Shares of other companies	12.2	11.4
Sundry debtors	207.-	184.2
Debts of affiliated companies	269.9	168.9
Sundry properties	6.1	5.05
Stocks in Treasury	68.-	0
Money in bank	54.8	46.9

Liabilities

Bonds	307.-	182.7
Social obligations	58.7	53.6
Supplies	84.1	76.5
Credits of affiliated companies	66.9	31.6
Bank loans	57.6	48.3
Sundry creditors	107.6	94.4

Profit and Loss

	1939	1938
Expenditures:		
Salaries and social expenditures	386.2	363.1
Amortization on bonds, 1928	1.6	0.3
Interest	13.-	9.9
Taxes	171.4	125.-
Various reserves	7.-	2.2
Retirement fund	5.-	5.-
Statutory reserve	5.7	2.3
Amortization, including 3.5 on holdings	171.2	135.7
Net Profit	56.1	55.1
Increase in net profit	18%	25%
Receipts:		
Gross profits	786.3	667.2
From affiliated companies	24.7	19.6
Interest	2.3	8.3
Sundry receipts	8.7	3.6

Sundry receipts probably include profits on bonds sold from the treasury. The capital was increased in 1939 by 11 million Rm. against a total authorized increase of 80 million Rm. At present the capital is 691 million Rm. as against 680 million at the end of 1938. The bonds sold plus discount were 102 million Rm. The total of the obligations is now 643 million Rm. against 449 million Rm. at the end of 1938. This shows the enormous financing for new armament installations. The net profit appears to have been adjusted at exactly the amount to maintain the dividend of 8% on the increased capital.

The company has bought the whole stock (8 million marks) of the A. G. Carbidwerke Deutsch-Matrei in Vienna. The Fabrique de peudre Skodawerke Wetzler Vienne now controls the Donau Chemie AG and has increased its capital to 12 million marks. The Bruckdorf AG Halle (lignite works) has been incorporated in the I. G. Farben.

The Societe Internationale pour Entreprises Chimiques, allied with the I. G. Farben, showed for 1939 a profit of 10,395,935 francs and will pay 8% dividend against 8 1/2% last year.

With expressions of my highest regards,

Sincerely yours,

J. Edgar Hoover

By Special Messenger

J. EDGAR HOOVER
DIRECTOR

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

July 16, 1940

PERSONAL AND
CONFIDENTIAL

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

My dear Mr. Secretary:

Major Van Oosten of the Royal Netherlands Indies Army has just furnished advice to this Bureau that, prior to the invasion of Holland, approximately 100,000 Germans and Austrians had peacefully penetrated the Netherlands. These persons were engaged as common laborers, domestics, and employees in munition factories which were built in the Netherlands in close proximity to the German border. Substantially all of the persons so employed remained entirely loyal to Germany and refrained from obtaining citizenship in the Netherlands.

At the time of the invasion of the Netherlands there were 300 German citizens employed by the German Legation. It is alleged that it was through this group Nazi activities were so well organized and for this reason Nazi domination over the Netherlands was facilitated.

Major Van Oosten disclosed that plans for subduing the Netherlands were so complete and methodical that it was possible to dominate the Rotterdam Airport within twenty minutes from the time the first parachute troops arrived. He further disclosed that the German Legation in the Netherlands was located across the street from the Dutch Military Headquarters and that after the siege of Holland had been commenced it was learned a tunnel had been prepared between the German Legation and the Dutch Military Headquarters in order that the latter might be destroyed.

I thought you would be interested in receiving this information.

Sincerely yours,

J. E. Hoover

BY SPECIAL MESSENGER

N EDGAR HOOVER
DIRECTOR

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

PERSONAL AND CONFIDENTIAL

July 17, 1940

BY SPECIAL MESSENGER

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

My dear Mr. Secretary:

I am transmitting herewith, as of possible interest to you, a copy of a statement dated July 16, 1940, containing information with regard to a strike to be called at the Bendix Products Division, Bendix Aviation Corporation, South Bend, Indiana, at ten o'clock on the morning of July 17, 1940.

In view of the information set forth in the attached statement concerning possible sabotage occurring at this plant, I am causing inquiry to be made for the purpose of ascertaining whether a matter within the investigative jurisdiction of the Federal Bureau of Investigation is involved.

Sincerely yours,

J. Edgar Hoover

Inclosure

July 16, 1940

MEMORANDUM

Information has been received that Mr. Marvin Haidt, Personnel Manager, Bendix Products Division, Bendix Aviation Corporation, South Bend, Indiana, has indicated one hundred Communist employees in this plant have agreed to stage an unauthorized strike at 10 o'clock on the morning of July 17, 1940. Mr. Haidt has allegedly indicated positive recommendations were made by the Inspection of Naval Materials Service that these one hundred employees be discharged.

Mr. Haidt has also allegedly indicated that an incident believed possibly attributable to sabotage occurred at the plant yesterday, July 15th.

July 22, 1940
12:18 p.m.

Secretary Frank Knox:	Hello, Mr. Secretary.
H.M.Jr:	How are you?
K:	I'm fine. I'm having lunch with you today.
H.M.Jr:	Wonderful.
K:	Where?
H.M.Jr:	Right in the Treasury in my office.
K:	All right, fine. Now how are you fixed for tomorrow night? Are you tied up?
H.M.Jr:	Well, I tell you, I'm going to that movie, "The Ramparts We Watch."
K:	Oh yes, I see. All right then. How about Wednesday night?
H.M.Jr:	Well .....
K:	I'm thinking of dinner down on the boat and go down the river and have a little talk.
H.M.Jr:	Can I talk to you about it at lunch? I would love to go either Wednesday or Thursday whichever you were free.
K:	Well, Thursday I promised to go down and inspect some of the Navy installations down the river.
H.M.Jr:	Can I take a rain-check on Wednesday?
K:	Yeah. Will you?
H.M.Jr:	Yeah.
K:	All right. That'll be fine.
H.M.Jr:	Are you bringing Stark with you?

K: Bringing whom?

H.M.Jr: Stark today?

K: Yes, I thought I would.

H.M.Jr: Good.

K: What about Johnny Sullivan? Would you like to bring him?

H.M.Jr: No. I meant today at lunch.

K: Oh, today at lunch. All right.

H.M.Jr: No, there'll be just you, Stark and I.

K: All right then. Stark -- I left him up at the Capital but I think he'll be in for lunch all right.

H.M.Jr: Well. Now today has nothing today with taxes, I hope, at least I haven't -- I want to talk about that meeting tomorrow morning.

K: I see.

H.M.Jr: I want a little help.

K: Well, Stark will be there -- he planned to be there.

H.M.Jr: Thank you.

K: And we'll be at your office at 1 o'clock.

H.M.Jr: Thank you.

K: All right.

July 22, 1940
12:45 p.m.

H.M.Jr: Ed?

Ed Foley: Yes, Mr. Secretary.

H.M.Jr: I talked to Bohn this morning, the head of the Cleveland Housing.

F: Yeah. Ernie Bohn.

H.M.Jr: Yeah. I told him that you were working on something to house single men.

F: Yeah.

H.M.Jr: Well, he's got some land -- some property there that has been given him for housing single women and he said if you knew how to fix -- get around the law so that you can house, as he put it, one-person families.

F: Yeah.

H.M.Jr: See?

F: Yeah.

H.M.Jr: Anything that you've done on it, if you'd send it to him he'd appreciate it.

F: All right. That, of course, is up to the U.S.H.A.

H.M.Jr: Yeah, that's what he knows.

F: I think as a matter of law it's all right. As a matter of policy they may not want to do it. I explained that to Mrs. Morgenthau in a little note I sent to her over the weekend.

H.M.Jr: ..... said you had something on the law.

F: Yeah.

H.M.Jr: I told him what you were doing for Mrs. Morgenthau and he said if you could tell him what -- the Junior League up there had some property and houses where for years they've housed single girls and they've turned that over to him and he said if -- he's trying to interpret the thing to -- one-person family as one person.

F: Yeah.

H.M.Jr: If you had anything on it he'd .....

F: All right. I had a little memorandum that I gave to Mrs. Doyle and I'll send a copy of that along to Ernie with a little note.

H.M.Jr: You know Henry is working for him.

F: Yes, I know that.

H.M.Jr: Right.

F: Yeah.

H.M.Jr: I just got a flash on the ticker that .....

F: Annenberg has gone to jail.

H.M.Jr: No.

F: Oh.

H.M.Jr: No, this is just along the same lines, and Hanes and Lewis Douglas are forming a separate independent Democratic movement for Willkie.

F: Well, that's where they belong -- both of them. (Laughs).

H.M.Jr: Well, this is all -- what do you think of my little move onto the .....

F: ..... business loans?

H.M.Jr: Yeah.

F: I think it's fine.

H.M.Jr: Yeah. Somebody has got to do something.

F: Sure. It's good.

July 22, 1940
2:42 p.m.

H.M.Jr: Hello.

Operator: Mr. Welles. Go ahead.

H.M.Jr: Hello.

Sumner Welles: Hello, Henry.

H.M.Jr: Sumner, if Herbert Feis saw those people I wonder if I could see him this afternoon so I could be brought up to date.

W: He has not, Henry, because it was Saturday and they were none of them there.

H.M.Jr: Oh.

W: And then I haven't yet had a chance to check up with him.

H.M.Jr: Well, I just -- before I went into that meeting I wanted to be up to date. Well, then there's nothing on that?

W: There's nothing further on that. It'll have to be taken up independently from now on.

H.M.Jr: Well, the date's on at 6 then, isn't it?

W: Yes, indeed. I spoke to Lothian on Saturday.

H.M.Jr: Thank you.

W: All right, Henry. Good-bye.

July 22, 1940.

MEMORANDUM

TO: Secretary Morgenthau

FROM: Mr. Gaston

Fritz Sternberg is a German refugee who has been in this country for some time. His address is 49 Mayflower Avenue, New Rochelle, N. Y. and his telephone number is Hamilton 4379. Bruce Bliven, Editor of the New Republic, from whom I got this information, suggests that we write to Sternberg rather than phone him since he speaks rather broken English.

Sternberg has been writing for The Infantry Journal and other military publications and is the author of one or two rather well known books, including "From Nazi Sources." Bliven is sure he would be pleased to come to Washington.

July 22, 1940.

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HEG/mah

COPY

Copy of paraphrase to TREASURY

PARAPHRASE OF TELEGRAM NO. 172, DATED JULY 22, NOON, FROM TEHRAN, IRAN.

The Legation at Tehran reports on July 22, 1940, that an order of the Iranian Ministry of Finance has forbidden all banks to buy sterling. No reason is offered, other than that sterling is ostensibly not being quoted.

891.5151/199

TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE
Monday, July 22, 1940

Press Service
No. 21-67

Secretary of the Treasury Morgenthau today announced the final subscription and allotment figures with respect to the current offering of 2-1/4 percent Treasury Bonds of 1954-56. Allotments on public subscriptions aggregated \$630,719,850. This amount includes \$39,110,300 allotted in full to subscribers for \$5,000 or less who specified that delivery be made in registered bonds 90 days after the issue date. In addition to the amount allotted on public subscriptions, \$40,600,000 of the bonds have been allotted to Government investment accounts, within the \$50,000,000 reservation.

Subscriptions and allotments were divided among the several Federal Reserve districts and the Treasury as follows:

Federal Reserve District	Total Subscriptions	Total Allotted
Boston	$ 628,019,500	$ 58,328,050
New York	2,924,302,650	270,526,400
Philadelphia	393,641,000	38,626,150
Cleveland	449,152,250	42,981,200
Richmond	221,241,700	22,349,350
Atlanta	204,688,950	20,114,450
Chicago	771,165,850	75,625,650
St. Louis	156,315,200	17,315,600
Minneapolis	89,506,900	9,717,100
Kansas City	113,212,450	13,200,350
Dallas	143,390,750	14,497,050
San Francisco	502,503,150	46,526,600
Treasury	7,931,200	911,900
Government Investment Accounts		40,600,000
TOTAL	$6,605,071,550	$671,319,850

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July 22, 1940

Under Secretary Bell

Mr. Cochran

STRICTLY CONFIDENTIAL

Reference is made to the attached memorandum of July 16 from our Foreign Funds Control, requesting more detailed information from the First National Bank of the City of New York as follows:

"Why are dividends to be paid in dollars in New York on the French, Belgian and Danzig issues of stock?

"Has this procedure been followed regularly in the past? If not, when and under what circumstances was the present procedure adopted?

"What is the source of the funds to be used in payment of dividends?"

In accordance with an understanding with Mr. Pehle, I talked this morning by telephone with Mr. Leon Fraser, President of the First National Bank of New York. Mr. Fraser stated that the B.I.S. had informed him last March, as he recalled the date, that the B.I.S. desired this year to pay all B.I.S. dividends through American dollars. It has not been the practice in the past to pay all dividends in any one currency since the various issues of B.I.S. stock are specified in the currency of the country of issue. The B.I.S. dividend has, however, been paid on a gold basis steadily since the B.I.S. was created, and there has frequently been discussion of the desirability of paying this through one gold currency. This year it was decided that exchange conditions were so difficult and most currencies so violently fluctuating that it would be most convenient to use the dollar for paying all of the dividend checks. The First National was advised that this procedure is to be followed. Subsequently, however, it developed that the First National was only to pay dividends to American residents and to certain residents of non-invaded countries in Europe, most particularly Switzerland. A sum of dollars was transferred from the B.I.S. through the Federal Reserve Bank of New York to the First National sufficient to take care of the dollar payments which the latter is to make. In past years the First National has always received a special dividend deposit for the payment of those dividends specified in dollars, so the utilization of the First National is entirely regular. Likewise the transfer of the dollars through the Federal is in strict accordance with B.I.S. regulations.

HMC;dm:7.22.40

July 22, 1940

Under Secretary Bell

Mr. Cochran

STRICTLY CONFIDENTIAL

Mr. Fletcher Warren, assistant to Mr. Berle in the Department of State, telephoned me this morning that a letter had come for Mr. Berle in his absence from Mr. Herbert L. Satterlee of 1 Beacon Street, New York City. Mr. Satterlee stated that he had applied for a license to cable $500 through Morgans to Mrs. Helen Hunt at General Delivery, Luchon, Haute Garonne, France. Mrs. Hunt is an old friend of Mr. Satterlee, married to a British retired officer. This aged couple is now in desperate circumstances, not being able to obtain any funds on letters of credit or checks, and their hotel willing no longer to extend hospitality without payment. Mr. Berle's office wishes to know the status of this application.

HMC:dm:7.22.40

TREASURY DEPARTMENT

INTER-OFFICE COMMUNICATION

DATE July 22, 1940

TO Secretary Morgenthau

FROM Mr. Cochran

CONFIDENTIAL

Activity of the six reporting banks in official sterling was as follows:

1. Purchased directly from authorized banks in London..........£ 15,000
   Purchased from the Federal Reserve Bank of New York..........£ 15,000
   Total purchases.........£ 30,000

2. There were no reported sales of official sterling.

Of the above-mentioned purchases, £21,000 were bought by the banks on behalf of their customers; the other £9,000 presumably were added to registered account balances.

The Federal Reserve Bank of New York also stated that a non-reporting bank purchased £82,000 in official sterling from the Federal.

In the open market, sterling opened at 3.90-1/4 and moved steadily downward to 3.80-3/4 by mid-afternoon. It closed at 3.81-1/2. In execution of customer orders, the six reporting banks sold £64,000 and purchased £49,000.

The other currencies closed as follows:

Swiss franc	.2272
Canadian dollar	11-3/8% discount
Lira	.0505
Reichsmark	.4004
Cuban peso	9-15/16% discount
Mexican peso	.2015 bid, .2040 offered

We purchased $6,000,000 in gold from the earmarked account of the Central Bank of the Argentine Republic.

The Federal Reserve Bank of New York reported that the following shipments of gold were consigned to it:

$26,783,000 from England, representing two shipments by the Bank of England, London, to be earmarked for account of His Britannic Majesty's Government.
1,800,000 from Portugal, shipped by the Bank of Portugal, to be earmarked for its account.

$28,583,000 Total

The State Department forwarded to us a cable stating that Samuel Montagu, London, shipped $138,000 in gold from England to the Chase National Bank, New York, for sale to the U. S. Assay Office.

The Bombay gold price advanced the equivalent of 7¢ to $33.84.

Spot silver in Bombay was equivalent to 44.06¢, up 3/16¢.

In London, spot silver was fixed 7/16d lower at 22-3/16d. The forward quotation was unchanged at 22-1/16d. According to reports from that center, Indian interests resold, for spot delivery, silver which had originally been purchased for shipment. The U. S. equivalents of the London silver prices were 40.34¢ and 40.11¢ respectively.

Handy and Harman's settlement price for foreign silver was unchanged at 34-3/4¢. The Treasury's purchase price for foreign silver was also unchanged at 35¢.

We made two purchases of silver totaling 100,000 ounces under the Silver Purchase Act, both of which were new production from foreign countries, for forward delivery.

CONFIDENTIAL

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE July 19, 1940

TO Secretary Morgenthau

FROM Mr. Cochran

CONFIDENTIAL

The foreign exchange market was quiet today, and the volume of transactions in both official and open market sterling remained fairly small.

On the basis of the official rates of 4.02-1/2 and 4.03-1/2, the six reporting banks consummated the following transactions:

1. Sales of £2,000 to the British Control, effected directly through authorized banks in London.

2. Purchases of £73,000 from the British Control, of which £18,000 were acquired directly from authorized banks in London, and £55,000 through the Federal Reserve Bank of New York.

So far as our reports indicate, none of the purchases from the Federal Reserve Bank were made by the reporting banks on behalf of their customers. The sterling so acquired apparently is being used to build up the balances in the banks' registered sterling accounts.

The Federal Reserve Bank also stated that non-reporting banks purchased £36,000 in official sterling from the Federal.

The turnover in official sterling for yesterday and today reveals a noteworthy contrast between the amount of purchases and sales. Whereas American banks, during the two days, bought a total of £229,000, they effected sales of only £7,000.

The open market in sterling was very dull, although the rate experienced considerable improvement. From an opening of 3.81, it rose to a high of 3.91, and closed at 3.90. On behalf of their customers, the six reporting banks made sales of £35,000 and purchases of £52,000.

The open market rate for the Canadian dollar again moved closer to the official level for that currency, closing at 11-1/4% discount. The official rates that have been quoted by the Canadian Foreign Exchange Control Board since last September are equivalent to 9-15/16% and 9-1/16% discount (rates at which the Board will buy and sell Canadian dollars respectively).

The other currencies closed as follows:

Swiss franc	.2272
Lira	.0505
Reichsmark	.4004
Cuban peso	9-15/16% discount
Mexican peso	.2015 bid, .2040 offered

There were no gold transactions consummated by us today.

The Federal Reserve Bank of New York reported the following shipments of gold:

$ 8,225,000	from England, shipped by the Bank of England to the Federal Reserve Bank of New York, to be earmarked for account of His Britannic Majesty's Government.
3,740,000	from Colombia, shipped by the Central Bank of the Colombian Republic to the Federal Reserve Bank of New York, to be earmarked for its account.
403,000	from England, shipped by Samuel Montagu, London, to the Irving Trust Company, New York.
400,000	from England, shipped by the Swiss Bank Corporation, London, to its New York agency.
140,000	from Portugal, shipped by the Bank of Portugal to the Federal Reserve Bank of New York, disposition unknown.
$12,908,000	Total

The Bombay gold price was slightly lower at the equivalent of $33.78.

Spot silver in Bombay was equivalent to 43.86¢, up 1/8¢.

In London, the prices fixed for spot and forward silver again rose 1/8d to 22-5/8d and 22-1/6d respectively. The U. S. equivalents were 41.13¢ and 40.11¢.

Handy and Harman's settlement price for foreign silver was unchanged at 34-3/4¢. The Treasury's purchase price for foreign silver was also unchanged at 35¢.

We made two purchases of silver totaling 100,000 ounces under the Silver Purchase Act, both of which were new production from foreign countries, for forward delivery.

H.M.Jr. CONFIDENTIAL

BRITISH EMBASSY,
WASHINGTON, D.C.

Personal and Secret

July 22nd, 1940

Dear Mr. Secretary,

I enclose herein for your personal and secret information a copy of the latest report received from London on the military situation.

Believe me,
Dear Mr. Secretary,
Very sincerely yours,

Lothian

The Honourable
Henry Morgenthau, Jr.,
United States Treasury,
Washington, D.C.

Telegram despatched from London
late on the evening of July 21st

31

1. The recent Anglo-Italian naval action took place in Antikithera Channel off northwest Crete. Early in action, "Sydney" hit the "Colleoni" in engine-room and stopped her; "Sydney" then left some destroyers to sink the "Colleoni" and continued to chase the other cruiser, "Federico da Barbiano" of the same class. Chase lasted 1½ hours and "Sydney" obtained several hits but enemy retained her speed and drew out of range. Our destroyers fired 4 torpedoes at the "Colleoni", 2 hit and sank her. 545 survivors including the Captain were picked up by destroyers which were bombed during this operation without result. There were no casualties in His Majesty's ships as a result of this action.

Channel convoy heavily attacked by about 30 enemy aircraft yesterday afternoon. Destroyer "Brazen" hit in engine room sank later off Dover when in tow; 3 wounded. Slight damage to one anti-submarine trawler. S.S. "Pulborough" (1,000 tons) sunk, S.S. "Westown" (700 tons) damaged and towed into Dover, no casualties.

32

Reported that battle cruiser "Gneisenau" left Trondjhem at 0900 hours July 20th.

French S.S. "Ile de France" (43,500 tons) has been requisitioned at Singapore. Believed that one-third of the crew will volunteer to serve.

2. Night of 19th-20th work of our heavy bombers difficult to observe owing to weather conditions. Successful attacks made on oil plant at Gelsenkirchen, railway target at Essen, air frame factories at Bremen, Wismar and Wenzendorf, and 3 aerodromes in northwest Germany and Holland. Single aircraft located and bombed warships "Scheer" and "Tirpitz" at Wilhelmshafen, results unobserved. Attack on barges and shipping at Emden resulted in large explosion and several fires; terrific explosion reported at Harlingen. Two Messerschmitts 110 shot down during these operations.

Yesterday 24 Blenheims despatched against specified oil targets aerodromes and aircraft factories in northwest Germany and to Kiel Canal; majority obliged to abandon tasks, one aircraft missing. One Hudson patrolling off Norwegian coast bombed wireless station at Utsire, wireless mast collapsed, station also damaged.

Last night 117 aircraft despatched as follows: 38 Wellingtons against oil and railway targets, 21 Whitleys against aircraft factories, 23 Hampdens to attack "Tirpitz" in Wilhelmshafen docks, 12 Blenheims against oil plants at Ghent and Vlaardingen, 3 Hudsons to attack Emden Basin,

127

33

18 Hampdens and 8 Swordfish mine-laying in Copenhagen area, Ems River and Hubertgat. Reports awaited; two Wellingtons and three Hampdens missing, one Hampden down in sea off Middlesborough.

3. Little enemy aircraft activity yesterday except at Dover. One bomb fell on British Oxygen Works at Cattedown, Plymouth, extensive damage, works out of production for some time.

Last night very extensive mine-laying operations off southwest coast and east coast, especially Harwich and Thames Estuary. Following ports closed today: Plymouth, Milford Haven, Preston, Newhaven, and Belfast.

Few bombs dropped at West Hartlepool, Lowestoft, Harwich, Swansea, Mountain Ash and Maryport: casualties slight.

Yesterday aircraft casualties in fighter operations: 9 enemy aircraft confirmed, 18 unconfirmed; our losses 5 Hurricanes and 1 Spitfire.

4. Shipping losses:-

(a) By U-Boat: British "Woodbury" (4,600 tons) sunk in western approaches on 18th; British "Pearlmoor" (4,500 tons) sunk northwest approaches on 19th.

(b)

(b) By Air: H.M. M/S Trawler "Crest Flower" sunk on 19th off Isle of Wight.

(c) By Mine: British "Troutpool" (5,000 tons) sunk off Bangor.

(d) By Raiders: "British Petrol" (7,000 tons) sunk on 14th West Indies. This German raider reported as ship of 9,000 tons painted in Swedish colours and armed with two 5.9 inch and two 3 inch guns and number of pom-poms and machine guns.

5. Egypt. During the night of July 19th-20th Blenheims searched Tobruk Harbour for Italian cruiser chased by "Sydney"; ship not located but shipping in harbour attacked by Blenheims and Swordfish, three direct hits, one causing major explosion.

Mediterranean. Further arrival of 18 S.79 bombers at Rhodes increases total strength of bombers in the Dodecanese to 77. Reinforcements compri-- 12 Stormo, reputed as Italy's most -ous bomber formation. This Stormo probably carried out recent Haifa raid. Reported German parachutists, engineers, and airmen have arrived in Lybia and more are expected.

Sudan. On 19th Wellesley aircraft bombed Agardot and Barentu aerodromes; one enemy aircraft destroyed and others damaged as well as W/T station at Barentu.

Kenya. On 18th four aircraft of S.A.A.F. blew up petrol dump destroying one enemy aircraft and severely damaged another at Neghelli aerodrome.

CONFIDENTIAL

July 22, 1940

To: The Secretary

From: Mr. Young

When Mr. Bloch L'Aine was here last Friday, he told me that he felt it was his duty to return to France regardless of the conditions or the personal repercussions which it might involve due to his former position as an international banker associated with Lazard Freres, and his Jewish origin.

He is the fourth generation of a family which has served France either in the Army or in the French Civil Service. He is convinced he must go back to see if he can help despite the hardships which he realizes he is bound to encounter. If it should turn out, however, that he could not be of help, it was his desire to return to the United States if it were still possible at that time for him to get out of France.

It was this thought which he had in mind when he asked you as a personal favor to find out what the State Department might be able to do toward permitting him and possibly his immediate family to reenter the United States on a more permanent basis. He mentioned the possibility of coming in under some quota which was not too full, and he was quite prepared to go to Cuba or whatever place might be designated to wait his turn for admission. At the present time he has a diplomatic passport as well as an ordinary passport, the latter expiring July, 1942.

Mr. Bloch L'Aine is planning to leave for France very shortly and is extremely anxious to clarify this situation before he leaves. He will be delighted to come to Washington at any time to confer with the State Department.

PY.

HR

GRAY

London

Dated July 22, 1940

Rec'd 3:40 p.m.

Secretary of State

Washington

2329, July 22, 6 p.m.

FOR TREASURY FROM BUTTERWORTH.

Doctor Outrata, who is in charge of financial matters for the Czech-Slovak National Committee called at the Embassy today and explained that when he and other members of the Committee left France they took with them and brought to this country French bank notes totalling 11 million francs. This they have declared to the British authorities and deposited for safe-keeping in a British bank. Doctor Outrata stated that he was having discussions with the Bank of England regarding the possible exchange of these francs for pounds but that he would prefer to acquire dollars for the whole or at least a part of this sum and he requested that I communicate with Washington to ascertain whether we would be interested in such a deal. While acceding to his request I expressed my personal opinion that it was unlikely that we could enter into such a transaction, particularly as France may at any time

prohibit

HR -2- No. 2329, July 22, 6 p.m. from London.

prohibit the importation of franc bank notes.

I think it is for this same reason that Dr. Outrata would like as quick an answer as possible and accordingly a prompt reply would be appreciated.

KENNEDY

CSB

HR

GRAY

Berlin

Dated July 22, 1940

Rec'd 10 p.m.

Secretary of State,

Washington.

3100, July 22, 8 p.m.

FOR TREASURY FROM HEATH AND FOR DEPARTMENT'S INFORMATION.

In the Sunday issue of the DAZ, Winschuh, the financial editor, discusses at length the gold problem of the United States under the title "gold boycott".

Stating that the United States has broken the rule that a creditor nation must have a passive balance of trade he asserts that it must now face the day of reckoning with no sure solution of its gold dilemma in sight.

He quotes Secretary Morgenthau as having declared on May 3rd that "if the political situation of the world should undergo a drastic change then international trade and finance may assume the character of domestic trade and an independent monetary system would cease to exist. Under such circumstances it might well be that gold would no longer be needed. Under these circumstances however

life

life would be so different from its predication that the loss in the value of gold would be the least of our troubles" (it will be noted that in thus quoting from the Secretary's speech Winschuh has omitted certain important phrases.)

He goes on to assert that the collapse of the value of gold would be a grave source of anxiety for the United States since it would also mean the loss of its prestige as an economically well advised, wise and successful great power.

He concludes his article with the following argument: obviously the starting of European trade following the war would be substantially facilitated through the use of gold. Obviously the reconstitution of European currencies and the organization of monetary cooperation is no easy task and the notions of a "labor currency" requires substantial development particularly as regards the thawing of the financial burdens of the war and the necessary return of balance between the consumption goods, economy and industries working on Government orders. In addition, Germany wishes above all to have an economy relieved as far as possible from

bureaucratic

HR -3- #3100, July 22, 8 p.m. from Berlin.

bureaucratic fetters. Particularly in this respect is gold (?) may attract the business man with the prospect of being able to conduct his business without a "paper war". The question "whether or not return to gold" has in these times, however, assumed such fundamental importance and political dimensions that technical advantages of gold are not the only considerations involved.

KIRK

WWC

MEMORANDUM

July 22, 1940.

TO: SECRETARY MORGENTHAU

FROM: MR. SULLIVAN

This memorandum is supplementary to that of July 16 relating to the probable excess profits and yields of an excess profits tax.

Assuming excess profits of $2,000,000,000, the following average effective rates would be necessary to yield the following amounts of revenue:

$ 500,000,000	—	25%
1,000,000,000	—	50
1,500,000,000	—	75
2,000,000,000	—	100

The following bracket rate schedules would roughly approximate the above effective rates:

Income bracket in per- cent of invested capital	Rates for: $500,000,000	$1,000,000,000	$1,500,000,000	$2,000,000,000
$5,000 plus 15% of in- vested capital	20%	45%	70%	100%
Between 15 and 30% of invested capital	40	60	85	100
Over 30% of invested capital	40	60	85	100

It is again important to observe that the above figures are highly tentative and subject to very substantial revision.

JLS

MEMORANDUM

July 22, 1940.

TO: Secretary Morgenthau

FROM: Mr. Sullivan

SUBJECT: Conference with certain Democrat members of the House Ways and Means and Senate Finance Committees from 2:00 to 4:15 PM, Monday, July 22, 1940.

Present: Representatives Doughton, Cooper, Boehne, Buck and McCormack; Senators Harrison, Byrd, Connally and George; Messrs. Beaman and O'Brien from the office of the Legislative Council of the House of Representatives; Messrs. Stam, Myers, Price and Stratton, from the Joint Committee Staff; and Messrs. Sullivan, Tarleau, Blough and Eichholz from the Treasury Department.

Chairman Doughton gave a brief summary of excess profits tax developments to date, including Congressional action on the Revenue Act of 1940, the message of the President to Congress on the excess profits tax, and the conferences of Congressional leaders at the Treasury and the White House. He indicated the desirability of having an agreement between the Treasury Department and the Joint Committee Staff, in order to save the time of the Ways and Means and Finance Committees. Messrs. Harrison and Cooper also said a few words.

Mr. Sullivan then explained the main outline of the excess profits tax plans on which the Treasury had worked. In the course of his exposition, there were frequent questions from and discussion among the Congressmen. The most significant among the points raised are briefly indicated later in this memorandum.

Mr. Doughton asked Mr. Sullivan if the Treasury and the Joint Committee Staff were in agreement on all points. Mr. Sullivan replied that there were four points on which they were not in agreement, of which three were minor in character. On the inquiry of Mr. Doughton, Mr. Stam stated that the major point of difference was whether invested capital should be used as a basis of taxation as in the plan suggested by the Treasury. Mr. Stam said he felt that the use of invested capital would impose hardships on some taxpayers and was not entirely a fair method. He then said that he had understood that Great Britain and Canada had abandoned or were about to abandon the use of invested capital and were using a comparison of pre-war and current earnings to measure excess profits. He said he was not proposing such a plan, and that he had no plan to suggest which was free from serious difficulty. Mr. Stam stated that if the invested capital principle was to be used, he believed the Treasury proposal was the best method that had been suggested for applying it.

Mr. Doughton then asked Mr. Sullivan if the Treasury was ready to proceed today. Mr. Sullivan assured the Committee that the Treasury was ready to proceed at once. Mr. Doughton then asked Mr. Stam if he was ready now, or wished more time. Mr. Stam indicated that he would like the remainder of this week to continue his research. Mr. Doughton then expressed the view, which was supported by Mr. Cooper, that it would be well to have an agreement between the Treasury and the Joint Committee Staff and that time would be saved for the Committee if consideration was postponed until next week, when presumably an agreement would have been reached or in the absence of an agreement, Mr. Stam would have a definite plan to present. It was accordingly determined to reconvene the group at 10:30 Tuesday morning, July 30th.

Among the important aspects of the excess profits tax discussed at the Conference were the following:

Senator Byrd asked whether the depreciation of assets recorded on the books would not reduce invested capital to zero in many cases. It was explained that since the deduction of depreciation was offset by the increase in other assets, the capital would remain intact unless there were losses or distributions of the capital to stockholders. Mr. Buck was interested in the same problem and also in the analogous problem of depletion.

Mr. McCormack, together with Senator Byrd, raised the question of whether the Treasury plan would arrive at an invested capital figure representing the true worth of the business. Mr. Sullivan answered that it might not, but that true worth was something on which reasonable men might have widely different opinions. The theoretical issue involved was not discussed and the administrative problems of determining the present worth of the business were raised in only a passing manner.

Mr. McCormack suggested that rather than determine invested capital as proposed in the Treasury plan, the Bureau of Internal Revenue and the taxpayer should sit down together and arrive at a mutually agreeable figure for invested capital.

Senator Connally expressed the belief that invested capital is necessary as a basis for excess profits taxation. He stated that he desired the tax to be imposed in time of peace as well as during an emergency period. In this, he was opposed by Mr. McCormack, while Senator George expressed the view that the tax would continue after the emergency.

Senator Connally expressed doubt as to the desirability of including borrowed capital as part of invested capital. There was considerable discussion whether a tax could be applied only to certain industries which benefited specifically from the defense program. Senator Byrd and others expressed the belief that it would be impossible to segregate the benefiting industries sufficiently to permit the distinction to be made.

Senator George appeared to be of the opinion that the tax should preferably apply only to profits in excess of those received during a base period. He expressed the opinion that if the invested capital basis were used, overcapitalized concerns (as examples he mentioned the United States Steel Corporation and the railroads) would pay little tax while smaller concerns would be heavily burdened.

JLS

July 22, 1940

Mr. Livesey

Mr. Cochran

Will you kindly send the following cablegram:

"American Embassy,

France.

For Matthews from the Treasury Department.

Reference your July 16 to Butterworth. We have talked with Phillips and Bewley about French balances in Great Britain. These officers suggest that Monick and other members of the French Embassy who, according to Butterworth's message of July 16, were then sailing for France, will be in a position to provide this information.

Reference your 63, July 13, 3 p.m. French balances in the United States were subjected by an Executive Order dated July 17 to treatment similar to that accorded assets of Denmark, Belgium and other invaded areas. No general licenses covering official French balances have been issued. The system is the same as explained to you when in Washington. All pertinent regulations under the control system have been mailed to you currently by this Treasury. Leroy-Beaulieu has likewise been provided and states that he has kept the French Ministry of Finance informed.

In summary you are advised that the following transactions with respect to property in which any interest, direct or indirect, is held by France, or by any person domiciled in, or a subject, citizen or resident of France, its territories, dependencies and possessions, on or since July 17, 1940, except persons domiciled or residing in the United States on such date, may be effected only pursuant to a license: (a) payments or transfers of credit involving one or more banking institutions within the United States; (b) exports from the United States or earmarking of gold or silver currency or bullion by any person within the United States; (d) dealings in evidences of indebtedness or ownership by any person within the United States; (e) any transaction designed to evade the foregoing requirements. Application for such license may be made to the Federal Reserve Bank of New York by the American banks referred to in your communication or by any party to such transaction, whether or not in the United States.

On July 19 Leroy-Beaulieu read to Treasury officials a cablegram sent by him to the French Ministry of Finance on July 15 giving his interpretation

HMD:lap-7/22/40

of American objectives of control as applied to French assets. He endeavored to obtain confirmation from the American Treasury officials as to the correctness of his interpretation of the control, which was refused. For your information, we did not consider his interpretation satisfactory."

HMJr

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE July 22, 1940

TO Secretary Morgenthau

FROM Mr. Gaston

MERCHANT SHIP MOVEMENTS

Matters Requiring Action by the Secretary of the Treasury

None.

Matters Not Requiring Action by the Secretary of the Treasury

Closed Cases

The Italian vessel ANTONIETTA requested on July 19, 1940, a departure permit for Philadelphia from Norfolk, Virginia. She carried 6,161 tons of scrap iron taken on at Port Arthur, Texas, and Pensacola, Florida, for Genoa, Italy. On June 11, 1940, she put in at Norfolk and has remained there ever since. The ANTONIETTA is unarmed and under charter to an Italian concern controlled by the Royal Italian Government. Her first officer is an officer in the Italian Naval Reserve. On inquiry, it was learned that she intends to go to Philadelphia to unload the scrap iron and to pick up fuel. A departure permit was authorized on the morning of July 20, 1940.

Pending Cases

There is no change in the status of the vessels described under paragraphs 2, 3, and 4 under "Pending Cases" in the July 17, 1940, report, nor are there any further developments on the normal peacetime consumption of petroleum products in Spain.

COPY

Secretary Morgenthau

July 17, 1940

Mr. Cairns

MERCHANT SHIP MOVEMENTS

Closed Cases

1. A departure permit was refused for the American Tanker ARIAN, carrying petroleum products to Spain. This vessel is owned by the Texas Company, and is at Port Arthur, Texas.

2. A departure permit was refused for the American Tanker NEVADA, carrying petroleum products to Spain. This vessel is owned by the Texas Company, and is at Port Arthur, Texas.

Pending Cases

1. The Texas Company has submitted a request to export 610,000 tons of petroleum products to Spain for the balance of the year 1940. This would make a grand total of 1,076,000 tons for the year 1940. A memorandum of a conference with representatives of the Texas Company held on July 17, 1940, is attached. This matter is under consideration.

2. The Texas Company has requested advice as to whether or not the SS MONTE JAVALON, under Spanish registry, will be permitted to carry 5,000 tons of asphalt to Spain. The vessel will be loaded at Port Neches, Texas, some time between August 10 and the early part of September. This matter is under consideration.

3. Suspicious circumstances have arisen in connection with the departure of the SIMLA, a Norwegian vessel now at the port of Philadelphia. No departure permit has been requested, but a stop order has been placed against such a request when it is received.

4. The Lithuanian Steamship DENNY is now in Boston. The Lithuanian-American Import & Export Corporation, 157 Chambers Street, New York City, has requested that it be advised if a departure permit is asked for this vessel. The corporation desires to submit certain facts to the Treasury Department before such permit is granted. This matter is under consideration.

HC/cp

(Initialed) H. C.

CC: Miss Chauncey
Mr. Foley

July 22, 1940

Secretary Morgenthau

Mr. Gaston

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(Signed) Herbert E. Gaston

HE/ep 7/22/40

[illegible]

Secretary Morgenthau

July 17, 1940

Mr. Cairns

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HC/ep

(Initialed) H. C.

CC: Miss Chauncey
Mr. Foley

July 22, 1940

My dear Mr. Nelson:

I am sending you herewith a copy of the President's message to the Congress of May 16, 1940. I want to draw your particular attention to Page 4 where the President said:

> "For the permanent record, I ask the Congress not to take any action which would in any way hamper or delay the delivery of American-made planes to foreign nations which have ordered them, or seek to purchase more planes. That, from the point of view of our own national defense, would be extremely shortsighted.
>
> * * *
>
> "Our immediate problem is to superimpose on this production capacity a greatly increased additional production capacity."

I am sure I am correct in interpreting the President's message that when he referred to American-made planes he meant the complete planes with engines.

Yours sincerely,

(Signed) H. Morgenthau, Jr.

Mr. Donald M. Nelson,
Coordinator of National
Defense Purchasing,
Federal Reserve Building,
Washington, D. C.

By Messenger 3'10

July 22, 1940

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By Messenger

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(Signed) H. Morgenthau, Jr.

Mr. William H. McReynolds,
Secretary to the Advisory Council
of National Defense,
State Department,
Washington, D. C.

By Messenger 3^10

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Mr. William H. McReynolds,
Secretary to the Advisory Council
of National Defense,
State Department,
Washington, D. C.

By Messenger

MEMORANDUM FOR THE SECRETARY

July 22, 1940

E. H. Foley, Jr.

Subject: Legislative proposals for small business loans.

There are two principal bills pending at this Session. One of them is S. 3511, which is entitled, A Bill "To establish a permanent industrial loan corporation to assist financing institutions in making credit available to commercial and industrial enterprises."

The industrial loan corporation would discount for or purchase from financing institutions obligations of commercial or industrial businesses and would also insure banks against losses which they might sustain upon obligations of commercial or industrial businesses. The management of the corporation would be vested in a Board of directors composed of members of the Board of Governors of the Federal Reserve System, and its capital stock and surplus would be composed of funds paid by the Secretary of the Treasury to purchase from each Federal Reserve Bank the stock of the Federal Deposit Insurance Corporation heretofore subscribed for by such bank. The amount to be paid by the Secretary of the Treasury would come from the miscellaneous receipts created by the increment resulting from reduction of the weight of the gold dollar.

On June 25, 1940, the Acting Secretary of the Treasury advised the Chairman of the Senate Committee on Banking and Currency that the RFC was already authorized to advance credit and capital to business enterprise and that the RFC was the proper agency through which to advance such assistance to business. I declined to initial this report.

The other bill is S. 3343, (which is almost identical with S. 3839) and which is entitled A Bill "To amend section 13b of the Federal Reserve Act, as amended."

This bill would amend section 13b which now authorizes Federal Reserve Banks to make loans to established industrial or commercial businesses by eliminating the requirements that the loans be made to established businesses, that they be made for the purpose of providing working capital, and would also eliminate the limitation on the maturity of the loans to five years.

This bill also provides that the financing institution obligate itself for only 10 percent of any loss sustained by the Federal Reserve Bank, instead of 20 percent as now provided.

On June 12, 1940, the Acting Secretary of the Treasury delivered personally a report to the Chairman of the Committee on Banking and Currency which suggested that instead of the bill, there be enacted an amendment which would discontinue entirely further advances of funds from the Treasury, requiring the repayment of advances heretofore made, and clarifying certain ambiguities now existing in the operation of section 13b.

This report pointed out that the maximum amount of loans outstanding at any time under section 13b was less than $33,000,000, and that on February 21 only $12,721,000 of loans were outstanding in addition to commitments of $8,436,000. I declined to initial this report.

CLK:mp
7/22'40

(Initialed) E. H. F., Jr.

July 22, 1940

This is the Treasury draft which was ready for presentation to the Ways and Means Committee on July 22nd, but the ~~Committee postponed the meeting~~ until July 30th.

was not ready to accept it & postponed consideration until 7/30.

Treasury Draft 7-22

7-30

The following sections numbered 1 to 15, inclusive (Title I), are intended as an amendment to the Internal Revenue Code to be inserted as a new subchapter. The section numbers will be changed and quotation marks will be inserted later.

The sections following the above mentioned sections (Title II) are intended as amendments to the Internal Revenue Code which are other than insertions of the new subchapter. They are necessary by reason of the new subchapter. They have been put in their proper places and surrounded by quotation marks.

TITLE I

EXCESS PROFITS TAX

SEC. 1. DEFINITION OF INVESTED CAPITAL.

For the purposes of this subchapter the invested capital for any taxable year (including the taxable years in the base period) shall be the average invested capital for such year, determined under section 2, reduced by an amount computed under section 6.

SEC. 2. AVERAGE INVESTED CAPITAL.

The average invested capital for any taxable year (including the taxable years for the base period) shall be the aggregate of the daily invested capital for each day of such taxable year, divided by the number of days in the twelve months preceding the day following the close of the taxable year.

SEC. 3. DAILY INVESTED CAPITAL.

The daily invested capital for any day of the taxable year shall be the sum of the equity invested capital for such day plus the borrowed invested capital for such day.

SEC. 4. EQUITY INVESTED CAPITAL.

(a) Definition.--The equity invested capital for any day of the taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts --

(1) Money paid in.--Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

(2) Property paid in.--Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined in the same manner as if the property were still held at the beginning of such taxable year. If such unadjusted basis is a substituted basis it shall be adjusted, with respect to the period before the property was paid in, in the manner provided in section 113(b)(2);

(3) Taxable stock dividends.—Distributions in stock --

(A) Made prior to such taxable year; and

(B) Previously made during such taxable year

to the extent to which they are considered distributions of earnings and profits other than earnings and profits of the taxable year; and

(4) Earnings and profits at beginning of year.--The accumulated earnings and profits as of the beginning of such taxable year;

less the sum of the following amounts --

(5) Distributions in previous years.--Distributions made prior to such taxable year which were not out of accumulated earnings and profits;

(6) Deficit in earnings and profits.--The deficit in accumulated earnings and profits as of the beginning of such taxable year; and

(7) Distributions during the year.—Distributions previously made during such taxable year which are not out of the earnings and profits of the taxable year.

(b) Rules for Application of Subsection (a).--For the purposes of subsection (a) --

(1) Distributions in stock.--The term "distribution in stock" means a distribution by a corporation to its shareholders in its stock or rights to acquire its stock. To the extent that such a distribution was not subject to tax in the hands of the distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or was not taxable to him under the applicable revenue law it shall not be considered a distribution.

(2) Distributions in first sixty days of taxable year.--In the application of such subsection to any taxable year beginning after December 31, 1940, so much of the distributions (taken in the order of time) made during the first sixty days thereof as does not exceed the accumulated earnings and profits as of the beginning of the taxable year (computed without regard to this paragraph) shall be considered to have been made on the last day of the preceding taxable year.

(3) Computation of earnings and profits of taxable year.—For the purposes of subsection (a)(3)(B) and (7) in determining whether a distribution is out of the earnings and profits of the taxable year, such earnings and profits shall be computed as of the close of the taxable year without diminution by reason of any distribution made during the taxable year and without regard to the amount of earnings and profits at the time the distribution was made.

SEC. 5. BORROWED INVESTED CAPITAL.

(a) Borrowed Capital.--The borrowed capital for any day of the taxable year shall be determined as of the beginning of such day and shall be the amount of the outstanding indebtedness (not including interest) of the taxpayer which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust.

(b) Borrowed Invested Capital.--Borrowed invested capital for any day of the taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts:

(1) An amount equal to that portion of the borrowed capital for such day which does not exceed the excess of $100,000 over the equity invested capital for such day;

(2)(A) If the equity invested capital for such day is less than $100,000, an amount equal to 66 2/3 per centum of that portion of the remainder of the borrowed capital for such day which does not exceed $900,000; or

(B) If the equity invested capital for such day is $100,000 or more and is less than $1,000,000, an amount equal to 66 2/3 per centum of that portion of the borrowed capital for such day which does not exceed the excess of $1,000,000 over the equity invested capital for such day; and

(3) An amount equal to 33 1/3 per centum of that portion of the borrowed capital for such day as exceeds the sum of —

(A) The amount ascertained under paragraph (1), plus

(B) 150 per centum of the amount ascertained under paragraph (2)

SEC. 6. ADMISSIBLE AND INADMISSIBLE ASSETS.

(a) Definitions.—For the purposes of this subchapter —

(1) The term "inadmissible assets" means —

(A) Stock in corporations except stock in a foreign personal-holding company; and

(B) Obligations described in section 22(b)(4)(A), (B), or (C) any part of the interest from which is excludible from gross income or allowable as a credit against net income.

(2) The term "admissible assets" means all assets other than inadmissible assets.

(b) Ratio of Inadmissibles to Total Assets.—The amount by which the average invested capital shall be reduced as provided in section 1 shall be an amount which is the same percentage of the average invested capital as the percentage which the total of the inadmissible assets is of the total of all assets. For such purposes, the amount attributable to each asset held at any time during the taxable year shall be determined by ascertaining the adjusted basis thereof (or, in the case of money, the amount thereof) for each day of the taxable year so held and adding such daily amounts. The determination of such daily amounts shall be made under regulations prescribed by the Commissioner with the approval of the Secretary. In the case of the taxable year the adjusted basis shall be the adjusted basis for determining loss upon sale or exchange as determined under section 113 of this title, and in the case of a taxable year in the base period the adjusted basis shall be the adjusted basis for determining loss upon sale or exchange as determined under the income tax law applicable to such taxable year.

(c) Computation of Inadmissible Assets in Case of Capital Gain or Capital Loss.—If an amount of capital gain or capital loss with respect to an inadmissible asset has been taken into account in computing net income for the taxable year, then, in computing the total inadmissible assets and the total of all assets for such year for the purposes of subsection (b), so much of the amount attributable to such inadmissible asset (computed without regard to this subsection) as bears the same ratio thereto as the amount of capital gain or loss so taken into account bears to the sum of such amount taken into account plus the dividends and interest on such asset for such year, shall be considered as an admissible asset and the remainder shall be considered as an inadmissible asset.

SEC. 7. EXCESS PROFITS NET INCOME.

(a) Taxable Years Beginning After December 31, 1939.—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13(a)(2), for such year except that the following adjustments shall be made:

(1) Dividends received.--The credit for dividends received shall apply, without limitation, to all dividends on stock of all corporations, except dividends (actual or constructive) on stock of foreign personal-holding companies;

(2) Interest.—The deduction allowable for such taxable year for interest shall be reduced by an amount which is the same percentage of so much of such interest as represents interest on the indebtedness included in the daily amounts of borrowed capital (determined under

section 5(a)) as the percentage which the sum of the daily amounts of borrowed invested capital (determined under section 5(b)) is of the sum of the daily amounts of the borrowed capital; and

(3) Income taxes.—The deduction for taxes allowable for such taxable year shall be increased by an amount equal to the tax under Chapter 1 payable for such taxable year.

(4) Depletion deduction.—The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to percentage depletion under section 114(b)(3) or (4).

(b) Taxable Years in Base Period.—The excess profits net income for any taxable year in the base period --

(1) Taxable years 1936 and 1937.—In the case of a taxable year subject to the Revenue Act of 1936, shall be the normal-tax net income, as defined in section 13(a) of such Act; or

(2) Taxable years 1938 and 1939.--In the case of any other taxable year in the base period, shall be the special class net income, as defined in section 14(a) of the applicable revenue law; except that the following adjustments shall be made:

(3) Dividends, interest, and taxes.--The credit for dividends received and the deductions for interest and taxes shall be adjusted in the same manner as provided in subsection (a)(1), (2), and (3), respectively; and

(4) Disallowed capital losses.--There shall be added an amount equal to the amount disallowed under section 117(d) of the applicable revenue law by reason of the application of the $2,000 limitation on the excess of losses over gains from the sale or exchange of capital assets.

SEC. 8. EXCESS PROFITS CREDIT.

(a) Definitions.--For the purposes of this subchapter --

(1)(A) The term "base period" in the case of any taxpayer (except a taxpayer described in subparagraph (B) of this paragraph) means the taxable years beginning after December 31, 1935, and before January 1, 1940.

(B) In the case of a taxpayer whose first taxable year under this subchapter begins on any date in 1940, which was in existence during only part of the forty-eight months prior to such date, the base period shall be such forty-eight months.

(2)(A) The term "base period net income" means the aggregate of the excess profits net income for each of the taxable years (except the years specified in subparagraph (B) of this paragraph) in the base period, reduced, in the case of each year in such period in which the deductions plus the credit for dividends received exceeded the gross income, by the amount of such excess. In determining the amount of each such excess, the adjustments provided in section 7(b) shall be made.

(B) In the case of a taxpayer the base period of which is determined under paragraph (1)(B) of this subsection, the excess profits net income for any of the taxable years the invested capital of which is computed under paragraph (3) shall be the sum of (i) 10 per centum of so much of the invested capital for such year as does not exceed $500,000 plus (ii) 8 per centum of the remainder of such invested capital.

(3) In the case of a taxpayer the base period of which is determined under paragraph (1)(B) of this subsection —

(A) The invested capital for each of the taxable years of twelve months (beginning with the beginning of its base period) during the whole of which it was not in existence shall be the amount determined under paragraph (5)(B) of this subsection; and

(B) The invested capital for the taxable year consisting of the remainder of that part of its base period during which it was not in existence shall be the amount determined under paragraph (5)(B) of this subsection multiplied by the number of days in such remainder, and divided by the number of days in the twelve months preceding the first day of its existence.

(4) The term "base period percentage" means the percentage which the base period net income is of the aggregate of the invested capital for each of the taxable years in the base period, but such percentage shall not be less than 4 nor more than 10.

(5) In the case of a taxpayer which was in existence before the beginning of its first taxable year under this subchapter, its lowest invested capital shall be whichever of the following amounts is the smaller:

(A) The smallest invested capital for any preceding taxable year beginning after December 31, 1939; or

(B) An amount equal to the invested capital as of the beginning of the first day of the taxpayer's first taxable year beginning after December 31, 1939, reduced by the same percentage of reduction as is applicable under section 6 in reduction of the average invested capital of the preceding taxable year.

(6) In the case of a taxpayer which was not in existence before the beginning of its first taxable year under this subchapter, its lowest invested capital shall be zero.

(b) Excess Profits Credit.--The excess profits credit shall be an amount equal to the sum of the following:

(1) With respect to that part of the invested capital for the taxable year which does not exceed $500,000 and does not exceed the lowest invested capital, an amount which is a percentage thereof equal to the base period percentage or 6 per centum, whichever is the greater;

(2) With respect to that part of the remainder of the invested capital for the taxable year which does not exceed the lowest invested capital, an amount which is a percentage thereof equal to the base period percentage;

(3) If neither the invested capital for the taxable year nor the lowest invested capital is more than $500,000, an amount equal to 10 per centum of the excess of the invested capital for the taxable year over the lowest invested capital;

(4) If both the invested capital for the taxable year and the lowest invested capital are more than $500,000, an amount equal to 8 per centum of the excess of the invested capital for the taxable year over the lowest invested capital; and

(5) If the invested capital for the taxable year is more than $500,000 and the lowest invested capital is not more than $500,000:

(A) 10 per centum of the excess of $500,000 over the lowest invested capital; plus

(B) 8 per centum of the excess of the invested capital for the taxable year over $500,000.

SEC. 9. IMPOSITION OF TAX.

(a) Definition of Adjusted Excess Profits Net Income.--As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income minus the sum of:

(1) Specific exemption.--A specific exemption of $5,000, or, if the taxable year is a period of less than twelve months, an amount ascertained by multiplying $5,000 by the number of days in the taxable year and dividing the result by the number of days in the twelve months preceding the day following the close of the taxable year; and

(2) Net long-term capital gain.—The amount of the net long-term capital gain, as defined in section 117(a)(8).

(b) Imposition.--There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1939, on the excess profits net income of every corporation (except a corporation exempt, etc.) a tax equal to the sum of the following:

(1) First bracket.—25 per centum of so much of the adjusted excess profits net income as does not exceed an amount equal to the excess of 15 per centum of the invested capital over the excess profits credit;

(2) Second bracket.—40 per centum of so much of the adjusted excess profits net income as exceeds an amount equal to 15 per centum of the invested capital and does not exceed 30 per centum of the invested capital;

(3) Third bracket.—50 per centum of so much of the adjusted excess profits net income as exceeds an amount equal to 30 per centum of the invested capital; plus

(4) Net long-term capital gains.—An amount of the net long-term capital gain equal to a percentage thereof which percentage is the highest rate applicable to any part of the adjusted excess profits net income; but the amount under this paragraph shall not exceed whichever of the following amounts is the smaller:

(A) The sum of (i) 25 per centum of the amount of such net long-term capital gain, plus (ii) the amount of the adjusted excess profits net income in excess of 15 per centum of the invested capital; or

(B) The sum of (i) 40 per centum of the amount of such net long-term capital gain, plus (ii) the amount of the adjusted excess profits net income in excess of 30 per centum of the invested capital.

(c) Alternative Tax.--Where the adjusted excess profits net income is less than 15 per centum of the invested capital, then the tax imposed by this section shall be an amount equal to 25 per centum of the amount by which the excess profits net income exceeds the sum of (1) the excess profits credit and (2) the specific exemption provided in subsection (a)(1).

SEC. 10. CONSOLIDATED RETURNS.

(a) Definition of "Affiliated Group".--As used in this section an "affiliated group" means one or more chains of corporations connected through stock ownership with a common parent corporation if --

(1) At least 95 per centum of the stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) The common parent corporation owns directly at least 95 per centum of the stock of at least one of the other corporations.

As used in this subsection the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(b) Filing of Consolidated Returns.—

(1) An affiliated group of corporations, determined as of the beginning of January 1, 1940, shall file a consolidated return for the taxable year of the common parent corporation under this subchapter beginning after December 31, 1939, and before January 1, 1941, in lieu of separate returns.

(2) Corporations required to file a consolidated return under paragraph (1) of this subsection shall file consolidated returns for the taxable years beginning after December 31, 1940, and before January 1, 1943, in lieu of separate returns, except that any of such corporations —

(A) Which at any time during the first of such taxable years would not be included within the affiliated group if the percentage figure in subsection (a) were 80 per centum in lieu of 95 per centum, shall not be included in the consolidated return for each of such taxable years, but shall be required to file a separate return for such years; or

(B) Which at any time during the second of such taxable years would not be included within the affiliated group if the percentage figure in subsection (a) were 80 per centun in lieu of 95 per centum, shall not be included in the consolidated return for such taxable year, but shall be required to file a separate return for such year.

(c) Regulations.—The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the base period percentage, the invested capital, and the excess profits net income, and to prevent avoidance of tax liability.

(d) Computation and Payment of Tax.--In any case in which a consolidated return is made the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b).

(e) Foreign Corporations.--A foreign corporation shall not be deemed to be affiliated with any other corporation within the meaning of this section.

(f) China Trade Act Corporations.--A corporation organized under the China Trade Act, 1922, shall not be deemed to be affiliated with any other corporation within the meaning of this section.

(g) Corporations Deriving Income From Possessions of United States.--For the purposes of this section a corporation entitled to the benefits of section 251, by reason of receiving a large percentage of its income from possessions of the United States, shall be treated as a foreign corporation.

(h) Allocation of Income and Deductions.--For allocation of income and deductions of related trades or businesses, see section 45.

SEC. 11. PERSONAL SERVICE CORPORATIONS.

(a) Definition.—As used in this subchapter, the term "personal service corporation" means a corporation whose income is to be ascribed primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation and in which capital (whether invested or borrowed) is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists of gains, profits, or income derived from trading as a principal.

(b) Election as to Taxability.—If a personal service corporation signifies, in its return for any taxable year, its desire not to be subject to the tax imposed under this subchapter for such taxable year, it shall be exempt from such tax for such year, and the provisions of Supplement S of Chapter 1 shall apply to the shareholders in such corporation who were such shareholders on the last day of such taxable year of the corporation.

SEC. 12. SPECIAL CASES.

(a) Equity Invested Capital.—Where the Commissioner determines that the equity invested capital as of the beginning of the taxpayer's first taxable year under this subchapter cannot be determined in accordance with section 4, such equity invested capital shall be an amount, determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, equal to the aggregate of the adjusted basis, at such time, of the assets of the taxpayer then held minus the indebtedness outstanding at such time. The equity invested capital for each day in the taxpayer's base period and for each day after the beginning of the taxpayer's first taxable year under this subchapter shall be determined, in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, using as the basic figure the equity invested capital as of the beginning of such first taxable year.

(b) Foreign Corporations.—In the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, the invested capital for any taxable year shall be determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, under which —

(1) General rule.--The daily invested capital for any day of the taxable year shall be the aggregate of the adjusted basis of each United States asset held by the taxpayer on the beginning of such day. In the application of section 6 in reduction of the average invested capital (determined on the basis of such daily invested capital), the terms "admissible assets" and "inadmissible assets" shall include only United States assets; or

(2) Exception.--If the Commissioner determines that the amount of United States assets of the taxpayer cannot be determined, the invested capital for the taxable year shall be an amount which is the same percentage of the aggregate of the adjusted basis of all assets held by the taxpayer as of the end of the last day of the taxable year which the net income for the taxable year from sources within the United States is of the total net income of the taxpayer for such year.

As used in this subsection, the term "United States asset" means an asset held by the taxpayer in the United States, determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary.

SEC. 13. EXEMPT CORPORATIONS.

The following corporations shall be exempt from the tax imposed by this subchapter:

(a) Corporations exempt under section 101 from the tax imposed by Chapter 1.

(b) Foreign personal holding companies, as defined in section 331.

(c) Mutual investment companies, as defined in section 361.

(d) Personal holding companies, as defined in section 501.

(e) Foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein.

SEC. 14. MEANING OF TERMS USED.

The terms used in this subchapter shall have the same meaning as when used in Chapter 1.

SEC. 15. ADMINISTRATIVE PROVISIONS.

All provisions of law (including penalties) applicable in respect of the taxes imposed by Chapter 1, shall, insofar as not inconsistent with this subchapter, be applicable in respect of the tax imposed by this subchapter.

TITLE II

AMENDMENTS TO CHAPTER 1 OF INTERNAL REVENUE CODE

SEC. 201. EARNINGS AND PROFITS OF CORPORATIONS.

(a) Under Internal Revenue Code.—Section 115 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

"(1) Effect on Earnings and Profits of Recognition of Gain or Loss and of Receipt of Tax-free Distributions.— Gain or loss from the sale or other disposition (after February 28, 1913) of property by a corporation shall increase or decrease its earnings and profits (for any period beginning after February 28, 1913) to, but not beyond, the extent to which such gain or loss was (under the law applicable to the year in which such sale or disposition was made) recognized in computing net income, or (in the case of loss) would have been so recognized under such law if under such law the basis (including a substituted basis) for determining the loss had been the fair market value on March 1, 1913, if higher than a basis otherwise determined. Where in determining the adjusted basis used in computing such recognized gain or loss, the adjustment to the basis (or, in the case of loss, the fair market value on March 1, 1913, if such value is higher than the basis) is different from the adjustment to such basis proper for the purpose of determining earnings and profits, then the latter adjustment shall be used in determining the increase or decrease above provided. Where a corporation receives (after February 28, 1913) a distribution from a second corporation which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, the amount of such distribution shall not increase the earnings and profits (for any period beginning after February 28, 1913) of the first corporation in the following cases:

"(1) No such increase shall be made in respect of the part of such distribution which (under such law) is directly applied in reduction of the basis of the stock in respect of which the distribution was made.

"(2) No such increase shall be made if (under such law) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received."

(b) Effective Date of Amendment.—The amendment made by subsection (a) shall be applicable to taxable years beginning after December 31, 1938.

(c) Under Prior Acts.—The following rules shall be applied, for the purposes of the Revenue Act of 1938 or any prior Revenue Act as if such rules were a part of each such Act when it was enacted, in determining the earnings and profits of a corporation for any period after February 28, 1913: Gain or loss from the sale or other disposition (after February 28, 1913) of property by a corporation shall increase or decrease its earnings and profits (for any period beginning after February 28, 1913) to, but not beyond, the extent to which such gain or loss was (under the law applicable to the year in which such sale or disposition was made) recognized in computing net income, or (in the case of loss) would have been so recognized under such law if under such law the basis (including a substituted basis) for determining the loss had been the fair market value on March 1, 1913, if higher than a basis otherwise determined. Where in determining the adjusted basis used in computing such recognized gain or loss, the adjustment to the basis (or, in the case of loss, the fair market value on March 1, 1913, if such value is higher than the basis) is different from the adjustment to such basis proper for the purpose of determining earnings and profits, then the latter adjustment shall be used in determining the increase or decrease above provided. Where a corporation receives (after February 28, 1913) a distribution from a second corporation which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, the amount of such distribution shall not increase the earnings and profits (for any period beginning after February 28, 1913) of the first corporation in the following cases:

(1) No such increase shall be made in respect of the part of such distribution which (under such law) is directly applied in reduction of the basis of the stock in respect of which the distribution was made.

(2) No such increase shall be made if (under such law) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received.

SEC. 202. TAX OF SHAREHOLDERS OF PERSONAL SERVICE CORPORATIONS.

Chapter 1 of the Internal Revenue Code is amended by inserting after Supplement R the following new Supplement:

"SUPPLEMENT S — TAX OF SHAREHOLDERS OF PERSONAL SERVICE CORPORATIONS

"SEC. 391. APPLICABILITY OF SUPPLEMENT.

"If a personal service corporation (as defined in section ___ of subchapter ___ of Chapter ___) is exempt under such section for any taxable year from the excess profits tax imposed by such subchapter, the provisions of this Supplement shall be applicable with respect to each shareholder of such corporation who was a shareholder in such corporation on the last day of such taxable year of the corporation.

"SEC. 392. UNDISTRIBUTED SUPPLEMENT S NET INCOME.

"For the purposes of this chapter, the term 'undistributed Supplement S net income' means the Supplement S net income (as defined in section 393) minus the amount of the dividends paid during the taxable year.

"SEC. 393. SUPPLEMENT S NET INCOME.

"For the purposes of this chapter 'Supplement S net income' means the net income, except that there shall be allowed as additional deductions —

"(a) The Federal income tax payable under this chapter for the taxable year; and

"(b) In lieu of the deduction allowed by section 23(q), contributions or gifts, payment of which is made within the taxable year, to or for the use of donees described in section

23(q) for the purposes therein specified, to an amount which does not exceed 15 per centum of the corporation's net income, computed without the benefit of this subsection and section 23(q).

"SEC. 394. CORPORATION INCOME TAXED TO SHAREHOLDERS.

"(a) General Rule.—The undistributed Supplement S net income of a personal service corporation shall be included in the gross income of the shareholders in the manner and to the extent set forth in this Supplement.

"(b) Amount Included in Gross Income.—Each shareholder who, on the last day of the taxable year of the corporation, was a shareholder in such corporation shall include in his gross income, as a dividend, for the taxable year for which or in which the taxable year of the corporation ends, the amount he would have received as a dividend if on such last day there had been distributed by the corporation, and received by the shareholders, an amount equal to the undistributed Supplement S net income of the corporation for the taxable year.

"(c) Credit for Obligations of the United States and Its Instrumentalities.—Each such shareholder shall be allowed a credit against net income, for the purposes of the tax imposed by section 11, 13, 14, 201, 204, 207, or 362, of his proportionate share of the interest specified in section 25(a)(1) or (2) which is included in the gross income of the corporation.

"(d) Effect on Capital Account of Personal Service Corporation.—An amount equal to the undistributed Supplement S net income of the personal service corporation for its taxable year shall be considered as paid-in surplus or as a contribution to capital, and the accumulated earnings and profits as of the close of the taxable year shall be correspondingly reduced, if such amount or any portion thereof is required to be included as a dividend in the gross income of the shareholders.

"(e) Basis of Stock in Hands of Shareholders.—The amount required to be included in the gross income of the shareholder under subsection (b) shall, for the purpose of adjusting the basis of his stock with respect to which the distribution would have been made (if it had been made), be treated as having been reinvested by the shareholder as a contribution to the capital of the corporation; but only to the extent to which such amount is included in his gross income in his return, increased or decreased by any adjustment of such amount in the last determination of the shareholder's tax liability, made before the expiration of seven years after the date prescribed by law for filing the return.

"(f) Period of Limitation on Assessment and Collection.— For period of limitation on assessment and collection without assessment, in the case of failure to include in gross income the amount properly includible therein under subsection (b), see section 275(d).

"SEC. 395. NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS.

"In the case of a shareholder taxable under section 211(a) or 231(a), his distributive share of the undistributed Supplement S net income of the corporation required to be included in the gross income shall be considered as a dividend received by him from sources within the United States.

"SEC. 396. SHAREHOLDER'S TAX PAID BY CORPORATION.

"If a personal service corporation is exempt for any taxable year under section ___ of subchapter ___ of Chapter ___ from excess profits tax, it shall, at the time of filing its return, pay to the collector an amount equal to the amount that would be required by section 143(b) or 144 to be deducted and withheld by the corporation if any amount required by this Supplement to be included in the gross income of the shareholder had been, on the last day of the taxable year of the corporation, paid to the shareholder in cash as a dividend. Such amount shall be collected and paid in the same manner as the amount of tax due in excess of that shown by the taxpayer upon a return in the case of a mathematical error appearing on the face of the return."

SEC. 203. STATUTE OF LIMITATIONS IN CASE OF CONSTRUCTIVE DIVIDENDS.

Section 275(d) of the Internal Revenue Code (relating to statute of limitations) is amended to read as follows:

"(d) Constructive Dividends.—If the taxpayer omits from gross income an amount properly includible therein:

"(1) Foreign personal holding companies.—Under section 337(b) (relating to the inclusion in the gross income of United States shareholders of their distributive shares of the undistributed Supplement P net income of a foreign personal holding company); or

"(2) Personal service corporations.—Under section 394(b) (relating to the inclusion in the gross income of shareholders of their distributive shares of undistributed Supplement S net income of a personal service corporation);

the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within seven years after the return was filed."

SEC. 204. CREDIT OF NONRESIDENT ALIEN OF TAX AS SHAREHOLDER IN PERSONAL SERVICE CORPORATION.

Section 216 of the Internal Revenue Code (relating to credit against tax of a nonresident alien individual) is amended by adding at the end thereof a new sentence to read as follows: "A nonresident alien individual shall be allowed as a credit against his tax the amount required by section 396 to be paid by the personal service corporation of which he is a shareholder with respect to his tax liability under Supplement S."

SEC. 205. CREDIT OF FOREIGN CORPORATION OF TAX AS SHAREHOLDER IN PERSONAL SERVICE CORPORATION.

Section 234 of the Internal Revenue Code (relating to credits against tax of foreign corporations) is amended by adding at the end thereof a new sentence to read as follows: "A foreign corporation shall be allowed as a credit against its tax the amount required by section 396 to be paid by the personal service corporation of which it is a shareholder with respect to its tax liability under Supplement S."

"(1) No such increase shall be made in respect of the part of such distribution which (under such law) is directly applied in reduction of the basis of the stock in respect of which the distribution was made.

"(2) No such increase shall be made if (under such law) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received."

(b) Effective Date of Amendment.—The amendment made by subsection (a) shall be applicable to taxable years beginning after December 31, 1938.

(c) Under Prior Acts.—The following rules shall be applied, for the purposes of the Revenue Act of 1938 or any prior Revenue Act as if such rules were a part of each such Act when it was enacted, in determining the earnings and profits of a corporation for any period after February 28, 1913: Gain or loss from the sale or other disposition (after February 28, 1913) of property by a corporation shall increase or decrease its earnings and profits (for any period beginning in computing net income, or (in the case of loss) would have been so recognized under such law if under such law the basis (including a substituted basis) for determining the loss had been the fair market value on March 1, 1913, if higher than a basis otherwise determined. Where in determining the adjusted basis used in computing such recognized gain or loss, the adjustment to the basis (or, in the case of loss, the fair market value on March 1, 1913, if such value is higher than the basis) is different from the adjustment to such basis proper for the purpose of determining earnings and profits, then the latter adjustment shall be used in determining the increase or decrease above provided. Where a corporation receives (after February 28, 1913) a distribution from a second corporation which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, the amount of such distribution shall not increase the earnings and profits (for any period beginning after February 28, 1913) of the first corporation in the following cases:

SEC. 15. ADMINISTRATIVE PROVISIONS.

All provisions of law (including penalties) applicable in respect of the taxes imposed by Chapter 1, shall, insofar as not inconsistent with this subchapter, be applicable in respect of the tax imposed by this subchapter.

TITLE II

AMENDMENTS TO CHAPTER 1 OF INTERNAL REVENUE CODE

SEC. 201. EARNINGS AND PROFITS OF CORPORATIONS.

(a) Under Internal Revenue Code.—Section 115 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

"(1) Effect on Earnings and Profits of Recognition of Gain or Loss and of Receipt of Tax-free Distributions.— Gain or loss from the sale or other disposition (after February 28, 1913) of property by a corporation shall increase or decrease its earnings and profits (for any period beginning after February 28, 1913) to, but not beyond, the extent to which such gain or loss was (under the law applicable to the year in which such sale or disposition was made) recognized

As used in this subsection, the term "United States asset" means an asset held by the taxpayer in the United States, determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary.

SEC. 13. EXEMPT CORPORATIONS.

The following corporations shall be exempt from the tax imposed by this subchapter:

(a) Corporations exempt under section 101 from the tax imposed by Chapter 1.

(b) Foreign personal holding companies, as defined in section 331.

(c) Mutual investment companies, as defined in section 361.

(d) Personal holding companies, as defined in section 501.

(e) Foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein.

SEC. 14. MEANING OF TERMS USED.

The terms used in this subchapter shall have the same meaning as when used in Chapter 1.

invested capital for any taxable year shall be determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, under which --

(1) General rule.--The daily invested capital for any day of the taxable year shall be the aggregate of the adjusted basis of each United States asset held by the taxpayer on the beginning of such day. In the application of section 6 in reduction of the average invested capital (determined on the basis of such daily invested capital), the terms "admissible assets" and "inadmissible assets" shall include only United States assets; or

(2) Exception.--If the Commissioner determines that the amount of United States assets of the taxpayer cannot be determined, the invested capital for the taxable year shall be an amount which is the same percentage of the aggregate of the adjusted basis of all assets held by the taxpayer as of the end of the last day of the taxable year which the net income for the taxable year from sources within the United States is of the total net income of the taxpayer for such year.

SEC. 12. SPECIAL CASES.

(a) Equity Invested Capital.—Where the Commissioner determines that the equity invested capital as of the beginning of the taxpayer's first taxable year under this subchapter cannot be determined in accordance with section 4, such equity invested capital shall be an amount, determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, equal to the aggregate of the adjusted basis, at such time, of the assets of the taxpayer then held minus the indebtedness outstanding at such time. The equity invested capital for each day in the taxpayer's base period and for each day after the beginning of the taxpayer's first taxable year under this subchapter shall be determined, in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, using as the basic figure the equity invested capital as of the beginning of such first taxable year.

(b) Foreign Corporations.—In the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, the

SEC. 11. PERSONAL SERVICE CORPORATIONS.

(a) Definition.--As used in this subchapter, the term "personal service corporation" means a corporation whose income is to be ascribed primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation and in which capital (whether invested or borrowed) is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists of gains, profits, or income derived from trading as a principal.

(b) Election as to Taxability.--If a personal service corporation signifies, in its return for any taxable year, its desire not to be subject to the tax imposed under this subchapter for such taxable year, it shall be exempt from such tax for such year, and the provisions of Supplement S of Chapter 1 shall apply to the shareholders in such corporation who were such shareholders on the last day of such taxable year of the corporation.

period percentage, the invested capital, and the excess profits net income, and to prevent avoidance of tax liability.

(d) Computation and Payment of Tax.—In any case in which a consolidated return is made the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b).

(e) Foreign Corporations.—A foreign corporation shall not be deemed to be affiliated with any other corporation within the meaning of this section.

(f) China Trade Act Corporations.—A corporation organized under the China Trade Act, 1922, shall not be deemed to be affiliated with any other corporation within the meaning of this section.

(g) Corporations Deriving Income From Possessions of United States.—For the purposes of this section a corporation entitled to the benefits of section 251, by reason of receiving a large percentage of its income from possessions of the United States, shall be treated as a foreign corporation.

(h) Allocation of Income and Deductions.—For allocation of income and deductions of related trades or businesses, see section 45.

CONFIDENTIAL.

BUSINESS ADVISORY COUNCIL
FOR THE
DEPARTMENT OF COMMERCE

Recommendations
of the
Committee on Taxation
on the
EXCESS PROFITS TAX

Approved in Substance
Executive Committee
Business Advisory Council
July 12, 1940.

13154

The evident need for additional revenue legislation to help defray the cost of current and prospective expenditures for national defense and apparent popular opinion that such additional revenue should be derived from the increase in net profits or income attributable to expected improvement in business and industrial activity have resulted in a number of proposals for the levy of an excess profits tax during the emergency period. Members of the Tax Committee have reviewed a number of these proposals and have discussed the question generally with representatives of the Treasury Department, and in the event the Congress should decide to levy such a tax, recommend that it be imposed in conformity with suggestions as follows:

1. That the basis or measure for determination of the tax be made in all respects as definite and certain as may be.

> It is of primary importance that taxpayers know with reasonable certainty the burdens with which they are faced, and the importance of this fact increases with increase in tax rates. Heavy taxes affect prices, and uncertainties as to tax liability tend to cause price inflation to cover maximum rather than actual tax burdens. Moreover, high tax rates accentuate administrative problems and difficulties and increase risks of litigation, expensive to both taxpayers and government. Such difficulties and risks are substantially reduced by definiteness and certainty in the provisions of the law imposing the tax.

2. That the tax be imposed on all corporations and associations, other than personal service and exempt corporations, for a limited period of three to five years, the first taxable year to be the first calendar or fiscal year commencing after December 31, 1939.

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Due to difficulties of administration and the fact that individual surtaxes should provide an adequate means for taxing excess profits earned by individual enterprises, partnerships, personal service corporations, etc., it is felt that the excess profits tax should be limited to corporations and associations corporate in nature. It may be observed that an excess profits tax applicable to all taxpayers was tried for the year 1917, and presumably for such reasons was there-after limited to corporations and associations for 1918 and subsequent years.

3. That the tax for each year be made the smaller of two tentative taxes as follows: (a) A tax based upon net profits in excess of average net profits for a defined base period preceding the emergency period; and (b) a tax based upon net profits in excess of a specified percentage of invested capital, a specific credit of $3,000 to be allowed in either case.

While it appears that the levy of tax upon net profits in excess of average net profits for a base period would be the simplest and most uniformly desirable type of levy for a limited emergency period, it would evidently result in substantial hardships in certain cases. The necessity for some type of equalization is readily seen when you compare the inadequate base period income of such businesses as heavy goods, railways, and the like, with more adequate incomes of other business with comparatively small investment in base period years. It is believed that the alternative methods of determination would eliminate substantial inequalities of application in the great majority of cases. It is suggested that the taxpayer, by regulation or otherwise, be afforded an option to report and pay the tax computed by either method, waiving the benefit of the alternative computation. The specific credit of $3,000 is suggested for the relief of small corporations and corresponds to a similar credit allowed under the 1918 and 1921 Revenue Acts.

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4. That the tax be imposed at rates substantially as follows:

	Net Profits Bracket		Tax Rate
Method (a)	0 - 100%*	of average net profits for base period	exempt
	100%* - 150%	of average net profits for base period	20%
	Over 150%	of average net profits for base period	40%
Method (b)	0 - 8%*	of invested capital	exempt
	8%* - 20%	of invested capital	20%
	Over 20%	of invested capital	40%

* Plus specific exemption of $3,000.

The rates suggested under method (b) are the same as the excess profits tax rates levied under the 1921 Revenue Act. It is believed that such rates should be considered maximum peace-time rates under that method, especially in view of the current normal income tax rate of 20.9% which reflects an increase of 10.9% over that imposed for 1921. The net profits brackets and tax rates suggested under method (a) are recommended for study by the Treasury Department.

5. That net profits for the taxable year and for each year of the base period be the normal tax net income for such year less the amount of normal income tax due thereon, and that the definition of invested capital for the taxable year be substantially the same as the definition thereof in the 1921 Revenue Act.

Administrative problems incident to determinations of invested capital would be minimized for the Treasury Department and for numerous taxpayers by having such determinations vary as little as may be from those formerly required under the 1921 Act.

6. That the base period be the four calendar years, 1936-1939, or the four fiscal years commencing during such calendar years, and that the average net profits for such period be the average net profits for any three of such four years selected by the taxpayer.

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It is felt that the privilege of omitting one year from the four-year period would to a great extent obviate the inequity arising from years of subnormal profits. Corporations in existence for less than the full base period should be permitted to use average net profits for the full calendar or fiscal years included in such period of existence, unless resultant hardship indicates proper handling in accordance with suggestion 7. Corporate successors of transferees following non-taxable reorganizations or liquidations effected during or after the base period should be permitted to use average net profits of their predecessor corporations in the determination of average net profits for such period.

7. That the excess profits tax law include provisions similar to those of Sections 327 and 328 of the 1921 Revenue Act.

This recommendation is made for the purpose of avoiding exceptional hardships or marked inequalities due to abnormal conditions affecting either net profits or invested capital.

8. That net profits and invested capital of affiliated corporations, for both excess profits tax and income tax purposes, be required to be determined upon a consolidated return basis.

Consolidation of net profits and invested capital for the determination of income and excess profits tax was required during the World War period. As a result, numerous groups of affiliated corporations have a history of determination of invested capital on a consolidated basis which, from the viewpoint of administrative economies for taxpayers and government, would be the normal starting point for determinations required under the proposed excess profits tax law, due to settlement of many controversial points in their earlier history. It is felt that consolidated returns would not result in any material loss in revenue for 1940 and subsequent years, and that any such loss would be more than compensated by the avoidance of numerous administrative difficulties and controversies relating to intercompany profits, investments and accounts between affiliated corporations.

9. That the foreign income and profits tax credit be allowed against the domestic income and excess profits taxes combined rather than against the domestic income tax only.

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The more liberal application was allowed corporations in computing income, excess profits, and war profits taxes payable during the World War years, and would prevent the possibility that corporations might, in certain instances, be required to pay combined domestic and foreign taxes at effective rates of more than 100%.

10. That in the event the alternative levy of the tax upon net profits in excess of average net profits for the base period is not adopted, consideration be given to the desirability of including in the invested capital of a corporation any indebtedness represented by its securities.

Many corporations, especially those engaged in transportation and mining activities, are financed substantially through borrowed capital as distinguished from equity or investment capital. Since the invested capital represented by the equity securities of such corporations would in many instances be relatively nominal, there is some question whether the uniformity of application of an excess profits tax necessarily correlated with capital investment would not be improved by according the same treatment to corporate bonds and other obligations and interest paid thereon as is provided for capital stock and dividends paid.

11. That the capital stock and excess profits taxes now in effect be repealed and that, in lieu thereof, there be imposed on all corporations and associations now subject to capital stock tax an excise tax measured by 1-1/4% of the excess profits tax credit; i. e., 1-1/4% of the average net profits of the corporation for three years of the base period or 8% of its invested capital, whichever is the smaller.

Adoption of this provision should result in approximately the same amount of revenue as is derived from the capital stock and excess profits taxes now in effect. It would, moreover, remove the guess-work basis of wide-spread objection to the present capital stock and excess profits taxes and could apparently be administered with even less difficulty and expense both to the Treasury Department and to the taxpayer.

M. B. FOLSOM, Vice Chairman
Business Advisory Council
July 18, 1940

13159

Title III

Repeal of Profit-Limiting Provisions of Vinson-Trammell Act and Merchant Marine Act

Sec. 301. The provisions of section 3 of the Act of March 27, 1934 (48 Stat. 505, 34 U.S.C. sec. 496), as amended, beginning with the first proviso thereof, and section 2(b) of the Act of June 28, 1940 (Public, No. 671, 76th Cong., 3d sess.), shall not apply to any such contracts or subcontracts for the construction or manufacture of any complete naval vessel or any Army or Navy aircraft, or any portion thereof, as are entered into after the date of enactment of this Act or are completed in a taxable year beginning after December 31, 1939, and any agreement to pay into the Treasury profit in excess of 10 per centum, 12 per centum, or 8 per centum, as the case may be, of the contract prices of any such contracts or subcontracts shall be without effect.

Sec. 302. The provisions of section 505(b) of the Merchant Marine Act, 1936 (49 Stat. 1998, 46 U.S.C., Sup. 5, sec. 1155), as amended, shall not apply to any such contracts or subcontracts for the construction, reconditioning, or reconstruction of any vessel as are entered into after the date of enactment of this Act or are completed in a taxable year beginning after December 31, 1939, and any agreement to pay to the United States Maritime Commission profit in excess of 10 per centum of the total contract prices of any such contracts or subcontracts shall be without effect.

Title IV

Amortization of Cost of Defense Facilities

SECTION 401--Amortization of cost of defense facilities.

Section 23 of Chapter 1 of the Internal Revenue Code (relating to deductions from gross income) is amended by adding at the end thereof a new subsection reading as follows--

"(t) Amortization of cost of defense facilities--

(1) In the case of a corporation (at its election) a deduction for amortization of the adjusted basis (computed <u>without the application</u> of this subsection) of any emergency facility constructed after July 10, 1940 and during the continuance of the emergency declared to exist by the President on September 8, 1939. Except as provided in paragraph (3), such deduction shall be computed on the basis of a period of sixty months. The amortization period shall (at the election of the taxpayer) commence either (1) with the beginning of the taxable year during which the emergency facility is constructed or (2) with the beginning of the next succeeding taxable year. The failure of a taxpayer to claim a deduction for amortization in its return for the year during which the facility is constructed shall not deprive it of the deductions for such year provided under section 23(l), relating to depreciation.

(2) A corporation may discontinue its deduction for amortization as to any emergency facility as of the beginning of any month by filing prior thereto a notice in writing with the Commissioner of Internal Revenue designating such month. In such a case, it shall be entitled to the deductions provided under section 23(1), relating to depreciation, beginning with the first day of the month following such discontinuance, but it shall not be entitled thereafter to any further deductions under this subsection for amortization with respect to such emergency facility.

(3) If within sixty months from the beginning of the amortization period with respect to any emergency facility, either (1) the President has proclaimed that the emergency referred to in the President's message of September 8, 1939 has ceased to exist or (2) the Secretary of War or the Secretary of Navy has certified to the Commissioner of Internal Revenue that any emergency facility is no longer necessary in the interest of national defense, the corporation may elect to terminate the amortization period with respect to such emergency facility as of the date of the President's proclamation or as of the date of the certificate of the Secretary, by filing amended returns for all taxable years for which it claimed amortization under this subsection, and the amortization deduction

shall be recomputed on the basis of the amortization period as so terminated. Notwithstanding any other provision of law, any overpayment resulting from such recomputation of the amortization deduction shall be credited or refunded to the taxpayer if claim therefor is filed with the Collector of Internal Revenue for its district within one year after the date of such termination of the amortization period.

(4) During the amortization period, the allowances under this subsection with respect to any emergency facility shall be inclusive of all deductions for exhaustion, wear and tear, and obsolescence with respect to such facility.

(5) Deductions made pursuant to this subsection shall be reflected in the corporation's financial books of account, in its reports to shareholders, and in its reports to the Federal Government or any of its agencies.

(6) The provisions of this subsection shall apply only to such emergency facilities as the Advisory Commission and either the Secretary of War or the Secretary of Navy certify to the Commissioner of Internal Revenue are necessary in the interest of national defense during the emergency referred to in the President's message of September 8, 1939. The issuance of such certificate shall be subject to such regulations as the President may prescribe.

(7) When used in this subsection—

The term "emergency facilities" means buildings, machinery and equipment;

The term "constructed" means constructed, reconstructed, erected, installed or acquired;

The term "Advisory Commission" means the Advisory Commission to the Council of National Defense.

(8) The provisions of this subsection shall be applied in computing net income for purposes of excess-profits taxes as well as income taxes.

(9) Any taxpayer taking deductions for amortization of emergency facilities pursuant to the provisions of this subsection may not thereafter destroy, demolish, or by any act impair the productive capacity of such emergency facilities without the consent in writing of the Secretary of War or of the Secretary of Navy. In the event such consent is not given within a period of ninety days from the date of receipt of written request therefor, the Secretary of War or the Secretary of Navy, as the case may be, shall and he is hereby directed to purchase such facilities at a price which he shall fix. The taxpayer shall have an option to repurchase such facilities at the price which he was paid before such facilities are resold to any other person."

THE FOREIGN SERVICE
OF THE
UNITED STATES OF AMERICA

AMERICAN EMBASSY
Berlin, July 22, 1940.

H. Merle Cochran, Esquire,
Office of the Secretary of the Treasury,
Washington, D. C.

Dear Merle:

The new Counselor of the Estonian Legation, Albert Tattar, who arrived here about three weeks ago, told me that he had a $200 check drawn by the Bank of Estonia on the National City Bank and asked me whether there was any likelihood that we would block the credits of the Baltic countries in the United States and whether it would be advisable for him to cash his check immediately. He said that the German banks would accept it only for collection.

I told him that I would inform him if we did take action against Estonian credits in the United States, which has since occurred. About a week ago he was called back to Estonia for consultation. He was supposed to have returned yesterday but has not done so and, with the news this morning that the three countries have been definitely taken over by Russia, he probably never will get out. He left this check with his wife who asked me today through the Estonian Minister here if I could send it by pouch for collection.

Under normal circumstances I would have refused the request but did not feel that I could in the present instance. He left her with relatively little funds and she may never see him again.

Could you ask the appropriate section of the Treasury which deals with blocked credits of occupied countries to permit payment of this check and, if such permission is granted and there are funds to cover it, could you have it deposited to my account No. 122282 in the West End Branch of the Washington Loan and Trust Company and then send me a brief telegram, "Estonian check deposited". In the contrary case, if there are no funds to cover the check or if for some reason it cannot be cashed, will you telegraph briefly the facts? I enclose a check for $3.00 which I trust will cover the cost of your cable.

Sincerely yours,

(Signed) Donald R. Heath
Donald R. Heath,
First Secretary of Embassy

Upon receipt of your affirmative advice that the check is good and deposited to my account I will pay over the proceeds in dollar currency to the Estonian Counsellor, if he returns, and if he does not, to his wife.

(Initialed) D.R.H.

dm

July 22, 1940
2:50 p.m.

H.M.Jr:	Hello.
Operator:	Colonel Maxwell.
H.M.Jr:	Hello.
Colonel Maxwell:	Colonel Maxwell.
H.M.Jr:	This is Morgenthau speaking.
M:	Yes, Mr. Secretary.
H.M.Jr:	How are you?
M:	Fine, thank you.
H.M.Jr:	Colonel, what is the status of the proposal to cancel all outstanding licenses issued prior to July 5th.
M:	Well, the Secretary of State is quite anxious not to have anything -- make that necessary. Now, we've looked over -- as I told you the last time we talked about it -- I've looked over the outstanding ones on Sweden which was the case in question at that time and they're not material amounts -- they're no great amounts of anything that are in that category of outstanding and incompleted licenses.
H.M.Jr:	Have you got a list of outstanding and incompleted licenses which were issued?
M:	Well, I have only in the case of Sweden.
H.M.Jr:	Have you got them for the rest of the countries?
M:	No, we haven't -- we haven't asked for that on any country except Sweden.
H.M.Jr:	Well, I'd like to ask you something unless you ask me not to, because I've discussed this again with the President and I got the distinct feeling that he wanted to do this for all -- not just Sweden, and I wondered

if you would mind putting it up to him once more and let him decide.

M: Well, I most certainly will do that.

H.M.Jr: Because he's holding me responsible for not letting this stuff go and I'm in an impossible position and I talked to him about it and he gave me the distinct feeling that he wanted to cancel all outstanding licenses. As a matter of fact, at this Council of National Defense meeting at which the Cabinet was present he made the statement that that had been done and I didn't want to contradict him because I figured it was up to some of the other people to do that. I think that was last -- well, whenever this thing met the last time. So if you would do that and then let him decide.

M: Yes. Well, of course, that's exactly -- when we talked before and I developed the Swedish situation, I put it up very definitely so there shouldn't have been any misunderstanding and I had the message back that the matter was being discussed with you again.

H.M.Jr: Well, since then though I've had another discussion with the President and I got this impression. And could I also ask that you have a complete list of outstanding licenses which are -- remain? Is that very difficult?

M: Well, I think it would take a little time to compile it. It's not .....

H.M.Jr: Well, could it be done but in the meantime, whatever this would be, Directive No. 6 or 7, could it be sent up to Hyde Park to the President?

M: You mean the -- insofar -- the one we discussed before.

H.M.Jr: No, I mean the one for everything.

M: I see.

H.M.Jr: I mean, to put on his desk a Directive, I think that's what you call them, which would cancel all outstanding licenses issued prior to the 5th of July.

M: Well, your contention is that you feel that that is his understanding what he .....

H.M.Jr: Would like.

M: .....expects to be done.

H.M.Jr: Yes, and he's up there and he can decide quietly whether he wants to do it or not, but I got that distinct impression from him that's what he does want to do -- and that's personally what I hope he'll do.

M: Yes.

H.M.Jr: Because it'll make my job here on Customs and these ships much, much easier.

M: Yes. Yes, well I appreciate that.

H.M.Jr: Now to show you the confusion, for instance. Last Saturday we let one of these vessels go; Wednesday Mr. Hull calls up, why hadn't we let the Swedish vessel go? Well, we told him we had let it go the previous Saturday and by Friday it reaches Admiral Stark and he calls up on the same thing.

M: (Laughs). Well, of course, that's hopeless.

H.M.Jr: Yes. Well, may I ask, will you send it up to the President?

M: Yes, sir. I'll go into the question right away and I'll let you know how it comes out.

H.M.Jr: And I'm talking on <u>all</u> outstanding licenses just not .....

M: Yes.

H.M.Jr: And then would you also have somebody begin to prepare a list of these in case the President should say, well, what does this mean and who will it hit?

M: Yes. Well, he undoubtedly would ask that question.

H.M.Jr: Yes.

M: And that'll of course take a little time to do in view of all the other rush of business that the license people have over there.

H.M.Jr: But just to get out this Directive and put it in the pouch oughtn't to take more than fifteen or twenty minutes.

M: Yes. Well, that I'll take care of.

H.M.Jr: Thank you so much.

M: Yes, sir.

H.M.Jr: Thank you.

July 22, 1940
3:24 p.m.

H.M.Jr: Hello.

Operator: Secretary Ickes is busy talking on long distance. I'm waiting for him.

H.M.Jr: O. K.

3:25 p.m.

H.MJr: Hello.

Operator: Secretary Ickes.

H.M.Jr: Hello.

Secretary Ickes: Hello, Henry.

H.M.Jr: How are you?

I: Very well.

H.M.Jr: Harold, a couple of weeks ago I brought up the question at Cabinet in connection with oil to Spain and at that time you said you had in preparation a statement which could be used if necessary showing that on conservation grounds no oil should leave this country.

I: No. What I said was that I had a -- was having a study made and a report was then being written showing about the situation with respect to oil along the Atlantic sea coast in the event of an emergency. It just reached my desk here now.

H.M.Jr: That couldn't be interpreted so by you that .....

I: I haven't looked at it yet.

H.M.Jr: Well, I tell you, I'm working terribly hard on this thing, see?

I: Yeah.

H.M.Jr: And if you could see your way clear, if necessary and the President wanted to use it, to say that no oil should leave this country for national defense and conservation, I mean, it would be terribly helpful, if he wished it.

I: Yeah.

H.M.Jr: What? Hello?

I: Yes, I get you.

H.M.Jr: See?

I: Yeah. (Aside -- before Holland and Swanson and the other man go down there I want to see them. Hold them, also hold Commissioner of General Land Office.) I'm sending for them now.

H.M.Jr: Oh. Well, the thought is, I'm working up something -- the possibility of being able to control the oil and .....

I: It ought to be done.

H.M.Jr: ..... and I'm sending up now for you only a proclamation of the President to stop -- add oil and oil products to his list, plus scrap iron, but I need your help.....

I: All right.

H.M.Jr: ..... on the stuff inside the United States.

I: All right, I've just sent for my people now on it.

H.M.Jr: Did you hear him tell Hull that he wanted to handle Central America and South America?

I: Yes.

H.M.Jr: Well, from that day until Friday they've never done a damn thing over there.

I: Well, that's to be expected.

H.M.Jr: And in discussing this with the President, I recommended that if we do this oil thing that he let you handle it, so .....

I: Well, why didn't you suggest somebody that he'd be willing to let handle it?

H.M.Jr: Well, that's what I thought I was doing. I mean, I used helium as an example.

I: Yeah.

H.M.Jr: Somebody's got to do this that's got the .....

I: Oh, hell! It ought to have been done then first.

H.M.Jr: Well, anyway .....

I: The way they piddle around here.

H.M.Jr: Will you .....

I: I'll let you know, Henry.

H.M.Jr: Thank you.

I: All right.

GROUP MEETING

July 22, 1940
11:45 a.m.

Present: Mr. Thompson
Mr. Sullivan
Mr. Haas
Mr. Young
Mr. Schwarz
Mr. Foley
Mr. Cochran
Mr. Gaston
Mr. Viner
Mr. Bell
Mr. Graves
Mrs Klotz

H.M.Jr: I will unload first. Dan, I read this memorandum of yours - hello, Viner - on Treasury financing in '41. I think I understand it. I read it twice very, very carefully. I think --

Bell: I read it over carefully to myself and it was a little jumbled because I can only spend five minutes at a time on it.

H.M.Jr: It isn't up to your standard.

Bell: It isn't clear.

H.M.Jr: You had better make it simple for me.

I think this, gentlemen: I think it is terribly important that in connection - if I have to make an appearance on the Hill, that I state frankly and openly what the situation is on the financing, you see, because I think the Congress and the people of the United States are entitled to it and - because the way Bell has it, he has got a perfectly feasible way - if you don't mind my using the word - to circumvent the situation if the debt limit is not raised above 45 and I think that what we ought to do when we go up just as soon as possible is to say, "Now, we can do it two ways. We can - under the existing law this is the only way we can do it. Or if Congress wants to and we recommend they can raise the debt limit from 45 to 'X', whatever we decide it should be," but I think we ought to come right out in the open and say it and I think with that in mind, if you could sort of rewrite a formal statement for me and that gets down to the fact - after all, I don't draw the distinction between money appropriated and money permitted to be contracted for in this bill.

Bell: The only distinction is that you need to draw it. You don't need a debt increase for the contractual obligations until some time maybe in '42. Eventually you will need it, but you don't need it now.

H.M.Jr: You can think it over personally. You can tell Congress that they ought to take into consideration that that is being contracted and whoever is here will have to go up to Congress twice a year to get a debt increase. They ought to increase the debt sufficiently to take care of the money which is to be spent and money to be out of here. I think that is - if I may use the word - rather statesmanlike on my part. Wouldn't you think so, Viner?

Viner: I think you might say you would like to endow your successor, if there is to be one, with that freedom of action.

H.M.Jr: Because what he has to go through to circumvent that situation is childish and very poor policy. If you would write something and take advantage of Viner's being here to have him go over it, I think it would be very good and then that leads me to your (Sullivan's) proposals - questionmark - with a five million dollar appropriation, how much taxes we want to raise, which all was part and parcel of this picture, and I don't know the answer, but I don't think - talking - I mean, I have had time to think about it. I don't think we will be able again to say it is five billion dollars and sell five billion dollars of five-year notes on top of the already outstanding notes. If I had a table from you (Sullivan) showing the five hundred million, a billion, and a billion and a half, what this excess profits tax would do, I could sort of soak it up.

Sullivan: You have.

H.M.Jr: No.

Sullivan: You asked for that Friday afternoon and it came in Friday afternoon.

H.M.Jr: I am sorry. I have got every piece of paper here that anybody gave me.

Sullivan: I sent it in Friday afternoon.

H.M.Jr: I don't know where it went, John, and I don't know how you got it, but the stuff I wanted and asked for, I got. I did not get that.

Sullivan: I will find out what happened to it, because it left my office something before 1:00 o'clock.

H.M.Jr: Two people can get it, Mrs. Klotz or McKay, and it didn't come to me.

Sullivan: I sent it to McKay, one sheet of paper.

H.M.Jr: Well, I have read everything I took with me.

Klotz: Well, I will look for it.

H.M.Jr: Well, shall I give this to Viner to read and then he can return it to my file?

Bell: Well, you can keep that and I will give Viner a copy and talk to him about it.

H.M.Jr: Well, you see I missed - will you (Sullivan) put into Bell's hands after you leave this room a copy of the memorandum and then he can take that and let's evolve something as a fiscal policy, you see, looking forward to what Congress is voting, how we are going to finance it and how we are going to raise the money, but I would like to take advantage of Viner's being here in the next day or two. As a matter of fact --

Bell: I will talk to him.

H.M.Jr: I would like to meet on this at 8:30 tomorrow morning when I am fresh. Is that all right with you, Jake?

Viner: Yes.

H.M.Jr: I think you (Sullivan) ought to be here.

Sullivan: Yes, sir.

H.M.Jr: If you can make it.

Sullivan: What, not until 8:30?

H.M.Jr: I will make you a little bet you aren't here by 8:30.

Sullivan: What is the bet?

H.M.Jr: A package of my Camels against your stink weeds.

Sullivan: It is a bet.

H.M.Jr: If I can get you here on a package of cigarettes, it will be a good investment.

Now, that much for that. I find myself doing a lot of talking, but I have got a lot of stuff.

Now, Merle, I read this thing from Irigoyen and if I sent this to the President he would say, "Well, why don't you send it down to Mr. Hull?" I think the first to get it should be Mr. Hull.

Cochran: I thought someone should have it while they are down there.

H.M.Jr: Well, what I would suggest is, I think it is important enough that if you will fix me up a letter right away and have this copied - this was given to me Saturday and - he must get a pouch from the State Department.

Cochran: I think they might be disposed to cable part of that if we would send it in a letter to Mr. Welles.

H.M.Jr: I think it ought to go, if you will take care of it. And then will you see that in strict confidence a copy of this is furnished to Mr. - what is the coordinator on South America?

Foley: Forrestal.

H.M.Jr: And ask him after he has read it if he will talk to me.

Cochran: Yes, sir.

H.M.Jr: Then by accident - I don't get anything from the State Department. Ambassador Lothian gave me this memorandum, which I would like Bell and the people on his committee to read, stating that the British have decided that they are not going to let any food of any kind get into either occupied France or free France. Now, the State Department - I think it is outrageous. They never furnish me with this. Lothian asked me whether I had seen it and I hadn't, so he sent me another copy.

Bell: It is very important in connection with this decision you have to make.

H.M.Jr: There is no such thing as the State Department ever furnishing me with anything.

Where is Philip Young? Phil, if this is an order, just return it to Mrs. Klotz. If I have to do anything, let me know. (Handing letter from Secretary of War under date of July 18 to Mr. Young).

This is also for your committee, Bell, Settlement Committee on funds in Hongkong.

Herbert, in the July 15th issue of the New Republic, the War of Factories by Fritz Sternberg - I wish through Secret Service and any other sources that you have, literary or otherwise, you could find out who Fritz Sternberg is. I don't know if anybody else knows. It is one of the best articles - and you (Sullivan) ought to read it, particularly on the tax thing, and anybody else interested in taxes. The main thing that it shows - the German production - they show that as the German production both in dollars and velocity increased the last five years, the earnings stayed stable but the taxes just absorbed the increase in the earnings. In other words, if a man had a turn-over of a million dollars in '34 and his taxes were a hundred thousand dollars and the turn-over went to ten million dollars in '39, his taxes went up and his net profit stayed the same. It is very, very - and if Sternberg is here and he is okay and everything, I would like that fellow to come down, because we are going to have to do some publicizing on our tax methods and this is one of the most intelligent things I have read. I will lend it to you if you will give it back to me.

And if anybody has not yet read in that issue, "If You Were President", who is interested in anything fiscal, I recommend that also.

Gaston: July 15, New Republic.

H.M.Jr: And Ed, I am going to do something about loans to small business men. Now, whoever is working on that for the present, if they could polish it off and have a little meeting in my office at 9:00 o'clock tomorrow morning, invite Tom and Ben to come, will you, at 9:00 o'clock? And polish off what is there. I am thinking in terms, now, so we don't have any misunderstanding, of loans to men of $25,000 or under. I am not thinking of anything else, you see. The only one that I know of that at all appealed to me was the plan of the FHA insurance, but where the risk is spread over the whole amount and not just asking the banks to take the first ten percent, which is silly. I would like to go into it. We have got to do something about it. If they wanted to talk about an industrial bank long-term loan to industry, we could do it, but I suppose with RFC we can't. But I would like to discuss it anyway. I mean - what do they call that bank in France, Jake, the one that does that?

Viner: The Credit Mobilier, the real estate bank?

H.M.Jr: No, industrial bank, long-term loans.

Viner: Credit Foncier.

Cochran: That is a mortgage bank.

H.M.Jr: No, I mean industry. It is intermediate credit to industry. Are they fairly punctual, those boys?

Viner: There was a Bank of England set up in England.

Sullivan: They both smoke.

H.M.Jr: Are they fairly - well, tell them a quarter of 9:00. Do you want to sit in on it, Jake?

Viner: As an observer.

H.M.Jr: Bell?

All right, a quarter of 9:00.

Will you polish it off and see what we have got?

Foley: Yes.

H.M.Jr: What else did I write down?

Bell: Is that tomorrow morning?

H.M.Jr: Yes.

Viner: You are not going to work back on your schedule, are you?

H.M.Jr: No, we start at 8:30 when Sullivan gets here on the tax thing and then we will invite Corcoran and Cohen to get here at a quarter of 9:00 and we will meet them at 9:00.

Bell: And expect them to show up at 9:00.

H.M.Jr: Yes. And Herbert, I want to compliment Coast Guard on the best Federal building I have seen since I have been in Washington at that Coast Guard Lifesaving Station.

Gaston: Is that so? The new one at --

H.M.Jr: Yes. I almost stayed there. They have a guest room which is on the lake, which is the best room there. If you go out there --

Gaston: I will have them arrange that.

H.M.Jr: And that architect, if we have any more Treasury work, I want to grab him. They say he does a job and then goes on a binge for so long, and then another job.

Gaston: Is he a Government architect?

H.M.Jr: No, Cleveland. He is a man over 70, graduated from the French School of Architecture, and that is the best looking building I have ever seen. It is monolithic concrete. It is really beautiful.

Gaston: I think that is a good idea instead of so many brick buildings.

H.M.Jr: It is the best looking thing you ever saw.

Gaston:	I was talking to Waesche about using that at the station in New London.
H.M.Jr:	It is so much better than anything I have seen anywhere; I don't know of anything that will compare with it.
Viner:	Can we get to see some good photographs of it?
Gaston:	I will get some of it.
H.M.Jr:	There are pictures inside.
Thompson:	I have nothing.
H.M.Jr:	Incidentally, I came in from Cleveland in an hour and a half this morning. We hit 248 with a tail wind.
Gaston:	Ground speed?
H.M.Jr:	Yes. My ears are all stopped up.
Bell:	We have a copy of a cable which came to the Federal Reserve Bank from the State Bank of Russia --
H.M.Jr:	You have got to talk a little louder, Bell, my ears are all stopped up.
Bell:	I say we have a copy of a cable which the Federal Reserve received from the State Bank of Russia. It says, "We consider Executive Order of July 15 mentioned by you as having no connection to gold required by State Bank of Russia and being its property. In consequence, delay in execution our instructions which we suffer losses or which we hold you responsible."
H.M.Jr:	Who is this from?
Bell:	"We insist upon immediate execution our instructions. Awaiting information regarding execution."

This was in reply to a wire which the Latvian, Lithuanian and Esthonian Banks had sent to the Federal Reserve to transfer their gold balances to the State Bank of Russia.

H.M.Jr: Who sent this?

Bell: The State Bank of Russia.

H.M.Jr: They are going to hold us responsible?

Bell: The Federal Reserve Bank in New York.

H.M.Jr: Wonderful.

Bell: The Federal Reserve Bank replied they couldn't execute the orders because they had to apply to the Treasury for a license and they consider themselves as having no connection.

H.M.Jr: Offset it against our debt, the Russian debt.

Bell: It is quite interesting. We are prepared --

Viner: Do you want us to let the State Department know about that?

Bell: I don't know whether they know about it or not.

Cochran: No, I don't know.

H.M.Jr: Besides our own legal boys, show that to Professor Chamberlain.

Bell: We are prepared to discuss now an Executive Order regarding securities that may have a foreign stamp of some kind on them, get out an Executive Order and require a stamp something like that (showing sample) to be attached to each security. We have been working on it for some time.

H.M.Jr: Marvelous. Who is this?

Bell: Marshall.

H.M.Jr: I don't know why he was chosen.

Bell: Harold says they have an engraving of Marshall and he hasn't been used on a security or on currency.

H.M.Jr: Robert Marshall, isn't it?

Graves: John.

H.M.Jr: John?

Klotz: That isn't good looking.

Bell: Robert Morris. I would like to discuss that today or tomorrow, if I could.

H.M.Jr: What are you doing at 9:30 tomorrow morning?

Viner: You should have gotten a stamp - one of the stamps used by the Treasury during the "Non-Intercourse" Act.

Bell: When was that?

Viner: 1810 to '14.

H.M.Jr: They have done a lot of work on this one now.

Bell: Yes.

H.M.Jr: That is good enough. What else?

Bell: Did you see the letter that came from Secretary Hull regarding the - sending over a letter from the German Charge d'Affaires?

H.M.Jr: No.

Bell: Commenting on the Netherlands decree.

H.M.Jr: No.

Bell: It says - I will read one paragraph.

"In the name of my Government I have the honor to call attention to the fact that the measure of the refugee Netherlands Government mentioned above lacks any legal basis and consequently is to be considered an arbitrary act which is in the most outraged contradiction itself to the principles of the inviolability of private property. Recognition of the orders of the refugee Netherlands Government concerning assets which could not belong to it would render the depositories of such assets liable for damages."

H.M.Jr: You had better let both Foley and Professor Chamberlain - when is Chamberlain coming down again?

Foley: I don't know when he expects to be back, do you, Dan?

Graves: I saw him this morning at the Cosmos Club.

Foley: He is probably back here. He went back Friday afternoon and I didn't see him before he left.

Thompson: He expected to be here this morning.

Bell: He didn't go back home. He went down in Virginia over the week-end.

H.M.Jr: Well, I want to go over things with him tomorrow. Will you tell him 3:00 o'clock tomorrow, if he is here?

Bell: All right.

H.M.Jr: Or 11:00 tomorrow morning. 11:00 will be better. I will be fresher. Will you let McKay know?

Bell: Yes, sir. That is all.

H.M.Jr: And when he is here, will you let him sit in at your 4:00 o'clock meeting?

Bell: He is sitting in.

H.M.Jr: Harold?

Graves: I would like to stay behind to ask you a question.

H.M.Jr: That is all right.

Graves: I have nothing.

H.M.Jr: George, I want you to get into this small business stuff.

Haas: All right.

H.M.Jr: So get busy, see, and the thing that I was thinking of, the best way to do this thing would be if we could send one of George's men to a Federal Reserve field office, an RFC field office and let each of them sit there for a week and go through their applications and see the people that come in, what kind of stuff do they want. Pick Baltimore and let a fellow go to Baltimore and go through this stuff, both the RFC and Federal Reserve stuff. George has been all through this for me and we will not let Jesse pick stuff to send over here the way he did to Bill Douglas, but let us - let George or somebody go to Baltimore or Richmond and just sit there and go through these files. We ought to do it openly; let them know we are going to go there; be there when the fellows come in. You have got enough help, haven't you?

Haas: Oh, yes. We will switch somebody around to do what is necessary.

H.M.Jr: Well, the point is if you actually had a week's experience and then the people argued about the credit, all right, but if you are there and go through the files and see the people that come in and have a talk with them, that is the best way to do it, isn't it, Jake?

Viner: It is the only way really to know what the thing means.

H.M.Jr: And I would start that today.

Viner: The only point is, do the people know - is that a going organization now on that point, will there be applications and so on?

H.M.Jr: They say they take care of everything.

Viner: But does the public know?

H.M.Jr: If they don't - well, I don't know and I am part of the public, but we have got to do something in the next four years for the small business man. This is a long viewpoint.

Gaston: Don't smile when you say that.

H.M.Jr: Just so I don't --

Viner: You have waited eight years. I don't see why you should be so impatient.

H.M.Jr: That is just the reason. I had a talk today with a fellow. He was saying that we have done this for the sharecropper and this man, and so forth and so on, how about doing something for the small business man. I have had this down for three days. Either Richmond or Baltimore or both. One at a time will be enough. And do it openly. I mean, get letters from Jones and Eccles, we are going to do it above board.

Haas: He may not be very busy.

H.M.Jr: Who?

Haas: I mean the man we send to those places. The applications may be few and far between.

H.M.Jr: Viner had a lot of experience. We went all through that in '34.

Bell: Wonder if it wouldn't be better for them to look at these statistics the Federal Reserve Board has.

Viner: Yes, that is what I had in mind.

Bell: And the various Federal Reserve Banks.

Viner: And also I would pick out an area with small factories in it.

H.M.Jr: All right, George.

Haas: I am okay. Excuse me a second.

Viner: I think if --

Haas: I have something more.

H.M.Jr: Phil, please prepare the same kind of letter for Mr. Nelson that we did, showing part of the President's statement on May 10 or May 16. You know the letters that went out.

(Mr. Haas handed report to Secretary)

I think we had better have Nelson here tomorrow at 10:00 o'clock and McReynolds. Otherwise, suddenly we agree on everything and then Nelson didn't hear about it and he wants priority. What else do you know?

Young: Nothing else.

H.M.Jr: Oh, would you - between you and Mrs. Klotz - I want a little statement of what Bloch-Laine wants so that I can mention it to Mr. Welles at 6:00 o'clock tonight when he comes to the house. Did you take care of Mr. Purvis coming in from Canada? Did they ask you anything about it?

Young: No, sir, I haven't heard anything about it.

H.M.Jr: When I go home at 6:00 I want to take something with me. The P-40's for the Allies are piling up?

Haas: Allies, that is right.

H.M.Jr: It doesn't say so.

Haas: It says on the top the British contracts.

H.M.Jr: It isn't clear, George. Six hours a day for the English or both English and --

Haas: For the English, Mr. Secretary. That isn't clear, I see now. It is for the English. By September 1, the P-36's requiring the Wright Cyclone engine will be all completed, he estimates. And then from that time on they will be producing six airplanes, these P-40's, and unless they have six Allison engines a day, they are just going to pile up in storage. He says --

H.M.Jr: Why is the Wright Cyclone so far behind?

Haas: Well, they had a little delivery trouble there, too, but Mr. Vaughn was up there at the plant and he has promised them to come through with that, so he says that situation will get better rather than getting worse.

The Allison people have made some promises, too, but he is very skeptical about getting the engines. He says the Army is getting them all, as you know, so far.

H.M.Jr: Well, Lookheed isn't so bad, is it?

Haas: No, but he had none except that one almost complete waiting for two engines. The Allison didn't do so well last week. There is another item I noticed. You will notice the figures for deliveries this week when you get the report will be down. The Wright plant took a week's vacation.

H.M.Jr: They did?

Haas: That is what they said on their report.

H.M.Jr: Well, that is nice.

Chick?

Schwarz: I have two matters here. Tomorrow morning in the Federal Register will appear the T.D. which gives up the green duplicate copy on the income tax returns which Mr. Sullivan has worked on and I suggest you may wish to have a short piece to hand out at the press conference this afternoon.

H.M.Jr: Well, take care of it.

Schwarz: I will do that.

The other matter involves the first of the new shipments of gold from New York to Fort Knox. They begin Thursday. Is that right?

Graves: The 25th.

H.M.Jr: I wouldn't say anything.

Graves: I wouldn't think so, either.

Schwarz: Mrs. Ross, of course, is eager to --

H.M.Jr: If she does anything like that, she gets fired.

Schwarz: I like to have your moral support.

H.M.Jr: Let her take a ride with a motorcycle cop.

Viner: Why not put her on one of the trucks and take photographs?

Gaston: That has been done.

H.M.Jr: Seriously, tell Mrs. Ross I will be very much annoyed if there is any publicity.

Graves: I will tell her.

H.M.Jr: Where were we? You have taken care of "Seeing Nellie Home", haven't you? That is Harold Graves' assignment.

Cochran: Mr. Brady of the American Consulate at Rangoon is coming in to see me this afternoon.

H.M.Jr: Who?

Cochran: Mr. Brady.

H.M.Jr: From where?

Cochran: Rangoon. He has been sending in some pretty good reports on Chinese --

H.M.Jr: He is a Consul?

Cochran: Yes, sir.

H.M.Jr: Will he be here all week?

Cochran: Yes, sir.

H.M.Jr: I would like to see him.

Cochran: Do you want to suggest a date or shall I see Mac?

H.M.Jr: Mac.

Cochran: All right, because he has stayed over, hoping that he could --

H.M.Jr: Maybe we can work it in tomorrow between 8:30 and 9:00.

Cochran: All right. That is all I have.

H.M.Jr: John?

Sullivan: Mr. Helvering was in this morning. He is anxious to leave this afternoon.

H.M.Jr: My God, he has been away --

Sullivan: To August 8. I think he had some talk with you and you suggested he report back here today.

H.M.Jr: How long has the man been away?

Sullivan: I don't know, sir.

H.M.Jr: My understanding was he was going to go home first then go to the Convention and I thought he was coming back to go to work.

Sullivan: I don't know, I wasn't here when he left and I don't know what the understanding was.

H.M.Jr: I really don't remember. I didn't remember that he was going away again.

Sullivan: He hoped to get away this afternoon.

H.M.Jr: I think he ought to stay here while this bill is on the fire.

Sullivan: Well, he spoke of that and he said from what he could gather he would be more valuable here later on.

H.M.Jr: He has worked pretty hard. When he works, he works hard.

Sullivan: Oh, there isn't any doubt about that at all, sir. He did look tired this morning. He really did.

H.M.Jr: I suggest a week-end in Cleveland.

Sullivan: He was at the Convention all week. I should think he would be tired.

H.M.Jr: All right.

Sullivan: There is a meeting this afternoon at 2:00 o'clock on the tax bill which there has been some talk about. Mr. Doughton and Mr. Cooper and Mr. Harrison and, I think, Senators King and George will be there, too.

Bell: Is the bill ready?

Sullivan: What do you mean, ready?

Bell: It is past the deadline.

Sullivan: At five minutes of 9:00 there wasn't anybody to deliver it to (handing bill to Secretary).

H.M.Jr: Where were you at five minutes of 9:00?

Sullivan: Right here, sir.

H.M.Jr: Did you come down with Knox?

Sullivan: Certainly.

H.M.Jr: And you came down this morning?

Sullivan: We were right here at five minutes of 8:00.

H.M.Jr: And you left New Hampshire this morning?

Sullivan: Ten minutes past 6:00.

H.M.Jr: Traveling with Knox gets you up, doesn't it?

Sullivan: Well, it is a hard habit to break.

Gaston: It gets him up or keeps him up?

H.M.Jr: Both. I am all for Knox. He is a good guy. That is very sweet of you. Did you have any trouble getting that nice ribbon?

Sullivan: No, no trouble at all, sir.

H.M.Jr: All right. Anything else?

Sullivan: No, sir.

H.M.Jr: Ed?

Foley: Here are those papers for the safe which you gave me on Friday.

Knudsen called up on Friday and he wanted an opinion as to the RFC's powers to make loans both under the 1940 National Defense amendment of the RFC powers and under the Glass-Steagall Amendment of 1938 powers to corporations in the United States for national defense purposes where the facilities will be utilized both for us and for the British, and I have this opinion that holds that they have adequate power under both sections to make that type of loan. Now, the opinion, like all our opinions, is addressed to you. Is it all right to give it to Mr. Knudsen?

H.M.Jr: Yes.

Foley: He will use it in his talks with Jesse, but I am confident that the Attorney General will sustain us.

H.M.Jr: I think on a thing like that, before you give it to him you ought to show it to the Attorney General.

Foley: All right.

H.M.Jr: Or what you could do to save time, give it to him and say you are sending one over to the Attorney General, but I would give it to the Attorney General.

Foley: All right.

H.M.Jr: On third thought, I would not give it to him until the Attorney General has passed on it.

Foley: Okay.

H.M.Jr: I would let the Attorney General pass it. It is really up to the Attorney General. I have a reason.

Foley: Yes.

H.M.Jr: All right? I have a reason, a good reason.

Anything else, Ed?

Foley: I would like to talk to you about a couple of Executive Orders. I have them in the alternative. One would add oil and petroleum products to the list of products within the embargo. The other would add oil and petroleum products and scrap iron and I think we ought to --

H.M.Jr: Let me have those.

Foley: ....produce one or the other, because we need them to implement our ship control.

H.M.Jr: I want those for lunch.

Foley: We can't control oil to Spain simply through the control of the ships. I think that oil ought to be added to the --

H.M.Jr: Can you release it then?

Foley: Sure, all you have to do is issue a license.

Gaston: That question was considered quite extensively in one of the meetings to frame that proclamation, but they decided they wouldn't include petroleum and wouldn't include anything that wasn't actually short or urgently needed, critical for national defense.

H.M.Jr: Leaving the Treasury representatives out of it, there isn't a man on that committee --

Gaston: I know, they are terrible.

H.M.Jr: ....who can see beyond the end of his nose.

Gaston: That is right, and if only some of the other departments besides the Treasury would recognize the fact that the way to keep us out of war is to keep England fighting, we would get much further ahead in much less time.

H.M.Jr: Let me handle this at lunch.

Foley: Yes, I think it is very important that our hand be implemented by having oil and petroleum products added to the list of embargoed products. We are holding ships, Herbert.

Gaston: Yes, I know.

H.M.Jr: Let me take care of this. What else?

Foley: Nothing.

H.M.Jr: Herbert? Oh, I won't give you this. I read this thing that Cox prepared for Nelson. As far as I am concerned, it is all right.

Foley: I think that gives us the control we need.

H.M.Jr: I would like you (Thompson) to read it and then return it to my files. It is an administrative matter.

Gaston: Here is that report that Cairns got up.

H.M.Jr: That is good.

Gaston: There is a case of a ship to load asphalt for Spain, Texas Company. I don't know of any reason why a cargo of road asphalt shouldn't be shipped to Spain.

H.M.Jr: I would let it go.

All right, now. Harold wants to whisper in my ear and Mr. Gaston will stay a minute.

TREASURY DEPARTMENT

INTER-OFFICE COMMUNICATION CONFIDENTIAL

DATE July 22, 1940

TO Secretary Morgenthau

FROM Mr. Haas

Subject: The Business Situation,
Week ending July 20, 1940.

Conclusions

(1) The national defense program is providing increasing support to industry through new construction awards and new industrial orders. For example:

(a) Heavy construction awards, chiefly for Federal defense projects, established a new high record last week.

(b) Structural steel awards have increased to the highest figure, with one exception, since September 1938.

(c) New orders of the U. S. Steel Corporation have risen to 149 per cent of capacity, from 109 per cent the previous week.

(d) New orders for lumber have reached the best levels since last fall.

(2) Eventually the defense orders will become a major business factor. For the time being, however, business activity is tending to slacken, as evidenced by the failure of weekly business indexes in the second week of July to equal their late-June levels. There is no evidence, so far, that the FRB index in July will exceed the June figure of 114.

(3) While prices of industrial raw materials (including steel scrap) declined somewhat further last week, a firmer undertone was noted near the end of the week in some markets. This may foreshadow a strengthening trend in commodity prices. The BLS all-commodity price index has risen gradually in the two weeks ended July 13.

- - - - -

The general situation

The recent slackening tendency in business activity, which has been accompanied by some weakness in prices of industrial materials, became more evident in the week ended July 13, when weekly indexes of business activity failed to equal their late-June level. The New York Times index in that week (see Chart 1, upper section) showed no recovery from the decline registered during the Fourth of July week, and stood at an FRB equivalent of 113. This compares with an FRB index of 114 in June. The levelling out in production rates is reflected in a number of important industries. (Lower section of Chart 1). Steel ingot production has held practically unchanged over the past two weeks, when the seasonal trend should be upward. Automobile production has declined rapidly in preparation for an early changeover to 1941 models. Cotton mill activity in the second week of July (after seasonal adjustment) was slightly lower than in the last week of June. Lumber production (adjusted) has not made a normal recovery from the holiday shutdown.

The levelling-out in business activity seems to indicate a tendency in many industries to await actual defense orders before stepping up production further. Uncertainty over the present war situation, particularly with respect to its influence on the continuation of export war orders, has apparently also been a factor.

Defense orders increasing rapidly

Defense orders are rapidly coming into the foreground as a major business factor. This fact was particularly evident in the volume of awards for heavy construction projects in the United States and outlying possessions last week. (See Chart 2, upper section.) According to the Engineering News Record, "Never before in history has such a volume of construction contracts been let in one week as were placed on the books in the seven days ending Tuesday, July 16." The total amounted to $217,000,000 (including $47,000,000 in outlying possessions), which compares with a previous record figure of $162,000,000 in one week of March 1930. Naval base projects accounted for the bulk of the awards.

Structural steel awards (lower section of Chart 2) have likewise shown a pronounced upturn. The total for fabricated structural steel, fabricated steel plate, sheet steel piling, and reinforcing bars during the week ended July 16, amounted to 64,560 tons, more than double the previous week's figure. With one exception, this is the highest since September 1938.

Steel orders gain markedly

New orders reported by the U. S. Steel Corporation for the week ended July 11 jumped to 149 per cent of capacity, as compared with 109 per cent in the previous week. (See Chart 3, upper section.) Since this is far in excess of recent production rates, as shown on the chart, it indicates an increased backlog of unfilled orders. Steel production this week is scheduled at 88.2 per cent of capacity, an increase of 1.4 points over last week's rate, and a new high for the year.

A greater concentration of orders in the field of heavy steels has apparently given the U. S. Steel Corporation a production advantage over most of the independent companies. In the past week, this Corporation has operated at 90 per cent of capacity, as compared with an average of 85 per cent for the independent companies. (Lower section of chart)

Steel scrap prices declined further last week, notably at Youngstown, Pittsburgh and Buffalo, with the Iron Age composite price off 33¢ a ton to $18.38. Japan has completed buying about 300,000 tons of scrap, according to press reports, apparently including some stocks on the Eastern seaboard originally destined for Italy.

Recent reports that a shortage of pig iron is beginning to handicap Canadian steel production attracts attention to the fact that the Dominion has only 10 blast furnaces and, over the last ten years, has produced only 2.5 per cent as much pig iron as the United States.

New orders index improves

Our weekly index of new orders for the week ended July 13 recovered strongly from its holiday dip, aided both by increased steel orders and by increased orders for miscellaneous products, particularly for building materials and electrical equipment.

(See Chart 4.) Lumber orders recovered to about the level reached in the last week of June, which was the highest since early October of 1939.

New orders reported by the General Electric Company in the week ended July 13 rose sharply to the highest weekly figure on our records, going back to 1933. It is reported that both this company and Westinghouse have the largest backlog of electrical equipment orders on record, and are booked at capacity for a year or more on heavy products. In view of this situation, according to press reports, the new British powder plant in the South has been obliged to utilize second-hand electrical equipment from a western utility company.

Prices of basic commodities decline

Spot prices of both raw industrial materials and food products declined somewhat further last week. (See Chart 5.) Near the end of the week, however, some evidence of a firmer tendency was noticeable in the futures markets for a number of commodities, namely wheat, sugar, wool, rubber, tin, and zinc, which may foreshadow a revival of demand. The BLS all-commodities index improved gradually during the two weeks ended July 13, following a 6-weeks' downward trend.

Among the industrial raw materials, rubber prices last week moved upward, in contrast to the group average. Uncertainty about Japanese intentions regarding the Dutch East Indies was a bullish influence, but in the long run many traders believe that Japanese control in the Dutch islands would make for larger production and lower prices, since British restriction would then be impossible. Deliveries to Continental Europe have apparently been much reduced in June and July, increasing the amount potentially available for United States delivery.

Hides futures prices have declined considerably because of fears that exports of hides from South America would bring added competition to domestic production.

Cotton spot prices were lower last week, partly because of reduced exports. For the second week in succession no cotton moved to any country on the Continent, a situation which is unprecedented since the first few weeks of the World War. The crop outlook, on the other hand, has become more unfavorable because of excessive rains and cool weather.

Copper futures last week showed definite weakness, precipitated by the award of a Navy contract to Kennecott for 2,000,000 pounds of Grade A copper at a price fully three-quarters of a cent lower than the regular producers' market price.

Tin prices were little changed last week, when negotiations looking toward the smelting of Bolivian ore in the United States were reported. Although Bolivian output alone could not supply United States consumption, which last year was estimated at 70,460 long tons, assurance of a part of the necessary supply would be a safeguard. Bolivia now produces about 36,000 long tons of tin annually, which is smelted in the United Kingdom where operating costs are reduced by the mixing of Nigerian ore with Bolivian ore, and by other factors. At present the United States has two experimental smelters with a combined annual capacity of slightly over 1,000 long tons per year.

Cost of living

The cost-of-living index of the National Industrial Conference Board has held generally steady since last September, with a slight rise in the past three months due almost entirely to an increase in food prices. The June index of 86.4 exceeds by 0.5 point the figure for last September.

Weekly business indexes

Business activity as measured by the New York Times index in the week ending July 13 failed to regain the loss suffered in the previous holiday week, and in fact declined 0.2 point to 100.2. This figure is 2.7 points below that of the pre-holiday week.

The principal factors in this slight decline were sharp decreases in the adjusted indexes of automobile production and cotton mill activity, with the indexes of miscellaneous freight car loadings and steel ingot production also lower. The decline in the index of cotton mill activity followed six consecutive gains which had carried the index to a high level. Conversely, a sharp advance in the index of lumber production, and a substantial gain in the index of electric power production, partly retraced unusually sharp declines of the previous week resulting from holiday influences.

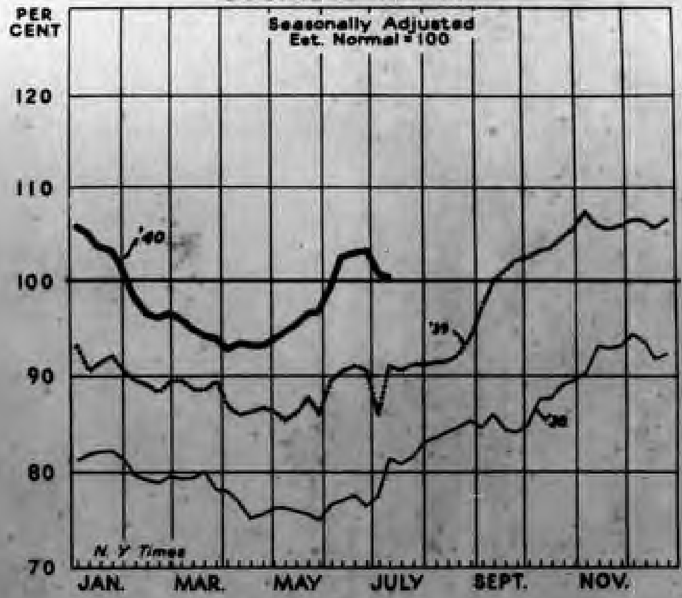
Barron's index of business activity for the week ending July 13 showed a greater downturn than the Times index, falling 1.3 points to 112.2.

Preliminary data for the week ending July 20 reveal further moderate declines in the indexes of steel ingot and automobile production. Although actual steel operations held up well they did not come up to seasonal requirements, and it is now estimated that a decline of about 3 points occurred in the adjusted index.

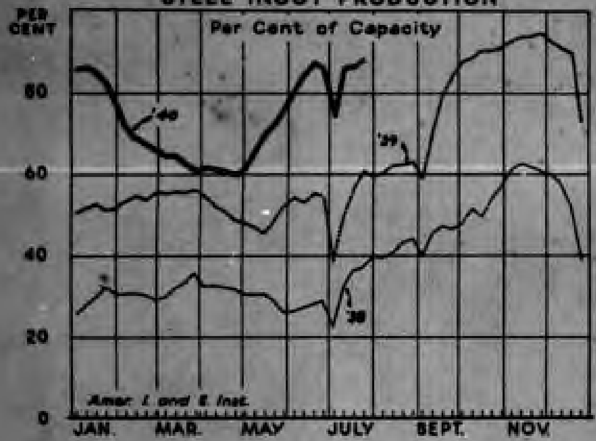
Automobile production during the week ended July 20 was reduced nearly 12,200 units to 53,020, a figure about 100 units below the corresponding week of 1939. While this merely reflects preparation for an early changeover, it will reduce the seasonally-adjusted New York Times index of automobile production. Actual retail sales tendencies, according to Ward's Reports, continue highly encouraging. General Motors' retail sales in the first 10 days of July were only 29 per cent lower than in the last period of June, as compared with a decline of 40 per cent at that time last year.

SELECTED BUSINESS INDICES

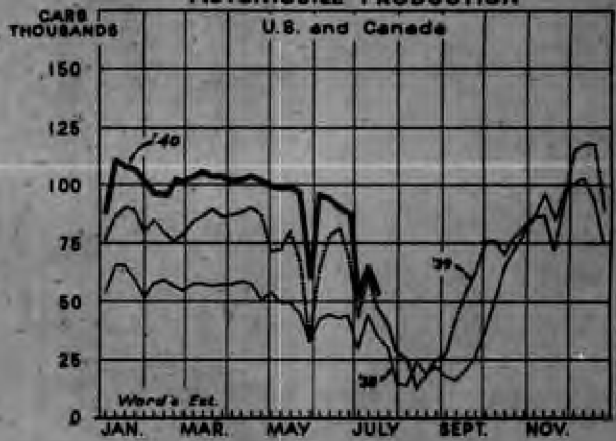
BUSINESS ACTIVITY



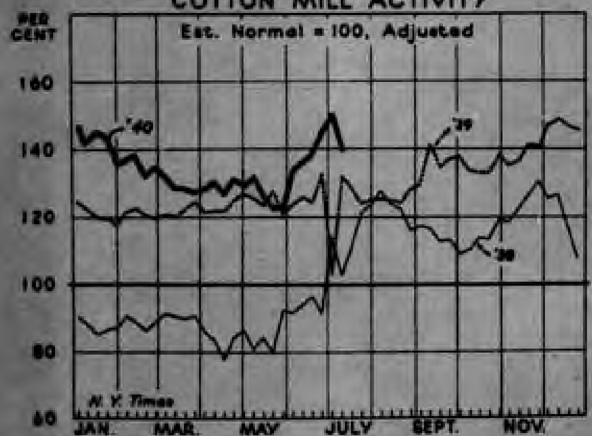
STEEL INGOT PRODUCTION



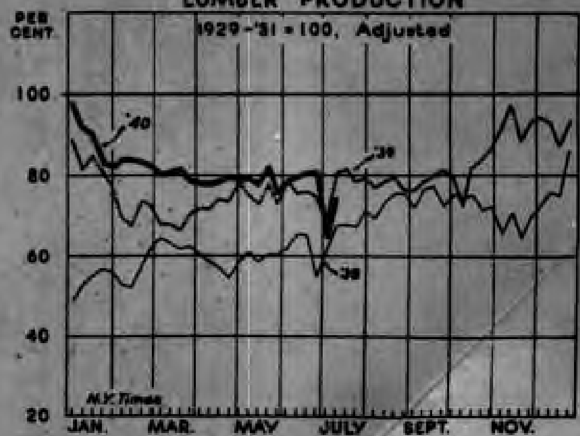
AUTOMOBILE PRODUCTION



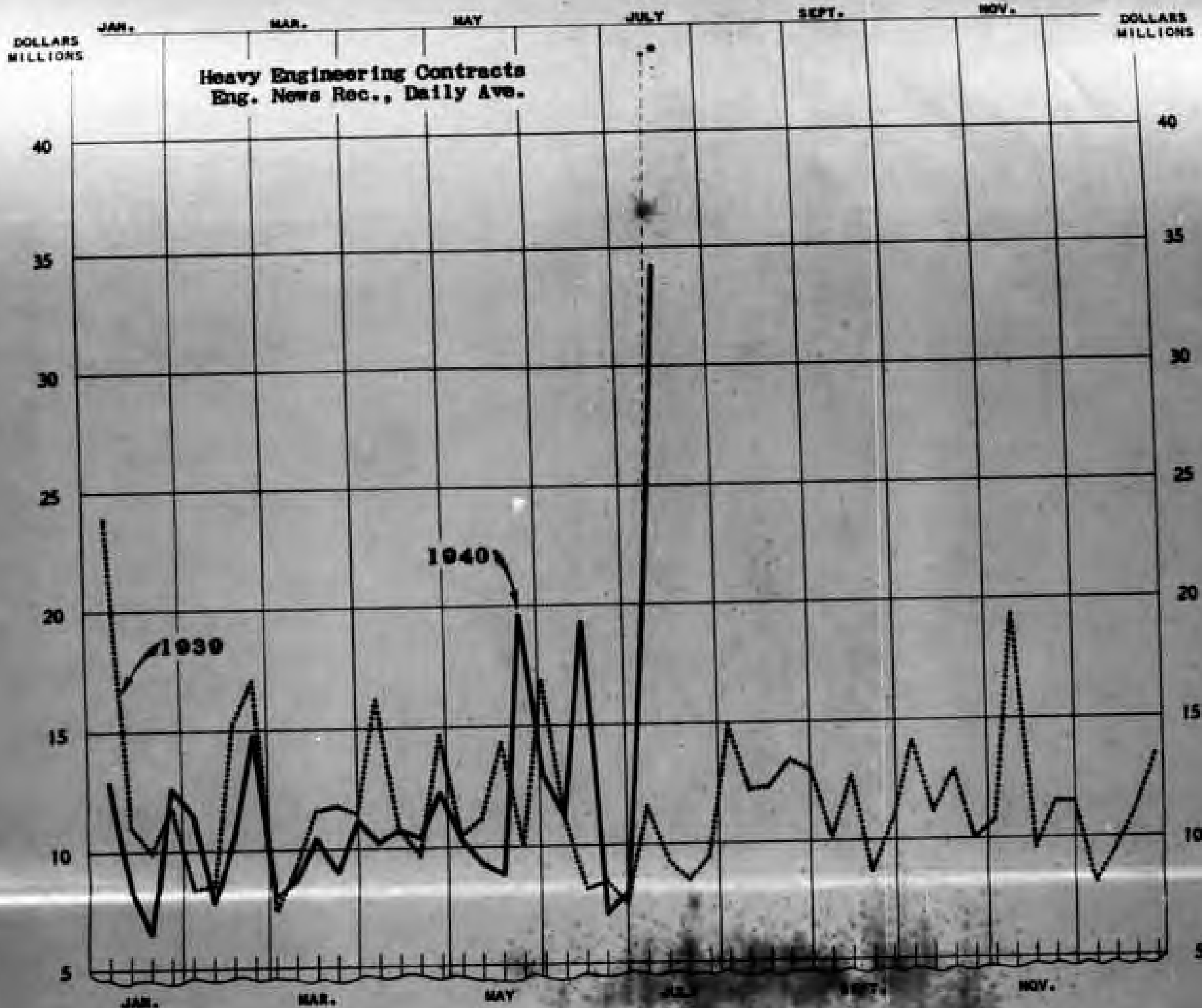
COTTON MILL ACTIVITY

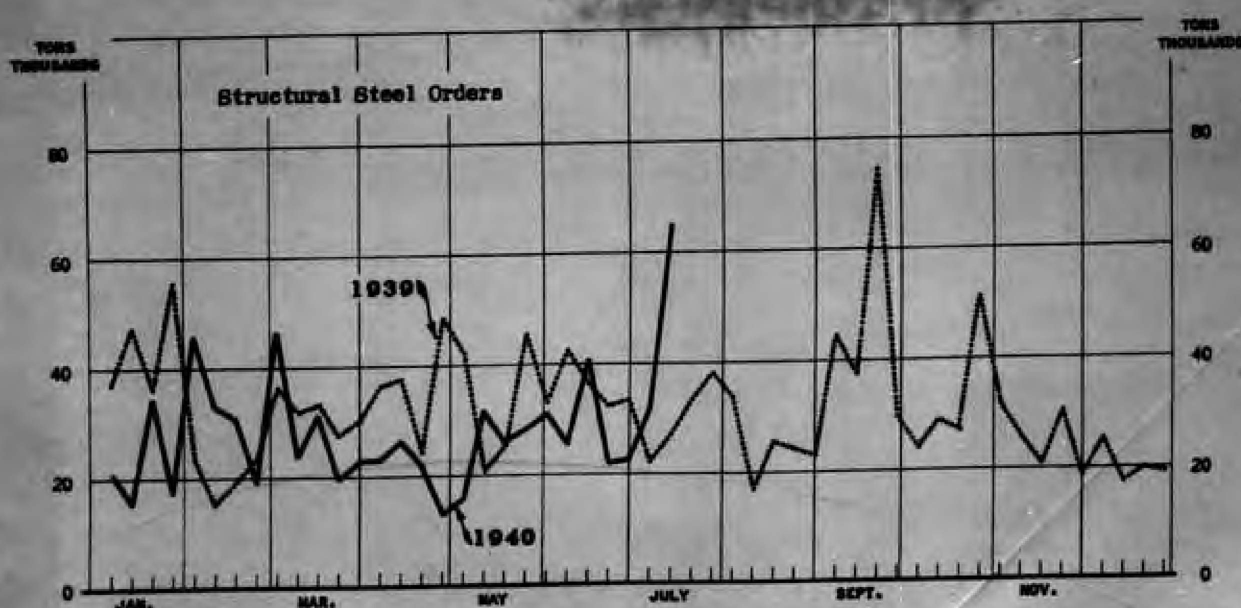


LUMBER PRODUCTION



CONSTRUCTION AND STRUCTURAL STEEL ORDERS

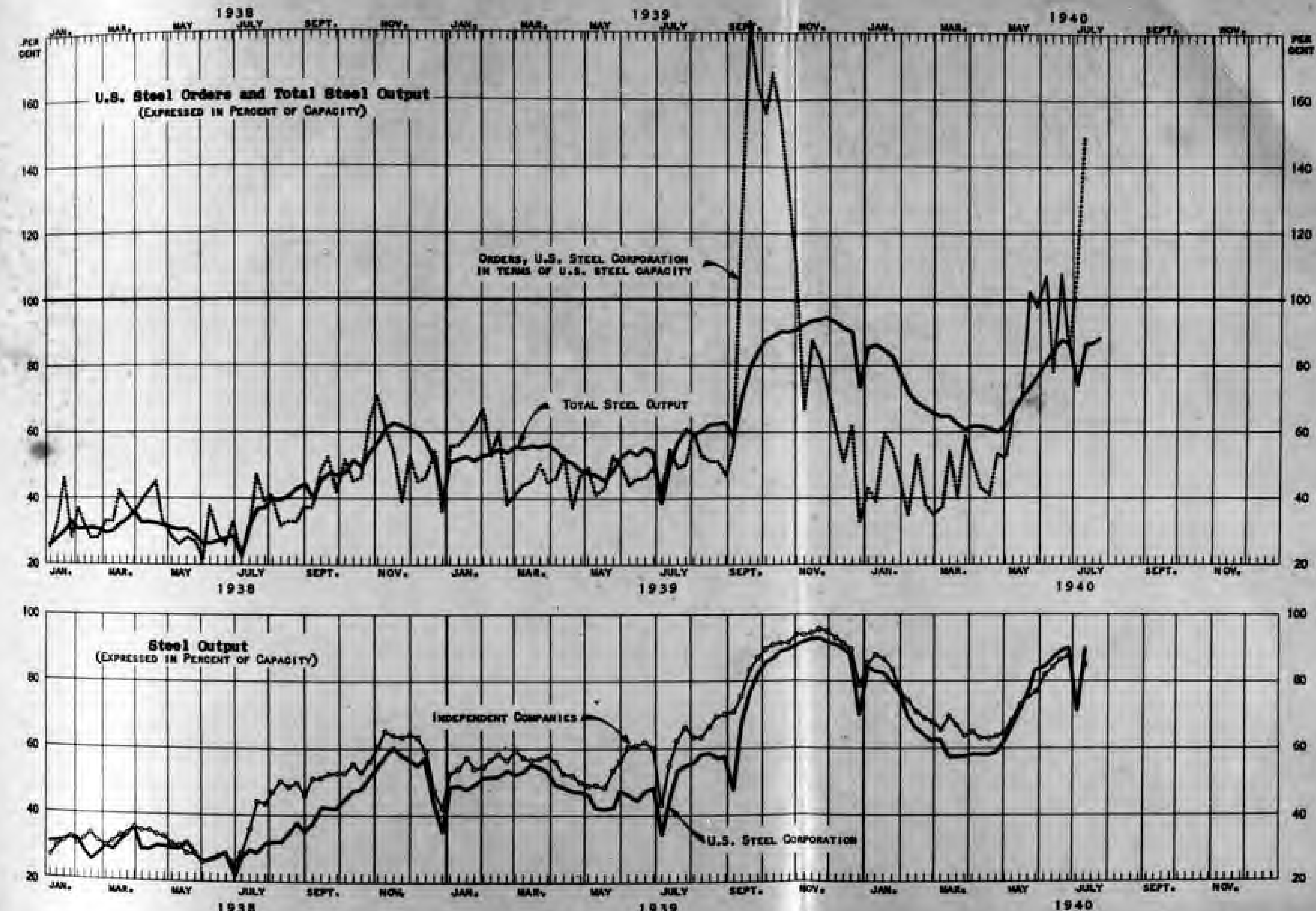




*INCLUDING OUTLYING POSSESSIONS OF THE U.S.

Chart 3
CONFIDENTIAL

STEEL INGOT PRODUCTION AND U. S. STEEL CORPORATION ORDERS



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Division of Research and Statistics

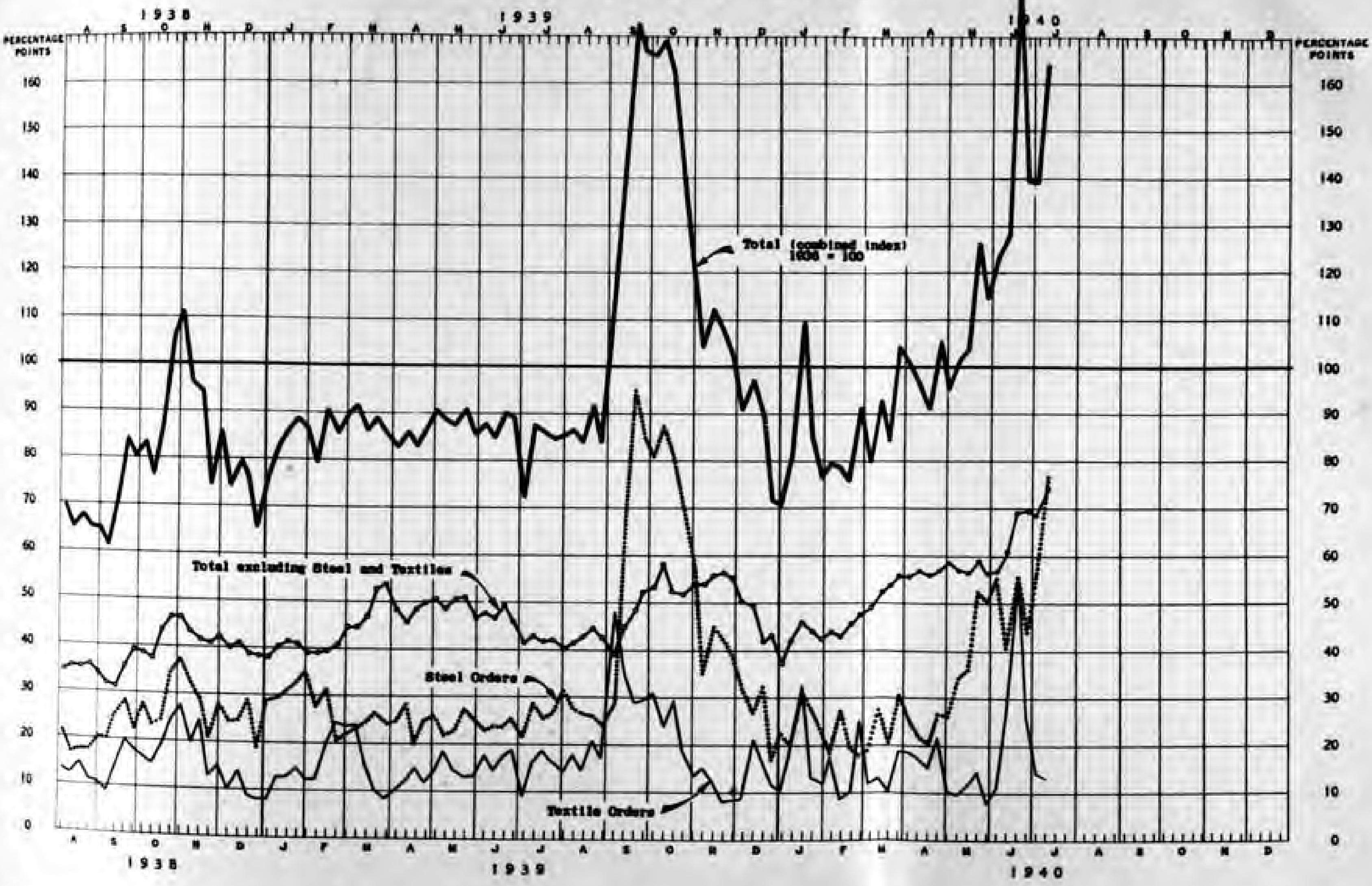
I - 46 - B

Chart 4
CONFIDENTIAL

159

INDICES OF NEW ORDERS

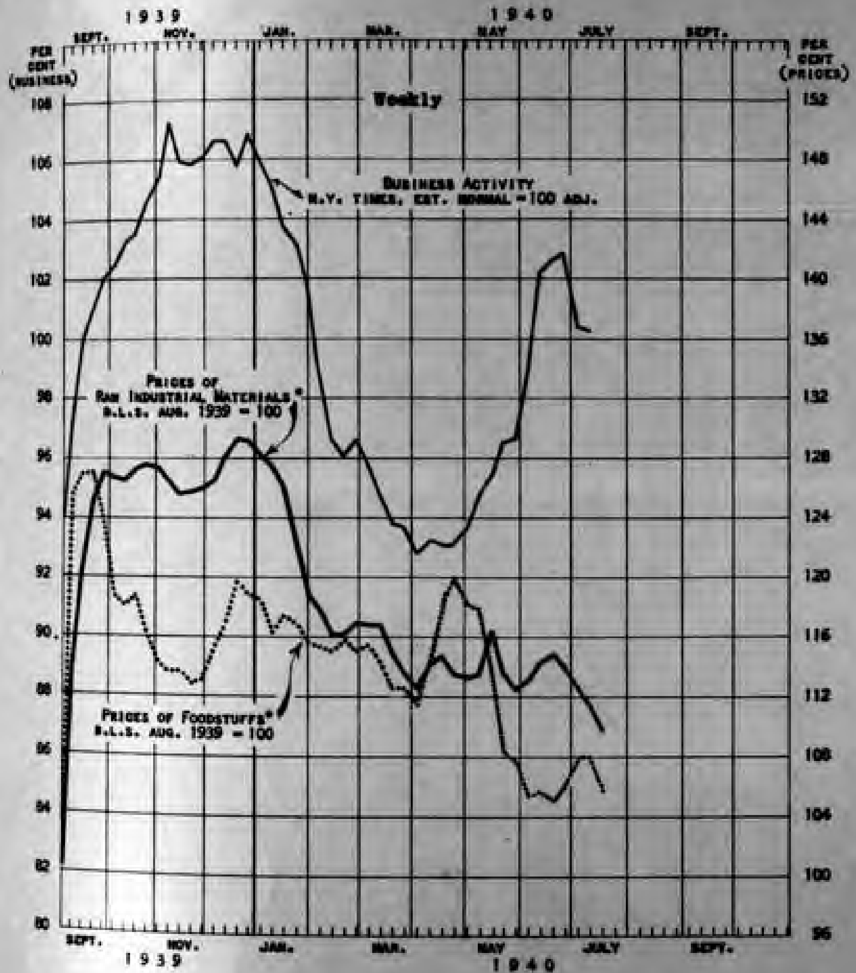
Combined Index of New Orders and Selected Components

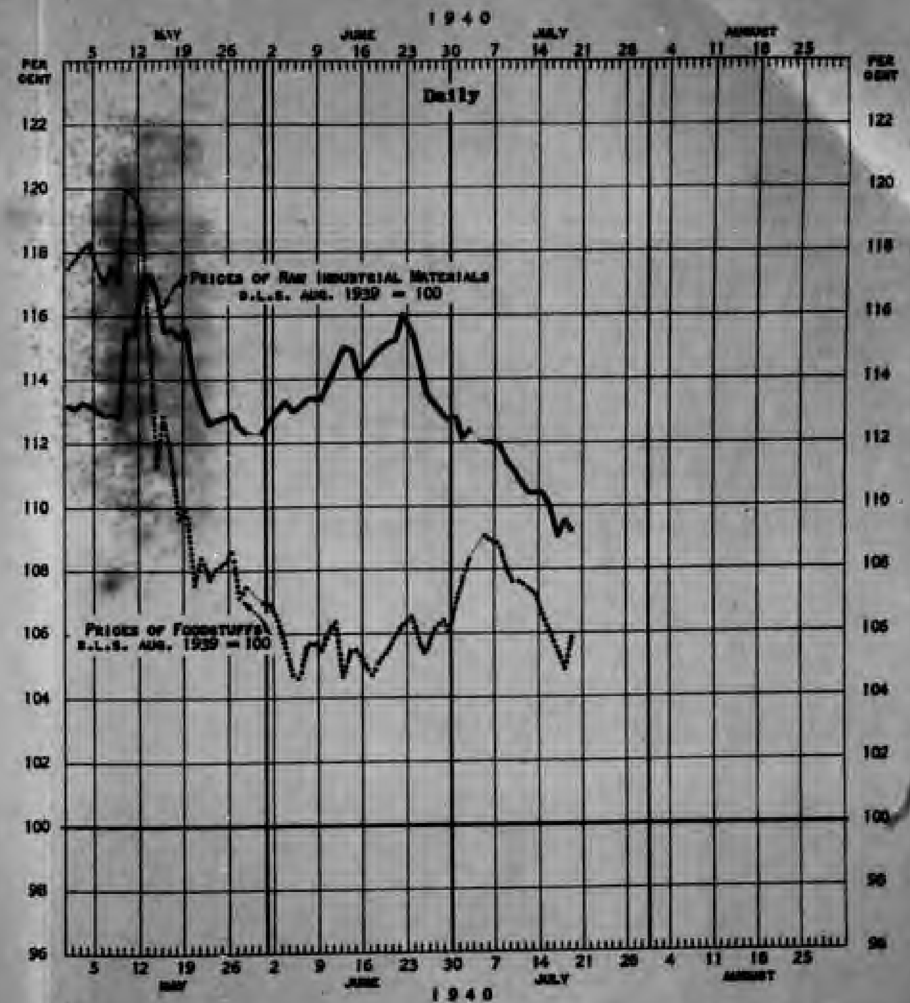


Office of the Secretary of the Treasury
Division of Research and Statistics

I - 85 - C

BUSINESS ACTIVITY AND PRICES OF RAW INDUSTRIAL MATERIALS AND FOODSTUFFS





*FIVE DAY AVERAGE FOR PRICES

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

G - 310 - A

July 22, 1940

Dear Harold:

Thank you for the July 18th letter from Mexico City.

I should be delighted if you would continue to send me these reports as I enjoy reading them very much.

With kind regards,

Yours sincerely,

Henry

Mr. Harold Hochschild,
American Metals Company,
61 Broadway,
New York, N. Y.

July 22, 1940

Dear Harold:

Thank you for the July 18th letter from Mexico City.

I should be delighted if you would continue to send me these reports as I enjoy reading them very much.

With kind regards,

Yours sincerely,

Henry

Mr. Harold Hochschild,
American Metals Company,
61 Broadway,
New York, N. Y.

July 22, 1940

Dear Harold:

Thank you for the July 16th letter from Mexico City.

I should be delighted if you would continue to send me these reports as I enjoy reading them very much.

With kind regards,

Yours sincerely,

Henry

Mr. Harold Hochschild,
American Metals Company,
61 Broadway,
New York, N. Y.

From Mr. H. K. Hochschild

<u>Copy of letter of July 16, 1940 from Mexico City</u>

Last Thursday, the day of the recounting of the votes, passed without incident. The Almazanistas refused to go to the official counting as they were afraid of personal attacks and other rough handling, which for reasons I declare later on, they are trying to avoid under all circumstances. The machine brought in a number of "pistoleros" from the rural districts, which fact is simply mentioned to show that the labor unions and Lombardo Toledano are not trusted any more by the party. The Almazanistas met at secret places and issued 150 certificates for their own deputies, which the Government tried to avoid but without success. So we have now a double amount of deputies holding certification of their having been elected, and the old Chamber will have to decide which ones are legal and which ones are not, some time in August.

The reason why Almazan is trying to avoid blood shed is to avoid persecution of his party. Undoubtedly long before the election the old trick to try and make it appear that an unfriendly candidate is trying to make a revolution and then take this as a reason to liquidate him, did not work in Almazan's case, and for this reason also he is trying to avoid blood shed.

The logical result will probably be that Avila Camacho will be President, but to avoid the sting of a clear imposition, the party will have to cede a lot of seats in the Chamber to Almazan, of course, less than the majority. Many indications point toward this settlement and it remains to be seen if Almazan will be satisfied with it. Somehow or other, I believe he will be, as I do not know what else he is going to do unless, of course, politics in your country or influences from Washington should determine otherwise.

In this connection I point out the fact that the Government observers declared that in five districts of the twelve electoral districts in Mexico City the elections were held in illegal form. Some optimistic people believe that this will give Avila Camacho a chanc[e] to get out of the Chamber such politicians who belong to the party whom he wants to get rid of, specially the communists, and at the same time they will satisfy the Almazanista voters who were so overwhelming, especially in the big cities and in Mexico City.

Economically there are no news whatsoever. The exchange remains at 5 with practically no transactions, demand and offers leveling themselves fairly well. Business is going somewhat back into normal lines and merchants assure me that their sales, while having fallen off considerably in the last few months, are now slowly and gradually picking up.

Mrs Kerz tell H.H. I enjoy reading these letters

[illegible]

RDS

PLAIN

Budapest

Dated July 22, 1940

Rec'd 3:19 a.m., 23rd

Secretary of State,

Washington.

167, Twentysecond.

Futura very anxious know result Legation's 161, July 6th. Please reply. STCOR

MONTGOMERY

EMB

JR

PLAIN

Oslo

Dated July 22, 1940

Rec'd 3:48 p.m.

Secretary of State,

Washington.

783, twenty-second.

Presluft Incorporated Oslo requests license transfer 3000 dollars from Realbankens account with New York Trust Company to American manufacturers for consignment stocks. Norges Bank approves transfer. Matter urgent. Stcor.

PRESTON

CSB

ATP

PLAIN

LONDON

Dated July 22, 1940

Rec'd 1:56 p.m.

Secretary of State,

Washington

2328 July 22, 5 p.m.

FOR TREASURY FROM BUTTERWORTH

1. The Government's weekly deficit, which averaged pounds 29.7 million in April, pounds 35 million in May and pounds 52.3 million in June, was during the first two weeks in July respectively pounds 53.1 and pounds 43.6 million. The Manner in which the deficit was met in the quarter ended June 30 was reported in my No. 1913 of July 1. Since that date, as reported in my No. 2094 of July 10, the weekly exchequer returns have omitted all details of money raised by creation of debt but the following figures have been published for the periods stated: between July 2 and July 9, from savings certificates pounds 9.4 million; baby bonds pounds 17 million; and interest-free loans pounds 7.4 million: between July 1 and July 16, from 2-1/2 percent bonds pounds 67 million: in the three weeks ended July 19, from increases in tender treasury bills issued pounds 41 million: and by the new deposit certificates described in my No. 1992 of July 5, pounds 10 million on Friday June 28 pounds 20 million on

July

-2- #2328 July 22, 5 p.m. from London

July 5, but for the two subsequent Fridays nil. The good receipts from 2-1/2 percent "on tap" bonds, naturally heavy in the first weeks of the issue as they absorb accumulated savings, have evidently put the exchequer temporarily in funds to a sufficient degree to enable it to repay the Bank of England ways and means advances of about pounds 20 million at the 30th of June, to under allot by pounds 4 million on July 18 the pounds 65 million of treasury bills tenders for which were invited, and to refrain from borrowing from the banks by special deposits on the last two Fridays. The higher level weekly returns from savings cerificates and baby bonds (which averaged about pounds 4 million per week in April and May and over pounds 11 million per week in June and July) as well as amounts offered free of interest, have also assisted.

2. The Bank of England has requested the stock exchange to advise members that the word "France" which appears twice in the declaration contained in section 2 of forms D and B should in future be deleted. (see revision pages 53 C and D enclosed with despatch No. 5362 of June 6). Forms D. and B (the latter used for bearer securities) fileable for transfers of securities between United Kingdom

residents

-3- #2328 July 22, 5 p.m. from London

residents carry a declaration which must be made by the transferee to the effect that no enemy, or enemy subject living outside the United Kingdon, Palestine or France. will have any interest in the security. The deletion of the word "France" means in effect that any interest by an enemy subject residing in France would render approval of the application for transfer of the security illegal.

KENNEDY

CSB

July 22, 1940

STRICTLY CONFIDENTIAL

The Honorable Sumner Welles,

Acting Secretary of State.

Dear Mr. Secretary:

I have pleasure in transmitting herewith, as of possible interest to the Department of State and also to Secretary Hull at Havana, a copy of a memorandum which was delivered to the Treasury Department by Mr. Irigoyen, Argentine Economic and Financial Counselor, and stated by him to represent a personal message from the Minister of Finance of Argentina to myself.

Very truly yours,

(Signed) H. Morgenthau, Jr.

Secretary of the Treasury

Enc.

[illegible]:lmg-7/22/40

By Messenger 405

(Personal note from the Minister of Finance of Argentina to the Secretary of the Treasury, delivered at 12 noon on July 18 by Mr. Irigoyen to Mr. Cochran in the Treasury)

MEMORANDUM

The war and blockade have upset the equilibrium in the international transactions of Argentina. As a result of war policies of the belligerent nations we have accumulated substantial unrealizable balances in blocked currencies; on the other hand the balance of payments in free currencies may show a deficit of more than 400 million pesos in the next twelve months. Our reserves of gold and foreign exchange held abroad amount to approximately 200 million pesos. Under the present rate of deficit accumulation they will be exhausted in the next five months.

The country must export in order to pay for necessary imports. Even if we adopt a policy of drastic curtailment in our imports it is not possible to reduce them beyond certain limits. Moreover, commitments arising from the importation of certain vital necessities must take precedence over and above any other commitments.

The Government is at this moment contemplating the adoption of certain measures in order to minimize the drain on its foreign exchange reserves. These measures will be taken solely with that purpose in view and are to be considered as of an emergency nature.

Imports of goods payable in free currencies, which in this case means chiefly imports from the United States, will be reduced drastically. Certain imports such as jewelry, furs, furniture, perfumes, toys, etc. will be prohibited altogether.

Imports like automobiles, farming machinery, building materials, electrical appliances, transportation equipment, to mention only the most important will be variously reduced to between 40 and 60 percent of the total imported last year.

Iron and steel, industrial equipment, fuel, etc. will continue to come in as heretofore.

As a second step to be taken at a somewhat later stage the Government is studying the possibility of blocking all private and corporate financial transfers to the free currency countries. It is expected that this will result in a further economy of our rapidly depleting foreign exchange resources.

The Government also intends to take some internal measures such as aid to farmers and other groups which are facing a severe shrinkage in their income. We are aware that this and the rearmament expenditures will put a severe strain on our finances but they are unavoidable if we desire to preserve our present internal political and social equilibrium. We consider the preservation of our institutions as of paramount importance in order to maintain internal peace and to be able to cooperate in continental affairs.

It seems very likely that if active warfare ceases in Europe in the near future our trade with that continent will be carried out under conditions that will not permit a rapid correction of the present situation. The exchange of goods will probably be made through clearing or barter agreements, which naturally will prevent the improvement of our free currencies position.

It is of special interest to note that the German Government has recently approached our Government with a view of starting again the operation of the clearing agreement between both countries which was suspended in September 1939. They expect to be in a position to begin purchases and shipments towards the end of September.

It seems unnecessary to add that in our present situation any buyer of our products would be welcome. And it is also unnecessary to point out that there is no Government in the Argentine that could refuse to trade with Germany today without exposing itself to the most serious sanctions on the part of public opinion with the natural political consequences.

It would be unfair to our friends in the United States Government if we did not candidly express the feeling prevalent in our country as to the possible outcome of the Havana Conference. Our Government is willing to do its share in bringing about economic cooperation in a continental scale. But past experience have taught us the difficulties involved in such a program and public opinion in the Argentine is highly skeptical as to any tangible and immediate improvement of the present situation resulting from the meeting.

There is no doubt in our minds that the most constructive step that the United States Government could take to help us to meet the present emergency would be to make immediately substantial purchases of some of our surpluses such as linseed, wool, hides and ment. Any such move on the part of the United States would not only result in an immediate improvement in our position but would also be instrumental in bringing about the proper spirit of cooperation in any long term plans that might be developed in this continent.

Any emergency action on the part of the United States of the nature mentioned above should be followed up immediately by some practical and comprehensive trade agreement between the two countries resulting in an increase of our sales in the American market, as well as in greater purchases of American goods on our part. It is to the expansion of our sales here that we must ultimately look to find the means to meet the payments for our imports as well as of all other obligations in this country.

July 22, 1940

STRICTLY CONFIDENTIAL

James Forrestal, Esquire,

Administrative Assistant to the President.

Dear Mr. Forrestal:

I have pleasure in attaching, for your strictest confidence, a copy of a memorandum which was delivered to the Treasury Department by Mr. Irigoyen, Argentine Economic and Financial Counselor, and stated by him to represent a personal message from the Minister of Finance of Argentina to myself.

Very truly yours,

(Signed) H. Morgenthau, Jr.

Secretary of the Treasury

Encl.

[illegible]-7/22/40

By Messenger 4 25

July 22, 1940
2:11 p.m.

H.M.Jr: Hello.

Operator: It will take about three or four minutes to get Mr. Purvis to the telephone.

H.M.Jr: That's all right.

Operator: Right.

2:15 p.m.

H.M.Jr: Hello.

Operator: Mr. Purvis. Go ahead.

H.M.Jr: Hello.

Arthur Purvis: Hello. Good afternoon.

H.M.Jr: How are you?

P: Very well, thank you.

H.M.Jr: Well, can you hear me all right?

P: I have to thank you very much for an extremely nice photograph which I'm going to put up immediately and value enormously.

H.M.Jr: Well, I hope you'll give me one of yours.

P: (Laughs). Oh, that's very nice of you.

H.M.Jr: I'd like to have one also.

P: That's very nice of you.

H.M.Jr: You know, I never heard about Mrs. Purvis wanting to come in.

P: No. As a matter of fact, I tell you why I didn't worry you about it. When I telephoned her a little later that day, she told me that she had got a permit.

H.M.Jr: Oh.

P: What I did wonder though was as to whether I might bring her passport down -- but I'll have a word with Mrs. Klotz about it -- to see whether I could get some sort of .....

H.M.Jr: Visa?

P: ..... visa that would be all right when she goes up and down with all these children coming.

H.M.Jr: Well, we could do it on our end I'm quite sure.

P: Well, that's the only end that would -- I'll bring it down and talk with Mrs. Klotz if I may.

H.M.Jr: Yes. She's my expert on passports.

P: (Laughs).

H.M.Jr: And how to get by the State Department.

P: (Laughs). Yes, that's right. That has more applications than passports.

H.M.Jr: Right. Well, I -- still on the personal vein before I get to the other -- I am seriously thinking of taking my family somewhere to Canada the middle of August.

P: Oh, yes.

H.M.Jr: And I'd like to get some suggestions from you tomorrow.

P: Middle August. I'll do a little thinking about that.

H.M.Jr: Will you?

P: Do you want to go far or do you want to go -- I mean, is it a traveling trip or is it a trip on which you would want to settle down in one place.

H.M.Jr: Well, we'd like to settle in one place -- some place where we could be fairly comfortable. You know -- the wilds all outdoors and the comforts of home.

P: That's right. How many would there be?

H.M.Jr: Well, I think there'd be the whole family -- there'd be five of us.

P: Five and that would be middle August?

H.M.Jr: Yes, for a week.

P: Let me do a little thinking there.

H.M.Jr: Will you?

P: I will.

H.M.Jr: Good. Now, without saying anything to you I've been following Curtiss at Buffalo every week. Have you got a pencil?

P: Yes, I have.

H.M.Jr: Well, on the week ending July 13th they had for you eleven P-40's without any engines.

P: Yes. That's right.

H.M.Jr: No Allison engines and they had 43 P-36's with no Wright engines.

P: That's correct. Yes.

H.M.Jr: Now on the week ending the 20th they had 16 P-40's with no Allison's and 49 P-36's with the Wright Cyclone engines missing.

P: 49?

H.M.Jr: 49.

P: Yes.

H.M.Jr: Now I thought that that might be something to bring up tomorrow when they're crowding you about getting all the engines.

P: Yes. Yes, because actually there is a definite shortage there.

H.M.Jr: You've got it. I don't have to draw you a picture do I.

P: No, not a bit. (Laughs).

H.M.Jr: All right.

P: Excellent.

H.M.Jr: What?

P: Excellent.

H.M.Jr: I thought that you might be able to use that.

P: I got that pretty quickly. (Laughs).

H.M.Jr: Now tomorrow there'll be Secretary of War, Navy and Mr. Knudsen and I've also brought in Mr. -- oh, this man from Sears Roebuck .....

P: Oh, Nelson.

H.M.Jr: Yeah, because I don't want to have another session of having him say he's the czar .....

P: You're quite right. It just hits us again, that's all.

H.M.Jr: .....of all priorities so I'm having them all in at one time and .....

P: I'd like to bring down if I may Maurice Wilson with me.

H.M.Jr: Oh, fine.

P: I think that's the best one instead of the other fellow.

H.M.Jr: Yes. And also on Allison, last week ending the 20th they dropped back to 11 engines -- the week before they had done 18.

P: Oh, yes.

H.M.Jr: So it doesn't look very hopeful.

P: I wonder what's happened there. I'd better ring Sloan.

H.M.Jr: I'm going to call him also because there's something wrong there.

P: Uh-huh.

H.M.Jr: And you might find out also -- you can do it better than I can -- how is Wright going to catch up on those engines for you, because after all if you could lay your hands on 49 P-36's right now they'd be very useful.

P: Exactly. Oh, yes, anything is useful just now.

H.M.Jr: To say nothing of 16 P-40's.

P: Exactly. Yes, it's a big lot.

H.M.Jr: Right. Well, I'll be seeing you tomorrow.

P: All right then. That's at 10 a.m., isn't it?

H.M.Jr: Right.

P: Thank you very much.

H.M.Jr: Good-night.

P: Good-night.

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Treasury Department
Division of Research and Statistics

Date July 22, 1940

To: Secretary Morgenthau

From: Mr. Haas

STRICTLY CONFIDENTIAL

CURTISS - WRIGHT CORPORATION

Airframes held in storage awaiting engines:

British Purchasing Commission contracts -

Week ending July 13 - 11 P-40s (requiring Allison engines)
43 P-36s (requiring Wright Cyclone engines)

Week ending July 20 - 16 P-40s (requiring Allison engines)
49 P-36s (requiring Wright Cyclone engines)

Comment by Mr. Jansen, Plant Manager:

The Army is now taking all the Allison engines. The P-40s are piling up at the rate of approximately one a day and will reach about 55 by the end of August if no engines are received in the interim.

The situation with regard to the P-36s, which require Wright Cyclone engines, will probably not get any worse as increased deliveries of these engines are expected.

Mr. Jansen pointed out that by the first of September the Wright Cyclone engine planes will all be complete, and the Curtiss-Wright Corporation will require at that time 6 Allison engines per day.

LOCKHEED AIRCRAFT CORPORATION

Mr. Carr, Production Control Manager, stated that they have no airframes in storage awaiting engine deliveries. He mentioned, however, that one twin-engine, Army interceptor is practically complete and will be held up unless 2 Allison engines are received shortly.

Mr. Carr added that the lack of Allison engines was, however, holding up some plant work, and that this situation would get worse if the engines are not received in the very near future.

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STRICTLY CONFIDENTIAL

ALLISON ENGINEERING COMPANY

Deliveries of Airplane Engines

	Actual deliveries	Estimated deliveries on existing orders
1940		
January	10	
May 1 - 23	10	
May 24 - June 1	5	
June 2 - 8	4	
June 9 - 15	8	
June 16 - 22	11	
June 23 - 30	8	
June 30 - July 6	6	
July 7 - 13	18	
July 14 - 20	11	
July 21 - 31		121
August		160
September		310
October		351
November		331
December		332
1941		
January		362
February		416
March		416
April		414
May		408
June		437
July		320
August		294
September		431
October		45
November		45
December		45
1942		
January		25
February		21

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

July 22, 1940.

TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE
Monday, July 22, 1940

Press Service
No. 21-67

Secretary of the Treasury Morgenthau today announced the final subscription and allotment figures with respect to the current offering of 2-1/4 percent Treasury Bonds of 1954-56. Allotments on public subscriptions aggregated $630,719,850. This amount includes $39,110,300 allotted in full to subscribers for $5,000 or less who specified that delivery be made in registered bonds 90 days after the issue date. In addition to the amount allotted on public subscriptions, $40,600,000 of the bonds have been allotted to Government investment accounts, within the $50,000,000 reservation.

Subscriptions and allotments were divided among the several Federal Reserve districts and the Treasury as follows:

Federal Reserve District	Total Subscriptions	Total Allotted
Boston	$ 628,019,500	$ 58,328,050
New York	2,924,302,650	270,526,400
Philadelphia	393,641,000	38,626,150
Cleveland	449,152,250	42,981,200
Richmond	221,241,700	22,349,350
Atlanta	204,688,950	20,114,450
Chicago	771,165,850	75,625,650
St. Louis	156,315,200	17,315,600
Minneapolis	89,506,900	9,717,100
Kansas City	113,212,450	13,200,350
Dallas	143,390,750	14,497,050
San Francisco	502,503,150	46,526,600
Treasury	7,931,200	911,900
Government Investment Accounts		40,600,000
TOTAL	$6,605,071,550	$671,319,850

July 22, 1940

My dear Mr. President:

As you know, for about a week or ten days, pursuant to our control of ship movements, we have been holding up two Texas oil tankers loaded with oil products for the Spanish Government oil monopoly.

At your suggestion, after consulting with the Navy Department, we offered on behalf of the Navy to buy these two cargoes of oil from the Texas Company. Since making this offer, we have had no definite answer from the Texas Company.

In order to implement our authority so that we may continue this policy, not only for Spain, but possibly in other parts of the world, I am inclosing a proposed amendment for your signature adding petroleum and petroleum products and scrap metals to your existing list of strategic materials subject to embargo, pursuant to Public 703.

Signing of this proposed amendment to the outstanding Embargo Proclamation does not necessarily mean that we will immediately stop the export of all petroleum products and scrap metals. It does mean, however, that we may do so if you decide it is in the interest of national defense policy.

Yours sincerely,

s- H. Morgenthau, Jr.

The President,

STRICTLY CONFIDENTIAL

The White House.

2 Incls.

By Messenger 3:35

Copy to Mr. Foley 7/22/40

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July 22, 1940

My dear Mr. President:

As you know, for about a week or ten days, pursuant to our control of ship movements, we have been holding up two Texas oil tankers loaded with oil products for the Spanish Government oil monopoly.

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Yours sincerely,

s - H. Morgenthau, Jr.

STRICTLY CONFIDENTIAL

The President,

The White House.

2 Encls.

By Messenger 3:35

(pursuant to control of ship movements,

DRAFT

My dear Mr. President:

As you know, for about a week or ten days we have been holding up two Texas oil tankers loaded with oil products for the Spanish Government oil monopoly.

At your suggestion, after consulting with the Navy Department, we offered on behalf of the Navy to buy these two cargoes of oil from the Texas Company. Since making this offer, we have had no definite answer from the Texas Company.

In order to ~~have the necessary~~ implement our authority so that we may ~~to~~ continue this policy, not only for Spain, but possibly in other parts of the world, I am inclosing a proposed amendment ~~herewith an amended proclamation~~ for your signature adding petroleum and petroleum products and scrap metals ~~iron~~ to your existing list of strategic materials subject to embargo, pursuant to Public 703. Signing of this proclamation does not necessarily mean~~, for example,~~ that we will immediately stop the export of all petroleum products and scrap ~~iron, but~~ metals. It does mean, however, that we ~~may~~ do so if you decide it is in the interest of national defense policy.

Yours sincerely,

proposed amendment to the outstanding embargo proclamation

AMENDMENT OF REGULATIONS GOVERNING THE EXPORTATION OF ARTICLES UNDER THE PRESIDENT'S PROCLAMATIONS ISSUED PURSUANT TO PROVISIONS OF SECTION 6 OF PUBLIC—No. 703—76th CONGRESS [H. R. 9850]

Pursuant to the authority vested in me by the provisions of Section 6 of Public—No. 703—76th Congress [H. R. 9850], I hereby prescribe the following amendments and additions to the regulations issued by me on July 2, 1940:

I. After subsection g and before subsection h under the heading "Chemicals as follows" is added: "g_1 Petroleum and petroleum products."

II. After subsection e under the heading "Products as follows" is added: "f. Scrap iron and other scrap metals."

THE WHITE HOUSE

July , 1940

ADMINISTRATION OF SECTION 6 OF PUBLIC—NO. 703—
76th CONGRESS—AN ACT ENTITLED, "AN ACT TO EX-
PEDITE THE STRENGTHENING OF THE NATIONAL
DEFENSE" APPROVED JULY 2, 1940

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

AMENDMENT OF PROCLAMATION

The Proclamation issued by me on July 2, 1940 under Section 6 of Public—No. 703—76th Congress (H.R. 9850) is amended and supplemented as follows:

I. After subsection g and before subsection h of Section 3, there is added "[illegible]. Petroleum and petroleum products."

II. After subsection e of Section 4 there is added "f. Scrap iron and other scrap metal."

IN WITNESS WHEREOF, I have hereunto set my hand and caused the seal of the United States of America to be affixed.

DONE at the City of Washington this ________ day of July, in the year of our Lord nineteen hundred and forty, and of the Independence of the United States of America the one hundred and sixty-fourth.

By the President:

Secretary of State.

July 23, 1940

Dear Mr. Knudsen:

In accordance with your request, I am enclosing the opinion of my General Counsel to the effect that the Reconstruction Finance Corporation has adequate authority to loan funds, either under the 1940 National Defense Amendment or under the 1938 Glass-Steagall Amendment, to manufacturers of articles and materials useful for national defense who have contracts to supply such articles and materials to the United States and to Great Britain.

Sincerely yours

(Signed) H. Morgenthau, Jr.

Attachment

Honorable William S. Knudsen,
Advisory Commission to the Council
of National Defense,
Federal Reserve Building,
Washington, D.C.

[illegible]
7/23/40

cc to Mr. Thompson

By Messenger 3[20]

July 23, 1940

My dear Mr. Secretary:

The X Company, a manufacturer of articles and materials useful for national defense, has contracted to supply the Government of the United States and the Government of Great Britain with certain of those articles and materials. In order to fulfill those contracts it is necessary that the X Company increase its productive capacity by plant construction, expansion, and equipment. Those new plant facilities will be used for the fulfilment of the above-mentioned contracts. While it is not known what use will be made of those facilities after the completion of those contracts, presumably they will continue to be available for fulfilling future contracts of a similar nature, if that becomes necessary for the national defense. It is understood that the X Company desires to obtain the capital for that expansion from the Reconstruction Finance Corporation by way of a loan and has, in order to secure the repayment of the loan, offered to execute to the Corporation a mortgage without recourse covering the new plant facilities.

You have inquired whether the Reconstruction Finance Corporation may lawfully lend that capital to the X Company for those purposes. It is my opinion that, as a matter of law, the propriety of such a loan is beyond question.

Section 5d of the Reconstruction Finance Corporation Act, as amended (U.S.C., Sup. V, title 15, sec. 606b), as added to by section 5 of the Act of June 25, 1940 (Public, No. 664, 76th Congress, 3rd Sess.), provides in part:

"In order to aid the Government of the United States in its national-defense program, the Corporation is authorized--

"(1) To make loans to, or, when requested by the Federal Loan Administrator with the approval of the President, purchase the capital stock of, any corporation (a) for the purpose of producing, acquiring, and carrying strategic and critical materials as defined by the President, and (b) for plant construction, expansion and equipment, and working capital, to be used by the corporation in the manufacture of equipment and supplies necessary to the national defense, on such terms and conditions and with such maturities as the Corporation may determine; * * *."

In my opinion, the above statute confers complete authority on the Reconstruction Finance Corporation to make the loan in question.

Under the terms of the statute the loans which the Reconstruction Finance Corporation is authorized to make, in aid of the national defense program, are for plant construction, expansion, and equipment, which in turn are to be used for the manufacture of articles "necessary to the national defense". The plain purpose of those words is simply to define the kind or type of equipment and supplies which will be produced by the plant. There is no language used which would require the United States to purchase all or any of those products. The language of the statute is clear and unmistakable that so long as a plant produces equipment and supplies of a type "necessary to the national defense", a loan for the construction, expansion, or equipment of the plant falls within the authority of the Reconstruction Finance Corporation.

One of the most pressing problems with which the Congress was concerned in providing for the nation's defense was the expansion and augmentation of private plant capacity which could be used in producing not only the articles and materials which are needed at the present time to strengthen our armed forces, but also for fulfilling the needs of an uncertain future. The Congress in enacting section 5d(1) was not concerned with the acquisition of specific articles and materials for defense purposes; various appropriation acts were passed for that purpose. See: Act of June 13, 1940 (Public, No. 611, 76th Congress, 3rd Sess.); Act of June 15, 1940 (Public, No. 635, 76th Congress, 3rd Sess.); Act of June 26, 1940 (Public, No. 667, 76th Congress, 3rd Sess.); Act of July 2, 1940 (Public, No. 703, 76th Congress, 3rd Sess.). See also the statute to expedite the acquisition of naval equipment - the Act of June 28, 1940 (Public, No. 671, 76th Congress, 3rd Sess.).

The problem of expanding existing private plant capacity beyond the nation's immediate needs was known to the Congress. The President had repeatedly brought the problem to the attention of the Congress, and he had specifically pointed out to the Congress that the production of war materials in this country for export would increase our plant capacity and our skilled personnel to the advantage of our national defense, since the increase in plant capacity and the additional skilled personnel would be available if and when the time for their need should arise.

In an address delivered personally to a Joint Session of the Congress, on September 21, 1939, the President stated:

> "From a purely material point of view, what is the advantage to us in sending all manner of articles across the ocean for final processing there when we could give employment to thousands by doing it here? Incidentally, and again from the material point of view, by such employment we automatically aid our own national defense." ((1939) 85 Cong. Rec. 10; H. Doc. No. 474)

In an address on national defense delivered personally to a Joint Session of the Congress, on May 16, 1940, the President said:

> "From the point of view of our own defense, therefore, great additional production capacity is our principal air requisite.
>
> "For the permanent record, I ask the Congress not to take any action which would in any way hamper or delay the delivery of American-made planes to foreign nations which have ordered them, or seek to purchase more planes. That, from the point of view of our own national defense, would be extremely short-sighted.
>
> "During the past year American production capacity for war planes, including engines, has risen from approximately 6,000 planes a year to more than double that number, due in greater part to the placing of foreign orders.
>
> "Our immediate problem is to superimpose on this production capacity a greatly increased additional production capacity. I should like to see this Nation geared up to the ability to turn out at least 50,000 planes a year." (Underscoring supplied.) (86 Cong. Rec., May 16, 1940, at 9534; H. Doc. No. 751)

In a message to the Congress, transmitting a request for additional appropriations and authorizations for the national defense, the President said:

> "Over and beyond the acquisition of this actual material is the evident requirement for the immediate creation of additional production facilities to meet possible future emergencies as well as present deficiencies in the making of munitions, such as guns, ammunition, and fire-control equipment. These facilities require a long time to create and to reach quantity production. The increased gravity of the situation indicates that action should be taken without delay.
>
> * * * * *
>
> "In the national effort for defense upon which we are now engaged, it is imperative that we make full and effective use of the mighty capacities that lie in our population. Here as yet undeveloped lie the ability and the strength needed in the building up of our armaments to provide a sure industrial foundation for the meeting of any and all defense requirements. Without the full development of these skills, our national defense will be less than it must be in the critical days which lie ahead. Without the full contribution of our people, our defense cannot attain the invulnerability which the Nation demands and which we are determined it shall have." (86 Cong. Rec., May 31, 1940, at 11055 and 11087; H. Doc. 799)

It appears from the debates on the bill in the Senate that the concern of the legislators was to encourage the establishment of private enterprises rather than the creation of Government corporations to supply the Government with needed materials for national defense. (86 Cong. Rec., June 15, 1940, at pages 12597-12615) The same appears in the debates of the House of Representatives. (86

Cong. Rec., June 14, 1940, at pages 12497-12520). The debates of the Congress are, of course, relevant to show a common agreement on the purpose of a statute. Wright v. Vinton Branch of the Mountain Trust Bank of Roanoke, (1937) 300 U.S. 440, 464 n. See also the hearings on S. 3938, 76th Cong., 3rd Sess. (1940) 38-71, a companion bill to H.R. 9958, 76th Cong., 3rd Sess., which became the Act of June 25, 1940. It would have been inconsistent with that purpose for the Congress to have refused to authorize loans to private industry for the enlargement of its productive capacity except upon the condition that all the output be sold to the United States Government. Furthermore, it would have been a shortsighted policy indeed which would have limited plant expansion to exactly that necessary for the immediate needs of the Government. The events happening in Europe were such that no person could undertake to say what the needs of the United States Government would be at any time in the future. It is well known that a plant expansion cannot be carried out over night. The erection of new buildings, the installation of new machinery, and the organization of such a plant require time. The Congress could not have intended that the placing of future orders should await additional expansion in the future. That is especially true when it is realized that, since every order which is filled for customers other than the United States will also bear a portion of the cost of that increased expansion, such expansion can be had at less expense to the Government.

If it be argued that the Congress could not have intended that the increased plant capacity, achieved by capital provided by the Reconstruction Finance Corporation, should be available to fulfill contracts for others than the Government of the United States because such other contracts might hold up production for the United States, a complete answer is to be found in section 2(a) of the Act of June 28, 1940 (Public, No. 671, 76th Congress, 3rd Sess.), which provides, in part:

> "* * * deliveries of material under all orders placed pursuant to the authority of this section and all other naval contracts or orders and all Army contracts and orders shall, in the discretion of the President, take priority over all deliveries for private account or for export:* * *."1/

Under that section it is clear that all increased plant capacity will be available for the fulfilment of contracts of the Government if the President should find that necessary. Since but a few days elapsed between the passage of those Acts, the Congress must have enacted each in the light of the other. It is, therefore, self-evident that all augmentations of plant facilities made with the

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1/ See also section 120 of National Defense Act of 1916, 39 Stat. 213 (U.S.C. title 50, sec. 80), granting the President similar (but more drastic) authority when war is imminent or during time of war.

use of loans by the Reconstruction Finance Corporation will be available for the national defense.

II.

It is not necessary, however, to rely solely on the paragraph added to section 5d of the Reconstruction Finance Corporation Act by section 5 of the Act of June 25, 1940, for authority to make the loan here under consideration. Authority to make the loan may also be found in section 5d of the Reconstruction Finance Corporation Act, as amended by the Act of April 13, 1938 (the Glass-Steagall Act) 52 Stat. 212 (U.S.C., Sup. V, title 15, sec. 606b), without the new paragraph. That section provides, in part, as it appears in the Code:

> "* * * The Corporation is further authorized and empowered to purchase the securities and obligations of, and to make loans to, any business enterprise when capital or credit, at prevailing rates for the character of loan applied for, is not otherwise available: Provided, That all such purchases of securities and obligations and all such loans shall be, in the opinion of the board of directors, of such sound value, or so secured, as reasonably to assure retirement or repayment; may be made or effected either directly or in cooperation with banks or other lending institutions through agreements to participate or by the purchase of participations, or otherwise; shall be made only when, in the opinion of the board of directors, the business enterprise is solvent; and shall be made under such terms, conditions, and restrictions as the corporation may determine: Provided further, That in carrying out the provisions of this section, the Corporation may purchase securities and obligations, and may make loans, with such maturities as the Corporation may determine, notwithstanding any other provision of law.* * *"

The language of that section clearly would seem to authorize the Corporation to make a loan, taking as security a non-recourse mortgage, provided that the loan is of such sound value or is so secured that repayment or retirement will reasonably be assured and that the business enterprise to which the loan is made is, in the judgment of the board of directors of the Corporation, solvent. It is understood that capital or credit, at prevailing rates for the character of loan applied for, is not otherwise available. There is nothing in the Act which, if the enterprise be solvent, either requires security for all loans, or requires security of a particular type to be taken. This is borne out, not only by the plain language of the statute quoted, supra, but also by the evidences of Congressional intent appearing in the legislative history of the Act. The language in the Act before the Glass-Steagall amendment was as follows:

> "* * * Such loans shall, in the opinion of the board of directors of the Corporation, be so secured as reasonably to assure repayment of the loans, * * *." Section 10 of the Act of January 31, 1935, 49 Stat. 5.

That the Congress intended to liberalize that portion of the Act by providing "sound value" as an alternate basis for a loan, so that security need not be the sole condition therefor, is plain from the statements by Representative Steagall, Chairman of the Committee on Banking and Currency, who introduced the measure in the House.

In (1938) 83 Cong. Rec. 4674-4675, he stated:

> "* * * The bill has another provision which liberalizes the authority of the Corporation in making business loans of all types. Under existing law the Corporation, in making industrial or business

loans, is required to take security that will reasonably insure the repayment or liquidation of the loan. Under this bill the Corporation may make loans on a different basis -- and I will read the language so as to be sure that I am entirely accurate:

"'Such loans or obligations to be of such sound value or so secured as reasonably to assure retirement or repayment.'

"It is quite clear from this language that it is the agreed purpose of the bill to authorize the Corporation to make loans upon a basis of soundness on the one hand, or to purchase obligations, make advances, or still as under existing law, to make such loans where repayment is reasonably assured. There is not in the present bill the arbitrary requirement that no loan shall be made except where its repayment is secured by collateral. We have departed from that requirement of existing law. That is quite a marked change and constitutes a very large liberalization of the act.

* * * *

"Mr. STEAGALL. * * * I have tried to make it clear that this bill authorizes loans to be made without the customary collateral or security requirements. The basis is soundness. Any loan that is of sound value, whether it is to an individual, a partnership, or a corporation, would be considered.

"The purpose of that is to permit the Corporation to deal with actualities in these transactions and to grant extensions from time to time. There is no limit here within which maturities are to be established under contracts for loans, the purpose being to permit the Corporation to so liberalize its policies and its practices that it may come to the aid of any city, corporation, or partnership that has security of sound value upon which they cannot secure accommodations through ordinary channels. That is the whole purpose of the bill.

* * * *

"Mr. SADOWSKI. The purposes of the bill are good, but it seems to me that all of the provisions of the bill seem to rest upon the kind of rules and regulations the R. F. C. will promulgate. What assurance has the gentleman or the Members of this House it is going to bring out such rules and regulations that the Nation will be able to benefit under the provisions of this bill?

"Mr. STEAGALL. May I say to the gentleman, in answer to his question, that the whole matter was discussed by the committee in the hearings held on the proposed legislation. Statements have been made that it probably would not be helpful to publicize. The committee will bear out this statement, that delinquencies and foreclosures by the Corporation upon industrial loans show that the Corporation has gone further than was ever contemplated under either the language, the letter, or the purpose of the law by which they were acting. That is the reason we have liberalized the law in this instance, to prevent immediate foreclosures, to permit extension of obligations from time to time, and to permit loans without rigorous rules of collateral."

During the hearings on H.R. 10055 (which was superseded by S. 3735, a bill which, except for the addition of a paragraph not relevant here, was identical therewith, and which became the Glass-Steagall Act), some disagreement was expressed upon the interpretation of the words "of sound value". Most of the Committee members, especially Mr. Steagall, took the view that the addition of the new language liberalized the making of loans, so that collateral security need not be required in all cases, provided there was "sound value". The Chairman of the Reconstruction Finance Corporation, Mr. Jesse Jones, and the General Counsel of the Corporation, Mr. Claude Hamilton, Jr., took the narrower position that the proposed legislation made no change in the security requirements at all; that "of such sound value" referred only to purchases of obligations, and not to loans; and that loans must still be secured. That difference of opinion will be found on the following pages of the Hearings on (1938) H.R. 10055, 75th Cong., 3rd Sess.: 13, 15, 19, 20, 25, 32, and 34-35.

It is manifest from the hearings that the Congress was trying to liberalize, while the Chairman of the Reconstruction Finance Corporation was attempting to restrict, the security requirements for loans to be made under the proposed statute. The anomalous situation was thus presented of an administrative officer of an agency attempting to restrict powers which it was intended to bestow upon that agency. The only member of the Committee who appears to have accepted the interpretation of Messrs. Jones and Hamilton with relation to the phrase "of such sound value" was Mr. Williams. Chairman Steagall, however, in his explanation of the bill on the floor of the House of Representatives, quoted, supra, did not accept the interpretation of Messrs. Jones and Hamilton.[2] Expository statements by the sponsors of legislation may be used as aids in the interpretation of that legislation. Wright v. Vinton Branch of the Mountain Trust Bank of Roanoke, (1930) 300 U.S. 440, 463; United States v.

2/ Even in the face of Mr. Steagall's statement, Mr. Jones, in a speech made after the passage of the Act, declared that loans made by the Reconstruction Finance Corporation under the Glass-Steagall Bill must be secured. See (1938) 83 Cong. Rec. (Appendix) 1641-1642.

The American Trucking Associations, (No. 713, U.S.S. Ct., May 27, 1940).

There can be no doubt, then, of the Congressional intent in the Act of April 13, 1938, to remove the requirement of security as the sole condition upon which a loan may be granted. If the Reconstruction Finance Corporation has power to make loans without requiring any security, it cannot be argued that, when security is offered, it must be security of a particular type. The Act itself does not specify what kind of security shall be taken if security is offered. It merely requires that the security shall reasonably assure repayment. The Corporation has not in practice restricted itself to one specific type of security. During the hearings which are mentioned above, many kinds of security acceptable to the Corporation were mentioned. At page 13, thereof, Mr. Hamilton stated, in response to a question, that the security might be a pledge of personal property, assignment of accounts receivable, or a mortgage on real estate. On page 17, he indicated that an inventory would be good security for a loan to a retail store, if the state law permitted. On page 28 Mr. Jones said that the usual security for an industrial establishment was a mortgage on the plant. On page 44, Mr. Jones made the following statement:

> "We want to make any sound loan where we think the credit is good and the money will be repaid. We do not care what the security is. We would be glad to make the loans. What we are trying to do is to promote work and business." (Underscoring supplied.)

In the Senate Hearings before the Committee on Banking and Currency on (1938) S. 3735, 75th Cong., 3rd Sess. 4, Mr. Jones said:

> "* * * We want to say: 'All right; if somebody needs some money in any community, and they can give us security and put the money to good use, and not use it to pay some present-existing debt, but to buy something and hire someone, then we want to make the loan'."

Nowhere in the hearings was indication given that any security other than that which would reasonably assure repayment was required.

Under section 5d of the Reconstruction Finance Corporation Act, as amended by the Glass-Steagall Act, it is my opinion, therefore, that the Reconstruction Finance Corporation would be acting wholly within its powers in making the proposed loan to the X Company if the X Company is solvent and the prospective loan is "of such sound value" as to reasonably assure repayment, or if the mortgage without recourse, covering the proposed additional plant facilities, reasonably assures repayment.

It should be pointed out, however, that what constitutes "sound value" and what loans are secured "reasonably to assure retirement or repayment" are matters left solely to the discretion of the Board of Directors of the Reconstruction Finance Corporation and are not subject to review by any other governmental agency except possibly the Federal Laon Administrator under his general supervisory powers.

It is my opinion, therefore, that there is adequate authority in the Reconstruction Finance Corporation to make the proposed loan either under the 1940 National Defense Amendment, supra, or under the 1938 Glass-Steagall Amendment, supra.

Very truly yours,

(Signed) E. H. Foley, Jr.

General Counsel.

The Honorable

The Secretary of the Treasury.