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DEPARTMENT OF STATE
WASHINGTON

March 18, 1939.

My dear Mr. Secretary:

I enclose herewith six copies of paraphrase of telegram No. 352 just received from Ambassador Kennedy, transmitting a message for you with regard to gold which is held in England for the account of Czechoslovakia.

Sincerely yours,

Herbert Feis

Herbert Feis,
Adviser on International
Economic Affairs.

Enclosure:
No. 352 of March 17
from London; 6 copies.

The Honorable

Henry Morgenthau, Jr.,

Secretary of the Treasury.

March 18, 1939

12:20 pm

Present:

Mr. Bewley
Mr. Leroy-Beaulieu
Mr. Lochhead
Mrs. Klotz

HM, Jr: Come on! Let's do away with the "Alphonse and Gaston" stuff. The pound might slip an eighth while you are doing it!

I didn't know -- the reason I asked you to come -- how exciting the day would be through the exchanges, but unless Mr. Lochhead has been withholding information from me, it has not been.

Mr. Lochhead: Exchanges have been very quiet, today, and as far as we know from the last report I think it was about \$13,000,000 to \$15,000,000 losses in dollars in London, which was a comparatively small volume. The market over there was quite small. We also checked up in New York, this morning. They had practically no orders from abroad; nothing domestically anyway, but none of the banks here had received orders of any importance from foreign correspondents, so it has turned out to be a very nice, quiet

HM, Jr: What I would like to say, if you Leroy-Beaulieu) can be back in Washington -- don't you like Washington?

Mr. Beaulieu: Yes, I love it. I spent nearly the whole month of January here, from the 13th of January to the 13th of February.

HM, Jr: That was planes, wasn't it?

Mr. Beaulieu: Yes, that's right.

HM, Jr: High flying; not high finance. Well,

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if you would ...

Mr. Beaulieu: Yes, I will be glad to. I will, certainly.

HM, Jr: I don't know, and it's helpful to me to know that you gentlemen are around. Something might happen. We have these requests for our banks -- did you tell him?

Mr. Lochhead: We told Mr. Bewley.

HM, Jr: Well, you can explain that.

If you people would care to wait until around one o'clock, we are getting out a very important release affecting German.

Mr. Bewley: Yes.

HM, Jr: It's being mimeographed now.

HM, Jr: Would you rather wait or have it sent to the Embassy?

Mr. Bewley: I would rather come back.

Mr. Lochhead: We can send it to the Embassy.

Mr. Bewley: Or send it up.

HM, Jr: Would you (Leroy-Beaulieu) rather have it sent up?

Mr. Beaulieu: I would rather wait, because I was told by my Embassy of a cable for me from Paris and I think it must be about the same question, so I am waiting for it here.

Mr. Bewley: Maybe I had better, too.

HM, Jr: It's quite important. I just asked -- I thought it would be ready, but it isn't. It will be ready about one o'clock. I know both your people will be interested in seeing it. It's invoking countervailing duties on all German merchandise.

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Mr. Bewley: Yes.

HM, Jr: We are going to -- we say that they are dumping on us and, therefore, we are going to put in countervailing duties affecting all of Greater Germany.

Mr. Beaulieu: Uh-huh!

HM, Jr: And each importer will have to prove that he isn't being subsidized by the Government to dump goods on us. It's very far-reaching.

Mr. Bewley: Yes.

Mr. Leroy-Beaulieu: Does it also deal with the old Czech balances here?

HM, Jr: That we have taken care of separately. We have asked our banks, informally, until the State Department knows -- they have tied up all Czech balances. All Czech balances are tied up, but on a purely informal basis. I have no legal rights, but all banks have agreed to do it. Last night we said that all but one part of Czechoslovakia is Germany and then today we are saying that Germany has been dumping its goods on us and, therefore, from now on they will have to pay higher duty.

Mr. Leroy-Beaulieu: I see!

Mr. Bewley: And you are going to state your more permanent policy on Czechoslovakian money after Monday? This is only temporary?

HM, Jr: I have put it "until further notice", but the State Department said they might have some word for us Monday, but we are asking the banks to hold everything until Monday.

But what I am telling you about the release, if you would mind not phoning to your Embassy until you actually get it in your hand.

Mr. Bewley: Yes; quite.

Mr. Leroy-Beaulieu: Surely. Surely.

HM, Jr: We think it's very far-reaching in so far

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as exports of Germany to this country. You see, we find what they have been doing is a manufacturer will buy cotton, send it over and the Germans pay them -- what is it, 25% above the world market? Isn't that it?

Mr. Lochhead: Yes.

HM, Jr: And then they give him that money and he buys some German merchandise with that and that extra 25% bonus makes it possible for me to sell it on our market below cost. That's the method that they have been using.

Mr. Lochhead: You will have each one determined ...

HM, Jr: And then each importer will have to demonstrate that he did not get this bonus. Every importer on every transaction will have to demonstrate.

Mr. Leroy-Beaulieu: They used this method in South America also, didn't they?

HM, Jr: And we haven't been able to prove it, but we think we are correct, but Mr. Davis, in New York, who bought Mexican oil, sold it to Germany; they paid him way above the world price and he bought, in Germany, oil pipe and then sold it to Houston, Texas, below our cost of production. It's the same thing, but in that case it was oil pipe to the oil country and that's the way they have been handling it. We haven't been able to prove it, but of course after this, this fellow will have to prove it isn't so. The burden of proof is on the importer; not on the Government.

Mr. Bewley: The importer may be different from the exporter.

HM, Jr: The American importer will have to prove that the merchandise that he is receiving, that an export bounty has not been paid, and the burden of proof is on the American importer and in each case he has to prove it, which he can't, under the present method.

But, as I say -- I didn't know when you (Bewley) were in -- this decision was only made last night; at Cabinet, as a matter of fact -- so we did not know it, but I am passing it along and I am sure your people will

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be interested and if you are available Monday, if anything happens

Mr. Bewley: I rather hoped to go away for a couple of days, but I can come back.

HM,Jr: How far away?

Mr. Bewley: I was going first to Yorktown, to see the Taylors, but do you think I should be here?

HM,Jr: You are asking me?

Mr. Bewley: I thought I would better ask.

HM,Jr: I would like you here Monday. It's one of the times of split seconds. I think you will be happier. As long as you ask me, I would like you available.

Mr. Bewley: All right.

HM,Jr: If you get back by Monday noon

Mr. Bewley: Oh, yes! Quite!

HM,Jr: Be back by Monday noon. Can you do that?

Mr. Bewley: Yes, I can do that.

HM,Jr: Because things don't happen until around noon.

Mr. Bewley: All right.

HM,Jr: That's the trouble when people ask me about the Taylors for a weekend. I know how nice it is down there and I hate to spoil it, but a lot of other people's week-ends are spoiled too.

Mr. Bewley: It's all right.

HM,Jr: Thanks for coming in.

In the meantime, the Tripartite is functioning!

oOo-oOo

REB

GRAY

London

Dated March 18, 1939

Rec'd 1:30 p. m.

Secretary of State,
Washington.

359, March 18, 1 p. m.

FOR TREASURY FROM BUTTERWORTH.

Apropos of our telephone conversation of last evening, I venture to refer to the statements in the second paragraph of my 346, March 16, 7 p. m. With this week's events Europe has entered upon a new phase: Germany's open and undisguised aggression in the case of Czechoslovakia is making and will continue to make acutely anxious all countries contiguous to Germany and Italy and flights of capital from these countries to the United States, the only really safe repository for funds in the world, must be expected. The very swiftness of the previous German moves will induce many holders of free capital in countries contiguous to Germany and Italy to take advance precautions to protect their savings. Nervousness even though it may vary from time to time will be constantly more acute with consequent repercussions on the exchanges, for there will be
little

REB

2-#359, From London, Mar. 18, 1p.m.

little or no room for rationalizing away the fear of war. "When", rather than "whether", will be the haunting query.

Furthermore, the Prime Minister's speech of last evening marks a turning point in British policy: national security becomes an all important objective. Of the greatest significance in terms of future developments is Chamberlain's statement "in our own country we must all review the position with that sense of responsibility which its gravity demands. Nothing must be excluded from that review which bears upon the national safety. Every aspect of our national life must be looked at again from that angle."

Needless to say this week's events shattered Sir John Simon's hopes that things would take such a turn "as to preclude the continuation of the arms race and the necessity of additional borrowing beyond the pounds eight hundred million now authorized. The British Government's estimate of armament expenditure of pounds five hundred eighty million in the coming financial year will probably now be revised and may well involve substantial tax increases in the budget.

The

REB

3-#359, From London, Mar. 18, 1p.m.

The sterling exchange even with its strengthened defences will be in an increasingly precarious position.

KENNEDY

CSB

NO. 100

Rangoon, Burma, March 18, 1939.

STRICTLY CONFIDENTIAL

SUBJECT: Shipments of war materials.

THE HONORABLE

THE SECRETARY OF STATE,

WASHINGTON, D.C.

SIR:

I have the honor to report, supplementing information transmitted to the Department, that T. K. Tseng, Vice Minister for Foreign Affairs of the National Government of China, who has been in Rangoon for several months, places the total of war materials of various kinds imported for China at Rangoon up to this time at approximately 15,000 tons. He says that only about 2,000 tons of these materials have been, to date, shipped from Rangoon to Lashio over the Burma Railways, and that at present supplies being moved by truck from Lashio are taken only as far as Chafang, a town in Yunnan about 24 miles beyond the Burma border, where there are provisional storage facilities for about 1,500 tons. The Burma Railways, he says, are giving the Chinese shipping interests here full cooperation.

The shipments from Rangoon have included some high explosive, machine-guns and ammunition, shells, small-arm ammunition, and a few field guns. A considerable quantity of the 1,300 tons of TNT brought here from Italy is still at this port (in a barge in the Rangoon

River which is under constant guard by military police), and other supplies still in storage here include Russian field pieces, machine-guns and ammunition, shells, anti-aircraft guns, two French tanks, and French trench mortars and ammunition.

No Customs Statistics Issued.

No customs statistics of imports for China are available. The statistics are being compiled by the Rangoon Customs, but only for the Burmese Government. Up to this time the Government has acceded to the request of the Chinese and has not authorized the issue or publication of the statistics. The Chinese have asked for the suppression of the statistics with the object of keeping information concerning supplies from the Japanese, but it has been pointed out by a Customs official that as the documents covering shipments pass through several hands, it might be possible for the Japanese to obtain the information in question.

Motor Transport From Lashio.

Transportation of materials from Lashio into China by motor truck is at present chiefly in the hands of a local contractor. As previously reported, this contractor (S. Vertannes) recently purchased 120 Chevrolet trucks from the General Motors dealers in Rangoon, and these trucks have now been fitted with bodies and have been sent to Lashio. Fifty of the trucks were shipped by rail. The contractor has now arranged for the purchase of 65 additional Chevrolet trucks for use in transporting war materials, and some trucks owned by smaller contractors are being used.

American Trucks for China.

Eighty Dodge trucks which were shipped from the United States to Hong Kong some time ago have been re-shipped to Rangoon and are being equipped with bodies. It is reported that there are 100 or more additional units to follow from Hong Kong, and that all of these trucks will be used by the Southwest Transportation Company on the Burma-Yunnan road. The 500 Dodge trucks recently obtained in the United States as the result of the credit granted by the Export-Import Bank are expected to reach this port within a short time. Two men from the Dodge factory will come here to supervise the assembly work necessary. The 500 General Motors trucks also obtained under the credit mentioned are due to reach Rangoon early in April, on the S.S. PRESIDENT MONROE, and the work required to assemble them will be done here.

Eighteen Stewart trucks have been purchased in the United States for the Yunnan Highway Board, of which Mr. Ta'n Po-ying is the head, and will be delivered at Rangoon.

In a letter from Hong Kong, dated March 8, 1939, Mr. Dewey W. Smith, Vice President of the Studebaker Export Corporation, who was in Rangoon in December, says that the Chinese Government is still buying in Hong Kong, that his company is shipping to the Red Cross in China 66 trucks, and that it will ship 100 additional units within the next few weeks; also, that the Red Cross now has about 200 Studebakers, and that it probably will have over 500 units by the end

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of this year.

A direct importation from the United States of 2,800 Firestone truck tires for China has been made at Rangoon. The tires were purchased in the United States.

New Ship Services to Rangoon.

It is announced that three vessels of the Roosevelt Steamship Company, now operating between Atlantic ports of the United States and ports of India, will call at Rangoon with cargo within the next three months. The first of the three vessels, the M.S. WICHITA, is expected at this port on March 24th, and it will deliver 225 cases of Dodge truck chassis and parts. The second vessel will arrive in April, and the third in May.

The local agents of the Kerr Steamship Company, Limited, have announced that vessels of the Silver Line sailing from Atlantic ports of the United States will in future call monthly at Rangoon, if either inward or outward cargo is obtainable. The first ship of the new service will arrive here in May, it is stated. The vessels are chartered Norwegian ships.

Direct Shipments and Transshipments.

A shipment of 450 tons of machine-guns and ammunition arrived here on the S.S. DERBYSHIRE of the Bibby Line on February 26th. The supplies are reported to be of French origin, loaded at Marseilles. Materials recently unloaded at Singapore by the French steamers ANADYR and YALOU and consisting of 413 cases of Hotchkiss machine-guns, parts, and ammunition, and one anti-aircraft gun have been brought to this port by vessels of the British India Steam Navigation Company in regi-

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lar service between Singapore and Rangoon. There has been transshipment at Singapore of considerable quantities of war materials for China, and it appears that this is to continue, as it is stated that C. M. Chen, who has been in local charge of the activities of the Southwest Transportation Company, will go to Singapore to remain some time. His successor in Rangoon, also named Chen, has arrived here. Mr. C. M. Chen was formerly Director of the Railway Through Traffic Administration of the Chinese Ministry of Communications, and he came to Rangoon last year to make arrangements for transit shipments of war supplies through Burma.

The British steamship CAPE ST. FRANCIS arrived at Rangoon from Hong Kong on March 15th with a cargo of war supplies of various kinds reported to amount to 3,000 tons or more. The ship was consigned to Dowell and Company, Limited, a British concern long identified with China's import and export trade, which recently opened an office at this port, and it is said to have been chartered by that concern to move supplies previously imported at Hong Kong for the Chinese Government.

Payment of Customs Duties.

The Chinese Vice Minister for Foreign Affairs has stated that payments of customs duties on materials formally cleared for shipment from Rangoon up to March 4th amounted to approximately Rupees 864,000 (about \$302,400 at present exchange). The payments were at the rate of one-sixteenth of the fully duty of 50 percent ad valorem, and consequently they represented a total appraised value of Rupees 27,648,000 (about

\$9,676,800). The percentage of the total imports covered by these payments was not stated.

Shells Listed as "Poison Gas".

A Rangoon port official is authority for the statement that in a consignment of shells unloaded at Rangoon for shipment to China 130 packages were listed as "poison gas". Later, Chinese representatives here asserted that the description was incorrect, as the shells contained high explosive, not poison gas. The port authorities were not satisfied, and sent sample shells to the Rangoon arsenal at the military cantonment here for examination. It was found, the port official said, that the shells contained, in fact, high explosive, not poison gas.

Agreement for Frontier Crossing.

It is understood that a formal agreement between the Governments of Burma and China covering motor transport between the two countries has been proposed and will probably be drawn up. At the present time trucks from Burma are entering China (Yunnan) under informal permission. Chinese interests may later send their own trucks with Chinese drivers to Lashio. In connection with the contemplated operation of the 80 Dodge trucks which recently arrived here from Hong Kong, the Southwest Transportation Company is arranging for 100 Chinese drivers to be given the examination required by the rules governing the issue of licenses to operate trucks in Burma.

Customs Arrangements for Shipments.

A Chinese customs station has been established at

Lungling, about 80 miles from the Burma frontier, with an advance examining station at Chefang, where materials are now being delivered from Lashio. There is a Burma customs officer at Lashio, and a customs examiner at Kyukhok, at the frontier. Regulations for the remission or drawback of fifteen-sixteenths of the duty payable on goods imported at Rangoon for re-export to China by way of Lashio-Kyukhok, Bhamo-Panghkan, or Bhamo-Tengyueh were printed in the official BURMA GAZETTE of March 4th. Provisions for the remission of duty require the payment of one-sixteenth and the execution of a bond for the remaining fifteen-sixteenths, which is subject to cancellation on the production of customs proof of re-exportation to China. Under the drawback provisions, the full duty is payable at the time of importation or clearance, and fifteen-sixteenths is returnable on proof of re-exportation. The Bhamo-Panghkan route is that over which shipments of materials and equipment to the new factory of the Central Aircraft Manufacturing Company, across the Chinese frontier a short distance from Panghkan, are being made.

Contract for British Trucks.

In its issue of March 15th the RANGOON TIMES printed a press report from London to the effect that the Chinese Government had signed a contract with Thornycrofts (John I. Thornycroft and Company, Limited, London) for 300 motor trucks, of a value of "over £35,000", and that delivery at Rangoon of the first instalment would be made immediately. Later Reuters'

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correspondent here reported that the contract was understood to be for 1,000 trucks, and the value £250,000, that given for 500 trucks being obviously a mistake. In my despatch no. 149, of January 31, 1939, I included a report that 400 Thornycroft motor trucks obtained under a British credit would be used in commercial traffic on the Yunnan-Burma road.

Respectfully yours,

Austin C. Brady
American Consul

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Distribution:

1. Original and four copies to Department.
2. Copy to American Embassy, London.
3. Copy to American Consulate, Yunnanfu.
4. Copy to American Consulate General, Calcutta.

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A true copy of

the signed original

Regraded Unclassified

March 18, 1939

To: The Secretary

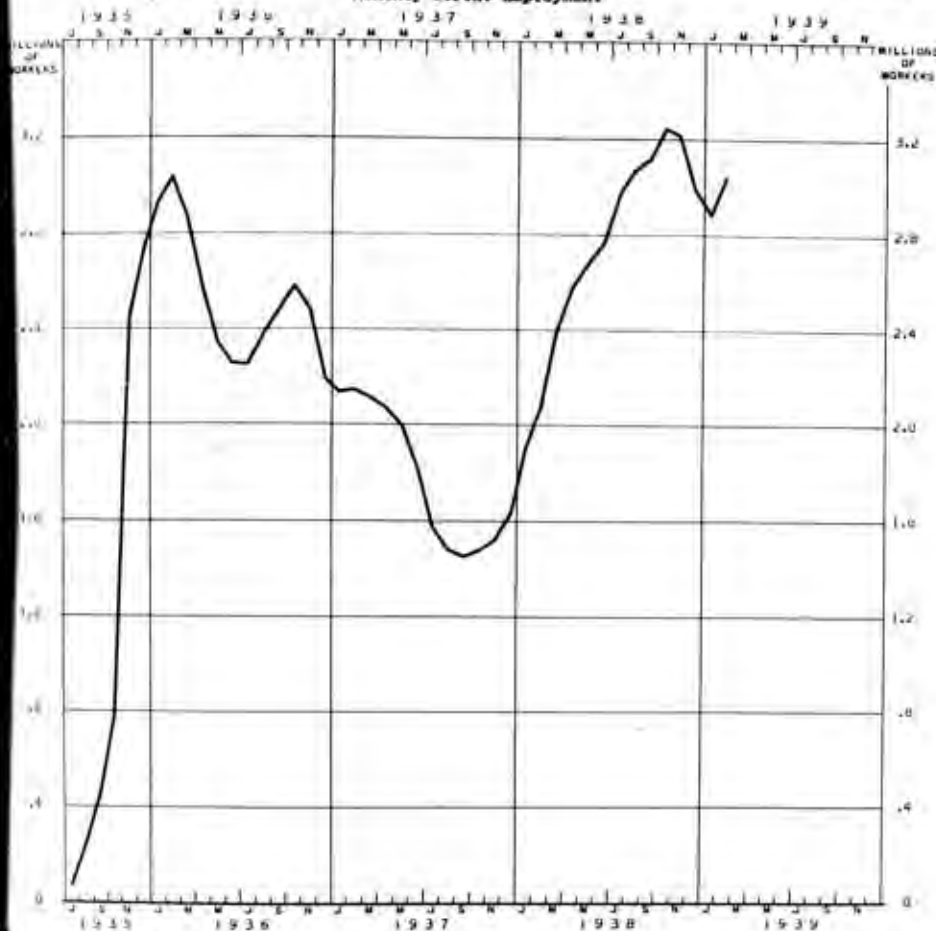
From: Miss Lonigan *EL*

GA
The total number of WPA workers
on March 11, 1939 is 3,009,486.

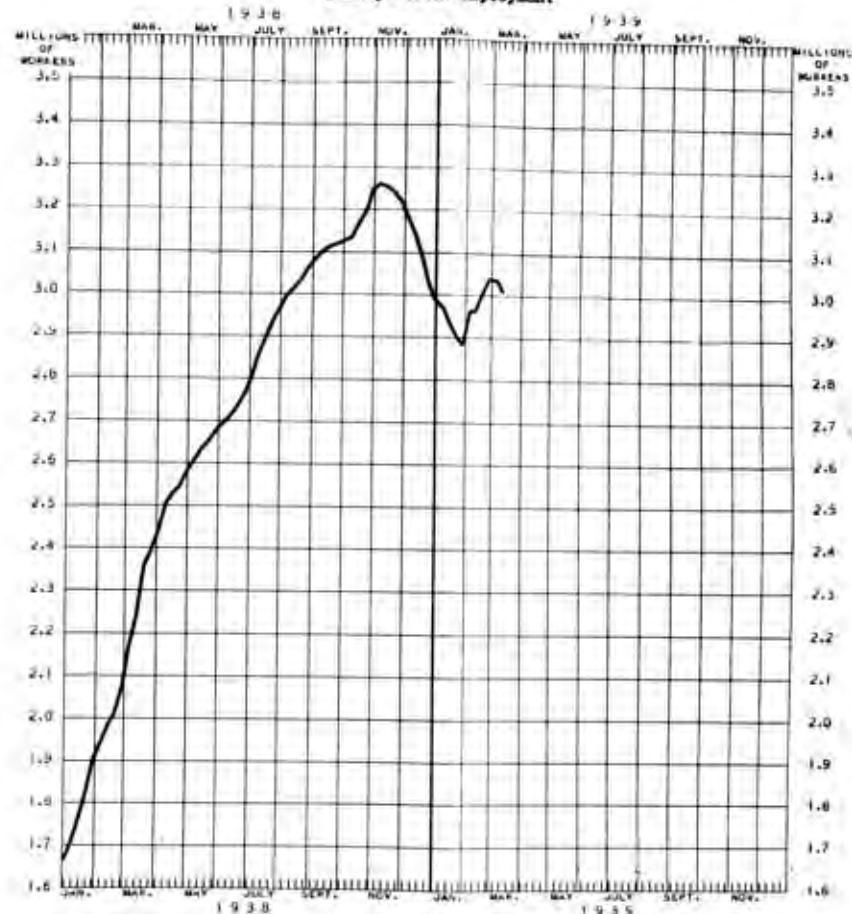
The decrease during the week from
March 4 to March 11 was 24,759 workers.

WORKS PROGRESS ADMINISTRATION
Number of Workers Employed
United States

Monthly W.P.A. Employment



Weekly W.P.A. Employment



SOURCE: WORKS PROGRESS ADMINISTRATION

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

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Regraded Unclassified

WORKS PROGRESS ADMINISTRATION

Number of Workers Employed - Weekly

20

United States

Week ending 1938	Number of Workers (In thousands)
June 4	2,693
June 11	2,712
June 18	2,736
June 25	2,767
July 2	2,807
July 9	2,853
July 16	2,899
July 23	2,938
July 30	2,967
August 6	2,993
August 13	3,017
August 20	3,039
August 27	3,067
September 3	3,086
September 10	3,102
September 17	3,114
September 24	3,120
October 1	3,129
October 8	3,137
October 15	3,167
October 22	3,201
October 29	3,245
November 5	3,263
November 12	3,258
November 19	3,244
November 26	3,216
December 3	3,185
December 10	3,139
December 17	3,083
December 24	3,021
December 31	2,986
1939	
January 7	2,967
January 14	2,927
January 21	2,898
January 28	2,883
February 4	2,966
February 11	2,964
February 18	3,010
February 25	3,043
March 4	3,034
March 11	3,009 a/

Source: Works Progress Administration

a/ Confidential

WORKS PROGRESS ADMINISTRATION
Number of Workers Employed - Monthly
United States

21

	Number of Workers (In thousands)
1936	
January	2,926
February	3,036
March	2,872
April	2,570
May	2,340
June	2,256
July	2,249
August	2,377
September	2,482
October	2,581
November	2,483
December	2,192
1937	
January	2,138
February	2,146
March	2,115
April	2,070
May	1,999
June	1,821
July	1,569
August	1,480
September	1,451
October	1,476
November	1,520
December	1,629
1938	
January	1,901
February	2,075
March	2,395
April	2,582
May	2,678
June	2,767
July	2,967
August	3,067
September	3,120
October	3,245
November	3,216
December	2,986
1939	
January	2,883
February	3,043 ^{a/}

Source: Works Progress Administration

^{a/} Confidential

Monthly figures are weekly figures for the
latest week of the month.

They include certified and non-certified workers.

Regraded Unclassified

March 18, 1939.
9:20 a.m.

WMJr: Hello.

Operator: Mr. Messersmith. Go ahead.
Geo. S.

Messersmith: Hello.

WMJr: Hello, Messersmith.

M: Oh, good morning.

WMJr: I'm only handling emergencies today. What is it?

M: Why, it's -- it's a personnel matter with respect to
Paris, Mr. Secretary.

WMJr: Oh well, that will have to go over.

M: It will have to go over?

WMJr: Yeah.

M: Yeah. Can I come over in the next week one day?

WMJr: Oh sure. Call me Monday because I'm only handling --
I'm really only handling emergencies.

M: All right. I agree with you.

WMJr: But sure, I'll be delighted to see you any time.

M: All right. I'll get in touch with your office Monday
morning.

WMJr: Thank you so much.

M: All right.

WMJr: Good bye.

M: Good bye.

March 19, 1939.
9:25 a.m.

HMJr: Hello.

Operator: Go ahead.

HMJr: Hello.

Miss Bumgardner: Hello.

HMJr: Mr. Morgenthau speaking.

B: Yes, Mr. Morgenthau.

HMJr: Who is this please?

B: This is Bumgardner, Mr. Morgenthau.

HMJr: Who?

B: Miss Bumgardner; the Attorney General's personal secretary.

HMJr: Right! Now, the Attorney General was to have at my office at nine o'clock the ruling on countervailing duties.

B: Yes.

HMJr: I'm waiting for it.

B: Will you hold the line, please? I'll.....

HMJr: No.....

B: Yes.

HMJr: You just do it, will you?

B: Yes.

HMJr: And -- it's nine twenty-five and I -- I -- as far as I know it isn't here.

B: Well, I'll check right away. I guess I know.....

HMJr: Are you familiar with it?

B: Yes, I am, Mr. Morgenthau.

HMJr: What is. ...

- 2 -

B: I was away yesterday, but I know he left word that that was to be at your office at nine o'clock.

HMAJr: Well, if it hasn't, follow through on it and see it gets into my own hands.

B: I will right away.

HMAJr: Thank you so much.

B: Sorry you had to call about it.

HMAJr: That's all right.

March 18, 1939.
11:18 a.m.

HMJr: Hello.

Operator: Mr. Welles. Go ahead.

HMJr: Hello.

Sumner
Welles: Hello, Henry. How are you feeling?

HMJr: Oh, I'm alive; how are you?

W: I'm -- I'm all right, thanks.

HMJr: I've just been doing social security.

W: I see.

HMJr: I -- when are you in favor of old age benefits starting? I'm in favor of them starting tonight.

W: I'm in favor of their starting at the age of forty-five.

HMJr: Me too.

W: Henry, I just wanted to get one thing clear in my own mind.....

HMJr: Please.

W: I had Thompson in last night.

HMJr: Oh, yes.

W: And I gave him the statement which you had had sent to me. I didn't give it to him textually, I read it to him.

HMJr: I understand.

W: And he expressed the opinion that his Government would be greatly concerned, to which I made no comment whatever.

HMJr: Right.

W: I wanted to know, is that statement of yours coming out today or is it coming out Monday?

HMJr: No, we were planning to release it about twelve-thirty.

W: That's fine. Because I think the sooner these things are done in sequence, the better the effect will be.

HMJr: Well, that's what I thought.

W: Yeah.

HMJr: And that's what I thought the spirit was yesterday.

W: That's just -- just exactly what I wanted.

HMJr: The boys are outside and if they -- we only got the Attorney General's opinion at ten.

W: I see.

HMJr: So that delayed us a little bit.

W: Yeah.

HMJr: No, we've been planning to do it between twelve and one.

W: That's grand.

HMJr: All right?

W: Thank you very much indeed.

HMJr: How's your -- you.....

W: What?

HMJr: You must be having a terrible time over there.

W: Well, it's been pretty strenuous, and.....

HMJr: I -- is there anything in this -- truth of this paper about Rumania now?

W: Well, Charlie Hurd of the New York Times called me up last night to give me that story.....

HMJr: Yeah.

W: And he says it's absolutely authentic. Now, we haven't got it from Bucharest but we have it in a cable from Kennedy today.

HMJr: I see.

- 3 -

W: So I imagine it's true.

HMAJr: Well, between twelve and one we shoot it.

W: That's fine.

HMAJr: Thank you.

W: Thank you, Henry. Good bye.

March 18, 1939.
12:19 p.m.

HMJr: Hello.

Operator: Secretary Ickes. Go ahead.

HMJr: Hello, Harold.

Harold Ickes: Hello, Henry.

HMJr: How are you?

I: Fine. Henry, giving a little party -- stag party Tuesday night in honor of -- of Pa Colonel General Secretary Watson.

HMJr: Really?

I: At which the President will be the guest of -- almost equal honor.

HMJr: On Tuesday?

I: Tuesday.

HMJr: I don't know whether we've got a thing, but if I have I'll try and break it. Could I let you know?

I: Will you let me know?

HMJr: What?

I: Will you let me know?

HMJr: I'll let you know this after.....

I: We haven't got the presses going over in the Bureau of Engraving, so bring a wad with you.

HMJr: All right.

I: Because you'll need it.

HMJr: What time would that be, Harold.

I: Six-thirty.

HMJr: Six-thirty at your house?

I: Yes, sir.

HMJr: Next Tuesday.

I: That's right.

HMJr: Sounds most interesting.

I: All right, Henry.

HMJr: And as I say, unless there's something that I don't know about; but I'll call you up when I go home. I'm at the office.

I: All right, Henry.

HMJr: Thanks very much for asking me.

I: I hope you can come.

HMJr: I hope so too.

I: Good bye.

March 18, 1930.
10:37 p.m.

WMJr: Hello.

Operator: Secretary Wallace. Go ahead.

WMJr: Hello.

Henry Wallace: Hello, Henry?

WMJr: Yes, Henry.

W: How are you getting along?

WMJr: O. K. We're getting out our release here in half an hour on countervailing duties on Germany.

W: Oh, yes. Bill Thatcher was in here and I wondered if you would care to eat lunch with him sometime.

WMJr: Well.....

W: He's got a reultimsted Farmers Union out in the northwest and he has -- well, I think it would be interesting for you and him to exchange views. He has some rather vigorous ideas of his own, I find.

WMJr: Well, if he's around Wednesday; if you want.....

W: How's that?

WMJr: I'd love to. I say, I'd love to.

W: Would you like to. "

WMJr: Yeah.

W: I -- well, what day would you suggest?

WMJr: Wednesday.

W: Wednesday?

WMJr: Yeah.

W: All right. I'll find if he's still going to be in town on Wednesday.

WMJr: Do you want to come here, or would you like me over there?

- 2 -

- W: Well, I'll invite you over here again. I'm still -- I'll still be behind on the meals.
- W: Well, I -- I enjoyed the last meal.
- W: All right, we.....
- W: Seeing it's Agriculture, we'll come over there.
- W: All right, sir.
- W: You let me know?
- W: I'll let you know. One other thing, when I got through at Cabinet yesterday, I had a talk with Patterson; find that -- I might have expected this, because Dan Roper is one of the vice -- Oscar Johnson's vice presidents.
- W: Yeah.
- W: Find that commerce has very -- that the folks down the line in commerce have a rather strong ideas against the -- against any export subsidy plan.
- W: Well.....
- W: But I think everything's going to work out fine, but I thought I'd let you know about that.....
- W: Well, that was a funny move that Cordell made anyway, to bring in the Commerce Department at this time.
- W: I had a good talk with Edminister and I feel that we're going to get the thing smoothed out, but that -- there's a possibility of a -- in view of that -- of that hookup, and in view of what Patterson told me about the way the people -- you see, it's rather a curious thing -- a very funny thing, they got hold of Patterson just before he came to Cabinet meeting and furnished him with a lot of arguments against -- they said, "Now, cotton may come up this afternoon," and they furnished him with a lot of arguments against the export plan.
- W: I'll be darned.
- W: Then, low and behold, it did come up.
- W: Well.....

- 3 -

W: But I don't -- I don't -- please don't.....

MR: No, no, no. I understand.

W: It's just simply amusing that's all, because I think everything is going to work out fine.

MR: Just a big happy family.

W: It's just a big happy family. We just get so much fun out of it all, Henry, it just.....

MR: Yeah, as long as you keep your back to the wall though.

W: (Laughter) That's all right, Henry.

MR: All right.

W: This is just for your information.

MR: I understand.

W: All right.

MR: I always walk backwards.

W: (Laughter) That's a good idea.

MR: C. K.

W: Fine. Good b.y.e.

MR: Good bye.



DEPARTMENT OF STATE
WASHINGTON

March 20, 1939.

My dear Mr. Secretary:

I am enclosing for your confidential information a copy of paraphrase of telegram No. 57 of March 20 from the American Legation, Praha, with regard to the gold of the National Bank at Praha.

Sincerely yours,

Herbert Feis

Herbert Feis,
Adviser on International
Economic Affairs.

Enclosure:

Paraphrase, No. 57
of March 20 from
Praha.

The Honorable

Henry Morgenthau, Jr.,

Secretary of the Treasury.

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Legation, Praha, Czechoslovakia

DATE: March 20, 1939, 11 a.m.

NO.: 57

A good authority has informed me that on examination of the vaults of the National Bank here the Germans found no gold. Where the gold is now I do not know, but believe it most likely that it was shipped to England; there is little doubt that several planes left here secretly for England just before the Germans took over this area. A story is also being circulated that on March 13 or 14 Beran and Syrový paid a clandestine visit to London by airplane.

CARR.

EA:LWW

FS

PLAIN

London

Dated March 20, 1939

Rec'd 2:03 p.m.

Secretary of State,
Washington.

RUSH

37¹/₂, March 20, 6 p.m.

FOR TREASURY FROM BUTTERWORTH.

I had a talk with Phillips at the British Treasury.

1. He said that the Chancellor of the Exchequer would make known to the House of Commons the steps taken by the Bank of England at the Treasury's request to ensure that Czechoslovakia's assets in London would for the moment be blocked and that a bill would be introduced in the House of Commons this week regularizing the position. The bill would provide that gold, securities and balances held on behalf of the former Czechoslovakia Government, the former National Bank of Czechoslovakia or any persons in the former Czechoslovakian Republic now on deposit in Great Britain could not be dealt with except with the consent of the British Treasury. The bill will also contain a provision to indemnify institutions operating in Great Britain against any losses that may be incurred through the carrying out these instructions. Both the instructions and the indemnity

of

FS 2-No. 374, March 20, 6 p.m. from London

of course are applicable to foreign banks operating here.

Phillips said they did not propose to repeat their experience over Austria, namely, to turn over all the assets in effect to the German authorities and then have to make a play without these trump cards for the settlement of obligations to British nationals. He said however that he did not expect that the British courts would in the future hand down judgments which would entail payments by the British Treasury as a result of the indemnification.

A notice has also been posted on the Stock Exchange requesting members to refrain from making any payments from balances or handing over any security held on behalf of residents in Czechoslovakia and stating that in the case of any uncertainty reference should be made to the Bank of England.

2. Phillips expressed satisfaction that the British fund had not lost unusual large quantities of gold given the prevailing circumstances. He emphasized however that this was merely "the beginning of a long job" and that it was very difficult to see the course of events at the moment. He called attention to the widening out of the forward rates as an indication of difficult times to come.

HE

FS 3-No. 374, March 20, 6 p.m. from London

He added that the joint stock banks were being informally and confidentially circularized to scrutinize all such transactions particularly carefully so that the prohibitions now in force would be as effective as possible; he implied that the British fund would not for the time being operate in the forward market to prevent a widening of the rate.. He also mentioned the substantial gold losses which were taking place in the case of Holland, Belgium and Switzerland.

3. Phillips stated that a note was being drafted to be sent to the French and American Governments regarding the practice which has been steadily growing since last fall of sending single gold bars by parcel post from France to the United States. While it was doubtless facilitating the efflux of gold from Europe his main objection lay in the fact that it was queering the gold fixing price because by this method gold bars could be shipped in bulk from London to Paris and singly from Paris to New York at approximately 3d. per ounce cheaper. The facility arises out of the Franco-American convention of December 1935 which permits a package to be shipped even if the value exceeds the declared limit of 1000 gold francs. The British Treasury has attempted to stop the practice through the insurance companies but the insuring is done through independent

FS 4-No. 374, March 20, 6 p.m. from London

independent Swiss concerns which will not discontinue such operations. The ordinary shipping rates would have to be cut by half to make the postal channel unprofitable.

Phillips stated that under the general postal arrangements gold can only be despatched under terms acceptable to the recipient country. The United Kingdom and India restrict sending and receiving to L 5, South Africa maintains a complete prohibition and Holland only allows the traffic if a certificate from the Ministry of Finance is obtained which in reality is not obtainable.

Phillips stated that he wanted you to have this background before receiving the official communication and he expressed the hope that France and the United States could singly or jointly devise a means of putting a stop to this practice. He felt reasonably sure that if such postal shipments were prohibited between France and the United States it would not be found possible to send such gold shipments from any other country to the United States by parcel post.

KLP

KENNEDY



DEPARTMENT OF STATE
WASHINGTON

March 20, 1939.

The Secretary of State presents his compliments to the Honorable the Secretary of the Treasury, and encloses for his strictly confidential information a copy of paraphrase of telegram No. 367 from the Ambassador at London.

Enclosure:

Paraphrase, No. 367
of March 20 from London.

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, London, England

DATE: March 20, 1939, 4 p.m.

NO.: 367

RUSH.

The following is strictly confidential for the Secretary of State and the Secretary of the Treasury:

Legislation is being introduced by Sir John Simon which will permit the Bank of England to hold up deposits in this country for Czech account. Sir John is a little embarrassed to admit in the House of Commons he has held them up without the authority to do so. However, he will argue that, at the time the original 10,000,000 pounds was voted to help out the Czechs after the conferences at Munich, it certainly had not been the intention to give the benefit of those funds to Germany. He will say that England is justified in trying to get back the advance already made in the amount of 3 1/2 million pounds.

KENNEDY.

FS

PLAIN

London

Dated March 20, 1939

Rec'd 2:55 p.m.

Secretary of State,
Washington.

375, March 20, 7 p.m.

FOR TREASURY FROM BUTTERWORTH.

The London Stock Exchange was weak again today with British Government securities leading the decline. War Loan 3½'s closed at 96.

The City is both nervous and perplexed. It realizes that the British Government's past policy has failed; it hopes that a new and better policy is in the process of formulation; and it has no definite idea what that policy will be or may entail.

The British authorities gave dollars freely at 4.68 1/8 and in the given circumstances the take-off was moderate. Gold fixing was large 258 bars being sold at 148s 6 d; 38 were married and the British fund supplied all of the remainder. After fixing market gold was offered at 148s 5½d which would work out at 34.7485 but arbitrageurs were reluctant to ship fearing insurance rises. There is little or no evidence of an increase in gold hoarding.

-of

FS 2-No. 375, March 20, 7 p.m. from London

Of the continental countries the Swiss franc in particular was weak and depreciated considerably in the absence of official support.

ALC

KENNEDY

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: March 20, 1939, 5 p.m.

NO.: 520

FROM COCHRAN.

The Paris market is nervous and depressed considering the international political tension and awaiting the appearance of decrees which Daladier will issue under his newly acquired authority. In support of the spot franc the French stabilization fund has yielded sterling; more offerings of forward franc. Sharp sag in French rentes. Losses of 6 to 10 percent in French shares. Dollars are being given importantly by Dutch control. The belga is being held at dollar parity. There has been a decline of about 1 percent in the Swiss franc, with flight of Danubian capital from Swiss centers. There is speculation among traders in Paris as to what concrete assistance the United States may be expected to give to France. These traders are curious over the gossip that Laval left Paris tonight to make a visit to Rome.

At five o'clock I had a talk with the Bank of France. The French control had by that time yielded 400,000 pounds. As compared with other European centers, this loss is not indicative of excessive pressure, since my friend believed that about five million dollars had
been

- 2 -

been spent by the Swiss, about ten million^{dollars}/by the Dutch,
and twenty million dollars by the British.

BULLITT.

EA:LWW

C A B L E

45

From: Bankers Trust Company of New York,
London Office

Date: March 20, 1939

DE CASTELLANE REPORTS CABINET RECEIVED WIDEST POWERS THAT WERE
EVER GIVEN TO A FRENCH GOVERNMENT SINCE THIRD REPUBLIC IN FACT
POWERS ARE DICTATORIAL. IT WILL EXPIRE NOVEMBER 30TH GOVERNMENT
HAVING TO SUBMIT DECREES TO PARLIAMENT BEFORE DECEMBER 31ST.
DALADIER'S GOVERNMENT HAVE FULL SUPPORT OF COUNTRY INCLUDING
COMMUNISTS WHO FOUGHT THE POWERS IN CHAMBER BUT WHOSE PAPERS ARE
IN FAVOR OF THEM. THIS IS LOOKED UPON AS THE LAST PHASE OF NATIONAL
REDRESSMENT. CERTAIN DECREES WILL PROBABLY BE ISSUED TODAY INTENDED
COMPLETE NATIONAL DEFENSE. 40,000 SPECIALISTS CALLED UP TO MAN
MAGINOT LINE. RUSSIAN PROTESTS CREATED VERY GOOD IMPRESSION
BELIEVED YUGOSLAVIA WILL FALL IN LINE DUE THEIR SUPPORT OF
CZECHOSLOVAKIA SINCE VERSAILLES. GENERALLY BELIEVED SEIZURE
CZECHOSLOVAKIA GRAVE POLITICAL BLUNDER. CONFIRMATION RECEIVED
IN PARIS OF ECONOMIC PRESSURE PUT ON RUMANIA. LAVAL NOT IN ROME
BUT SAID TO HAVE BOASTED HIS ABILITY MAKE SATISFACTORY SETTLEMENT
MUSSOLINI IF ASKED TO DO SO. AT POPE'S CORONATION CROWN PRINCE
RECEIVED TREMENDOUS CHEERING WHILST PRACTICALLY NO DEMONSTRATION
FOR CIANO. ITALIAN PEOPLE VERY MUCH CONCERNED. 1,200,000 to
1,300,000 GERMAN TROOPS UNDER ARMS. IN ITALY 700,000 CALLED UP
PLUS 100,000 IN LIBYA LARGE SUPPLIES AMMUNITION BEING SENT FROM
GERMANY TO ITALY. IN MILITARY CIRCLES DISAPPEARANCE OF CZECHO-
SLOVAKIA CONSIDERED AS DISASTER HOWEVER AM NOT PESSIMISTIC AS I
BELIEVE FIRM STAND TAKEN BY FRENCH GOVERNMENT IN CLOSE COOPERATION
WITH ENGLAND WILL MAKE DEFINITE IMPRESSION ON HITLER.



TREASURY DEPARTMENT

WASHINGTON

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Kunming, March 20, 1939

To: Secretary Morgenthau
From: J. Ionsing Buck

THE TIEN MING (KUNMING-BURMA) RAILWAY

Mr. Whitehouse, a Britisher who inspected the route of the Tien Mien Railway for the Ministry of Communications, stated to me that the Burma Railway interests in Burma are not considering extending their line to the Chinese border to meet the Chinese line until the latter is completed, and even then there may be some question of whether or not they will do it. There appears to be no doubt about the Chinese intention of building the line from Kunming to the Burma border judging by the amount of activity. Mr. Sak, Director of the Railway, Mr. Mau, League of Nations adviser to Ministry of Communications, and others in a position to judge, all state that it would be a tremendous advantage if the Burmese Railway could be extended to the border immediately so as to facilitate bringing materials for the Chinese part of the line. It appears as if some pressure should be brought on the Burmese Railway interests to carry out such extension of their line.

To: Secretary Morgenthau
From: J. Lossing Buck

Kunming, March 20, 1939 -2-

TRANSPORTATION

(Interview with Mr. H. C. Maur, League of Nations advisor to
Ministry of Communications)

"The capacity of the French Railway can be trebled if the amount of rolling stock is sufficiently increased. At present the French Railway officials are thinking in terms of increasing the capacity only 50 per cent as they are afraid to invest too heavily. I am recommending to the Minister of Communications that he buy or borrow rolling stock from other railroads and loan same to the French Railway and after the war use such rolling stock on new railways in China."

"A new road is being completed from Indo-China into Western Kwangsi to take care of road transportation in case the present road through Kanning is cut by the Japanese. The road from Linchow to Kweiyang is so badly rutted now that private cars cannot pass."

"The Southwest Highway Company is the best organized transportation company and the Southwest Transportation Company is second. The former is for road maintenance and for civilian transportation."

"French and British interests are discussing the possibility of financing the Kunming-Suifu Railway but it will probably take them years. Is there any possibility of American interests financing it? Construction work is not very difficult on this road from Kunming to Suanwei but much of the remaining section is extremely mountainous and subject to landslides. I have seen this country from the

To: Secretary Morgenthau
From: J. Lossing Buck

Kunming, March 20, 1939

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plane. It will take years to build this line. After it is built comes the question of its economic value after the Yangtze is opened."

"I have urged the Minister time after time to give more attention to the proper surfacing of the roads so as to cut down on wear and tear of trucks."

To: Secretary Morgenthau
From: J. Louising Buck

Kunming, March 20, 1939

-4-

KUNMING-SUIFU (SZECHWAN) RAILWAY

(Interview with Mr. T. Sung, Director, March 13, 1939)

"Earthwork on the railway bed is well along for a distance of 50 kilometers out from Kunming. Small culverts, temporary bridges and earthwork to Suanwei, a distance of 250 kilometers north of Kunming, will be completed by September, 1939 ready for laying rails. If materials can be brought in, the railroad will be running to Suanwei by the end of this year. 30,000 workmen are now employed and will be increased to 100,000 by the end of this month. Some improvement in longer hours of work by the workmen is taking place. The railroad is divided into five sections with five surveying parties totalling 300 persons in the field."

"The congestion at the Kunming French Station will end in June when goods can be unloaded in temporary secluded godowns along this new line. The connecting line to the first station where rail materials will be unloaded will be completed within two weeks."

To: Secretary Morgenthau
From: J. Lossing Buck

Kunming, March 20, 1939

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(Interview and inspection trip with Mr. Wu, Chief Engineer
of Kunming-Suifu Railway, March 18, 1939)

Through the courtesy of Mr. Sung, Mr. Wu took me for an inspection trip of the work on the road bed and on the Union Station of this railway and the Kunming-Burma Railway. The earthwork on the connecting link of this railway with the French Railway is practically completed. The bridge to the station half way between the two lines will be finished in two weeks. The distance of this connecting link is five kilometers and rails are laid to the bridge, about one-half the total distance. Earthwork on the Union Station is perhaps 50 per cent completed. The layout is good. Mr. Wu pointed to an unfinished road bed which had to be abandoned on account of objection of local large landlords (officials).

Mr. Wu mentioned the extreme difficulty of building the line from Weining to Suifu, a distance of 350 kilometers where grades will be as high as 12.5 per cent and curves 15 per cent. The drop in elevation between these two points is about 1900 meters.

To: Secretary Morgenthau
From J. Lessing Buck

EXTENSION OF SILKWORM INDUSTRY IN YUNNAN

The former head of the Central University Sericulture Experiment Station, Mr. Chan Chung-hwei, is now representing the Ministry of Economics for the promotion of sericulture in Yunnan. He took me to his Sericulture station here and I found him in the process of setting out 160 acres in mulberries shipped from Chekiang province. The land is hill land with good soil depth but rather infertile. A silk filature site has been chosen on the outskirts of Kunming and work will be started soon. Three haies have been selected for the extension of the industry and the National Agricultural Promotion Commission has just granted Yunnan province 20,000 yuan to assist in sericulture extension. In all, about one half million yuan are being devoted to the promotion of the industry. The object is to produce raw silk to meet the standards of American filatures and for shipment to America.

March 20, 1939.
11:39 a.m.

WJr: Hello.

Operator: Mr. Altmeyer. Go ahead.

WJr: Hello.

Arthur
Altmeyer: Hello.

WJr: Hello.

A: Altmeyer.

WJr: Morgenthau.

A: Yes.

WJr: I wanted to tell you before we went to the President. I have changed my position over the weekend on this program.

A: I see.

WJr: And I want to tell you what it is. I'm in favor of not increasing the tax, but permitting the benefits to start in '40. Now, I have with me about four different memorandums that I have been asked to give the President; one from Eccles, which I haven't yet received; one from Mr. Frederic Delano; and one from Mr. Lauson Curry and Ben Cohen, all of which are a little bit different and all of which I have been asked to give the President.

A: But.....

WJr: I.....

A: But all to the effect of not wanting to increase the tax.

WJr: Oh no, the Curry -- the Curry-Cohen plan is quite different. The Curry-Cohen plan is that -- to start paying everybody over sixty-five years old immediately.

A: Yeah.

WJr: It would cost around nine hundred million dollars.

A: Uh-huh. But you -- you changed your mind, and you're not in favor of increasing the tax?

- 2 -

FMJr: I'm in favor of not increasing the tax but -- but starting the benefits in '40.

A: I see. Why did you change your mind?

FMJr: Well, I've been doing nothing but working on it since that, and I've just decided after listening to everybody for a month that, from every standpoint, that that's the best advice I can give the President.

A: I see.

FMJr: I mean, it isn't arrived at lightly. I have just worn myself out arriving at the conclusion.

A: Yeah. All right.

FMJr: But I wanted you to know.

A: All right.

FMJr: Thank you.

March 20, 1939.
11:38 a.m.

WMJr: Hello.
Alben W.
Barkley: Hello.
WMJr: Hello, Alben.
B: Hello, Henry.
WMJr: How are you?
B: All right, how are you?
WMJr: Oh, I've been better and I've been worse.
B: Well, I'll tell you what I called you about. I don't know that anybody will do it, but in the event somebody takes a crack at your order about this twenty-five per cent increase in duties.....
WMJr: Yes?
B: I'd like to have the facts over here from which it's based. Could you send me something over?
WMJr: Oh, I'd love to.
B: So that if anybody brings it up, I'll know what I'm doing.
WMJr: I'll send Ed Foley up there with Johnson from Customs.
B: Well listen, I won't have time to talk to them. If you've got any -- because I've got to be on the floor.
WMJr: Well.....
B: On this reorganization; but I thought if you had a memorandum of some kind.....
WMJr: Well, we'll dash off something.
B: Huh?
WMJr: I'll dash off something for you.
B: All right. I -- I want the facts. I know, of course, in a general way, but I mean the specific.....
WMJr: Right.

- 2 -

B: Facts upon which you base this.....

HMJr: Who should we give it to if you're on the floor?

B: Well, just send it in to me.

HMJr: Righto.

B: All right.

HMJr: Thanks for the opportunity.

B: All right.

March 20, 1939.
9:32 a.m.

HMJr: Hello.

Operator: Mr. Welles. Go ahead.

HMJr: Hello.

Sumner:
Welles: Good morning, Henry.

HMJr: Hello, Sumner.

W: I wanted to ask you if it would be convenient for you, since I find now that I'm at my desk that I'm tied up here with no end of things, that I could drop in to see you to have our talk, say nine-thirty tomorrow morning instead of today.

HMJr: As far as I know, Sumner. If anything should come up between now and then, why we'll just change it.

W: Yes, indeed. Just let me know.

HMJr: See?

W: If I don't hear from you, I'll drop in at nine-thirty tomorrow morning.

HMJr: Fine!

W: And one other thing.....

HMJr: Please.

W: The President was speaking to me yesterday on the telephone, referred to a report that Elephant had rendered you last summer.....

HMJr: Yes.

W: Which rejoices in the title of the "E.T.B. report".

HMJr: Yeah.

W: He wanted very much to have me go over that. Could you have a copy sent to me?

HMJr: Well, this thing -- I'll send you a copy with one understanding, that this thing does not have my endorsement.

W: I understand.

- 2 -

HMJr: See?

W: Yeah.

HMJr: I mean these are a number of things which the attorneys put down but does not -- it raises a lot of questions but it does not have my endorsement.

W: Yes indeed.

HMJr: See?

W: I understand fully.

HMJr: With that understanding, I will send it to you.

W: Thank you very much.

HMJr: I'll have it over within the hour

W: Thank you, Henry.

HMJr: Righto.

W: I'll see you in the morning. Good bye.

HMJr: Good bye.

March 20, 1939.
11:40 a.m.

Guy
Helvering: Yes.

HMJr: Henry talking.

H: Yeah. I thought, Mr. Secretary, you might be interested in knowing that in this Kansas City situation there was some pretty important evidence that was developed out there on Friday.

HMJr: Yeah.

H: Before the Grand Jury.

HMJr: Yeah.

H: Did you know about it?

HMJr: I don't know a thing about it.

H: Uh-huh. Well, we haven't got the report in. I -- I got that through another channel.

HMJr: Well, what -- what does it show, Guy?

H: Well, it shows this man McCormick who's received this big insurance money.....

HMJr: Yeah.

H: He broke down before the Grand Jury and told the whole story -- how much he paid Grenadin and how much he paid Malloy, the insurance commissioner and everything else.

HMJr: You -- you haven't got something that I could show the President at one o'clock on it?

H: No, I haven't -- the report to Mr. Irey isn't in yet.

HMJr: Well, what -- whatever you've got, I couldn't get that?

H: Well, the only thing I've got is one of men from our office here, Mr. Carter, my assistant, was in Kansas City and he just got back this morning.

HMJr: Could you write a -- a -- just an informal memorandum and send it to Mrs. Klotz and she could give it to me?

- 2 -

H: Yes.

HMJr: Will you do that so I can tell the President about it
at one o'clock.

H: Yes. All right.

HMJr: Thank you very much.

March 20, 1939.
2:31 p.m.

HMJr: Hello.

Operator: Chairman Douglas.

HMJr: Hello.

William O. Douglas: Hello, Henry.

HMJr: My heartiest congratulations.

D: Thank you, Henry. I appreciate it very much.

HMJr: I am simply delighted and had the opportunity to tell the President so at lunch. I just got back.

D: Well, it was very kind of you. I....

HMJr: I think it's wonderful.

D: I want to have a long talk with you before things are liquidated.

HMJr: Well, I want to talk with you, and I'm at your disposal.

D: Swell, Henry, and sometime this week I'd like to sit down for about an hour, maybe, and go over some stuff.

HMJr: Well.....

D: Make some plans for the future.

HMJr: All right. If you're free Thursday -- yeah Thursday. Are you free Thursday for lunch?

D: I'm not sure now whether I will be or not for this reason, I have to go up to New York for Wednesday, and whether I'll be back Thursday morning, I'm not sure.....

HMJr: Well.....

D: But I'll let you know tomorrow.

HMJr: You'll let me know.

D: Yeah.

HMJr: I'm very anxious to see you and congratulate you in person.

- 2 -

D: Thank you. Thank you, I appreciate it very much,
Henry.

HMJr: Good bye.

D: Good bye.

March 20, 1939.
3:14 p.m.

Operator: Go ahead.

HMJr: Hello.

Emanuel
Celler: Hello, Mr. Secretary?

HMJr: Talking.

C: Oh, Mr. Morgenthau, this is Mr. Celler.

HMJr: Hello, Mr. Celler.

C: I'm sorry we've been missing each other since last week.

HMJr: Well.....

C: You -- you called, I think.

HMJr: Yeah. I called you up to tell you I liked that radio duet that you and McCormack put on.

C: Well, that's nice to hear you say that.

HMJr: I thought that was very constructive.

C: Now, we're going on again in about ten days.

HMJr: Are you?

C: And if you have any ideas you wanted us to promulgate..

HMJr: Yes.

C: I'd be very happy to receive them.

HMJr: Well, that's something worth thinking about.

C: We had wonderful response.

HMJr: Did you?

C: Oh, the mails were terrific on it.

HMJr: Is that right?

C: And -- well, mostly -- mostly commendatory. I would say that -- oh, nine out of ten of the communications were commendatory.

- 2 -

WMJr: Is that right?

C: And I -- my experience and John's was the same.

WMJr: Well, you ought to let the White House know that.

C: Well, I'd be -- how would we do that? I'd be glad to do it.

WMJr: Well, you were down there the other morning. You....

C: Well, I -- I wasn't talking -- I didn't have that in mind. I had something else I was talking about, but I'll be glad to send word.

WMJr: Ah...

C: I'd want it -- I'd want to do it in the most effective way, though.

WMJr: Well....

C: Keep that in mind -- you might keep it in mind also when you have your chats.

WMJr: Right.

C: I'll -- I'll get to work on it, but now meanwhile if you -- if Mr. Hanes and you want us to get anything in there, you might -- I'll be glad to talk to you or John.

WMJr: Well, I meant to let the White House know -- I mean, simply if you walked down there some day and say to the President, "Here's the result of my radio talk. I'd like to show it to you."

C: Yes.

WMJr: I didn't mean to do anything publicly.

C: No. Oh, I know that. Oh, I'm aware of that, of course.

WMJr: Well, why don't you walk down there and simply say, "Here we -- McCormack and I made this talk and here's the -- here's an analysis of our response."

C: I -- I think that's a good suggestion.

WMJr: And you and McCormack might go down together.

C: That's a very, very good suggestion.

HMJr: I think it would be helpful at this time.

C: All right. Now, meanwhile tuck away in your mind the other idea -- if you want us to -- got any ideas you want to -- want us to spill on the radio in about two weeks over another National Hookup, why just let us -- let us know.

HMJr: O. K.

C: Now, one thing else, while I'm on the wire.....

HMJr: Yes.

C: I was very happy to see that matter of countervailing duties imposed against German -- against German imports.

HMJr: That's right.

C: I was -- was a little disturbed when I got the letter and then followed it up soon afterwards with the change. I didn't understand that, but Steve Gibbons called me.....

HMJr: Yeah.

C: And told me the situation.

HMJr: That's right.

C: Well, that's fine.

HMJr: O. K.

C: Thank you very much.

HMJr: Good bye.

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TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE March 20, 1939

TO Secretary Morgenthau
FROM W. H. Hadley

Summary of Government Security Market

week ended March 18, 1939

The principal feature of the government security market during the week was pronounced weakness during the last two days as a result of foreign developments. During the first of the week the market was quiet and practically unchanged. Although there was only a slight amount of selling during the period of weakness, quotations on Treasury bonds dropped from 5 to 19/32nds. At the close Saturday there was evidence, however, of potential demand and today (Monday) the market has resumed a firm tone and buying interest has again developed. Treasury notes were practically unchanged during the week while guaranteed bonds, in sympathy with Treasury bonds, were off 11 to 14/32nds.

Dealers' Portfolios

Principal change in dealers' holdings was a reduction of \$27 million in bond holdings. This was the result of partial distribution of bonds obtained on subscriptions. An increase in 1-year notes of \$12 million appears to give indication of dealers starting to accumulate "rights" for the next Treasury financing.

Dealers' Portfolio
(in millions)

	<u>Week ended</u> <u>March 11</u>	<u>Week ended</u> <u>March 18</u>	<u>Net Change</u>
Treasury bonds	53.0	36.0	- 27.0
Treasury notes (1 year)	20.0	32.3	+ 12.3
Treasury notes (1-5 yrs.)	20.7	9.9	- 10.8
Treasury bills	8.4	10.7	+ 2.3
H. O. L. C. bonds	18.2	9.9	- 8.3
F. F. M. C. bonds	<u>1.0</u>	<u>4.2</u>	<u>+ 3.2</u>
	131.3	103.0	- 28.3

Dealers' volume of business was considerably reduced from the previous week. Average daily volume was about \$180 million, of which about \$120 million was in Treasury bonds. Even on the days of weakness (Friday and Saturday) volume increased only slightly.

New Security Issues

The new corporate security market, except for one issue of \$1,200,000 long term bonds, was quiet. There are, however, two or three large issues in registration which may be forthcoming in the near future.

Corporate Bond Market

The corporate bond market also moved down considerably during the latter part of the week as a result of the unsettled European situation. Moody's AAA bond average, which had reached an all-time high in the previous week, was about 3/8ths of a point lower at the close of the week, while medium grade issues (BAA) went down 1-1/8 points. Medium and second grade rail bonds, which had led the previous rise, showed the greatest declines. Foreign issues, led by Czechoslovakian bonds, were substantially easier.

Treasury Investment Accounts

There were no purchases in the open market for investment account during the week. However, \$10 million short Treasury bonds (3-1/4% of 1941) were sold for account of Postal Savings and funds from this sale were re-invested in special 2% Treasury notes to the amount of \$11 million. Postal Savings now holds \$75 million special 2's. There was also a \$2,700,000 investment for Government Life Insurance Fund in special 2's, bringing the total of such holdings in this account to \$13,300,000.

Federal Reserve System Account

Aside from a \$1 million shift from short term bonds into the 1960-65's, the Reserve System confined its operations to replacement of Treasury bill maturities. The \$29 million maturity of March 15 was replaced by a like amount of bills, \$20,500,000 of which were new. In anticipation of \$72,710,000 maturity of March 23, the System has already purchased \$5 million Treasury bills and \$15,500,000 Treasury notes maturing from 1942 to 1943.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE Mar 20, 1939

TO Secretary Morgenthau
FROM A. Lockhead

Called up Dr. Feis, State Department, and reminded him that at the State Department's request the Secretary had telephoned the President of the Federal Reserve Bank of New York on Thursday night and had asked the Federal to get in touch with the New York banks and suggest to them that they make no extraordinary payments out of Czechoslovakian account for the balance of the week. As this request to the New York banks covered only the balance of last week, asked Feis if he had any further news on this subject. Feis checked with Under Secretary Welles and informed me that in view of the conversations the Secretary of the Treasury, Under Secretary Welles and the President had, Mr. Welles did not have any further instructions and thought that the State Department should be bound by whatever action the Treasury cared to take.

There were two possible courses of action discussed:

- (1) Not to give the banks any further instructions but trust to the fact that in the protection of their own interests they would probably not make any payments out of Czechoslovakian accounts before referring to the Federal Reserve Bank;
- (2) To call the banks and tell them that they would have to use their own judgment, but suggest that they not make any extraordinary payments until they had satisfied themselves that they were properly protected.

Dr. Feis stated that Mr. Welles would be agreeable to either one of these two courses, and as we had not been able to find anything much more than \$3,000,000 on deposit for former Czechoslovakian accounts in New York, the amounts on which payments could be stopped were not very important.

Secretary Morgenthau instructed Lockhead not to take any further action on this question until we had either received a request from the State Department or heard from the President of the Federal Reserve Bank of New York.

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March 20, 1939

Dear Sumner:

Complying with your request, I am sending you herewith various suggestions made to me by the General Counsel's Office.

Please bear in mind that these suggestions do not have my endorsement and I would appreciate it if you would not circulate them outside of your office.

Yours sincerely,

Hon. Sumner Welles,
Under-Secretary of State.

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Yours sincerely,

Hon. Sumner Welles,
Under-Secretary of State.

Our one and only copy - 72

Took to WH

Foley
R

lunch 3/20/31

Non-legislative Action Which the Government Can Take in
Case of a War Abroad in Which the United States is Not a Party.

I

Monetary and Fiscal Control

- A. Reinststate foreign exchange control by revoking the general license under which foreign exchange transactions are now taking place and extend such control to ordinary commercial transactions, which were not previously covered. Within this frame, any degree of control could be carried out.
- B. Stop selling gold and prohibit export of gold and silver.
- C. Take immediate steps to bring home gold and silver owned by the United States and held abroad.
- D. Status of Tripartite accord. We may wish either to terminate this on 24 hours' notice or take steps to strengthen the accord along lines which would extend our cooperation with the democratic countries.
- E. Nationalize or control holdings abroad of currencies, securities, etc., by American nationals.
- F. Use free gold and silver, stabilization fund, and other resources to support Government bond market and to cover demands for payment on "baby" bonds.
- G. Use free gold and silver and other available assets and means within the Government's power to counteract any contraction in the economy, fall in the market, or flight from the dollar, etc. Plans should be further developed with SEC and Federal Reserve Board for dealing with the sudden liquidation of foreign-owned securities and for supporting the Government bond market. This might entail the closing of the stock markets or might perhaps involve the setting up of machinery for the orderly liquidation of foreign-owned securities. In this connection papers have been drawn to create a privately-owned corporation to assist in the orderly liquidation of securities and other property of foreigners.
- H. Filing of detailed reports concerning all property in this country held by foreigners.
- I. Through control of payments by banks in this country, sterilization of all gold held in this country under earmark, and other means, prevent the use by belligerents of their assets in this country or the sale of their property in any manner inconsistent with our interests.

- 2 -

- J. Upon issuance of a Presidential proclamation recognizing the existence of a state of war, application of Section 3 of the Neutrality Act which makes it unlawful for any person within the United States to purchase, sell or exchange obligations of a belligerent government or to extend any credit to a belligerent.

II

Control of Prices and Supply of Commodities

- A. Creation of a central purchasing agency, representing the democracies, to get increased bargaining power as an antidote to rising prices of war and related materials.
- B. The use of cheap credit extended by RFC to competing companies which can get into production and/or which agree to keep prices down.
- C. Hearings before the Temporary National Economic Committee on commodities or articles whose prices are running up too high.
- D. The timing of Government purchasing to keep prices down.
- E. Use of any other Government agency or mechanism, such as, perhaps, the AAA, Export-Import Bank, etc., to control prices and supplies of commodities.

III

Customs Control

- A. Discriminatory Duties. Even in the absence of war, under the Customs laws, the President, when he finds it in the public interest, may proclaim new or additional duties up to 50 per cent of the value on articles wholly or in part the product of or imported in a vessel of Germany whenever he finds as a fact that such country discriminates in fact against the commerce of the United States. In published letters addressed to you in connection with trade agreement proclamations, the President, on several occasions, has stated that he finds it a fact that Germany discriminates against the commerce of the United States.

If, after the new duties are imposed, Germany maintains or increases its discrimination against the commerce of the United States, the President, if he deems it consistent with the interests of the United States may issue a further proclamation directing that the products of Germany or articles imported in German vessels shall be prohibited importation into the United States.

- 5 -

- B. If the President issues a proclamation under the Neutrality Act that a state of war exists between foreign nations, the following action must be taken:
1. Prevent the departure of vessels intended for conduct of hostilities or to supply warships of belligerents.
 2. Enforce the export and import restrictions of the regulations governing international traffic in arms.
 3. Enforce the observance of neutrality in radio communications by vessels.
- C. If the President also declares that the placing of restrictions on exports other than war materials is necessary to promote the peace and security of the United States, Customs and Coast Guard will have to prevent the departure of American vessels carrying such materials directly or indirectly to belligerent states.
- D. Whenever the President shall have issued proclamations under the "Cash and Carry" clause of the Neutrality Act, Coast Guard and Customs will be required to prevent exports unless title has passed to the consignee before shipment.
- E. Concurrently with the proclamation of a state of war under the Neutrality Act, or independently thereof, the President, under the Espionage Act of June 15, 1917, may declare a national emergency to exist, and the Secretary of the Treasury may make rules and regulations governing anchorage and movement of vessels from the territorial waters of the United States. Customs and Coast Guard would enforce such regulations. Rough drafts of the necessary papers have been prepared.
- F. If the President restricts or prohibits the importation of products of Germany on the ground that importation of products of the United States is prohibited or restricted by Germany, the Coast Guard and Customs will enforce such prohibition or restriction.
- G. If the President orders the detention of any vessels on the ground that it is discriminating against American nationals in the shipment of commodities Customs and Coast Guard will enforce the order.
- H. If the President orders the withholding of clearance of any German vessels on the grounds that the German Government is not affording the same facilities to American vessels as are afforded by the United States to German vessels, Customs and Coast Guard will enforce such order.

1. If the President, independently of the Neutrality Act, orders the withholding of clearance of any vessel on the ground that there is reasonable cause to believe that it is about to carry arms, etc. to a belligerent in violation of our laws, treaties, or international obligations, Coast Guard and Customs will enforce such order.
2. If the President exercises his authority to order the detention of certain armed vessels in ports of the United States if suspected of intent to aid belligerents, Coast Guard and Customs will enforce the detention.
3. If the President proclaims the finding of an emergency and grants authority to the Secretary of the Treasury, Customs will permit imports free of duty of food, clothing, medical, surgical and other supplies for use in emergency relief work or extend during the continuance of such an emergency the time prescribed for the performance of acts under the Customs laws.

WJTB
McCarty 8.11.76.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE

March 18, 1939

TO Secretary Morgenthau
FROM E. H. Foley, Jr., Acting General Counsel

Attached is a memorandum enumerating problems and possible courses of action affecting the Treasury Department which should be considered in the light of the current European crisis and possible developments.

I will be at Robert Winmill's, Warrenton, Virginia, until tomorrow evening. If you need me, I can get back to Washington in an hour. The telephone number is Warrenton 210.

E. H. F.

Attachment

77A

CONF

March 18, 1939

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

Attachment

EHP:s Typed 3/18/39

History means = 3/20/31 HM
End to war H.
6x170 *Read this*
713
Abp
700

Non-legislative Action Which the Government Can Take in
Case of a War Abroad in Which the United States is Not a Party.

I.
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- J. Upon issuance of a Presidential proclamation recognizing the existence of a state of war, application of Section 3 of the Neutrality Act which makes it unlawful for any person within the United States to purchase, sell or exchange obligations of a belligerent government or to extend any credit to a belligerent.

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- 77D
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White's memo - April 2

Proposed Course of Action for Tripartite Members

1. All Tripartite members other than the United States will requisition all foreign balances, securities, assets and gold owned by their nationals.
2. The United States will revoke general foreign exchange license and will tighten foreign exchange control and restrict payments by banking institutions in the United States. Copies of the documents accomplishing this marked Exhibit "A".
3. The United States will also require complete reports to be filed with respect to all foreign-owned balances, securities and all assets located in the United States. Copies of such report forms are annexed.
4. Other members of the Tripartite will require similar complete reports to be filed with respect to all foreign owned balances, securities and all assets located in their respective countries. We will furnish the foreign countries with copies of our report forms as a suggestion with the end in view of having all countries requiring comparable information to be filed.
5. All the information thus obtained will be made reciprocally available to the members of the Tripartite Accord.

The foregoing will facilitate enormously the Tripartite members in acquiring assets in this country belonging to its nationals, since the foreign nationals will know that we will have information as to their assets in this country which we will turn over to their governments. The foreign exchange control will prevent the foreigner from pulling the assets out of the United States while this system is being set up. It would seem probable that in a comparatively short time, say two weeks, the Tripartite members will have acquired all of the assets in this country owned by their nationals so that it will be possible to loosen the foreign exchange control. This program would likewise have the advantage of facilitating the carrying out of the government foreign policy.

6. There will be set up a committee consisting of representatives of each of the Tripartite members. This committee will coordinate the utilization of the foreign exchange assets of each of the Tripartite members located in the United States and elsewhere; and will also coordinate the liquidation of foreign securities. This committee will have complete information as to the foreign exchange assets of each country, each country's need for foreign exchange, the conditions of the markets in the United States as well as elsewhere and will therefore be in a position to facilitate an orderly use of foreign-owned assets in this country. Fundamentally this committee will only be of an advisory capacity, yet the likelihood is that it will be able to exercise great influence in view of the desires of the other Tripartite members to gain our cooperation. In connection with the formation of

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this committee and the taking of the action aforementioned, it will be desirable to make public a statement of the action to be taken and thereby instill confidence in the public and assure them that the governments involved have complete control of the situation and thus minimize the probabilities of panic conditions resulting.

7. A statement should be prepared to be presented to the various members of the Tripartite (except England, who should be informed of the measures taken), either by way of Cochran or by way of the financial representatives of the governments in Washington. Exhibit "C" is suggested draft of the statement to be given to the four foreign governments.

After having received the reaction of the various governments to the proposal we will be in a better position to decide the next move.

An alternative method of approach would be to first communicate with the French and indicate our belief that they should go along with the British proposal. Once having gained French approval, we would then consult with the French and British about the plan above mentioned. The approach to the junior members of the Tripartite would be made after an agreement is reached between the senior members thereby being able to bring stronger pressure to bear on the junior members if necessary.

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Exhibit "C"

Draft of suggested communications to members of the Tripartite
Accord

The recent behavior of our security markets has given us concern as to the future stability of the security markets in the event of an increasing acuteness of the international political situation. We feel it highly desirable to protect our economy as much as we can against the adverse effects arising from any sudden and large liquidation of foreign holdings in the United States and elsewhere.

One of the effective procedures which has suggested itself is for the members of the Tripartite Accord to consult with each other and agree upon measures for the control of the liquidation of foreign securities held by its nationals in each other's markets.

For its part, the United States Government proposes to take whatever steps are necessary to defend its security markets from disorderly liquidation of securities by foreigners in the event of major disturbances abroad, but to attain this end we prefer measures which will be consistent with the interests of the other countries and will be in full conformity with the spirit of the Tripartite Accord. We would appreciate a prompt expression of your views on this proposal.

Prepared by: Lawrence Seltzer
Sidney G. Tickler

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PARTMENT

INTER OFFICE COMMUNICATION

DATE March 20, 1939

TO Secretary Morgenthau
FROM Mr. Haas
Subject: Depression and Recovery in Great Britain and the United States

I. The General Thesis

The National Industrial Conference Board has published a bulletin, dated December 19, 1938, entitled "Depression and Recovery in the United Kingdom and the United States." The bulletin presents a considerable amount of factual material showing that the great depression was much less severe, and that economic recovery has been far more complete, in England than in the United States.

Although the bulletin does not express any such inference, many readers are likely to summarize the materials in some such fashion as this: "Great Britain embarked upon no NRA, no CWA, no FWA, no WPA, etc., etc. She kept her budget in balance right through the depression. By 1935, her recovery had already exceeded the 1929 levels in her industrial production and national income. The United States, in contrast, followed an expensive pump-priming policy which more than doubled the national debt. Yet (perhaps in consequence), her industrial production was still 5 percent below 1929 levels in her peak recovery year 1937, and her national income, even farther below -- despite the interim growth in population."

II. The Statistical Facts

In the great depression, per capita national income in the United States fell by 47 percent, and even in 1937 was still 23 percent below the 1929 level (N.I.C.B. estimates). In England, on the other hand, the maximum decline was only 16 percent; and by 1937, the British per capita national income had risen to 17 percent above the 1929 level.

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Between 1929 and 1938, the per capita governmental debt of the United States -- Federal, State, and local -- increased by 56 percent, and the per capita Federal debt alone, by 105 percent. During substantially the same period, the total per capita governmental debt of the United Kingdom increased by only 5½ percent, and that of the National Government alone by only 3½ percent, the bulk of which consisted of Treasury bills issued to the Equalisation Fund.

III. The Moral

Great Britain's experience clearly demonstrates -- in contradiction to the pessimism prevailing in some quarters in the United States -- that there are at least some circumstances in which private spending may still bring about full-fledged economic recovery in a capitalistic society.

There are doubtless some who would draw a different, less qualified moral: That deficit spending has been responsible for the delay and inadequacy of the American recovery, and conservative finance, for the rapidity and completeness of the British recovery.

We believe that the reasons for the differences in the experience of Great Britain and the United States since 1929 are many and varied; and that factors other than the contrasting governmental financial policies are of preeminent importance in accounting for the differing economic experience of the two countries. Several of the more conspicuous of these, only one of which, building, is mentioned in the N.I.C.P. Bulletin, are indicated below:

IV. Some Differences between the two Countries

1. The year 1929 was a boom year in the United States, but one of only moderate prosperity in Great Britain. In that year, total unemployment was only 1 percent in the United States, whereas more than 10 percent of the insured workers were unemployed in Great Britain. Hence, when 1929 is used as a base year for comparisons, the figures become especially unfavorable for the United States.

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The distortion introduced by the use of an unrepresentative year as the base period is illustrated in the accompanying chart and table, in which the results of taking the year 1935 as a base, thereby unduly favoring the United States, are compared with the results of taking 1929 as a base. It will be observed that with 1929 as a base, industrial production appears to have been relatively greater in Great Britain than in the United States in thirteen out of the last fifteen years; whereas when 1935 is taken as the base, industrial production appears to have been relatively greater in this country than in Great Britain in ten out of the last fifteen years.

Further, the fact that most of the Twenties constituted a period of subnormal economic activity in Great Britain, instead of one of great economic and speculative activity, as in the United States, minimized the relative amount of readjustment that had to take place in Great Britain during the crisis and depression. In the United States, in contrast, the large readjustments which would have been necessary in any event, were greatly increased by the banking collapse of early 1933.

3. The results of international trade cushioned the decline in England. The consuming power of the wage-earning classes increased even during the worst years of the slump, because the drastic declines in the prices of imported foods and raw materials more than offset the reductions in consuming power resulting from wage cuts and unemployment. 1/ The preexisting unemployment was already heavy and the effects of additions thereto were mitigated by unemployment compensation payments. As The Economist has put it, "Wage and salary earners ... after buying their food, drink, tobacco, and clothes had something like £250 millions a year more left over in 1932 than in 1924-7."

American agriculture suffered severely from the very conditions -- ruinously low prices -- which softened the depression in industrial England. The industrial sections of the United States did not enjoy a commensurate increase in effective purchasing power, both because part of our agricultural markets are abroad and because of rapidly growing unemployment.

1/ See G. D. A. MacDougall, "General Survey, 1929-1937," pages 18-36 in Britain in Recovery, London, 1938; Sir Isaac Pitman and Sons, Ltd., and The Economist Trade Supplement, December 30, 1934, page 19.

The departure of England from the gold standard in 1931 helped her to sustain that part of her industrial activity and national income which arose out of foreign trade, for it had the effect of reducing her export prices to her customers. The terms of trade continued to favor England, moreover, because her principal suppliers cut their prices or the value of their currencies even more than did England.

3. Economic recovery in England was stimulated by the adoption in 1931-1933 of a protective tariff policy covering virtually all manufactured goods. The stimulating effects of this radical change in economic policy arose only in part from the diversion of the current British internal market from foreign to domestic producers of manufactured goods. Perhaps of equal or greater importance was the non-recurring artificial demand for new capital facilities that was created by the changed tariff policy. Brand-new factories were built and new machinery produced to manufacture the goods previously imported.

The situation was much the same as it might be in the United States if Congress were to pass a law stipulating that, after January 1 next, all steel produced in the United States must be produced in the State of Texas, and all automobiles, in the State of Utah. Obviously, an enormous amount of new capital investment would take place.

4. The British housing boom, occurring about ten years after ours, played a very important part in the British recovery. During the Twenties, activity in private building lagged far behind that in the United States, and the British Government undertook a number of measures to stimulate residential construction. In 1928, the peak year of house construction in England during the Twenties, about three-fourths of all the new houses were either built directly by the public authorities or with Government assistance.

A radical change of policy was made after the onset of the depression, whereby the amount of public assistance was greatly reduced. Nevertheless, the level of building activity dropped only slightly -- to a low of 36 percent of the 1929 average (in 1931), as compared with a low of 22 percent for the United States (in 1933); and it quickly recovered and went on to new high levels.

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Some of the causative factors were:

(a) The stimulus of the examples of Government-built houses. The latter contributed greatly to what has been called "an almost revolutionary conception of what are tolerable housing standards among a vast section of the population."^{1/}

(b) The lowering of interest rates, the reduction in down payments (to as low as 5 percent), and the lengthening of maturities on loans by the building societies in collaboration with speculative builders.

(c) The migration of population from the regions depressed by low activity in the export trades ("the depressed areas") to the southwest; and, by reason of the increasing use of motor busses and automobiles, to the suburbs of cities.

These, among other factors, created a huge housing boom which was financed very largely by private enterprise without Government assistance. In 1937, when the total number of housing units erected was 45 percent greater than in 1928, only some 21 percent of the number was built by the public authorities or received public assistance.

5. Great Britain has been free from the marked antipathy between government and business that has been so conspicuous in the United States. There has been no such want of confidence in the Government among the business classes in Great Britain as has existed in this country. On the contrary, business in Great Britain has traditionally cooperated with the Government, usually without legislation.

Nor have these amicable relations been due to any conspicuous timidity on the part of the British Government with respect to action in fields that arouse considerable emotion among many American businessmen: Government ownership and regulation of industry, labor relations, and taxation.

(a) In the field of industry and its regulation, the British Government has in many ways been far more aggressive than the United States. The telephone and telegraph businesses have been Government monopolies

^{1/} Sir Harold Bellman in Britain in Recovery, page 432.

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for many years, operated by the post office. The British Broadcasting Company, which received its charter from Parliament, is supervised by the Postmaster General and has a monopoly of radio and television broadcasting and the sale of receivers. Some 63 percent of all electric power in Great Britain is produced by the local governments, operating a highly coordinated system.

In recent years, the National Government has aggressively promoted amalgamations and reorganizations in several basic industries -- coal mining, steel, cotton textiles, etc. For agriculture, the Government has adopted a program of subsidies and other forms of assistance which is fully as varied as our own.

The British Treasury, without obtaining specific enabling legislation, has been able to enjoin the flotation of new capital issues in the London market when it desired to reserve the market for Treasury securities; and it has been able, in the same informal but nonetheless effective manner, to prevent foreign securities issues from being floated at times when it deemed such prohibition helpful to the domestic business and financial situation.

(b) In the field of labor relations, the bargaining rights of labor unions have long been recognized in England by both Government and employers. Likewise, Parliament long ago provided for a nationwide system of old-age and widows' pensions; unemployment insurance for the majority of industrial workers; and a national dole system and local poor relief for the remainder.

(c) In the field of taxation, the British Government makes few concessions to business and the upper income classes. A British corporation must pay to the Government 27½ percent of its profits for ordinary income tax. 1/ This may be compared with Federal corporation taxes aggregating about 17 percent for large American corporations.

1/ Dividends received by stockholders are exempt from individual normal income tax (but not from surtaxes) because the corporation tax is regarded as a payment at the source for the stockholders.

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Individual income taxes are higher in the United States than in Great Britain only for incomes in excess of about \$800,000, and even for these by only a small margin. For all incomes significantly below \$800,000, the British taxes are substantially higher than the American taxes. On an income of \$40,000, for example, the British income tax amounts to about 38 percent; whereas the American income tax amounts to less than 15 percent; and on an income of \$100,000, the British tax amounts to about 50 percent, as compared with about 32 percent in the United States.*

It seems clear that the ability of the British Government to obtain the confidence and cooperation of the business classes cannot be explained in terms of partiality to business -- by American standards -- in the fields of Government ownership and regulation of industry, labor relations, or taxation.

Part of the explanation lies, no doubt, in the long tradition of Government and business cooperation. But more important, in all probability, is the fact that the British developments in the fields cited above were not newly born during the depression but had mainly taken place some years ago. They had been largely assimilated, psychologically and otherwise, in the British economy before the advent of the great depression.

In the United States, in contrast, a great many reforms in these fields of critical interest to businessmen have been crowded into the last few years. These include: Compulsory recognition of the right to collective bargaining; the TVA and other Federal power projects; the Securities and Exchange acts; Federal relief for the unemployed; social insurance legislation; greatly increased income tax rates; etc. In view of the natural fear among businessmen of any important changes in the legal framework within which they must operate, it is not surprising that this great concentration of reforms should intensify the suspicious and even hostile attitude toward Government that has long been at least latent among American businessmen.

It seems reasonable to conclude that the chief explanation of the greater tolerance of the British business classes for the kinds of legislation and governmental activity that have recently irritated and frightened American businessmen

* These examples are for a married man without children.

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is that the British have previously digested them and are now accustomed to them; and this is likely to be no less the case in this country in due course.

It is comforting to realize that the English businessman did not always accept reforms with conspicuous good grace. "There was a time in the nineteenth century when a rise in income tax -- even the very existence of the tax -- produced the very worst psychological reaction," says Ursula K. Hicks in her study, The Finance of British Government, 1920-1936. But Mrs. Hicks continues that "Having survived a 6 s. levy (30 percent normal tax) in the war period with relatively little damage, it hardly seems possible to frighten the British capitalist with any lesser obligation."

It is in a variety of differences, such as the five just reviewed, rather than in the single difference of budgetary policy that the explanation of the divergent economic experiences of Great Britain and the United States since 1929 is most reasonably sought. Certainly, it would seem impossible to explain the divergence in terms of general economic orthodoxy versus unorthodoxy. Great Britain left the gold standard nearly two years before the United States and her currency today is much less closely anchored to a fixed quantity of gold than is that of the United States. Great Britain's budget, if armament expenditures be fully included, has not been balanced for the past two years, during which rearmament borrowing has approximated £200 millions; and further such borrowing amounting to £350 millions is anticipated for the fiscal year beginning next month. It is striking to note that Great Britain's anticipated armament borrowing for the coming fiscal year, in relation to her population, is equivalent to a deficit of \$5 billions for the United States.

Attachment

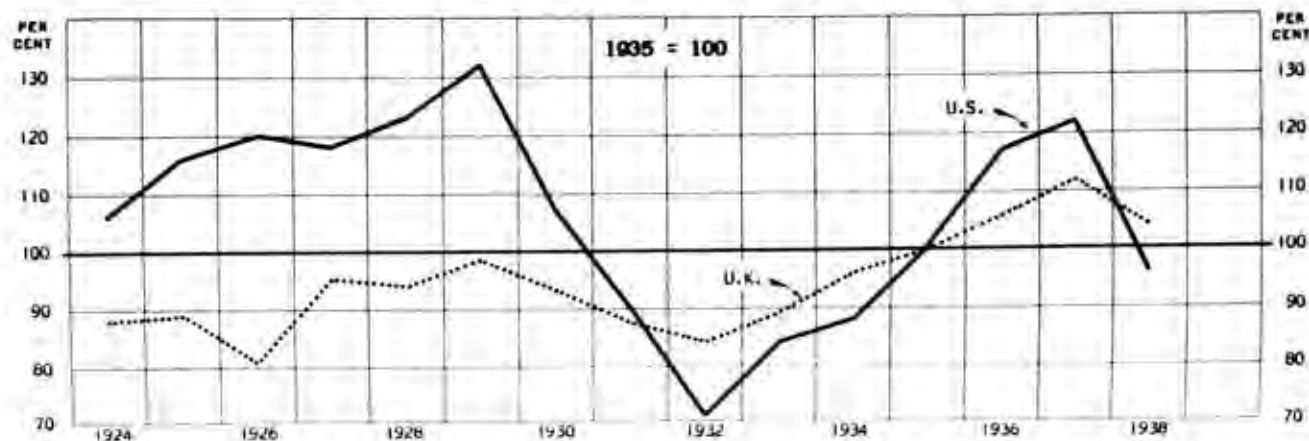
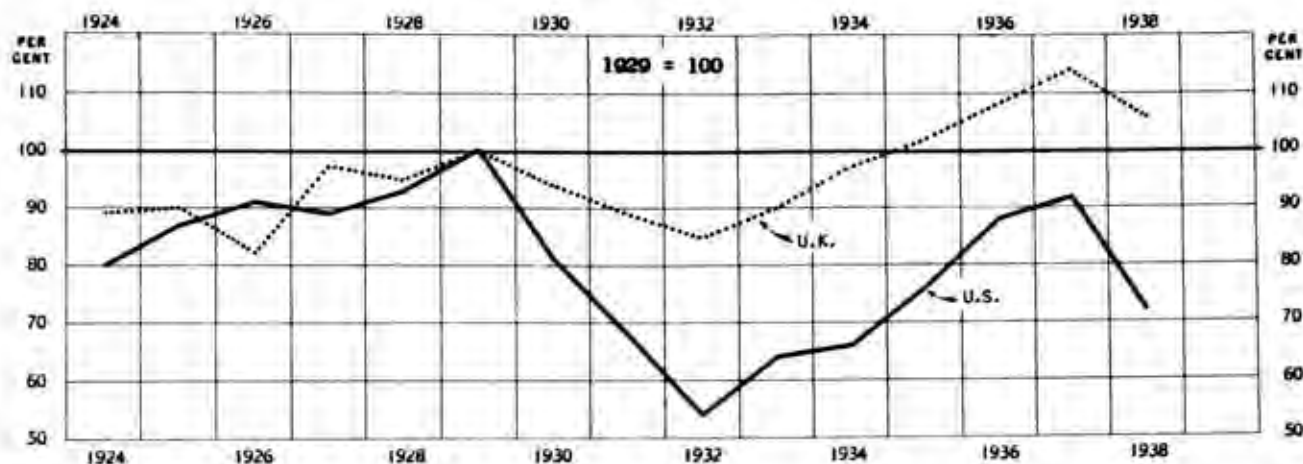
Industrial Production in the United States
and Great Britain

Year	United States	Great Britain	United States	Great Britain
	1935 = 100 ^{1/}		1929 = 100 ^{2/}	
1924	106	88	80	89
1925	116	89	87	90
1926	120	80½	91	82
1927	118	95½	89	97
1928	123	94	93	95
1929	132	98½	100	100
1930	107	93	81	94
1931	90	87½	68	89
1932	71	84	54	85
1933	84	89	64	90
1934	88	96	66	97
1935	100	100	76	102
1936	117	106	88	108
1937	122	112	92	114
1938	96	104 p.	72	106 p.

^{1/} For the United States, the Federal Reserve Board indexes have been converted into relatives of the year 1935. For Great Britain, the Economist indexes, which are based upon the year 1935 as 100, are used.

^{2/} For the United States, the Federal Reserve Board indexes, and for Great Britain, the Economist indexes, have been converted into relatives of the year 1929.

BUSINESS ACTIVITY IN UNITED STATES AND UNITED KINGDOM* 1924 TO 1938



* U.S. - F.R.B. INDEX OF INDUSTRIAL PRODUCTION
U.K. - ECONOMIST INDEX OF BUSINESS ACTIVITY

March 21, 1939

I talked to the President, a week ago yesterday, about the Annenberg case and I said, "I do not understand what the Attorney General meant when he said to me that pressure was being brought to bear on him from very high places on the Annenberg case." I said, "Mr. President, what did Frank Murphy mean?" He said, "I can tell you. Governor Earle was afraid that with this new Republican Administration, which Annenberg controls, that he, Earle, would get a Moscow trial on his own case and go to jail and Earle thought if this Administration would settle with Annenberg that, in return for that, Annenberg would see that Earle would not go to jail." The President also said, "I know of no reason why you should not go right straight through with this case, Henry, but that is where the pressure is coming from."

March 21, 1939

Miss LeHand told me to-day that the President
promised to dictate the letter to Senator Harrison to-day.

March 21, 1939

The Secretary again called up Grace Tully yesterday and asked her to remind the President to send the letter on taxes up to Senator Harrison.

March 21, 1939

My dear Mr. President:

I am enclosing herewith a review of the business situation for the week ending March 18. I thought you would be interested in reading it.

Yours sincerely,

(Signed) H. Morgenthau, Jr

The President,
The White House.

Enclosure.

RMCH:mas

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

CONFIDENTIAL

DATE March 20, 1939

TO Secretary Morgenthau
FROM Mr. Haas
Subject: The Business Situation,
Week ending March 18, 1939.

Developments of the week

1. The seizure of Czechoslovakia has dealt business confidence abroad a shock which is particularly severe in that it came at a time when business confidence and activity were rapidly reviving. The possibility of further adverse developments in the European situation introduces an important factor in our business outlook which is unpredictable. It seems clear, however, that the severe shock to confidence abroad, together with this week's wide break in domestic and foreign security markets, is likely to have some effect in holding back recovery despite the favorable domestic situation. An outbreak of war might result temporarily in further business curtailment.

2. The commodity price outlook has turned more unfavorable, owing to deflationary influences arising from the developments in eastern Europe. The Austrian annexation and the Sudeten annexation last year were similarly accompanied by deflationary price influences.

3. New orders during February were well maintained, despite a falling off in steel orders. A material improvement in orders for electrical equipment and railroad equipment is particularly encouraging, since increased activity in the durable goods industries must be counted on for any extensive further business gains.

4. The new orders index rose last week to near the high of the year, with increased orders reported for steel and textiles. This index in coming weeks should provide an important indication of the reaction which European developments may have on business activity in this country.

Outlook becomes less favorable

A severe blow was dealt this week to the improving business confidence abroad by the German seizure of western Czechoslovakia, which is likely to have repercussions on our own business situation. During recent months the feeling had been growing in England and France that the democracies of Europe were fast regaining the upper hand over Germany and Italy. Partly in reflection of this idea, business confidence in England and France has recently been improving, security prices in those countries have shown marked gains, business activity has been increasing, and a resulting improved demand for commodities has been a factor in the firming of commodity prices in world markets over the past several weeks. These developments had all tended to strengthen our business outlook.

This hopeful belief has now been abruptly shattered. In the opinion of the Wall Street Journal "Hitler's latest coup produced a greater moral shock than any of its predecessors, and is bound to have adverse effect on business." In the net, it means that

- (1) The European situation has become a more prominent menace in the immediate business outlook, since further developments in eastern Europe of a confidence-disturbing nature are not improbable;
- (2) The recent improvement in the foreign business trend can no longer be depended upon as a strengthening factor in the domestic outlook;
- (3) Commodity prices may be subjected to further deflationary influences, such as followed the Austrian annexation and the Sudeten annexation;
- (4) Business enthusiasm in this country will be dampened, and improvement over the next several months may consequently be more gradual than would otherwise have been the case. More serious European developments, now unpredictable, might result in an extension of the current business setback;
- (5) The world armament race will continue with renewed intensity.

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Commodity prices weaken

The trend of commodity prices this week has continued gradually downward, and it now appears that the setback last week may have reflected the first impact of deflationary influences arising out of the Czechoslovakian situation. Similarly, the German invasion of Austria on the 11th of March last year was anticipated by a decline in commodity prices that began in the futures markets two weeks earlier, and the long period of tension which preceded the Sudeten crisis last September was accompanied by a decline in commodity prices that began in July.

The Dow-Jones futures index (See Chart 1) was first to turn down two weeks ago, being somewhat more sensitive than the indexes of spot prices. Unlike during the crises in 1938, the downturn in commodity prices has not been accompanied by any material weakening in sterling exchange, apparently because of more effective support, though forward discounts on sterling have widened. It appears that spot sterling at present does not accurately reflect the deflationary pressure arising from foreign developments.

If sterling continues firm, this should have some influence in stabilizing commodity prices. Nevertheless, the shock which business confidence abroad had received, and the possibility that further unsettling developments may grow out of the invasion of Czechoslovakia, are likely to lead to a retrenchment in industrial demand abroad following the recent period of more active buying. This prospect has put the outlook for commodity prices in a more unfavorable light.

Stock prices lower with increased foreign selling

Stock markets here and abroad were apparently taken by surprise, and did not weaken materially until after the annexation of western Czechoslovakia had been accomplished. Realization of the full implication of this move later brought heavy selling of stocks in this country and abroad. The Dow-Jones industrial average was carried down to the lowest level since the end of January, and foreign transactions turned heavily to the selling side. (See Chart 2.)

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The break in stock prices at the time of the Munich crisis had little effect on business in this country, since industrial production was in an active upward trend and had some distance to go before reaching the level of consumer demand. In the present situation, production is at a level where increased demand is required to carry activity upward, and therefore more vulnerable to unsettling influences. Nevertheless, the domestic business foundation remains favorable for a further advance, and unless European developments become definitely more serious, they seem more likely to retard than to prevent a further recovery this year.

The automobile situation

The automobile outlook appears somewhat less favorable. The policy of the automobile companies to continue production at a relatively high rate during the winter in anticipation of spring demand has resulted in a less-than-seasonal spring increase in production to date. An increase in output this week to 86,725 units, from 84,095 units last week, brought a drop in the New York Times adjusted index to 86.8 from the previous week's figure of 90.2. The seasonal trend calls for sharp increases in production over the next few weeks.

Our comparison of production in relation to sales (See Chart 3) shows a larger surplus produced during January and February than in any of the previous three years. While this places the automobile industry in a position somewhat vulnerable to adverse developments, the increased stocks could easily be liquidated with a good spring buying season. The strength of current demand is indicated by the fact that General Motors' factory sales during January and February established a new all-time record for the company in that period.

New orders well maintained

New industrial orders during February showed only about the usual seasonal let-down, despite a rather sharp decline in steel orders. (See Chart 4.) Textile orders were sharply higher, while orders for building materials and automobiles showed a seasonal decline.

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An encouraging feature of the recent new orders trend is the upturn in orders for durable goods, notably railroad equipment and electrical equipment, both of which turned up in February to the highest levels since before the 1937-38 recession. Since any further extensive business gains must come largely from improvement in the durable goods industries, these upturns provide an indication that such an improvement may be under way.

The ratio of durable goods production to non-durable has increased substantially since the low was reached last summer, largely because of the sharp recovery in automobile production, but is still low in comparison with the ratio during 1936 and 1937. (See Chart 5.) The present situation in this respect may be compared with the situations at the beginning of 1935 and at the beginning of 1936. Minor corrective reactions which were then under way in both instances were followed by renewed business advances.

Our weekly index of new orders for the second week of March advanced 1.0 point to 89.6, which compares with the year's high of 90.9 reached in February. New orders for both steel and textiles were slightly higher, while other orders declined slightly from the year's high reached in the previous week.

Current business news

The FRB monthly index for February has been revised downward to 98 (preliminary).

The New York Times business index for the week ended March 11 held the previous week's gain, remaining unchanged at 89.5. For the following week, preliminary data indicate lower adjusted indexes for automobile production and steel production.

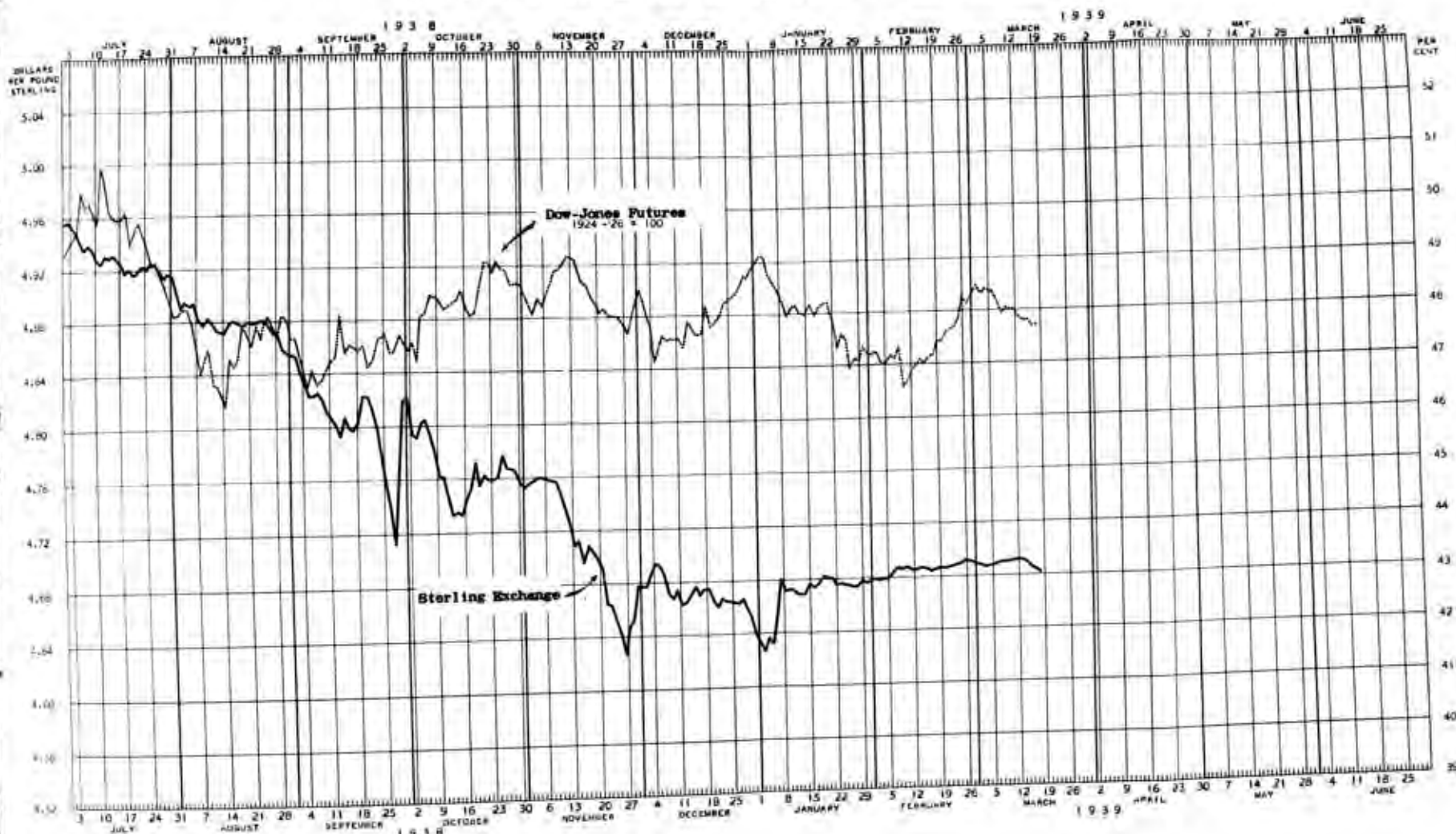
The adjusted index of cotton mill activity has increased somewhat further, and cotton consumption during February showed a more than seasonal gain over the previous month. For the 7 months of the season to date, domestic cotton consumption has exceeded that of any other season since 1929 with the exception of that in the record 1936-37 season.

While sensitive commodity prices declined this week and last, the BLS all-commodity index for the week ended March 11 rose slightly to equal the year's high point of 77.0 reached early in January. A rise in the building materials index to the highest level since last June, and advancing prices for farm products, largely accounted for the increase.

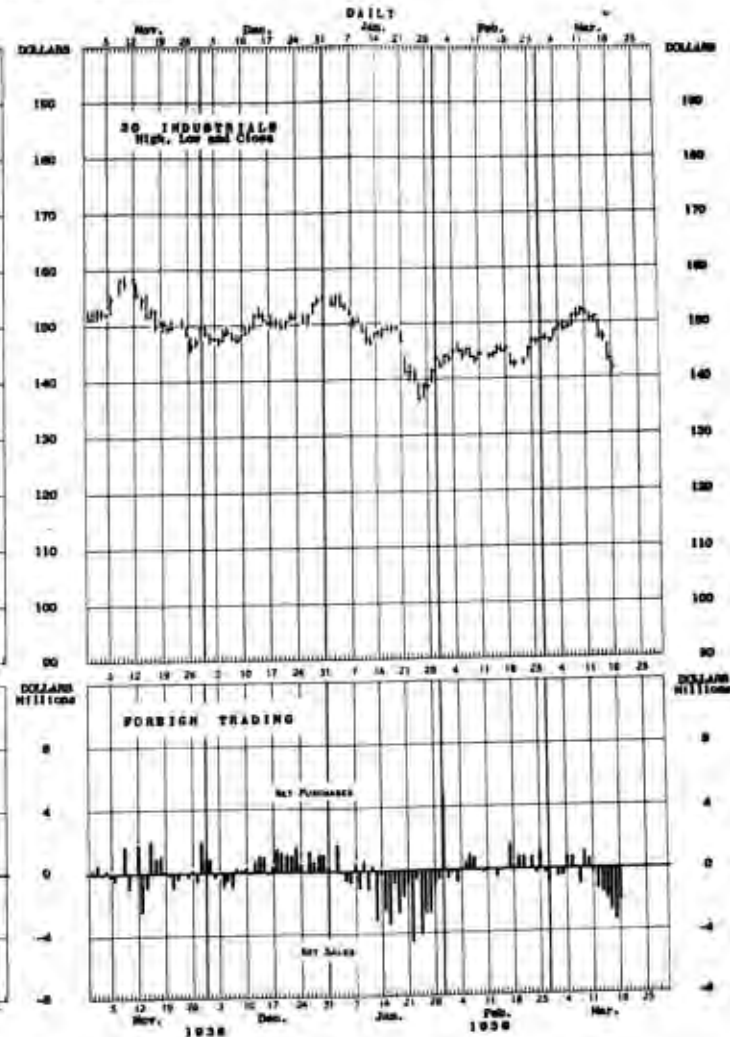
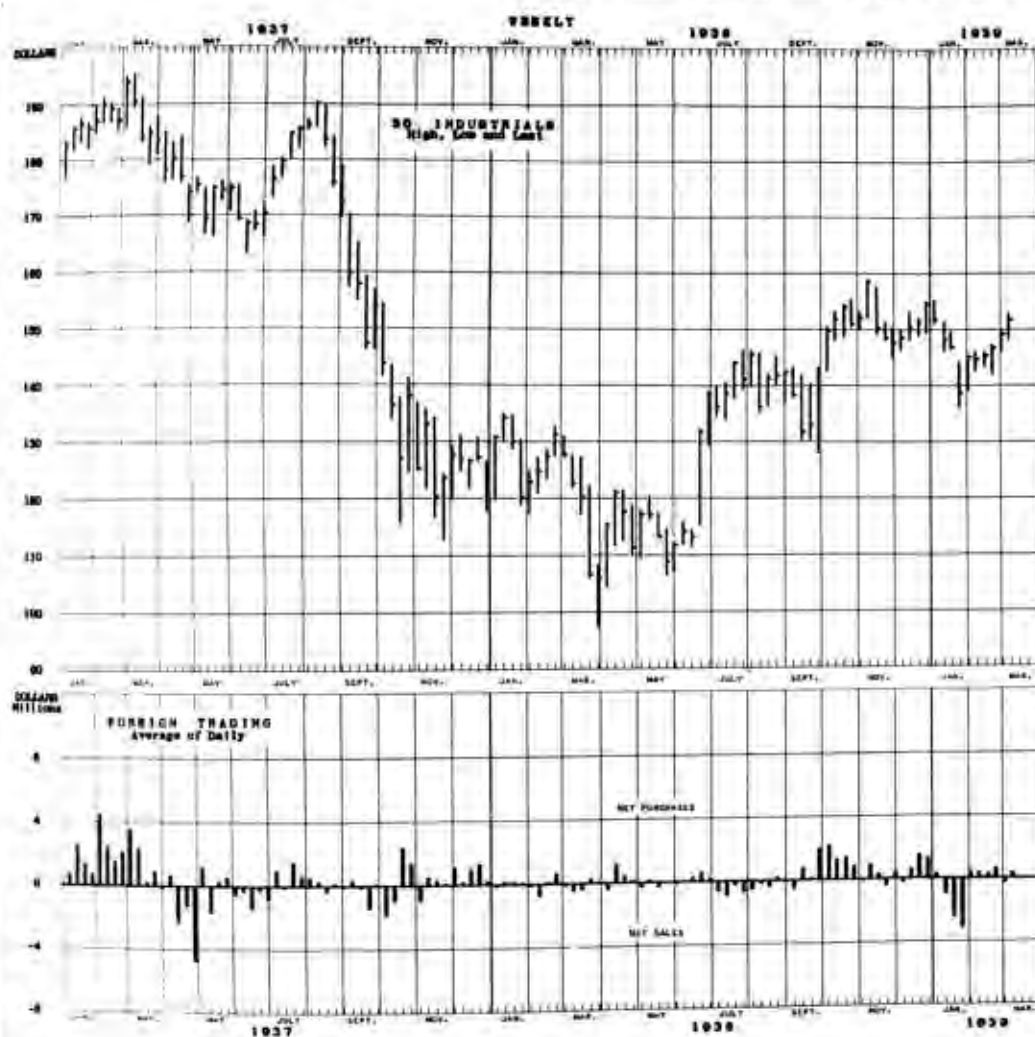
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Our index of confidence derived from bond price comparisons, which last week extended its gains further to a new high for the year, has turned down this week. Second grade bonds have weakened substantially in relation to high grade bonds, indicating less confidence in the outlook for profits.

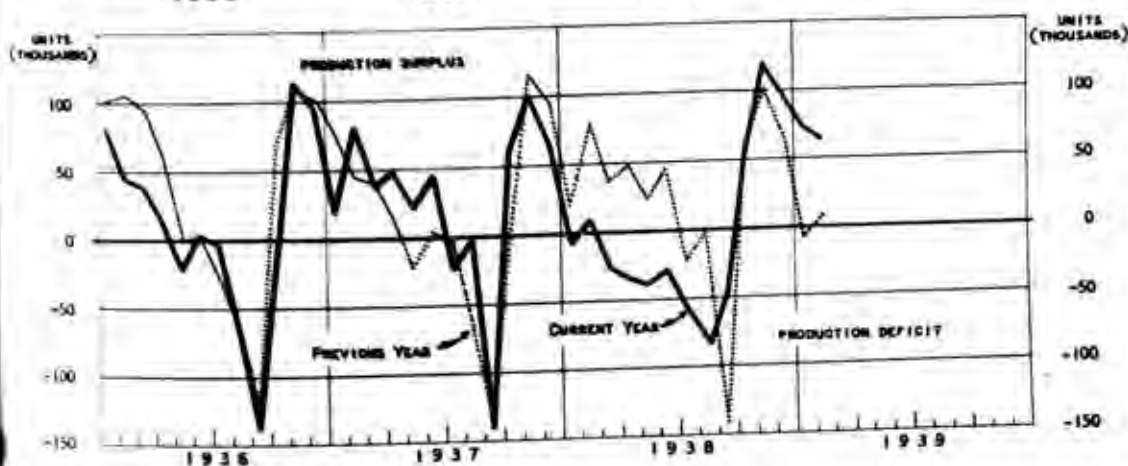
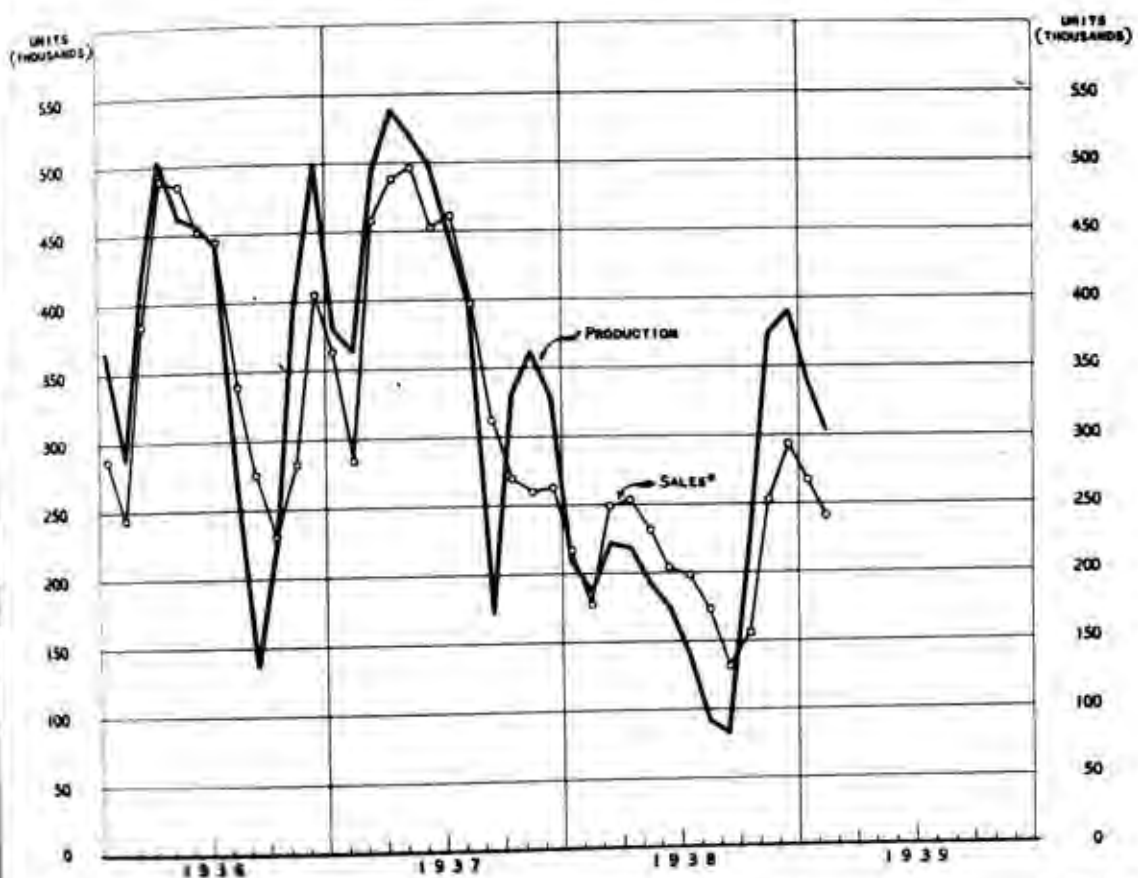
STERLING EXCHANGE AND PRICES OF COMMODITY FUTURES



STOCK PRICES AND FOREIGN TRADING IN DOMESTIC STOCKS
Daily Movement, Dow-Jones Industrials and Foreign Net Purchases and Sales

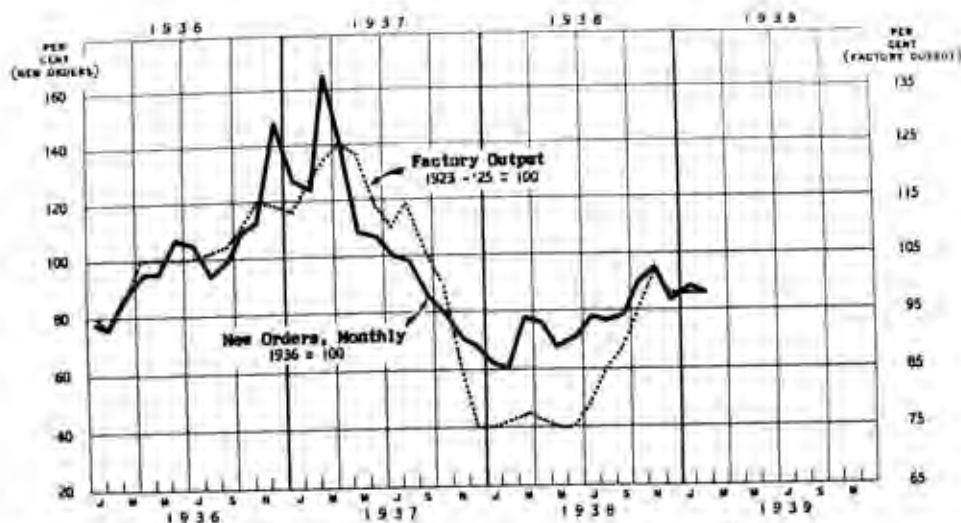


MONTHLY AUTOMOBILE PRODUCTION AND SALES*

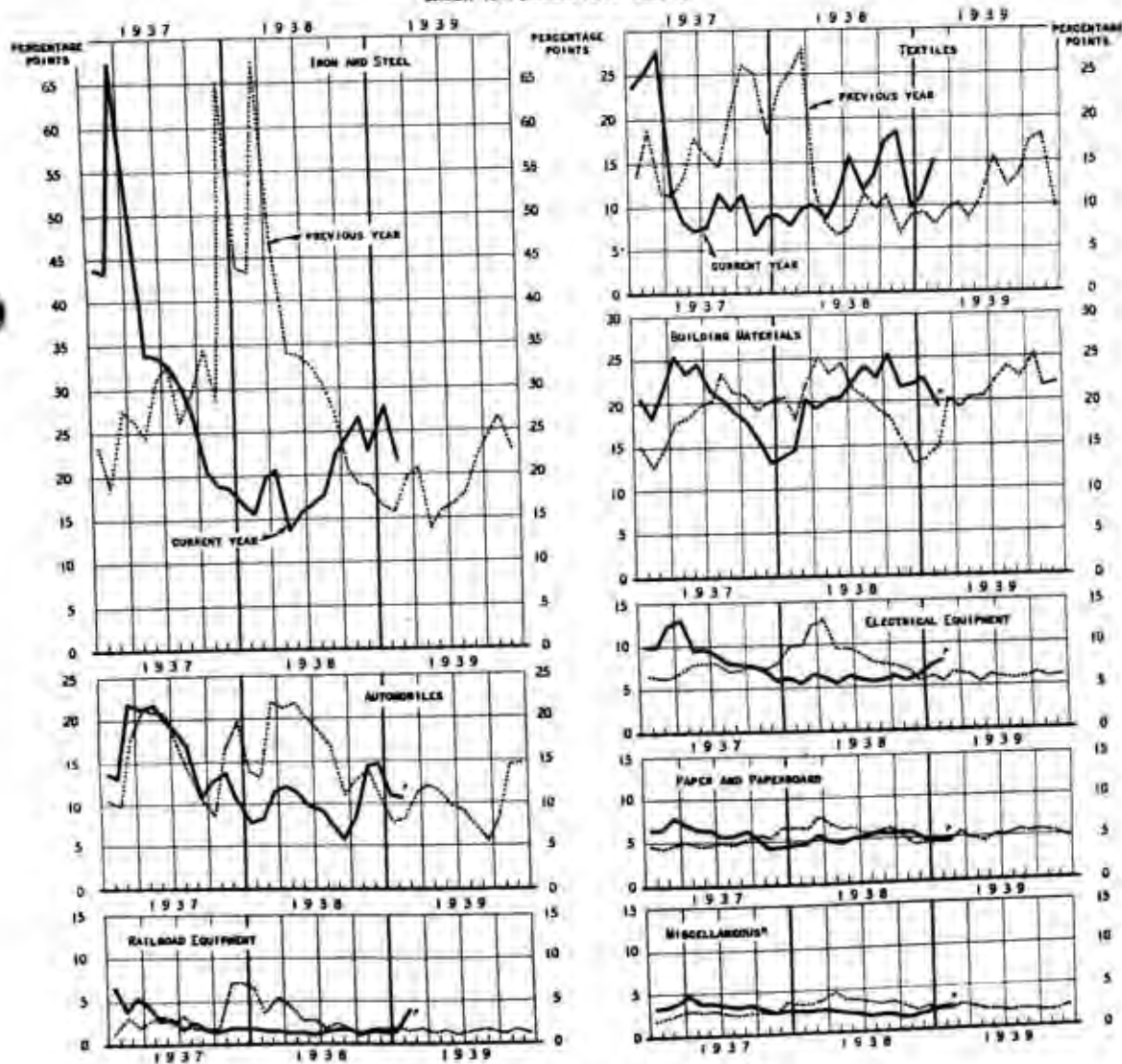


NEW AUTO REGISTRATIONS IN U.S. PLUS EXPORTS

NEW ORDERS AND FACTORY OUTPUT

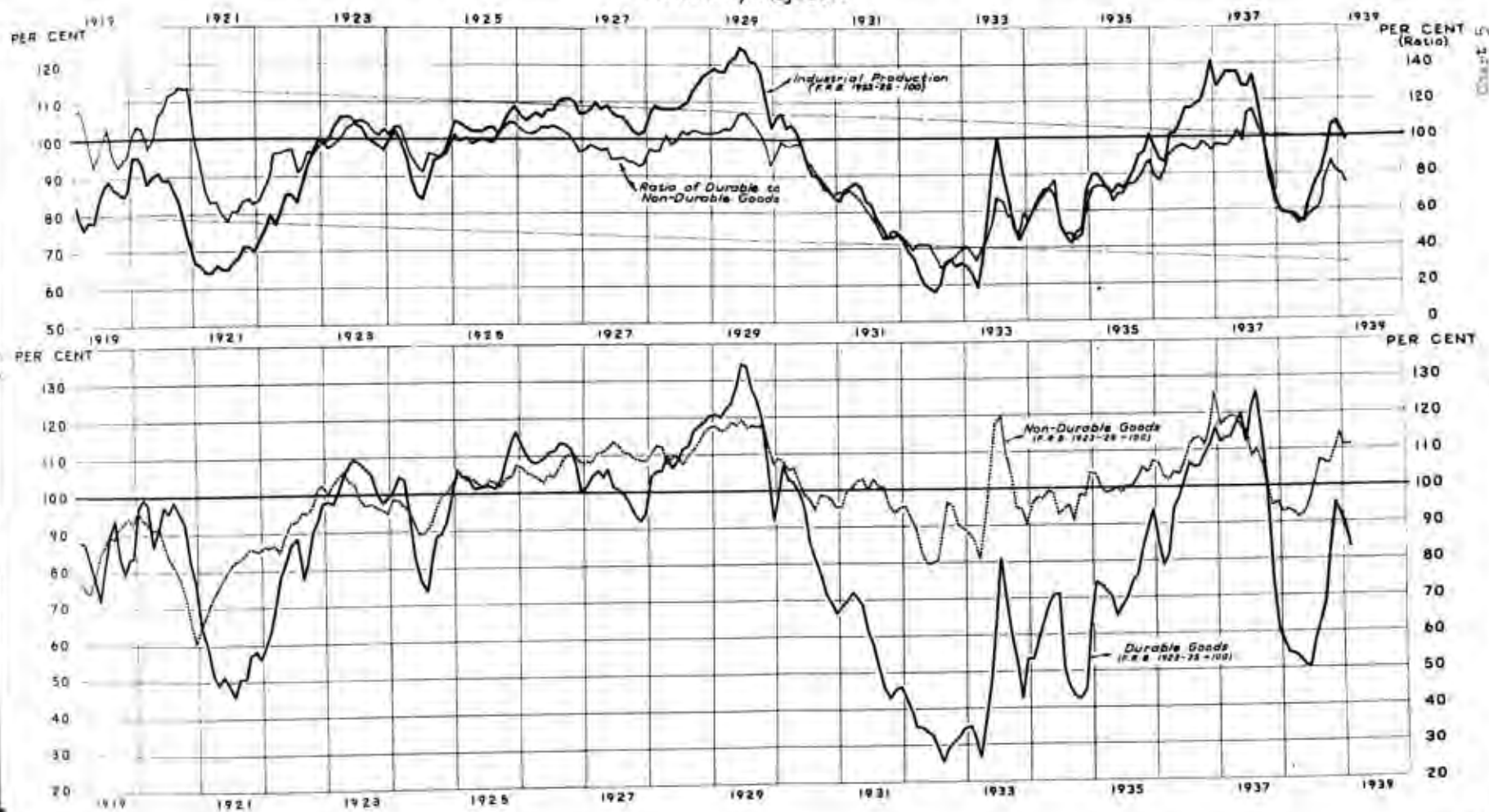


New Orders Grouped by Industries†
CURRENT YEAR COMPARED TO PREVIOUS YEAR



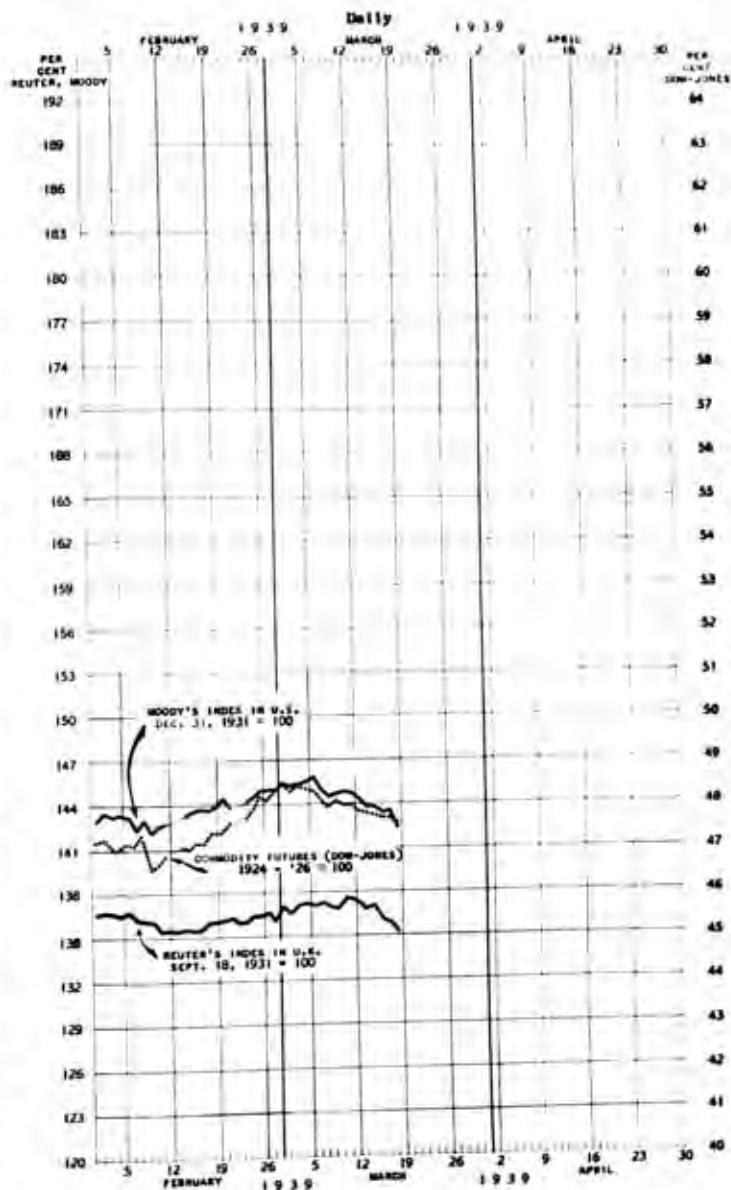
* INCLUDES MACHINE TOOLS, AGRICULTURAL EQUIPMENT AND OTHERS
† WEIGHTED ACCORDING TO RELATIVE IMPORTANCE

INDUSTRIAL PRODUCTION, AND DURABLE AND NON-DURABLE GOODS PRODUCTION Seasonally Adjusted

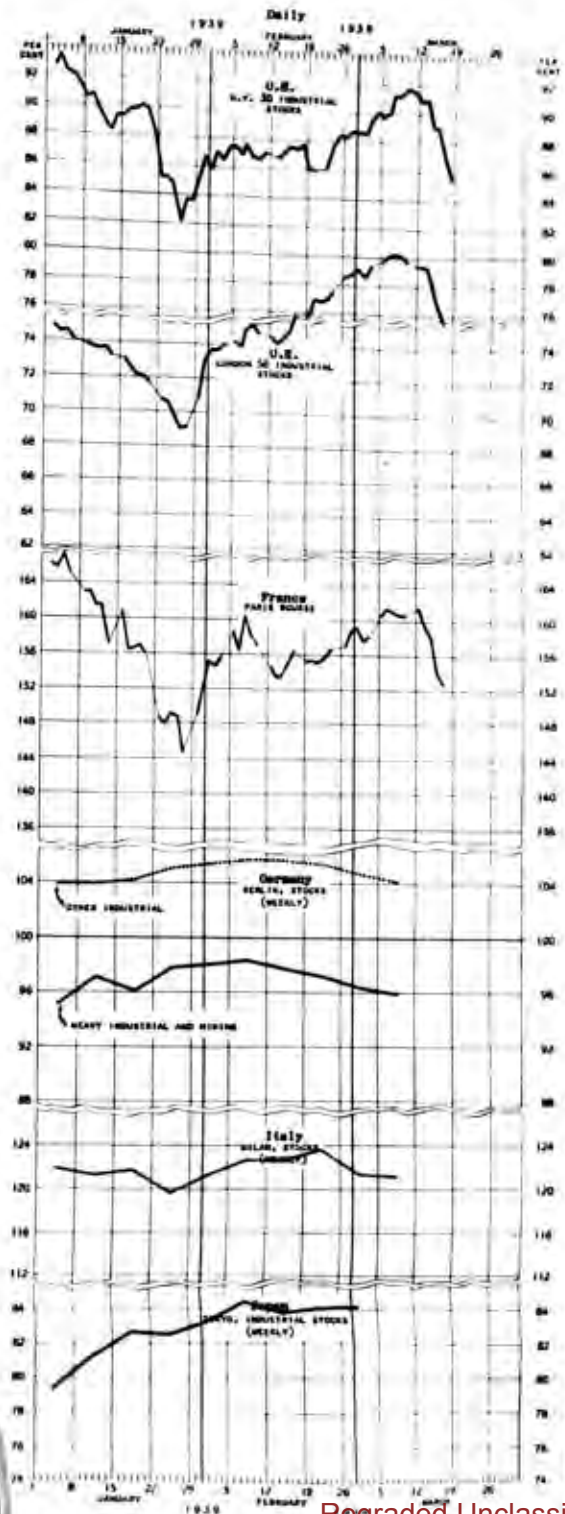
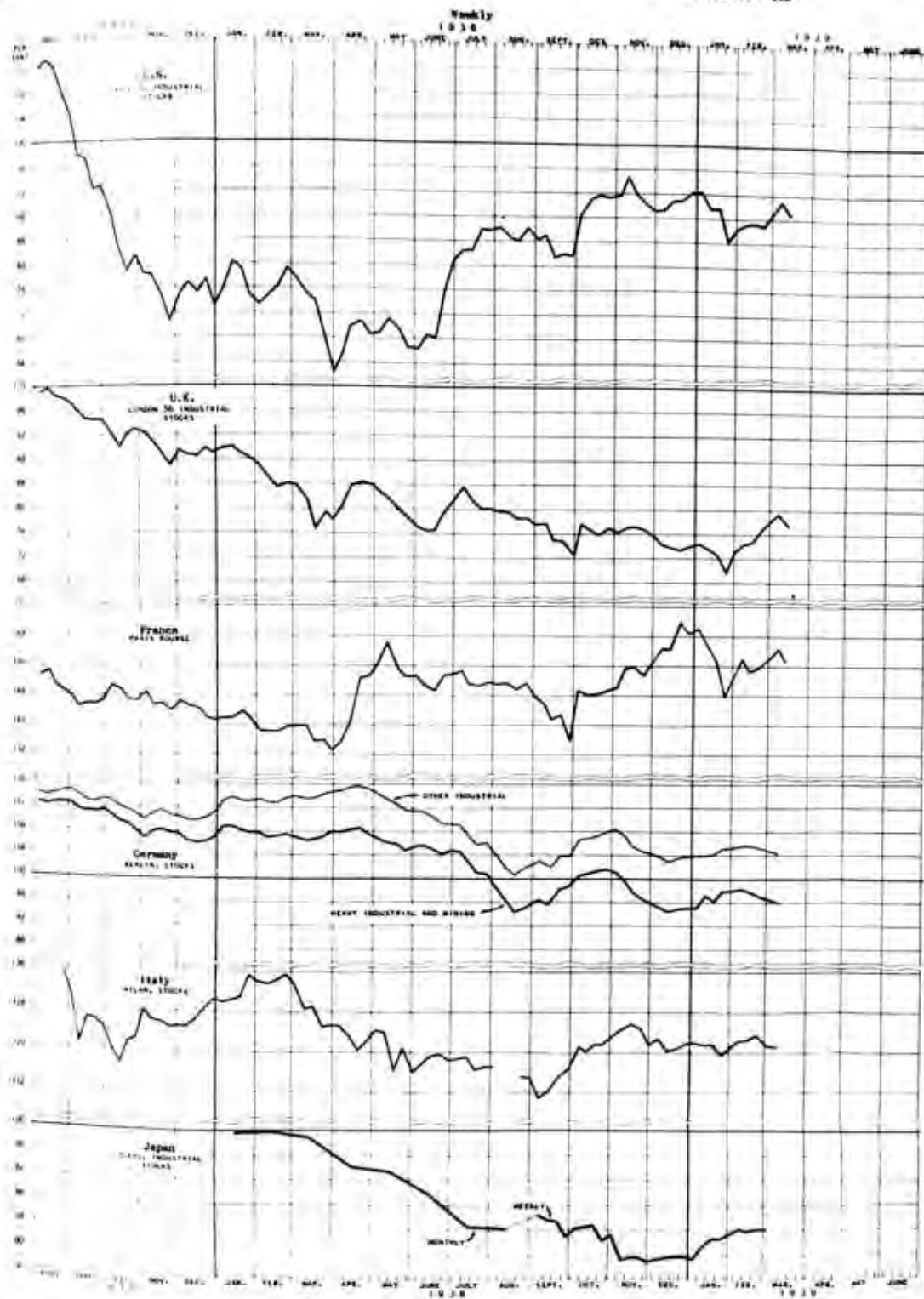


COMMODITY PRICE INDEXES IN U.S. AND U.K.

Weekly
(AVERAGE OF DAILY)
1938



INDICES OF FOREIGN AND DOMESTIC SECURITY PRICES August 1938 = 100



March 21, 1930.
10:19 a.m.

HMJr: Hello. Hello.
Earle
Baillie: Good morning, Henry.
HMJr: Hello, Earle.
B: How are you?
HMJr: Fine. Earle, I'm calling you up on triple confidential Treasury business.
B: O. K., sir.
HMJr: And there's something I want to ask you which you may or may not want to do, and if you don't, it's O. K. with me.
B: Right.
HMJr: It was brought to my attention by a very responsible person that there's a man by the name of J. S. Rosenbaum.....
B: Rosenbaum?
HMJr: Yeah.
B: Yeah.
HMJr: There's a father and son, and if you want to get something done through S.E.C., that's the man to go and see in New York.
B: That's interesting.
HMJr: Now, of course, I'm doing it; I want you to know why...
B: Right.
HMJr: Because I don't want any scandal; I don't want any back doors. If there's anything to it, I want to squelch it.
B: Yeah.
HMJr: And that's -- that's my only objective.
B: Right.

- 2 -

HEMr: And I appeal to you as a citizen.

B: You bet.

HEMr: Now, I should think if that were true, you'd ought to be able to run it down.

B: I think so too, and it does seem to me that if it had been true I should have known about it.

HEMr: Yeah.

B: J. S. Rosenbaum.

HEMr: Yeah.

B: Now, have you heard anything further about him except that name?

HEMr: No, I just understand that he's the fellow to go to, and if you go to him you can get things done.

B: Yeah. And he's supposed to be a friend of -- of.....

HEMr: Of Hall Roosevelt.

B: I see. Well now, -- all right, Henry, I'll -- I'll go after it.

HEMr: Right.

B: I think that Justice Black must feel less and less ill at ease each time that a new one of these fellows comes on.

HEMr: Well.....

B: That's -- that's my gesture to you.

HEMr: That's -- that's your -- you say that's your Wall Street gesture? Or your good-morning gesture?

B: That's my Connecticut gesture, but I thought it was a pretty good remark.

HEMr: You like it?

B: Henry, I'll go after this. Is this a rush thing from your point of view?

- 3 -

HMJr: No, no.

B: Well, I'll -- I'll try to look at it and talk to one or two people around.

HMJr: Yeah.

B: Very confidentially, on my own.

HMJr: Yeah.

B: And I -- I may not call you back until tomorrow night.

HMJr: Oh, that's -- that's.....

B: But it ought to be possible for me to find this out.

HMJr: Sure, you might even be glad to find out where the man is who could get things done.

B: Oh, my word! That's what I've been looking for all my life.

HMJr: (Hearty laughter)

B: All right, Henry.

HMJr: Thank you.

B: Good bye.

HMJr: Good bye.

1036
TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE March 21, 1939.

TO Secretary Morgenthau
FROM E. H. Foley, Jr., Acting General Counsel

Under Section 1 of the Espionage Act of June 15, 1917, 40 Stat. 220 (U.S.C. title 50, sec. 191), if the President, by proclamation or Executive order, declares a national emergency to exist by reason of actual or threatening war, insurrection or invasion, or disturbance or threatening disturbance of the international relations of the United States, the Secretary of the Treasury, with the approval of the President, may make rules and regulations governing the anchorage and movements of any vessel, foreign or domestic, in the territorial waters of the United States (except the Canal Zone for which other provision is made), may inspect such vessel at any time, place guards on such vessel and, if necessary in his opinion, in order to secure such vessels from damage and injury or prevent damage or injury to any harbor or waters of the United States or to secure the observance of the rights and obligations of the United States, take, by and with the consent of the President, for such purpose, full possession and control of such vessel and remove therefrom the officers and crew and all other persons not specially authorized by him to go or remain on board.

The regulations specifically authorized by the statute could be implemented by other regulations dealing with such matters as clearance of vessels, special licenses for harbor craft, etc. The proclamation and the regulations have been drafted and can be put before the President at any time. For your information, a copy of the drafts are attached.

The duties of the Secretary of the Treasury would probably be exercised by the Collectors of Customs and the Coast Guard. However, under Section 4 of the same Act the President is authorized to employ such part of the land or naval forces of the United States as he may deem necessary to carry out the purposes of the Act.

F.N.H.

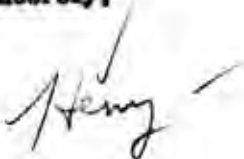
March 21, 1939.

Dear Joe:

Thank you very much for your letter of March 9th, with its high praise of my recent statement before the House Committee. It was most kind of you to write me as you did, and I appreciate your comment upon the statement, as well as your word of personal greeting.

With all good wishes,

Sincerely,



Honorable Joseph E. Davies,
Ambassador Extraordinary and
Plenipotentiary,
Embassy of the United States,
Brussels, Belgium.

GFF/dbs

Brussels, March 9, 1939.

PERSONAL

Dear Henry:

Joe Kennedy has just transmitted to me a copy of your statement before the House Committee on Coinage. I cannot refrain from dropping you a line with reference thereto.

It was an exceptionally able statement. The simplicity and clarity, combined with its comprehensiveness, struck my mind with great force and commanded my admiration.

I hope that you are standing up well under the heavy burdens which you are carrying.

With kindest personal regards, I am,

Sincerely yours,



Joseph E. Davies

N.B.--Please remember me cordially to your wonderful father and mother.

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

111

INDIQUEZ VOTRE NOM ET VOTRE
ADRESSE AU VERSO DE CETTE LETTRE
ZET UWEN NAAM EN UW ADRESSE
OP DE KEERZIJDE UWER BRIEF



PERSONAL

The Honorable

Henry Morgenthau,

Secretary of the Treasury,

Washington, D. C.,

U. S. A.

RECEIVED
C. G. MORGENTHAU

13 PM 12

MA

GRAY

London

Dated March 21, 1939

Rec'd 10: 52 a.m.

Secretary of State

Washington

377, March 21, noon

FOR TREASURY FROM BUTTERWORTH

The British treasury has given me a copy of a confidential notice to bankers and others concerned, relating to the Chancery of the Exchequer's letter dated March 17, 1939:

"One. The request made by the Chancellor of the Exchequer relates only to balances, securities and gold held on behalf of residents in Czechoslovakia. It does not therefore relate to the assets of any citizen of the former Czechoslovak Republic not so resident. The Chancellor's request does not relate to the payment of commercial debts nor to remittances to residents in Czechoslovakia other than by debit to the account of a resident in Czechoslovakia. The phrase residents in Czechoslovakia means the German Czechoslovak Republic; any corporation incorporated under the law of that Republic; any person ordinarily resident in the territories of that Republic on the 15th March, 1939.

The

MA # 2 - telegram # 377, March 21, noon, from London

Two. The Bank of England have been authorized by His Majesty's Treasury to grant permission for certain transactions. In any case of uncertainty or of an apparently abnormal transaction application should be made to the chief cashier's office Bank of England: but where a banker or firm is satisfied that a transaction falls properly under one of the following headings the Bank of England's permission may be assumed without further reference.

(a) The amount of any bill of exchange accepted prior to the 15th March 1939 by a firm in the United Kingdom on behalf of a resident in Czechoslovakia may on maturity be debited to the account of that customer.

(b) Any cheques drawn or instructions for payment issued before the 15th March 1939 may be acted upon.

(c) Any payment is permitted which is necessary to meet a debt or obligation to a British subject or to a person in the United Kingdom (other than a person resident in Czechoslovakia).

Any payment necessary to meet a debt or obligation to a person (other than a British subject) in a country abroad should be referred, but permission will be freely given in suitable cases.

(d) Assets belonging to British subjects resident in the territories of the former Czechoslovak Republic may be freely disposed of. Assets belonging to nationals of other

countries

MA -3- telegram # 377, March 21, noon, from London
countries so resident should not be disposed of without
reference but permission will be freely given in
suitable cases".

KENNEDY

RR:CSB

JR

GRAY

Paris

Dated March 21, 1930

Rec'd 3:01 p.m.

Secretary of State,
Washington.

527, March 21, 4 p.m.

The first series of measures taken under the special powers authorized by Parliament on March 19 were published in the Journal Officiel of today in the form of 16 decrees which had been approved in Council of Ministers last evening. They chiefly concern measures of a military nature relating to men and material.

Briefly stated the measures decreed provide notably for an increase of about 3,000 officers and noncommissioned officers in the land forces; the transfer of a certain number of cavalry officers to the artillery; the reorganization of the command of certain army corps districts; the maintenance in service of soldiers whose period of training has expired, and recall of reservists; the speeding up of the manufacture of armaments; a sixty hour working week (and supplementary hours if necessary) in enterprises directly

-2- #527, March 21, 4 p.m., from Paris.

directly or indirectly concerned with national defense;
financial assistance for enterprises engaged in the
supply of armaments; priority for contracts for national
defense over all other contracts; increase in number of
army engineers on duty in state armament factories;
increase in air personnel, notably weather forecasting;
and prohibition to divulge broadcast or publish military
information of any nature not rendered public by the
Government. (END SECTION ONE)

BULLITT

CSB

JR

GRAY

Paris

March 21, 1939

Rec'd 3:10 p.m.

Secretary of State,
Washington.

527, March 21, 4 p.m. (SECTION TWO).

Miscellaneous measures relate to administrative reorganization of the City of Marseille, the suppression of certain government agencies, and limitation of hiring of government personnel.

According to a semiofficial notice issued after the Council of Ministers yesterday, the Minister of Finance indicated to the Council that he will be in a position to meet the increase in national defense expenditures through economies resulting from administrative reorganization by a reduction of civil expenditures, and measures that would increase production in conformity with the general principles of the government's policy announced last November.

Please send copy to the Treasury. (END MESSAGE)

BULLITT

CSB

REB

PLAIN

London

Dated March 21, 1939

Rec'd 3:38 p. m.

Secretary of State,
Washington.

382, March 21, 7 p. m.

FOR TREASURY FROM BUTTERWORTH.

One. The British Treasury states that as far as it or the Bank of England knows most of the gold of the Czechoslovakian National Bank was in Praha when the Germans occupied the city and has been seized by them. My Czech source referred to in 336, March 15, 7 p. m., confirms this statement and gives the amount of gold thus obtained by Germany as the equivalent of £16 odd million.

The British Treasury also stated that their first and of necessity rough estimate of the amount of Czechoslovakian resources impounded in London as a result of the British prohibitions totals a little over £10 million; this figure is exclusive of the unexpended £6,750,000 of the £10 million credit in the Bank of England (see my 336, March 15, 7 p.m.) of the £10 million of impounded Czechoslovakian assets about £6 million represents gold or balances in London of the Czechoslovakian National Bank.

Two.

REB

2-#382, From London, Mar. 21, 7p.m.

Two. The city is beginning to recover from the first shock of the German seizure and dismemberment of Czechoslovakia. The London Stock Market was stronger today and British Government securities also improved, war loan for example closing $7/8$ up at 96- $7/8$.

Likewise the volume of trading on the foreign exchange market was smaller today, the dollar opened offered and the British authorities bought dollars during the morning. But in the afternoon the dollar turned bid and the British authorities sold dollars. The three months forward dollar was steady at 2- $1/4$. Gold fixing, however, was unusually large, 397 bars were dealt in of which 179 were married and the British fund took a few. There was one large transaction of 250 bars. Insurance was obtainable on the MANHATTAN and arbitrageurs bought gold for shipment.

KENNEDY

WVC

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: March 21, 1939, 5 p.m.

NO.: 528

FROM COCHRAN.

More cheerful Paris market today. Steadier continental currencies, the French franc in particular. Improvement in forward franc and French rentes. An article in L'INFORMATION attributes the lack of serious monetary upset at present to the perfected cooperation between and technique of stabilization funds, and especially to the French fund's stronger position. For the month of January the French budgetary revenue was below what had been estimated, but it is expected that there will be improvement in the February figures.

At five o'clock this afternoon I talked with the Bank of France. Today some pounds and a few dollars were gained by the French control. It was my friend's belief that the controls of Great Britain, Belgium and Switzerland had done practically nothing for the day, while a little was lost by the Netherlands. Banking sentiment, he said, seems to be that any danger of war has been deferred for the present.

Under date of March 20, the Ministry of Finance addressed the following letter to the Chairman of the
Association

- 2 -

Association of French Bankers:

"On account of recent events in Czechoslovakia, I have the honor to request you to be good enough immediately and unofficially to invite your members to block until further notice all holdings or credits that may be deposited with them for the account of Czechoslovakian individuals or concerns.

This measure should be applied with effect from March 15 last to all persons of Czechoslovakian nationality, with the exception of those who reside in France as long as they remain in this country."

BULLITT.

EA:LWW

OFFICE CORRESPONDENCE

CONFIDENTIAL FILES

L. W. Knobe

22 Noted
DATE March 21, 1939.

SUBJECT: TELEPHONE CONVERSATION WITH
DE NEDERLANDSCHE BANK.

I called Mr. de Jong at 10:26 a.m. with reference to our cable No. 77 of last night by which we requested shipment of about 45,000 ounces gold per steamship Black Heron on March 23. I explained that that cable had been sent without being shown to me and that it had been my intention to request the shipment of further gold only after my recent personal letter of March 14 had been received by him. In this letter, I continued, I had explained to him at length that there must be a misunderstanding in their interpretation of the September 1936 arrangement which in the form before us made it abundantly clear that our gold should always be sent by American boats. de Jong replied that on receipt of our cable he had intended to write us a letter, even though he did not think the matter was very important, but that now he would await receipt of my lines. At any rate I wanted him to know and understand that it was not our intention to be arbitrary and abrupt in the matter of these gold shipments. de Jong, I am sure, appreciated my call and the reason for which it was made.

I asked how things were looking in Europe today and he thought that they were a little less dark than yesterday when they had had a very big day selling dollars on a large scale. Today it was quieter in Amsterdam as well as in London. This he ascribed to a growing feeling that Italy might drift away from Germany and fall in line with the policy of the other powers. This feeling he admitted was based on nothing better than the fact that the Italian Ambassador in Berlin had been recalled to Rome to report on the situation.

LWK:KW

EXCERPT FROM CONVERSATION BETWEEN SUMNER WELLES AND H.M.Jr.,
MARCH 21, 1939 AT 12:07 P.M. WHICH REFERRED TO
CZECH BALANCES IN U.S. BANKS

HWJr: I had a good talk with Messersmith.

W: Oh, thanks.

HWJr: And I made a recommendation which he accepted.

W: Good.

HWJr: And I think he'll tell you about it -- on the Cochran matter.

W: Yeah. All right, thank you.

HWJr: O. K.

W: That's rather a headache.

HWJr: Well, let me just take sixty seconds and tell it to you, so as to get your own -- I said to pull Butterworth out of -- of London, I thought, was a great mistake.

W: Um-hm.

HWJr: Therefore, I made the suggestion, as long as Bullitt seemed so unhappy with this move, as proposed, let's send Cochran down to Rio de Janeiro with the understanding that he will be a trouble-shooter for the Treasury in South America.

W: Well, I think that's admirable.

HWJr: And Messersmith said he liked it very much.

W: I think that's an admirable solution.

HWJr: And you only were saying this morning we should strengthen ourselves down there.

W: Very much so. I think that's an admirable solution. Couldn't be better.

HWJr: O. K.

W: Thanks a lot.

HWJr: Good bye.

W: Good bye.

March 21, 1939

HM, Jr called the President at 12:15 and the following is their conversation.

HM, Jr: Good morning, Sir. On the Czech money in the New York banks, they held it up until this morning. Now they ask 'what?' The total amount on deposit of all the banks is only \$3,000,000 and in talking with Sumner Welles he said that he did not think it would be worth going to jail for \$3,000,000. We have no authority.

President: Is it Czech Government money?

HM, Jr: No. Private money. Lockheed said that the Government money is only \$12,000. The rest belongs to the Czech citizens.

President: I am just thinking out loud. Why can't an American manufacturer, an importer or exporter, who has debts owing him over there, go to the Supreme Court of New York -- I mean the State Court -- and get a temporary injunction against the taking of this money out of this country. I have sitting beside me the former Justice Wagner of the Supreme Court of New York. He will not give me an opinion. He is very cagey. I am sure that you can find some Judge who would be glad to issue such an injunction.

HM, Jr: We will explore it at once.

President: I am a bit of a devil.

HM, Jr: I'll say you are.

At the conclusion of the above conversation, HM, Jr called in Foley and told him about the President's suggestion. Foley said he did not see how it could be done.

(See attached records of conversations between HM, Jr and Sumner Welles and HM, Jr and Governor Harrison in connection with the above.)

March 21, 1939.
11:54 a.m.

HJr: Hello.

Operator: Governor Harrison. Go ahead.

HJr: Hello, George.

George Harrison: Hello. Henry?

HJr: Yeah.

H: One thing I wanted to ask you, do you remember when you talked to me last week about having these banks voluntarily cooperate about the Czechoslovak account?

HJr: Yeah.

H: You asked them to do it until Monday.

HJr: Yeah.

H: Two of them have called me up today and wanted to know whether they are still expected to hold back those accounts.

HJr: Yeah.

H: And I, not having heard anything from you, I didn't know -- I don't know quite what to tell them.

HJr: Well, I don't either and I was waiting to hear from you because I can't get an expression from Sumner Welles.

H: Yeah.

HJr: But supposing I call up Sumner and then call you back?

H: I think that we ought to clear it with them one way or another because as it stands, some of them may be making payments and others won't, don't you know?

HJr: Well, within the next ten minutes I'll call you.

H: All right. Now, there was one more thing. This attachment to the Reichs Bank account, do you know about that?

CHAIR: No, I'm not guilty.

H: (Laughter) Well, it was heard the Internal Revenue Bureau placed an attachment on the Reichs Bank balances in all the banks here in New York, for tax liens -- income tax to date they've had with them.

CHAIR: Johnny Hanes is sitting here; I'll ask him about it. He does these things, you know.

(Pause)

He says Helvering is coming over at three o'clock. He'll ask him about it and Hanes will call you back direct.

H: All right. I tell you what I was wondering. I think that if they get notice from all these banks that all the accounts have been attached and don't know our legal procedure, the amount is only a hundred and forty-four thousand and they are attaching maybe a couple millions of dollars. And.....

CHAIR: That might give us an idea on the Czech account.

H: I was wondering -- yes, if you want to protect the Export-Import Bank, the attachment procedure is the one to do it on; rather than to put these other banks at the responsibility of determining the legal question -- whether they should or should not make a payment.

CHAIR: Well, give me -- as to the attachment on the German -- German Reichs Bank, Hanes will -- will -- Hanes will let you know between now and four o'clock.

H: I see. Well -- my only point was, whether -- if you don't want them to think it's a political thing, whether there would be any advantage in our just tipping them off, that what they ought to do is just put up a bond and then they could have all the attachments vacated.

CHAIR: Well, all I can tell you, it does not come from my office and I know nothing about it.

H: Yeah.

CHAIR: See?

H: All right. Well, in other words, all I meant was if

you ask him just tell me whether he wants us to be helpful or not to be helpful.

HMJr: On -- on the German Reichs Bank?

H: Yeah.

HMJr: Well, he'll tell you.

H: All right.

HMJr: It's new to me and if any bank asks you, you say it does not come out of my office.

H: All right, Henry.

HMJr: Thank you.

March 21, 1939.
11:58 a.m.

HMJr: Hello.
Operator: Mr. Welles has a newspaper man with him.....
HMJr: Just....
O: His secretary thinks he better call you.
HMJr: O. K. Thanks.
O: Right.

March 21, 1939.
12:28 p.m.

HJr: Hello.

Operator: Governor Harrison. Go ahead.

HJr: Hello.

George Harrison: Hello.

HJr: George....

G: Yes, Henry.

HJr: I'm kind of bothered and if I don't sound -- something has happened to upset me, so I'm -- I'm trying to concentrate on this, see?

G: Yes.

HJr: Something else. Now, I've talked with the State Department, and as I understand it, there's about three million dollars worth of Czechoslovakian money belonging to their citizens.

G: Well, belonging to banks.

HJr: Well, -- banks.

G: Yes.

HJr: Now, the suggestion has been made that possibly importers and exporters in New York might want to tie up this money through the courts against money owing them in Czechoslovakia.

G: Yes?

HJr: But, as far as we're concerned, here in the Treasury, we don't feel that we can ask the banks to do this just on our request, because we have no power.

G: But I think that's wise, Henry, especially in view of the fact that the British, in asking that the funds be tied up, are willing to guaranty an indemnity. They are going to ask the Parliament for it, the implication being that there might be damages if they don't make payment, and you don't want to be in the position of making them suffer damages -- even voluntarily, if you're not in a position to indemnify them -- which you're not.

HMJr: Well, do you think there's any -- anything to this idea of getting importers or exporters in New York wanting to tie up the claims?

M: Well, I think that if they do, that's up to them. I don't think I'd suggest it.

HMJr: Well, think it over. Would you talk to your attorney about it?

M: Yes, I will.

HMJr: And I'll.....

M: I think it's a thing for the Export-Import Bank to think about.

HMJr: Uh-huh.

M: I -- and I -- we called Lockheed about that the very first day.

HMJr: Yes. Well, I'll pass that suggestion along to him, but as far as I'm concerned, I can't ask any bank to do something where I haven't got any legal right to ask it.

M: Yes.

HMJr: They'll have to use their own judgment.

M: Well, I -- that's what I think.

HMJr: Right.

M: I think most of them will probably do it anyway.

HMJr: Yeah.

M: But I -- I wouldn't renew the request if I were you.

HMJr: Well I'll take your advice.

M: All right.

HMJr: Thank you.

M: Yes, sir.

March 21, 1939.
12:07 p.m.

Operator: Go ahead.

HMJr: Hello.

Sumner: Hello, Henry. Did you want to speak to me?

Welles: Yes. George Harrison just called up and he wants to know what he should do about these Czech bank accounts. You see, we told them to hold them until Monday.

HMJr: Yes.

W: Now, he says, the banks are calling up and saying, what do we want? I tried to get a message through to you yesterday - from Lochhead to Feis, you see.

HMJr: Feis spoke to me about it.

W: Now, have you got any ideas?

HMJr: Well, I'll tell you quite honestly what I said to Feis.

W: Well, aren't you always honest with me, Sumner?

HMJr: I try to be.

W: (Laughter)

HMJr: I do my best.

W: O. K. I thought you were.

HMJr: I'll just repeat to you, which is a better way of putting it.

W: Well, all....

HMJr: What I said to him.

W: All right.

W: I said, "In view of the President's own interest in the matter, I had assumed that you and the President would discuss, under the existing conditions, what the Treasury felt able to do; that I wasn't familiar with the terms of the law, and I don't know exactly what the powers are."

- 2 -

EWJr: We have no powers.

W: The Federal Reserve Bank has none.

EWJr: None.

W: It's all a question of persuasion.

EWJr: Entirely.

W: He also told me that so far as the Federal Reserve Bank was informed, there had been very little activity.

EWJr: I think that's right.

W: And I don't know how much is involved either. Have you any figures?

EWJr: Well, just a minute, Lochhead is here, let me ask him.

(Pause)

Archie says there's only three million dollars involved all over New York.

W: New York.

EWJr: Yeah.

W: Well, the amount isn't sufficient, of course, for us to have to go to prison.

EWJr: No. No, if it was three hundred million dollars that would be worth while.

W: Yeah.

EWJr: I don't -- I think -- well, my own feeling is -- I didn't even know it was that little, I don't think it -- it's worth the Administration sticking its neck out with the New York banks.

W: No, I quite agree with you, but I do feel, in view of the President's interest in the matter, that you may want to discuss it with him before you give any answer.

EWJr: Well, supposing I call him up.

W: Yeah.

- 3 -

HMJr: Now here's a funny thing that's happened. Harrison called me up, and it seems that somebody from Internal Revenue on a tax case has tied up all of the accounts of the Reichs Bank and all of the deposits in New York.

W: Oh, really.

HMJr: And we are looking into it. I told Harrison he could say that it did not come from my office, but I said maybe that gives a method to tie up some of these others.

W: I see. That is an idea.

HMJr: But you think I better check with the President?

W: Well, I'd make that suggestion, Henry, because it's the thing that he himself is very much interested in.

HMJr: I'll do that.

W: All right.

HMJr: And let's leave it this way -- if he tells me -- if he takes the attitude that you and I are taking, that three million isn't worth while...

W: Yes.

HMJr: I'll tell Harrison that, but if he takes an opposite view, I'll call you back.

W: All right. Thank you.

HMJr: If you don't hear from me in the next fifteen minutes you know the President doesn't want me to stick my neck out.

W: All right. Thank you very much.

(Balance of conversation referred to transfer of Cochran to South America -- transcribed on separate page.)

March 21, 1939.
10:07 a.m.

Operator: Go ahead.

HMJr: Hello.

Wm. W.

Butterworth: Yes.

HMJr: Butterworth?

B: Yes, Mr. Secretary.

HMJr: Can you hear me?

B: Yes, very well.

HMJr: We got a rumor out of Prague.....

B: Yes.

HMJr: That when the people got there the cupboard was bare.
No gold. Hello? Hello?

B: Yes, sir. I can hear you, sir.

HMJr: Did you hear what I said.

B: Yes.

HMJr: Have you heard that?

B: No. I should doubt it very much.

HMJr: Well, this came -- well, this came from Carr.....

B: Yes.

HMJr: And I want you to run it down on your end.

B: All right, sir.

HMJr: See?

B: Yes, sir.

HMJr: It's pretty important.

B: Yes, sir.

HMJr: And if you get anything you use -- you can use the
cables, but it's supposed to have been moved to
London.

- 2 -

B: I see.

HMJr: See?

B: I see.

HMJr: That's where it's supposed to be.

B: Yes.

HMJr: And.....

B: Well, I think they have a good deal here anyway.

HMJr: Well, you can ask your friends over there what they know about it.

B: Yes.

HMJr: That we've had this rumor.....

B: Yes.

HMJr: And I should think somebody would know how much was there when they -- in the cupboard.

B: Right.

HMJr: Huh?

B: Well, I'll find that out and let you know, sir.

HMJr: Right. How are people -- is the tension getting better or worse?

B: Well, I think for the moment it's better. There's a lot of maneuvering going on.....

HMJr: Yeah.

B: Nobody exactly knows what the policy of the British Government is trying to evolve. It's attempting to resuscitate collective security.

HMJr: I see.

B: But my personal opinion is that this has to have a more important domestic angle than it has international angle at the moment.

HMJr: I see.

B: But this may be the means by which national service or conscription can be brought to occur.

WJr: Uh-huh -- uh-huh. Well.....

B: But at the moment both the -- the exchange market isn't under such heavy pressure today, and the French franc has -- has improved a little bit.

WJr: I see.

B: And the stock exchange is a little better.

WJr: I see.

B: But I think we're in for a difficult task. The nervousness is on a new level.

WJr: Uh-huh.

B: It will vary from time to time, but it -- it won't get back to the -- the old type.

WJr: We will not get back to what?

B: To the former type or somewhat complacent nervousness.

WJr: I see. Well, O. K.

B: You got my message of yesterday with my talk from Phillips.

WJr: Yes.

B: Right.

WJr: Yes. I have nothing to add. We are just watching things here.

B: are giving you further regulations which the British Treasury has issued to them.

WJr: Uh-huh. All right.

B: All right, sir.

WJr: Good bye.

B: Thank you.

FEDERAL BUREAU OF INVESTIGATION
U. S. DEPARTMENT OF JUSTICE

37

OFFICE CORRESPONDENCE
CONFIDENTIAL FILES

L. W. Knoke

DATE March 22, 1939,

SUBJECT TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

Mr. Bolton called at 11:18 this morning. There were a number of things which he thought we would be interested in. Firstly, there was a big dishoarding of gold going on largely for Swiss account. Most of this business was being done by bullion brokers and the gold was shipped directly to New York for sale there against dollars (this explains why today's turnover in the London market in gold was larger than that in dollars). Under the circumstances we should not be surprised to see big shipments of gold from London for private account. The second point of interest was a big demand for dollar notes again largely for Swiss account although some of the business originated in Holland and Belgium. Paris was today quoting a premium of 1% on dollar notes and Switzerland 1 1/4% to 1 3/8%. He expected that our banks would soon be shipping large amounts of such notes to Europe. I replied that we had been following this matter for quite a while now and that during the last few days instances of such shipments had multiplied. Most of the demand in Europe, Bolton continued, was for denominations of \$50 and \$100 and the Jews were among the principal buyers for the reason, of course, that they wanted something of which no definite knowledge could be had.

The third thing he wanted to mention was the blocking of Czech funds in London. A bill was going through Parliament today and would become law, nevertheless a number of difficulties were arising, among them the forward exchange contracts outstanding for Czechoslovakian

OFFICE CORRESPONDENCE

CONFIDENTIAL FILES

L. W. Knoke

DATE March 22, 1939.

SUBJECT: TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

2

account. He had requested the London banks to make a report to him of such contracts and to "put them into cold storage" until further notice. He wanted us to be fully informed as to what was going on in London in this respect. Bolton asked what the situation was in this respect here and I explained to him that after having made an informal request for voluntary cooperation in refraining for the rest of last week, from making unusual and important payments against Czech accounts, our Treasury now felt that they would prefer not to make any further suggestions one way or the other but rather to leave it to the banks to do what they considered right, assuming that they would report to us if anything unusual happened. I thought, I continued, that this decision was due partly to the fact that Czech funds here were too small to warrant further steps and partly that there was nothing in our law to enable our Government to indemnify the banks the way the British Government had done. That being so, Bolton thought ~~that~~ they might have to take additional precautions, watch transfers from London to New York and try to prevent the Germans from getting hold of blocked funds by transferring them to neutral free areas. Was there any thought of our Government obtaining legal powers similar to those asked of the British Parliament by the British Government? I answered that I didn't know but would it be worth the candle considering that there seemed to be only a few million dollars here in Czech balances? Incidentally the amount of Czech balances in England, Bolton estimated at from \$10,000,000 to \$15,000,000, including everything.

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

CONFIDENTIAL FILES

DATE March 22, 1939.

SUBJECT: TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

FROM: L. W. Knoke

3

The markets in London as well as in Paris generally speaking were steadier and smaller today. He, himself, had operated on a small scale only and that for the Belgium, the Swiss and various other central banks. The two centers of weakness today were Amsterdam and Zurich and it looked as though that would continue.

LWK:KW

124

240

ASSISTANT SECRETARY OF STATE
WASHINGTON

Personal

March 22, 1939.

Dear Mr. Secretary:

In accord with our conversation yesterday, I am sending you herewith a confidential memorandum I made thereof which I hope you will find a correct record.

I talked this matter over with Mr. Welles after I had seen you, as well as with Mr. Shaw who is the head of our personnel division, and they both are in agreement that the solution to the problem which you had suggested was more desirable and more feasible than the one we had presented to you. We will, therefore, proceed along the line laid down in this memorandum and I want to take this opportunity to tell you how much we all here appreciate your helpful cooperation in these problems.

The changes in question, of course, are dependent upon the time when the President may decide to make the announcement of the appointment of Wilson as a Chief of Mission. This may not happen for some weeks and perhaps for a month or more. We here, therefore, in this Department for the present are not making any mention of these contemplated changes. As soon as the President announces his action with respect to Wilson, we will make this announcement with regard to the

changes

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

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changes as outlined in the appended memorandum and which I understand have your approval.

In view of the fact that Cochran, when he arrives at Rio, may have work to do for you from time to time in other capitals in South America, and in view of the importance of our mutual interest in these problems, we are planning to send Ware Adams, one of our best young Foreign Service Officers, to Rio in the near future with the thought that he will act as a second to Cochran and be able to carry on when Cochran may be absent on your instructions in other capitals of South America. When Adams comes to Washington I hope you will have a few moments to receive him as I am sure you will find him admirably adapted to your, as well as to our needs.

With all good wishes,

Cordially yours,



Enclosure:
Copy of Memorandum.

A-M

Confidential

March 21, 1939.

U
Mr. Welles:

I saw Mr. Morgenthau this morning and informed him that, in view of the President's desire to appoint Wilson, now Counselor at Paris, as Chief of Mission, a situation arose which made it necessary for us to transfer Cochran. In our opinion it was impossible to appoint Cochran Counselor there and permit him to serve as Counselor in place of Wilson, in view of the known difficulties he has with members of the staff of the Embassy. Further, even though he were considered as competent to take this post, it would be impossible to designate him as such as the Ambassador had made it clear that this would not be possible in view of the circumstances. Creating a situation at Paris through which Cochran could act as Counselor of the Embassy would probably disrupt our organization there.

It is the intention to appoint Murphy as Counselor at Paris and the Ambassador desires this. It is the Ambassador's opinion that under these circumstances Cochran could not continue in any capacity at Paris and his transfer is necessary.

In view of these circumstances, the Department is considering the transfer of Cochran to the London Embassy to do the Treasury's work there instead of Butterworth and to transfer

fer

-2-

for Butterworth to Paris to do the work Cochran has been doing there. I asked Secretary Morgenthau if this would be agreeable to him. Secretary Morgenthau said that he understood thoroughly the situation at Paris and Mr. Bullitt's attitude with respect to Cochran acting as Counselor of the Embassy. In view of the President's desire to appoint Wilson a Minister, he realizes the necessity for a transfer of Cochran. He did not believe, however, that it was desirable to shift Cochran to London as Butterworth, after his experience in London, was now most useful and had his contacts well established. It would take Cochran a considerable time to get into the same position with respect to these contacts in London and for Butterworth to do the same in Paris. The London situation was for the present the more important and it did not seem to him, therefore, good judgment to move Butterworth from London.

Secretary Morgenthau said he would be agreeable to our sending Cochran to Rio de Janeiro as financial counselor there. In view of the important work we were planning there this would be a good assignment for Cochran and would be preferable to sending there a less experienced man as we were contemplating. He would be entirely agreeable to Cochran, while serving as financial counselor at Rio to also act for him in a roving capacity and he could make studies at Buenos Aires, Santiago and other South American capitals as this Department and the Treasury might find desirable.

I told Secretary Morgenthau that I agreed with him that
keeping

-3-

keeping Butterworth at London and sending Cochran to Rio was a better solution than the one we had in mind. I asked the Secretary whether he would be prepared to consider Matthews as the financial reporter at Paris. He said he did not know Mr. Matthews but would be glad to have his people look him over. I told the Secretary that Mr. Matthews was a first class man and I felt sure that his people would be highly satisfied with him once they knew him. We would leave the question of Matthews taking over Cochran's work at Paris until the Secretary had a chance to see him.

I am thoroughly in accord with Secretary Morgenthau's thought that, since Cochran has to be moved, it is not desirable, in view of the importance of the situation, to make the change in such a way as to affect both London and Paris. It is, I believe, better administrative practice and better all around to have Butterworth remain, for Cochran to go to Rio with this larger field in mind, and for Secretary Morgenthau to consider Matthews for the work at Paris where he has already made preliminary contact in the proper circles.

G.S. Messersmith.

MS
A-M:GSM:MF

FS

PLAIN

London

Dated March 22, 1939

Rec'd 3:16 p.m.

Secretary of State,
Washington.

387, March 22, 7 p.m.

FOR TREASURY FROM BUTTERWORTH.

Apprehension has increased in the city today due (a) to the seizure of Memel; (b) to the fact that some key reserve officers employed in the city have been informally advised to hold themselves in readiness should a call be found necessary; and (c) to the circulation of all manner of rumors of a more or less alarmist character. The London Stock Market has been weak and war loan for example lost a point to close at 95 7/8.

The most significant development in the exchange or gold markets has been the very large offerings of hoarded gold. Although 462 bars were sold at gold fixing of which 121 were married over 600 were really on offer and the gold sold was prorated. There have been large offerings after fixing but arbitrageurs are reluctant to purchase inasmuch as a meeting is now being held at Lloyds on war risk insurance. This process of dehoarding may gain momentum if acute apprehension continues because hoarders are realizing that

in

FS 2-No. 387, March 22, 7 p.m. from London

in the event of war they will lack shipping and insurance facilities to export their gold and that while the gold remains in the United Kingdom it stands a chance of being bombed. In short dollars seem a safer medium. Furthermore British hoarders of gold can in the event of war have their gold commandeered by the British Government at the old statutory price of 85s an ounce. But it is believed that the amount of British gold hoardings is small.

HPD

KENNEDY

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: March 22, 1939, 6 p.m.

NO.: 542

FROM COCHRAN.

Because of international political developments and uncertainties the continental markets today reverted to a state of depression. The strongest of the European currencies has been the French franc.

At half-past five when I talked with my friend at the Bank of France he said that the French fund had done even better today than yesterday, acquiring both dollars and sterling. This morning he said the British control had given two one-half million dollars, but the market's demand this afternoon was met mostly from sales of dollars on account of the Dutch and Swiss controls which have had to give support to their currencies; the belga is remaining steady.

Because of the fear that war risk insurance on gold will soon be doubled, private Swiss banks are said to be getting rid of gold holdings in London.

BULLITT.

EA:LWW



DEPARTMENT OF STATE
WASHINGTON

March 22, 1939.

My dear Mr. Secretary:

I enclose for your confidential information a copy of paraphrase of a telegram received from the American Legation at Bern, Switzerland, reporting on certain financial aspects of the situation arising from the German occupation of Czechoslovakia.

Sincerely yours,

Herbert Feis

Herbert Feis,
Adviser on International
Economic Affairs.

Enclosure:

Paraphrase, No. 21
of March 21 from Bern.

The Honorable

Henry Morgenthau, Jr.,
Secretary of the Treasury.

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Legation, Bern, Switzerland

DATE: March 31, 1938, 2 p.m.

NO.: 21

STRICTLY CONFIDENTIAL.

An absolutely reliable and authoritative source has given me the following information:

During the crisis last September the Swiss National Bank took over a credit of 50,000,000 francs granted by Swiss banks to the Czechoslovak Postal Savings Bank. Just five days before the Germans took over Praha, this credit was repaid in full. A covering deposit in the Swiss National Bank of 50,000,000 francs gold was withdrawn and sent to Germany. The Swiss National Bank officials assert that they do not know the nature of the transaction between the authorities in Czechoslovakia and Germany concerning this withdrawal, but consider it significant that it took place at that particular time and that the gold went to Germany. The Swiss officials congratulate themselves on their good fortune in thus getting rid of this liability with its delicate and potentially dangerous political implications before it was necessary to decide on legal recognition of successorship of the former Czech State.

The Swiss National Bank at the present time does not have any assets which belonged to the former Government
of

- 2 -

of Czechoslovakia. There has been a great reduction in Swiss private credits during the periods of tension since a year ago. The present amount probably does not go over 100,000,000 francs.

Consideration is now being given to the question of commercial and financial payments between Switzerland and Czechoslovakia. One proposal put forward is that there should be established a "provisional clearing" under which all payments of Switzerland destined to Czechoslovak territory will be required to be deposited in the Swiss National Bank in a special account until the situation has been cleared up. It is the desire of the Swiss authorities to avoid incorporation of such payments in the Swiss-German clearing - which would imply de jure recognition of German occupation of Czechoslovakia. Officials here have expressed to me their keen interest and approval of the stand taken by authorities in the United States with regard to Germany's action; they make no secret of their feeling that Swiss inclination to block payments as indicated above is strengthened by America's non-recognition. Imports from Czechoslovakia in 1938 were valued at 57 millions. Exports amounted to 43 millions.

Best authority has also informed me that Italy has been transferring gold to Switzerland very recently.

I do

- 3 -

I do not know how much gold has been transferred, but this action on the part of Italy is considered here as a gratifying sign that Italian authorities do not think that the neutrality of Switzerland is in danger.

BIGELOW.

EA:LWW

TELEGRAM RECEIVED

From

Rio de Janeiro

March 22, 1939

Secretary of State,
Washington.

82, March 22, 2 p.m.

The Bank of Brazil announced today the suspension of the purchase of compensation marks for the exportation of northern cotton to Germany. The reason for this decision is that the quota for northern cotton for the German market has been exhausted.

Please inform Department of Commerce.

SCOTTEN.

March 22, 1939.
12:26 p.m.

HMJr: Henry Morgenthau, Jr.

Sen. Wagner's
Sec'y: Yes.

HMJr: I'm calling on you to -- to be charitable to me.

Mr.
Will: (Laughter)

HMJr: I've just come back from the White House and confidentially the President gave us something to do which just won't keep.

W: Um-hm.

HMJr: So this letter on gold which I was supposed to read this morning, I've been unable to get to it yet. Now, would it be embarrassing to the Senator if I didn't get it up until late this afternoon?

W: No, I think that anytime this afternoon will be satisfactory, Secretary.

HMJr: Well, I'll definitely get it up this afternoon, but it may -- how late do you stay there?

W: Oh, we're here until six or later every day.

HMJr: Until when?

W: Until six or later.

HMJr: Well, will you still be able to get into the record?

W: Well, the -- the record won't be closed today, Secretary.

HMJr: It'll not be closed?

W: No.

HMJr: So you can get it in?

W: Well, we can get it in if we receive it today or tomorrow, as far as getting it in the record is concerned.

HMJr: Either today or tomorrow?

Yes. The chief reason that we're anxious to get it is so that the Senator can study the answers a little bit to gauge himself in further hearings.

WJr: Well, right after lunch, unless the White House sends for me again, I'll immediately go on it, so that -- it's my first order of business, but I have to do this for the President.

Surely. Well, that -- that'll be entirely satisfactory

WJr: Immediately after lunch, I'll do this.

Q: That's fine.

WJr: And I'll send it up with a special messenger to you.

Q: That's fine.

Jr: Please explain to the
the
please explain to/Senator why.

Surely, I'll be glad to.

WJr: Thank you so much.

Yes, sir.

March 22, 1939.
3:55 p.m.

James
Farley:

Secretary Ickes calling.

HMJr:

This is Harry Hopkins.

F:

Great! I'm delighted to be able -- I'm glad that we got straightened out on P.W.A. and W.P.A.

HMJr:

Are you? Well, I've got all the delegates for Iowa and I'm about ready to start business.

F:

Well, I think you're the fellow I want to talk to.

HMJr:

I'm just a farm boy from Iowa.

F:

I want to be -- I want to be appointed Postmaster in New York and I'd like to talk to you.

HMJr:

You would?

F:

Yes..

HMJr:

Well, what have you done for the party?

F:

Well, I've been -- I've -- I was an old Republican, a Progressive, but I affiliated with the Democrats.

HMJr:

Well, that qualifies you.

F:

O. K. How are you? How do you feel?

HMJr:

Well, I.....

F:

Things are -- things are upset the last few days around here, aren't they?

HMJr:

Oh, yes.

F:

Gosh!

HMJr:

When am I going to see you?

F:

Well, Henry, I'm going to positively see you Tuesday or Wednesday, and you name the day.

HMJr:

Well....

F:

I'd like to buy your lunch. You're always buying my lunch, but I'd like to buy yours, if you'll let me.

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HEJr: Well, if you do, you've got to come down to Sea Island.

F: Huh?

HEJr: You've got to come to Sea Island, Georgia.

F: When -- when are you going?

HEJr: Friday night.

F: Oh well, I won't see you.

HEJr: That's too damn bad.

F: How long are you going to be away?

HEJr: Two weeks.

F: More power to you.

HEJr: Righto!

F: More power to you. Well, I'm -- I'm sorry, but it's my fault and not yours.

HEJr: I think that's right.

F: Well, it is. No arguing against it.

HEJr: Yeah.

F: Henry, is it getting worse or better, in your judgment?

HEJr: In our -- our shop?

F: Yeah.

HEJr: Well, just a teentsy-weentsy bit encouraged.

F: You really feel that way.

HEJr: Yes, we are. We have.....

F: The doggone postal receipts are all right around the country.

HEJr: Oh, you're talking business?

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F: I'm talking business.

HMJr: Oh, I thought you were talking White House politics.

F: Oh no, I'm not talking about that.

HMJr: Oh, business?

F: Yeah.

HMJr: No, it's worse.

F: Worse?

HMJr: Sure.

F: All these things are.....

HMJr: Oh, sure.

F: That thing that happened yesterday didn't help any, did it?

HMJr: No, and the things abroad, and we're getting the repercussions

F: Hm.

HMJr: Oh, I -- I thought you meant how I was.....

F: Oh, I don't mean that. Oh, no, no, no.

HMJr: No, business is worse.

F: And do you think it's going to go that way?

HMJr: Yeah.

F: You really do?

HMJr: Unless somebody does something about it.

F: Harry isn't so well is he?

HMJr: No. They tell me he's -- he's been in bed, I guess, for a week or ten days.

F: Yes, so I -- since he came back from Baruch's.

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HMJr: (Laughter) So they tell me.

F: I have some G-men too, you know.

HMJr: You've got some damn good ones, and they don't go and get any pictures in the papers either.

F: That's right. Well, Henry, I -- you just forget it all and I'll see you when you come back, and I.....

HMJr: All right. Johnny Hanes will be here, and he's available.

F: O. K. Well, there isn't a thing I -- frankly, I didn't want to bother you; I just wanted to gab, and...

HMJr: That's what I wanted.

F: Yeah, I know you did, see?

HMJr: Well, just remember, I'm a farm boy from Iowa.

F: O. K. Well, I'm a city slicker from Chicago.

HMJr: O. K.

F: And thank you.

HMJr: Good bye.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

CONFIDENTIAL

DATE March 22, 1939

TO Secretary Morgenthau
FROM Mr. Haas *BA*

(1) In the Budget Message delivered by the President on January 3, 1938, the estimate of receipts for the then current fiscal year 1938 was \$6,320.5 millions; the initial estimate for fiscal year 1939 was \$5,919.4 millions. These estimates were prepared under the Revenue Acts of 1936 and 1937 which were then in existence. The proposed changes in the law, which later became the Revenue Act of 1938, did not affect the revenues of the fiscal year 1938. We estimated that the changes in the law would decrease the fiscal year 1939 revenues by \$63.6 millions, although certain changes in the law were only partially reflected in the fiscal year 1939 revenues and would not show their full effect upon revenues until subsequent fiscal years. At that time we estimated that in a year of relatively high levels of business and incomes, the new law would produce \$222.2 millions less revenue than the old law and in a year of relatively low business and incomes the new law would have produced \$80.7 millions less than the old law. A photostatic copy of a table which was given to Senator Harrison on May 19, 1938 is attached herewith.

(2) Fiscal year 1939 revenues were estimated at \$5,520.1 millions in the Budget Message delivered by the President on January 3, 1939.

(3) For departmental purposes, but not for publication, we break this fiscal year estimate into estimates of monthly receipts. The estimated receipts from July 1938 through February 1939 were \$3,632.0 millions and we actually collected \$3,652.8 millions, an increase of \$20.8 millions or 0.6 of 1 percent more than the estimate. There is attached herewith a table which includes a comparison of the estimated and actual receipts for the first eight months of the fiscal year 1939.

The wired reports of income tax collections through March 20 indicate that income tax collections for the entire fiscal year may exceed our estimates possibly by \$90 to \$100 millions. We can estimate this increase more exactly

Secretary Morgenthau - 2

on April 2 when we get a breakdown of these collections as between corporation and individual collections, and particularly as between full-paid and part-paid individual income tax collections. These collections are based principally on calendar year 1938 incomes. This increase over Budget estimates may be offset by a decrease in other receipts, such as miscellaneous excises and customs, if the adverse developments in the European situation retard business more than we had anticipated. So far as we can tell at this time receipts should equal the Budget expectations and probably may slightly exceed them.

Attachments.

CONFIDENTIAL

estimated increase (+) or decrease (-) in Federal internal revenue under the revenue Bill of 1938 as passed by the Senate on May 9, 1938, as compared with present law, at the levels of business used for the estimates contained in the President's Budget Message of January 3, 1938

(in millions of dollars)

	: At income levels of : Fiscal		
	: calendar years 1/ : year		
	: 1937	: 1938	: 1939 2/
Corporation taxes 3/	-200.5	- 53.7	- 43.9
Individual income tax	- 10.6	- 16.0	- 7.6
Estate and gift taxes	+ 1.4	+ 1.4	4/
Excise taxes			
Repealed taxes, concurrence of Senate and House bills			
Cruze petroleum	- 0.9	- 0.9	- 0.8
Toilet soaps, toothpastes, etc.	- 6.4	- 5.9	- 5.4
Sporting goods, cameras and lenses ...	- 7.7	- 7.3	- 6.9
Chewing gum	- 0.9	- 0.9	- 0.9
Furs	- 6.5	- 6.4	- 6.1
Phonograph records	- 0.3	- 0.3	- 0.3
Matches	- 6.9	- 6.9	- 6.9
Stamp tax on sales of produce for future delivery	- 4.0	- 3.0	- 2.9
Amendments to the tax on lumber	- 0.1	- 0.1	- 0.1
Exemption of palm oil and palm oil residue from the processing tax	- 0.1	- 0.1	- 0.1
Repeal of brewers' wort and malt sirup tax	- 0.7	- 0.6	- 0.6
Exemption of certain cooperative or non-profit corporations or associations from the electrical-energy tax	0.0	- 0.1	- 0.1
Increase in the distilled spirits tax	+ 22.0	+ 20.0	+ 19.0
Total increase (+) or decrease (-), excise taxes	- 12.5	- 12.4	- 12.1
Total increase (+) or decrease (-), all provisions	-222.2	- 80.7	- 63.6

Treasury Department, Division of Research and Statistics. May 9, 1938.

- 1/ Assuming that all provisions are fully reflected in revenues.
- 2/ Certain changes in the law are only partially reflected in fiscal year 1939 revenues, or do not affect revenues until a subsequent fiscal year.
- 3/ Including the estimated loss in individual income tax as a result of the decrease in dividends caused by proposed changes in the corporation income tax law.
- 4/ Not effective on fiscal year 1939 revenues.

Comparison of estimated 1/ and actual receipts for February 1959
and for the first eight months of fiscal year 1959

CONFIDENTIAL

Summary table - daily Treasury statement basis

(money figures in millions of dollars)

	February 1959				July 1958 - February 1959			
	Estimated receipts	Actual receipts	Increase + or decrease - over estimate	Amount : Percent	Estimated receipts	Actual receipts	Increase + or decrease - over estimate	Amount : Percent
General and special accounts								
Internal revenue:								
Income taxes	54.8	55.7	+ .9	+ 1.6	1,259.4	1,238.8	- .6	2/
Tax on unjust enrichment	.5	.5	0	0	4.3	4.2	- .1	2.5
Miscellaneous internal revenue	150.0	142.3	- 7.7	- 5.1	1,479.9	1,514.5	+ 34.6	+ 2.5
Pay-roll taxes:								
Social Security Act	141.4	154.4	+ 13.0	+ 9.2	461.0	475.2	+ 14.2	+ 3.1
Carriers Taxing Act of 1937	27.9	27.5	- .4	- 1.4	81.8	81.7	- .1	- .1
Total pay-roll taxes	169.3	181.9	+ 12.6	+ 7.4	542.8	556.9	+ 14.1	+ 2.6
Total internal revenue	374.6	380.4	+ 5.8	+ 1.5	3,266.4	3,314.4	+ 48.0	+ 1.5
Customs	28.8	22.4	- 6.4	- 22.2	223.2	210.3	- 12.9	- 5.8
Miscellaneous revenues and receipts	14.4	14.7	+ .3	+ 2.1	142.4	128.2	- 14.2	- 10.0
Total receipts, general and special accounts	417.8	417.5	- .3	- .1	3,632.0	3,652.8	+ 20.8	+ .6

Treasury Department, Division of Research and Statistics.

March 2, 1959.

- 1/ Monthly distribution of estimates for fiscal year 1959 appearing in the January 1959 Budget Message.
2/ Less than .05 percent.

3

CENTRAL HOUSING COMMITTEE

907 SIXTEENTH STREET
WASHINGTON

March 22, 1939

Dear Mr. Secretary:

A meeting of the Central Housing Committee was held Monday, March 20, at the Cosmos Club, at which matters of major importance to each of the housing agencies were discussed.

Great interest is shown in these meetings as indicated by the attendance. The agencies represented and the principals and alternates present were as follows:

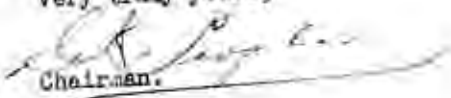
Commerce: Mr. Thorp and Dr. Briggs
Federal Home Loan Bank Board: Mr. Fahey and Dr. Loomis
Federal Housing Administration: Mr. Coleman and Dr. Fisher
National Emergency Council: Mr. Kellett
F. F. C. Mortgage Company: Mr. Williams and Mr. Dougherty
U. S. Housing Authority: Mr. Strauss and Mr. Vinton
Treasury: Myself, as Chairman, and Mr. Dunning

The question of the great desirability of a nation-wide housing census was discussed with Mr. Thorp, representing Mr. Hopkins; and all agencies represented believed that such a census would be of the greatest value in establishing factual data that would make possible the determination of size and character of housing projects according to need and local income levels, thus avoiding the large cost attendant upon individual surveys of large numbers of cities with the attendant loss of time and possibility of error.

Reports of a number of the sub-committees and reference groups indicate enthusiastic work along mutually helpful lines by the technicians of the various agencies. Particularly discussed was the work of the National Bureau of Standards, directed toward research and experimentation, looking toward more effective and less costly building materials for small houses, and the work of the sub-committee on Law and Legislation, who are directing their efforts toward a greater standardization of Lien Laws, Housing Legislation, a uniform mortgage act, etc.

The meetings of the Central Housing Committee and the interest evidenced by the heads of the various agencies demonstrate to my mind that a great deal may be accomplished by such meetings to develop better understanding and coordination of effort among the several agencies concerned.

Very truly yours,


Chairman.

The Honorable,

The Secretary of the Treasury.

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1
TREASURY DEPARTMENT
PROCUREMENT DIVISION
PUBLIC BUILDINGS BRANCH
WASHINGTON, D. C.
—
OFFICIAL BUSINESS

PENALTY FOR PRIVATE USE TO AVOID
PAYMENT OF POSTAGE, \$300

The Honorable,
The Secretary of the Treasury.

Regraded Unclassified

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: March 23, 1939, 6 p.m.

NO.: 551

FROM COCHRAN.

Today the Paris market sentiment is somewhat better because of better news of Franco's attitude and because of lack of offense in speech of King of Italy. Trading was light, but some dollars for the control were acquired by Chase. At five o'clock my friend told me that for the day he had also gained sterling, but to a lesser extent than dollar gains. Extensive support had to be given the Swiss franc by the Swiss control, but the florin was steadier and the belga had its best day for some time; more bids for forward franc.

March 16 Bank of France statement showed the ratio 63.37 versus 63.13, with no important changes. A request has been made of French exporters and importers that they report how much their commercial debts and credits with former Czechoslovakia are.

Today I had a visit from my Italian friend, who was on his way to Rome. He is to participate in the Fascist celebration there on Sunday, and the annual meeting next week of the Bank of Italy. He said that he still does not think war will come, unless trade with Germany is cut off to such an extent by the democracies that it will constitute sanctions against Germany.

BULLITT.

My dear Senators:

In your letter of March 14 you ask several important questions. These and similar questions, relating to gold and foreign exchange, have been asked so frequently that I welcome this opportunity to answer them and to make clear the policy of the Government with respect to these matters.

As you say, the questions raised involve technical matters which cannot be adequately handled in a page or two. However, I shall be as brief as is possible with materials of such complexity.

1. Who owns the gold now in the Treasury?

Title to all gold held by the Treasury, now amounting to about \$15 billion, is vested in the United States.

A large part of this gold (\$12,336,856,533 on March 15, 1939) is held as security for gold certificates (or credits payable in gold certificates) issued to and held by the Federal Reserve banks pursuant to the Gold Reserve Act. Such gold certificates may be redeemed in such amounts of gold bullion as, in the judgment of the Secretary of the Treasury, are necessary to settle international balances or to maintain the equal purchasing power of every kind of United States currency.

The remainder of the gold held by the Treasury, is accounted for as follows:

Gold Reserve - held pursuant to law as a reserve against United States notes and Treasury notes of 1890 -	\$ 156,039,430
Allocated to the Stabilization Fund	\$1,800,000,000
Gold in General Fund (against which gold certificates or credits have not as yet been issued)	
(a) Balance of increment resulting from reduction in the weight of the gold dollar	\$ 142,288,196
(b) In working balance	\$ 567,899,564

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The Treasury disposes of gold in the following ways:

- (a) For use in industry, profession or art. Any person needing gold for any such purpose can purchase gold from the Treasury.
- (b) For the purpose of meeting the international balance of payments. To this end the Treasury sells gold to the members of the Tripartite Accord and to their stabilization funds and fiscal agencies. The Treasury also may sell gold to foreign central banks upon application and under special conditions.

Neither Americans nor foreigners can obtain gold from the Treasury for the purpose of hoarding.

2. How much of the gold in the Treasury was purchased with funds obtained from the sale of interest-bearing obligations of the government?

The Treasury pays for gold with the cash assets in the General Fund, specifically out of the Treasury's deposit account with the Federal Reserve Bank of New York. The account is normally compensated by the deposit with the Federal Reserve Bank of gold certificates or gold certificate credits issued against the gold then acquired.

Up to December 22, 1936, it was the policy of the Treasury to issue to the Federal Reserve Bank gold certificates or gold certificate credits against the full value of the gold acquired. Under this procedure the purchase of gold by the Treasury did not involve any increase in the Federal debt either directly or indirectly. Shortly after December 22, 1936, however, the Treasury Department adopted a different procedure with respect to new gold purchases. Gold purchased was placed in an "inactive gold" account and paid for from the general cash balance of the Treasury without issue of additional gold certificates against the new gold acquisitions.

This procedure was departed from several times, however, by the issuance of gold certificates against gold released from the "inactive" account or against gold acquired but not placed in the "inactive" account. The "inactive" account was discontinued in April 1938, and at that time the Treasury issued \$1,400 millions in gold certificate credits to the Federal Reserve Banks against

the gold released from the "inactive gold" account and thus increased its cash balance by that amount. Since that time the Treasury has followed a policy of issuing gold certificates periodically for additional gold acquired. Gold purchases are permitted to accumulate in the General Fund in varying amounts before gold certificates are issued against them. On March 15, 1939, there was in the General Fund \$548 million of gold purchases against which gold certificates had not yet been issued but which had been paid for by checks drawn on the Treasury account with the Federal Reserve Bank of New York.

3. Why has so much gold come to the United States in the past five years?

Gold comes into the United States in settlement of the balance of international payments arising out of all transactions between the United States and all foreign countries. These international transactions include exports, imports, shipping services, tourists' expenditures, capital movements, interest payments, etc. When the demand for dollar exchange increases more rapidly than the supply of dollar exchange resulting from these transactions, the price of dollar exchange on the foreign exchange market rises. It may rise to a rate at which it becomes profitable for bankers and dealers, foreign and American, to ship gold to the United States, sell the gold to the Treasury for dollars, and then sell these dollars on the foreign exchange market.

Therefore, to answer the question why large amounts of gold flow to the United States it is necessary only to explain why United States dollar exchange is so much in demand.

A survey of our balance of payments for the last few years reveals at once that the greatly increased demand for dollar exchange which has taken place during the past five years is largely a consequence of the huge flow of capital to the United States and, more recently, of the large "favorable" trade balance. Some of the other categories of items in our international transactions can be held responsible for the substantial net increase in the demand for dollar exchange during this period. In fact, for several important categories the net demand for dollar exchange decreased. It is the flow of capital to this country, particularly before 1938, upon which our attention must be focused if we are to understand the chief reason for the large gold inflow.

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The following figures show the contrast between the large recorded inflow of capital in the past five years and the persistent and large outflow of capital in the years preceding:

1928	-850 million outflow	1934	+ 386 million inflow
1929	-217 " "	1935	+1,537 " "
1930	-752 " "	1936	+1,141 " "
1931	-490 " "	1937	+ 800 " "
1932	-152 " "	1938	+ 369 " "
1933	-336 " "		

The capital inflow in the years from 1935 through 1937 was the major factor responsible for the inflow of gold, for it amounted in total to \$3,500 million or 86 percent of the value of gold imported during that period.

The trade item did not become important from the point of view of gold inflows until the last quarter of 1937. From 1934 to 1937 the excess of our exports over imports averaged only 250 million a year. (Incidentally, if silver imports were included in our merchandise imports, which is the procedure followed by many countries in the world, our excess of exports over imports would have amounted to only \$80 million a year in this period.) In 1938, however, the favorable trade balance greatly increased and was the dominant factor inducing the large flow of gold into the United States. The excess of exports over imports totaled \$1,134 million — the largest we have had in seventeen years. This increased "favorable" balance of trade, together with other items, was responsible for the net inflow in that year of 1.6 billion of gold.

Thus it is evident that because there was a large inflow of capital in recent years, and in 1938 a large excess of exports over imports, there was a great increase in the net demand for dollar exchange; and because of this large increase in the net demand for dollars there was a large inflow of gold. Therefore, in the final analysis your question: "Why has so much gold come into the United States?" reduces itself to the questions: "Why did so much capital come to this country during the past five years?" and "Why did we have so large a 'favorable' trade balance in 1938?"

The answer to the first of these two questions, together with a description of the kinds of capital coming here, was given in some detail in my letter to Senator Vandenberg of September 22, 1936, a copy of which is enclosed for your convenience.

In Section 3 of that letter the causes of capital imports into the United States are set forth as follows:

"(a) Capital withdrawn from abroad by American owners because of the greater security or the more attractive field for investment offered the capital at home. The return of these funds to the United States -- much of which left the country in 1930-31-32 -- is, of course, an indication of the relative strength of our recovery and of the prevailing confidence in the future of American industry and American financial institutions.

"(b) Funds sent to this country by foreigners who likewise felt that American securities offered a more attractive or more secure investment opportunity than did investments available to them elsewhere.

"(c) Repurchase by foreigners of some of the foreign securities which Americans had purchased during the post-war decade and were now glad to get rid of even at low prices. This was particularly true of the securities of certain countries where nominal high exchange rates were coupled with devalues whereby the nationals of these countries were encouraged to repatriate these securities at an exchange profit to themselves, or where maintenance of debt service was provided for only internally but not for foreign holders.

"(d) Need created by increasing foreign trade for larger working dollar balances to be kept in American banks by foreign banks and traders. Our international trade during 1934 and 1935 increased by one-third over the two years previous. It is to be expected that this greater volume of foreign trade transactions would call for larger working dollar balances.

"(e) Fear prevailing in some countries abroad of confiscation of property or of loss through inflation of their local currencies led during this period to a

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Flight of capital from some of the countries whose economic and political situations have been threatened by disturbances with which you are doubtless familiar.

*(f) Lastly, funds sent to this country by speculators in the hope or expectation that an exchange profit will be possible if and when the currencies of their countries become depreciated in terms of the dollar.

"These are the causes which account for most of the capital inflows. Yet these capital inflows would not have resulted in such large sums being due to the United States were it not for the virtual cessation of foreign investments by Americans. Whereas in the years prior to the depression, annual foreign investments by Americans of more than a billion dollars were common, since 1931 the annual sums invested abroad have been negligible; nor does it appear that the United States will approach in the near future the predepression volume of foreign investment."

Since the above was written (September, 1936), nothing has occurred to alter substantially the trend of capital movements or the reasons for them. With the exception of one nine-month period, capital has continued to flow to the United States in large volume. During that nine-month period, October 1937 to June 1938, there was a net outflow of short-term capital of over \$1 billion, but the flow was reversed during the Fall of 1938, and more than a billion of short-term capital has since come to the United States.

Capital will continue to flow into the United States in large amounts so long as:

- (a) The opportunities for secure and profitable investment in foreign countries are not great enough to attract American capital abroad;
- (b) The prospects of continued recovery here appear satisfactory to foreigners;
- (c) The political situation abroad remains disturbed;
- (d) There is possibility of further depreciation of some foreign currencies.

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Whether the flow of capital into the United States will continue to take the form of gold or whether it will gradually assume the form of goods and services rather than gold depends upon the rapidity with which the mechanism of adjustments of international accounts operates. In earlier decades this adjustment process operated tolerably well and with fair speed to transform international movements of net balances into movements of goods and services. This adjustment process served to keep gold movements between countries relatively small in volume. In recent years, however, this mechanism has operated badly and haltingly. Moreover, it has had to operate under sudden and large capital and trade shifts which differed from those of earlier decades not only in magnitude but in character. To put it graphically, the mechanism of adjustment has had a heavier load to carry, the road has been uphill, and the incline has grown steeper.

The reasons and nature of this change taking place in the effectiveness of the so-called adjustment process of international accounts are matters too technical to warrant discussing in this letter. Suffice to say that because the numerous obstacles to rapid adjustment still prevail in virtually all countries with free exchanges any large movement of capital to the United States in the near future will doubtless take the form largely of an inflow of gold.

The significance of this fact as an explanation of the continuing flow of gold to the United States cannot be emphasized too strongly. As compared with the decades prior to 1930, there are now different relationships between international movements of capital and of gold, changes in domestic price levels, trade changes, contraction and expansion of credit, and changes in the volume of business activity. Realization of this basic economic change is necessary to appreciate the need for treating present day problems of gold and capital flows quite differently than was appropriate prior to 1929. Monetary experience of those years, particularly in its international aspects, does not suffice for safe guidance for present day policy.

4. Is it true that gold comes here in large amounts because the Treasury is paying a higher price than other countries for gold, and because it buys gold at a fixed price?

This is a question we frequently hear. Unfortunately it is not wholly clear just what is meant since the phrase a "higher price for gold" may be interpreted in two quite different ways, and the answer to each of the two interpretations would be arrived at through quite different lines of reasoning.

If the question be interpreted to mean that gold comes to the United States in large amounts because we pay a "higher price" than other countries do in terms of a money price (i.e., in terms of dollars) then the answer is definitely "no". The United States pays the same price for gold, allowing for arbitrage and transportation costs, that any other country does — no more and no less. We do not pay any higher prices for gold than does England or France or Belgium or India.

The price of gold that is permitted to move freely in international channels of trade is (and must be) virtually the same the world over. An Englishman who sells gold in London gets the same return in pounds and shillings for it — with small variations to be explained in a moment — as he would get were he to send the same gold to New York or to Amsterdam or to Paris or to Bombay to be sold. Right now, for example, he would get about 148 shillings for an ounce of gold in the London gold market. If he ships that gold and sells it to the United States, he gets \$35 an ounce (less 1/4 of 1 percent). When he converts the dollar proceeds of the sale of that ounce of gold back into sterling and deducts the expenses of shipping, he gets approximately the same amount of sterling as he would have obtained had he sold the gold at home — namely, about 148 shillings. In other words, when a foreigner translates the dollars he gets from the sale of his gold back to his own currency, he finds that the price of gold is almost the same in London, Paris, Amsterdam, or Johannesburg. We pay dollars for gold, England pays sterling, Holland pays guilders, etc., but when conversion from one currency into another is made at the prevailing exchange rates we find that an ounce of gold brings approximately the same price in one country as in another.

I say approximately the same price. There are slight relative variations in the price as between different countries, variations which inevitably result from changes in the supply of and demand for foreign exchange. Any change, no matter how slight, in the relationship of the supply of foreign exchange to the demand will bring about a change in the price for foreign exchange. The fluctuations of exchange rates, together with the fluctuations in the price of gold in terms of foreign currencies, result in the occurrence of relative differences in the price of gold in different national money markets when computed in terms of a single currency, but these relative variations can occur only within narrow limits.

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These slight relative variations in the price of gold as among various markets which make possible a profit in shipping gold from one country to another would continue whether we paid \$10 an ounce for gold, or \$50, or \$60. Slight variations in the dollar-sterling, dollar-franc, dollar-guilder rates, etc., do give dealers small profits when selling gold in one market rather than another but those variations operate as among all countries and at all levels of prices for gold; they are not peculiar to the United States alone, nor to the \$35 price for gold. Exactly the same condition prevailed when the price of gold was \$20.67 an ounce and when other countries had a fixed price of gold. It is the normal mechanism which has always prevailed and must inevitably prevail so long as gold is the international medium of exchange.

To dispose briefly of another common misconception. It has been sometimes claimed that gold comes here because the United States pays a fixed price for gold, whereas other countries buy gold at varying prices. The mere fact of fixity of the price of gold in terms of any given currency has little to do with the movement of gold. For example, England does not have a fixed price of gold, and yet her net imports of gold in some of the past few years were greater than ours. Belgium has had a fixed price for gold for two years, yet her reported gold holdings are no higher now than they were three years ago. Moreover, our gold price, although fixed in terms of dollars, is not fixed in terms of other currencies. When, for example, an Englishman sells gold to the United States, the number of dollars he gets may be fixed, but the amount of sterling he gets, if he converts the dollars into sterling, is not fixed; it fluctuates with every change in the sterling-dollar exchange rate. The amount in his own currency which an Englishman or a Frenchman receives when he sells gold is not fixed whether he sells his gold in New York, London or Paris.

So far in answer to this question the discussion has been based on the interpretation of the phrase "higher price" as meaning a higher monetary price. If, however, the phrase is to be understood to mean — as is doubtless intended by many who put the question — a "higher price" in terms not of money but of goods and services, then the question becomes a quite different one. It should then be phrased as follows: "Is it not true that gold comes to the United States in large amounts because we give more goods and services for a dollar (or its monetary equivalent in foreign currencies) than does any other country?"

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The answer to this question is likewise "no", though less unqualifiedly so because adequate statistical data for a categorical answer are not available.

The purchasing power of the dollar in the United States in terms of goods can be compared with its purchasing power in other countries only very roughly and only with respect to those goods which do (or easily might) move from country to country. With respect to "services" comparison of the purchasing power of the dollar in the United States and elsewhere relates chiefly to shipping services and the expenditures by tourists.

Now it is extremely difficult to measure the differences in purchasing power of gold or currency as between different countries even with respect to such goods and services. Fortunately, for the purposes of the question we are examining, no such measurement is necessary. Were it true that an ounce of gold had a significantly higher purchasing power over American internationally traded goods than over foreign goods, indirect but definite evidence would be revealed in our trade figures. Our export excess would have so increased since 1933 that either we would have drained the outside world of all its monetary gold, or we would have forced other countries to adopt strict exchange or import controls or much higher tariff schedules. No such developments have occurred. Foreign countries still have large gold holdings; many of them have not significantly heightened their barriers against imports of the world.

Compelling evidence that we do not pay a higher price for gold than do other countries in terms of goods and services is contained in the record of our balance of international payments on current account. For the years 1934 to 1937, inclusive, the balance of payments with respect to the pertinent commodity and service items was in the aggregate unfavorable by \$1,200 million, as far as the records show. Unfortunately, however, our international accounts, though more complete and reliable than those of other countries, are still subject to a substantial margin of error. In each year there has been a substantial "residual" item (i.e., unaccounted for) which during the four years in question totaled approximately \$1-1/2 billion due the United States. Some portion of this favorable balance must be allocated to trade and services — how much it is impossible to know. But, even if we allocated the whole residual item to commodity and service items — which would be an extravagant allowance — there would result only a small balance due the United States for those items during the four years in question — \$400 million for the four-year period.

This constitutes too small a sum relative to the magnitudes involved in our balance of payments to justify the claim that an ounce of gold can buy more here than elsewhere.

There is little basis, therefore, for the contention that an ounce of gold could in general buy more goods and services in the United States than elsewhere from the years 1934 to 1937, inclusive. Or to put it in simpler and more accurate terms, the United States did not achieve any special competitive advantage in international markets as a consequence of its external monetary policy. The change in the gold value of the dollar in 1933 merely helped the United States to regain its earlier position. In 1938 the trade situation appeared to change. We did experience a sharp increase in our trade balance. Exports, as pointed out earlier, exceeded imports in 1938 by some \$800 million more than in 1937. But most of this increase cannot be attributed to any changed relationship of the dollar to other currencies because the exports excess arose from a sharp decrease in imports, and not from an increase in exports. The recession in the United States more marked and earlier than in other countries caused a temporary decrease in our purchases from abroad greater than the simultaneous decrease in our exports. This gap may be expected to narrow as recovery proceeds.

The only sense in which it might be said that we give more for gold than other countries is that in addition to \$35 an ounce we also give peace, security, prospects of higher returns on investment, and better speculative opportunities, with the result that foreign capital funds flow here in the shape of gold. It is these values that constitute the chief factor conducive to a flow of gold to the United States.

5. How much more gold do you think we will get?

How much we will get depends upon the extent and direction of changes in our balance of trade and services, upon the output of new gold, and upon the trend of capital movements.

Since capital movements are so sensitive to international political and economic developments, one can only hazard a guess as to their future trend. At this moment it looks as though the European situation will remain so disturbed as to postpone for some time any substantial repatriation of foreign balances. It also appears as though early resumption of American lending abroad such as would cause a gold outflow is extremely unlikely.

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As for our balance on commodity and service items, the fear of war and the preparation for war by foreign nations are likely to sustain our exports and reduce American tourist travel in Europe and Asia — both developments making for additional gold inflows. On the other hand, continuance of our recovery here will tend to increase our imports and to increase American tourist travel in the Western hemisphere. I believe the latter trend will outweigh the other and that on commodity and service account the net balance due us will be less in 1939 than it was last year. On the other hand, capital inflows will probably be large so that, on the whole, it appears that in the near future the United States will continue to get gold, perhaps in as large volume as in recent years.

Current world gold production (outside the United States) now amounts to over one billion dollars per year. The bulk of this newly-mined gold can go only to a few countries. Most countries now utilize practically every available dollar of foreign exchange to purchase imports or to make additional payments on outstanding foreign debts. Much as they would like to acquire gold, and much as they need it, they want to acquire additional imports even more. Therefore, it is to be expected that until current hostilities and intensive preparedness for wars cease, and until the world economic situation improves, the bulk of the newly-mined gold will be added to the monetary stocks of only a few countries and the United States will get a substantial share of it.

6. Why doesn't the Treasury stop buying gold?

A simple way of stopping gold from coming into the United States would be for the Treasury to announce to the world that we will not buy any more gold for the time being. But, such a step, taken unilaterally, would have disastrous effects on our economy. It would disrupt the foreign exchanges and gold bullion markets and would very soon cause such drastic disturbances in international trade and even in the domestic sphere as seriously to impede the recovery of business.

Present relationships among the various leading currencies would be upset. The dollar probably would appreciate immediately in terms of other leading currencies. At present, when the demand for dollar exchange increases, foreigners need only obtain gold (either at home or on the London market), ship it here and obtain dollars in exchange. Thus an increased demand for dollar exchange

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relative to the supply is met. If, however, this means of securing dollar exchange were removed, dollars would rise in value indefinitely in terms of other currencies. While it is impossible to know in advance what rates of exchange would finally emerge, we can be certain of at least one thing — that no country would benefit from the ensuing international monetary disruption.

Were the United States, moreover, to declare a complete embargo on gold imports, it might deal a serious blow to the value of gold as a monetary medium. (Such action coming at a period when there was discussion of the possibility of world overabundance of gold might have repercussions which would disturb the public's confidence in the value of gold.) The leading gold producing areas would be hard hit and some might even be involved in a major economic crisis.

A closely related question that has frequently been asked is: "Should not the price of gold be reduced? Is not \$35 an ounce too high a price for gold?" Possibly the simplest way to answer this question is to examine the consequences that would ensue from an increase in the gold content of the dollar (or, to phrase it another way, from a decrease in the monetary value of gold).

A reduction by Congress in the monetary value of gold would probably not be as calamitous as a complete embargo. It would limit the extent of possible depreciation of gold (or appreciation of the dollar in terms of foreign currencies) and the psychological disturbance caused by the change would not be as potent, yet it would have disadvantages serious enough to render resort to any such action most unwise. If the reduction made in the price of gold were small, our trade and service balance would not be much affected over the next year or so, nor would the inflow of capital cease. Once the drop in the price of gold was regarded by the rest of the world as definitive, the subsequent effect on capital imports would be virtually nil. Our securities would continue to be bought for the same reasons that they are bought now and dollar balances on foreign account would also continue to increase for the same reasons that they are increasing now. But,

were a small decline in the price of gold to be regarded by numerous domestic and foreign investors and exchange speculators as being but the first of a series of drops, the result might well be to attract more, not less, funds to the United States, and to intensify the inflow of gold — the very thing it is designed to check. Speculators would rush to buy dollars and hold them here in anticipation of the next appreciation. Thus the effect on capital movements, both long-term and short-term, might more than offset the effect on trade and service items; instead of getting less gold we would find ourselves getting more.

On the other hand, were the monetary value of gold to be cut with one stroke substantially, and definitely — say, for example, to \$25 an ounce — the effect would be quite different from that described above. Such a step might reduce the volume of gold imports and perhaps give rise to an outflow of large dimensions; but, the economic effects on our economy of the change in the foreign exchange value of the dollar would be little short of disastrous. The 40 percent increase in the price of American currencies to foreigners would constitute a severe handicap upon our exports. Our exports play a role in the level of business activity much in excess of the magnitudes involved and so great an appreciation of our currency in terms of other currencies would be bound to curtail our exports seriously. In the past six months the dollar has appreciated in terms of other leading currencies by some 5 percent and price movements in the various countries have not been such as to offset this competitive disadvantage to us. The appreciation of the dollar has not been due to a change in the dollar price for gold but rather to a depreciation of foreign currencies in terms of gold. You will note that our exports during January 1939 were more than 40 percent less than they were in January 1938. Although it is too soon to evaluate the full significance of the decline, it is not unreasonable to assume that the less favorable position of the dollar in terms of other currency (i.e., higher prices of foreign currencies in terms of gold) contributed to the drop in exports.

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Our imports on the other hand would, in the event of a reduction in the price for gold to \$25 an ounce, be 30 percent cheaper. Our domestic producers would then be exposed to greatly sharpened competition in the American market from foreign producers both because the prices in dollars of imports would be less, and also because the numerous ad valorem duties would constitute smaller protection.

Foreigners would have a greater advantage in this market but unfortunately even this would be of dubious value to them. The ability of Americans to buy goods, whether imports or domestic goods, depends chiefly upon the state of business activity here. It is chiefly for that reason that our imports during the recession of 1938 dropped to almost one-half and that our imports began to increase in the Fall of 1938. Thus, though the sharp appreciation of the dollar would make foreign goods cheaper in this country, our imports might actually be less than during the previous period and instead of benefiting the rest of the world we would be hurting world business as well as our own.

Judging from past experience we could not expect the prices of domestic commodities and services to move either at home or abroad with sufficient rapidity to adjust quickly and fully to any substantial alteration in exchange rates. For many months, perhaps for years, the economic position of large groups of American producers, including farmers, would be worsened and there would be widespread unemployment. The combined effect on our domestic economy of a sharp drop in exports and of increasing competition in the domestic market would be keenly felt. Domestic prices would begin to fall. Many corporations would suffer loss of business and profits. In times such as the present these short-run effects — and by short-run we mean from a few months to several years — are of paramount importance. To brush aside, as some are prone to do, these short-run effects on the ground that in the long-run appropriate adjustments will take place is to ignore the unstable world in which we live and the real problems which confront us from day to day.

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Moreover, were we to reduce the price of gold and were it to result in an outflow of gold there is no reason to believe that the countries who most need gold would get it. On the contrary, were gold to leave the United States it would probably find a resting place in the very countries whose currencies would for the moment appear most secure. Certainly no gold would flow to Latin American countries in any substantial amount, nor would the Far East or the Balkans obtain more gold. The loss of gold by the United States would not correct the serious maldistribution. It would rather operate only to take away some from the United States which has too much and to add it to the holdings of other countries which likewise have too much.

Thus we are confronted with the fact that though we should like to receive less gold and even to get rid of substantial amounts of the gold we already have, there is, under the existing circumstances, no acceptable alternative to the policy we have been pursuing. In the case of all the proposals we have examined, the remedy has always been worse than the disease. The best way to reduce our gold inflow on commodity and service account is for us to have full recovery so that our imports will rise more rapidly than our exports.'

7. If what use to us is this large stock of gold? Is there any likelihood that we will get so much of the world's gold that we will "get stuck" with it?

Gold performs two monetary functions. First, it serves as a specie base for the monetary system. Secondly, it serves as the medium for settling international balances. These are distinct and separate functions. The present gold stock of the United States is about \$15 billion. The question you ask, therefore, is "Is \$15 billion of gold more than enough to accomplish these two functions which gold now performs in our economic system?"

It is doubtless true that we have more gold than we need to provide a specie base for our monetary system. Our laws require that a 40 percent reserve in gold certificates be held against Federal Reserve notes in circulation and a 35 percent reserve in gold certificates or lawful money against deposits of Federal Reserve banks. These legal reserve requirements are based on the assumption that gold reserve requirements operate as a control of the volume of means of payment, as a protection against excessive issue of notes and expansion of bank credit. At present, however, gold and gold certificate holdings are so far in excess of these legal requirements that they can hardly

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be said to constitute a protection against undue expansion of our currency and credit. We now have enough gold to permit an enormous expansion of credit and currency even after generous allowance for the outflow of gold that might accompany such an expansion. Legal reserve requirements do not of themselves necessarily protect us against an undue expansion of the volume of money and the monetary authorities must be prepared, when and if the occasion arises, to apply appropriate supplementary control. This is especially likely to be true when gold holdings are as great as they now are.

But it is desirable that the reserves be above the minimum required by law. Otherwise in a period of business recovery the limitations on the expansion of notes and deposits which the gold reserve would impose would operate to curb the rise in business activity, or an outflow of gold would tend to initiate a contraction of credit, irrespective of the legitimate needs of business. It is clear, therefore, that some excess of gold above the legal minimum is needed to protect our domestic economy against effects of fortuitous inflows and outflows of gold. We now, however, have more gold than is necessary to insure this protection.

The second and more important monetary function of gold is its employment as a means of settling international balances among nations. Gold has been used for this purpose from time immemorial, and modern governments have as yet found no satisfactory substitute; nor is there any sign that a satisfactory substitute will be found in the near future.

Important commercial countries which carry little or no gold stocks have difficulties in settling their international payments. They have to see to it that their imports and exports are maintained in a certain relationship to each other. To achieve that and to keep their foreign exchange rates from fluctuating wildly they frequently have to maintain strict exchange controls so as to restrict merchandise imports and the movement of capital.

Small countries, which are not precluded by political and prestige considerations from holding their reserves in the form of foreign exchange assets, can get along more or less satisfactorily without gold. But they can do so only because the countries whose currencies they hold as reserve assets do have large amounts of gold reserves.

Some countries (operating with very little gold or foreign exchange assets) have been pointed to as illustrations of the phenomenon that countries can carry on foreign trade and settle international transactions without resort to gold, and that gold is rapidly becoming obsolete even for this monetary role. Those who make this claim completely misread the experience of these countries. These very countries do in fact need and prize gold more and seek it more anxiously, than do countries that use gold freely to settle balances of international payments. It is their inability to obtain gold which forces them to adopt a far less satisfactory alternative method of adjusting their balance of international payments, - namely, the adoption of strict exchange control, of clearing agreements, of barter schemes, and the imposition of severe penalties against evasion and all the other business and liberty destroying procedures necessary to make the system work. There is no one thing which demonstrates more effectively the superiority of gold as a means for settling international balances than the experience of those countries that have tried to get along without it.

Without either gold or exchange controls, exchange rates would be very unstable. Any change in the balance of payments would have to be taken care of by international borrowing or lending, or the exchange rates would have to move to the point where the sums to be paid and the sums to be received were equated. Because we have abundant gold reserves we do not have to apply exchange restrictions, and broad changes in our balance of international payments can take place without interfering with the stability of the dollar exchange.

All these points have been granted by some critics, but they maintain that to fulfill both these functions much less than \$15 billion worth of gold would suffice. There is some merit to that contention, yet the future of international political and economic relationships is much too uncertain to justify our taking the steps which would be necessary if we were determined to reduce our gold holdings.

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One important factor to bear in mind in considering our gold policy is the psychological reaction of the public to a continuing loss of gold. Should a country be undergoing loss of gold over a considerable period of time, there is likely to result impaired confidence in that country's currency and in the stability of its monetary system long before it has exhausted the gold it possessed in excess of legal or traditional reserve requirements. This has happened time and again throughout the world. Without greater ability to forecast future political and economic developments than is vouchsafed us, it is impossible to say with certainty that we have too much gold. We can say with some assurance, however, that we have enough gold to meet all likely contingencies, and that we are in a strong position to defend the stability of our credit structure and of the dollar against any quick change in our international balance of payments, including any large withdrawal of foreign capital.

The danger that gold will no longer be used as a medium of international exchange is so remote as not to merit serious consideration. Other countries will surely continue to accept gold in the settlement of favorable balances of payments, because gold is as important to them as it is to us. England has over \$3 billion of gold. France has almost as much; Holland, Switzerland, and Belgium and many other countries have what are for them large holdings of gold. It is in the interest of these countries as much as it is in our own interest to continue to rely on gold as an essential part of their monetary system. Moreover, we must not overlook the fact that nations producing substantial quantities of gold have important vested interests in the continuation of gold as a monetary metal. The British Empire alone produces about half the world's gold. Even countries that produce relatively small amounts of gold find that those small amounts are an important source of national income to them.

Senator Wagner - 20

8. Isn't it true that foreigners are getting shares of our productive industries and giving us in return gold that we have no use for?

The amount of American securities which have been recently acquired by residents of foreign countries has been much less than is generally supposed. During the past four years the total of net foreign purchases of American securities amounted to only \$1.2 billion, as follows:

1935	\$317 millions
1936	601 "
1937	245 "
1938	49 "

There was, in addition, an increase in direct investments by foreigners as reported by the Department of Commerce of about \$175 million during this period. Altogether, the total amount of investments by foreigners in American securities or directly in American industry during the past four years has been less than one-fifth of the gold sent here during those years.

These sums do not, of course, represent the total of foreign capital which has come into the United States. Short-term funds owned by residents of foreign countries increased by \$1.8 billion. The bulk of these were demand deposits, which do not constitute acquisitions of shares in American industry and which do not earn any interest.

The acquisition of American securities by foreigners paid for with gold represents a transaction which admittedly is, under existing circumstances, of dubious advantage to the United States. Yet, given the relatively minor importance of the problem to date, we have not been able to convince ourselves that any of the possible remedies which we have so far examined gave promise of sufficient benefit to the national economy to offset their disadvantages.

On the other hand, it should be pointed out that if foreign holders of American securities liquidate their holdings and withdraw the proceeds, either gold or goods (and services) would necessarily be the resultant medium of withdrawal. If the vehicle of transmission were gold, its loss, in view of our large gold holdings could, of course, be regarded with equanimity. If the medium of transmission were goods, either because of direct purchases with the proceeds of the funds or because of the operations of the adjustment process, the resultant increase to our exports at a time when there exists a large volume of unemployed labor and other idle resources would have favorable effects on our economy.

7. What action, if any, should be taken with respect to the gold situation? Should we, for example, return to the gold standard of pre-1933?

The maldistribution of the world's gold is a reflection of the disturbed economic situation throughout the world and the chaotic international political situation. Redistribution can come only with progress toward the solution of the basic problems confronting world international relations.

In our study of this matter we have examined literally scores of proposals directed towards possible action to redistribute the world's gold. The major conclusion we have drawn is that any measure which would take the form of restrictions on the flow of gold into this country would have, at this time, detrimental effects upon our economy.

What disadvantages may be associated with the gold inflow are fortunately only of minor magnitude, and should, moreover, be attributed to the factors causing that inflow rather than to the inflow itself. Foreign ownership of American securities may, however, serve as a source of disturbance to our security markets in times of stress; similarly with short-term foreign capital sent here. On the other hand, the third factor responsible for the gold inflow to the United States — our export excess — does yield a gain.

The large inflow of gold in recent years has been a major factor in increasing excess bank reserves. These reserves do in some degree operate to stimulate an expansion of loans by banks and to keep the interest rate structure lower — both developments

Senator Wagner - 22

helping somewhat to promote a higher level of business activity. Nonetheless, the prospect of continued large inflows of gold has been a cause of some concern on the part of those who consider a large volume of excess reserves as constituting a potential danger of inflation, though I do not regard this problem as one of immediate import.

The only immediately disturbing aspect of the gold problem is the loss of gold by foreign countries. The countries losing gold may be adversely affected by the loss and some of the adverse effects would impinge indirectly on us. This is to be deplored, but the factors producing this situation are external to us and beyond our control, acting alone.

With respect to the suggestion that the United States return to the gold standard of pre-1933, I must state definitely that such a move would be harmful to the American people and of no value to the people of other countries. In the first place, a return to the pre-1933 gold standard would mean a return to the \$20.67 an ounce price for gold. This, in the absence of similar changes in the gold value of other currencies, would represent a depreciation of approximately 70 percent in all foreign currencies in terms of the dollar.

It is obvious that an increase in the cost of the dollar to the foreigner by 70 percent and a decrease in the cost of foreign currencies to the American importer by 40 percent would seriously disrupt our foreign and domestic trade. Price movements are not so general or so rapid as to adjust economic conditions quickly to changes in exchange rates, and such movements as would occur would take the form of falling prices, particularly prices of agricultural products and raw materials. From experience we know that such price movements have disastrous effects upon incomes, profits and the level of business activity. We might be precipitated into a depression rivalling the 1930-33 experience. There can be no question, therefore, of returning to a gold dollar with the pre-1933 content. The answer to question 4 above contains a full discussion of the foreseeable effects which would result from any substantial increase in the gold content of the dollar.

Even if what were proposed were a return not to the old gold value but to a pre-1933 gold standard with the present gold content of \$35.00 an ounce, such a step would be unwise at this time. Our present monetary system differs from the pre-1933 gold standard in three respects other than gold content. First, our currency is not convertible into gold coin, secondly, there are government controls over the movement of gold in and out of the country, and thirdly, there is executive authority to change the gold content of the dollar.

Convertibility of currency would, in my opinion, have no substantial advantages. Virtually every country in the world has recognized this fact and has withdrawn the privilege. For in normal times there is nothing to be gained by the right to convert currency into gold, whereas at all times convertibility has the potential disadvantage of creating a possible source of internal gold drain which would come into play at the very time when it would be most injurious. Internal hoarding of specie reserves has been, in the experience of many countries, one of the most important reasons for the weakening of currencies. Though the prospect of such a contingency in the United States seems at this time remote, it would nevertheless always be a possibility under a convertible currency system. Moreover, in the event that there should develop an emergency situation calling for a further change in the gold content of the dollar, the existence of private gold holdings would create unnecessary difficulties.

At present the movement of gold out of the country is in effect subject only to the restriction that it must be for the purpose of settling international balances. Gold moves freely to satisfy legitimate commercial and financial needs. The present powers of control over the movement of gold provide a safeguard that can instantly be used in the contingency of an international crisis.

The power to change the gold content of the dollar should be lodged in an authority which can, in case of necessity, act swiftly and in a manner which will minimize the disturbances resulting from any change. This power should always be available; its existence contributes to the maintenance of stable exchange relationships, which make the exercise of the power unnecessary.

It is important to realize that rumors of an impending change in the value of a currency, or any public discussion by responsible officials that such a change might be made, would in themselves be enough to induce large flows of capital either into the country or out of the country, depending upon whether the prospect is for an increase in the value of the dollar or for a decrease in the gold content of the dollar. Discussions in committees would be advance notice to speculators that such action might take place. The mere fact that it might take place would be sufficient to induce the flow of capital, because if the change did not actually occur, the speculation would have cost only the small charges attending any exchange transaction. Indeed, Congressional discussion would stimulate speculators to engage in activities of a sort which would of themselves tend to force Congress to take the action which had been in contemplation, even if on its own merits and in the absence of the situation created by the operations of the speculators, a negative decision would have been in order. The liquidation of foreign holdings of American capital might, under such circumstances, easily be powerful enough to disrupt the security exchanges and to introduce a chaotic situation in markets and in business generally. Since the prospect of devaluation would arise only under circumstances which were disturbing in any case, the outflow of capital would simply make bad things worse.

It therefore appears desirable that the Executive should have the power to alter the gold content of the national currency unit, in the public interest, and within clearly prescribed limits, as it is in most of the countries in the world, so that if an emergency situation should require its exercise, it could be exercised quickly, and without the necessity of prior public discussion and its concomitant invitation to speculative activities.

10. Did devaluation of the dollar in 1934 have an unfavorable effect on our imports?

Under one set of circumstances devaluation of a currency will induce an increase in imports and under a different set of circumstances it may decrease imports. Devaluation of the dollar in 1934 did contribute to an increase in United States imports.

Senator Wagner - 25

The value of American imports varies, in the main, with domestic business activity. When business is good in the United States, our imports are high; when business is bad, our imports are low. For example, between 1929 and 1932 imports dropped from \$4,400 million to \$1,300 million, a decrease of more than two-thirds. Again in 1938, owing largely to the recession which prevailed through most of that year, our imports dropped more than one-third. On the other hand, during the years of recovery - 1934, 1935, 1936 and 1937, our imports rose from the low of \$1.3 billion to over \$3 billion. Increases or decreases in the total value of a country's imports are due to changes in prices as well as to changes in quantity. A sharp drop in the prices of imported commodities which are competitive with domestic products has economic repercussions which are very disturbing to the country receiving the imports. At a time when business activity is declining, any potent source of further price declines serves only to lower still further the level of business activity and to increase unemployment.

The best way to increase our imports is to increase our national income. Any measure which serves to promote recovery increases our imports and contrariwise any measure which serves to reduce business activity operates to reduce our imports.

As a consequence of falling prices and declining business intensified by the widespread depreciation of other currencies in 1931-33, we bought less because our national income was less notwithstanding the greatly lowered cost of imported goods. Even though depreciation of the dollar made imported goods more expensive, the improvement in business activity which followed devaluation was one of the factors responsible for the rise in national income and the consequent increase in imports. Whether or not depreciation of a currency will lead to increased or decreased imports depends upon the conditions which precede such depreciation, and upon other measures which accompany it, as well as upon the reaction of other affected countries.

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11. Who in England and France have the power of altering the gold value of their currencies and what is the extent of that power?

In England the British Treasury has the power to alter the sterling price of gold through its operations in the gold market. There is no statutory restriction on the extent to which the British Treasury can change the sterling price of gold.

Similarly, the French Treasury, through the mechanism of its foreign exchange and gold operations, can alter the franc price of gold without any statutory restrictions. In addition, the Council of Ministers is authorized to fix ultimately by decree the gold content of the franc. As yet, they have not done so. The Council of Ministers, in other words, can decide whether or not there should be any statutory gold value for their currency and under existing law can fix that value at any amount it wishes.

12. Is there any basis to the contention that the power to devalue operates to undermine the businessman's confidence so as to deter him from making loans and investments in the United States?

A factor that more than any other will increase the confidence of businessmen in the future is the assurance that business will improve; a development contributing substantially to that expectation would be the prospect of a stable or moderately rising price level. What businessmen fear with regard to the dollar is not that the price level in the United States may remain stable or rise but that the price level in the United States may fall (i.e., that the purchasing power of the dollar may rise).

Senator Wagner - 27

From past experience we know that falling prices have disastrous effects upon our economic system. The national income declines, business profits disappear, the security of loans is undermined and the level of business activity falls. If the businessman could be assured that price levels will not fall sharply, he would have greater confidence that business profits and the value of investments would be maintained and consequently he would be more willing to make investments and loans. At no time in modern history have lenders hesitated to lend during times of stable or moderately rising prices and at no time has their desire to lend increased during a period of substantially falling prices. The power to devalue should thus constitute for the businessman an added assurance that prices will not be permitted to decline much or sharply in response to a marked depreciation of foreign currencies. This added assurance of domestic price stability should operate as an encouragement to investment.

The present attitude of the owner of capital towards the prospective value of the dollar is one of full confidence. This is borne out by the eagerness of the public to invest in long-term fixed interest bonds at almost the lowest interest rate in the history of this or any other country. The fact that people are willing to invest billions at low rates of interest, and run the risk of depreciation of the real value of the bonds which would accompany any sharp rise in the general price level, suggests that they have confidence in the way which courts most; namely, by their willingness to risk their capital.

The assertion that the continuance of the power to change the gold content of the dollar generates lack of confidence and hesitation in the business world is not, I am convinced, based on factual considerations. Rather, it seems to me, it stems from an effort to reestablish the validity of monetary theories that are ill adapted to the circumstances prevailing in recent years.

Senator Wagner - 28

Monetary disturbances in the world today arise from causes almost entirely outside our control. The effect of these disturbances on our monetary system has been such as to reflect greater confidence in the American dollar than in any other currency. This tribute to the soundness of the dollar, taking the form of huge transfers of funds to the United States, creates an unbalance which is the only factor in the situation which gives us any cause for real concern. The powers we possess have been sufficient to prevent any significant damaging effect on our domestic system. The monetary powers granted to the President by the Congress have been employed in such a way as to be powerful forces for stability rather than instability in the domestic economy and in the international field alike.

Sincerely,

Honorable Robert L. Wagner,

United States Senate.

3/21/59

MAR 23 1939

My dear Mr. President:

It has been brought to my attention that consideration is being given to the question of allocating the functions of the Office of the Comptroller of the Currency to the other banking organizations under the authority contained in the Reorganization Bill, which presumably will become law before my return from Sea Island on April 10th.

If this question is brought to you, I would appreciate it if you would withhold action until my return, and then permit me to discuss the matter with you. I should like to have Under Secretary Hanes and Comptroller Delano participate in such discussion.

Faithfully yours,

(Signed) H. Morganthau, Jr.

The President.

The White House.

H.M.

M.H.

March 23, 1939

For the Secretary

I understand that the President has recently indicated to both Senator Brown of Michigan and Congressman Steagall of Alabama that if the reorganization bill is passed, he proposes to consolidate in a single agency all of the bank examination that is done by Federal agencies. I hope that before any such action is taken, the President confers with you and that you confer with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation.

My excuse for addressing you directly about this matter is that the subject is one with which I was concerned for you in my former position in your office.

May I give you in brief form some of the considerations which seem important to me at the present time in the field of bank examination and supervision.

The statement, seemingly pretty generally accepted and, as a matter of fact, plausible and logical on its face, to the effect that there should be but a single Federal

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agency examining banks is, in my opinion, based upon a fallacy. We have a dual banking system in this country and two kinds of banks--those that are chartered by the Federal Government (national banks) and those that are chartered by states (state banks). If all banks were alike, I would agree that there should be a single examining agency. But as long as we have the two systems of banks, and I believe there are values to the dual system which should not be surrendered lightly, it is logical to have two examining agencies. Indeed, if all were to be combined in one agency, it would of necessity be made up of two divisions, one division for the examination of national banks and one division for the examination of state banks.

The forty-eight state bank commissioners charter, examine and supervise state-chartered banks. Similarly, the Comptroller of the Currency charters, examines and supervises national banks. The Federal Deposit Insurance Corporation can and does accept the examinations made by the state bank commissioners and the Comptroller of the Currency. The FDIC can and does examine,

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when deemed necessary, some state-chartered banks. The Federal Deposit Insurance Corporation can and sometimes does make joint examinations with the Comptroller of the Currency of national banks.

Congress cannot and certainly should not compel all banks to be nationally chartered. So long as there are special supervisors of state banks, there should be a special supervisor of national banks.

Since last October, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation have functioned virtually as one agency in the examination and supervision of national banks and insured state non-member banks. There is complete harmony of purpose, uniformity of action, and mutual exchange of information without physical unification. That is, I strongly believe, as it should be.

The national banks would be unwilling to have examination by the Federal Deposit Insurance Corporation substituted for examination by the Comptroller of the Currency. The state banks would be unwilling to be examined by an agency within the Treasury.

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I think there should be not more than two Federal agencies examining banks.

When the Federal Reserve Act was originally passed, the examination of national banks was not transferred to the Federal Reserve System; on the contrary, it was provided that the state bank members of the Federal Reserve System should be examined by the Comptroller of the Currency. This was in fundamental recognition of the fact that the examination of member banks having financial dealings with the Federal Reserve banks should be examined by an independent agency--independent of the Federal Reserve System. Later, by virtue of a "states right" issue and upon the ples of the few state banks that became members that they had been promised that they would not have to give up any of their state rights upon joining, and upon insistence that one of these rights was to be examined by state authority rather than Federal, the law was amended so that the state member banks could be examined by the Federal Reserve banks.

The Federal Reserve Board, as a matter of fact, does not examine member banks and the Federal Reserve banks

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have not been very active in such examinations. I think the Federal Deposit Insurance Corporation should be given the authority of examining all insured state banks, both members of the Federal Reserve System and those that are not members of the Federal Reserve System, and that the examination of national banks should be left in the Office of the Comptroller of the Currency.

The Federal Deposit Insurance Corporation cannot close a state bank. It can only withdraw insurance. Turning over the functions of the Comptroller of the Currency to the Federal Deposit Insurance Corporation would give it much greater authority over national banks than it has over state banks.

There are added reasons, which I shall not go into in this memorandum, why the examination of national banks should not be under the authority of either the Federal Reserve System or the Federal Deposit Insurance Corporation. There are other reasons, which I shall not go into here, why it should be in the Treasury Department.

Two reasons are most frequently assigned for the removal of the Office of the Comptroller of the Currency from the Treasury Department.

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One is that the Secretary of the Treasury, being the largest borrower in the market and being the largest creditor of the banks by virtue of the Government securities in the portfolios of the banks, is likely to place the interests of the Government over those of the banks and force the banks to take Government securities beyond safe bounds (assuming that there are unsafe bounds). There are no indications that national banks are in a different position so far as their holdings of Government bonds are concerned than are state banks. There is no evidence that the Secretary of the Treasury has forced either kind of banks to buy Government bonds. Moreover, it is absurd to talk about banks holding too great amounts of Government securities (except from the point of view that they use them as a haven of safety when they ought to be venturing more of their funds in commercial loans).

The other argument used is that the Secretary of the Treasury is a political officer and his domination of the Office of the Comptroller of the Currency will be political. I do not believe that there is any greater possibility

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of the Secretary of the Treasury being overly political than of the Comptroller of the Currency himself being overly political, or of the Chairman of the Board of Governors of the Federal Reserve System being overly political, or of the Chairman of the Federal Deposit Insurance Corporation, or of any other independent agency of the Government being overly political. Removing the Secretary of the Treasury from membership in the Federal Reserve System did not take politics out of the Board of Governors of the Federal Reserve System. I think the influence of the Secretaries of the Treasury whom I have known -- Mr. Mellon, Mr. Mills, and Mr. Morgenthau -- has been helpful rather than otherwise to all of the banking agencies.


Jpm

R-433

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Statement for the Press

STATEMENT BY MARRINER S. ECCLES
BEFORE THE
SENATE SPECIAL SILVER COMMITTEE
THURSDAY, MARCH 23, 1939.

TO BE RELEASED UPON DELIVERY AT THE HEARING

R-433

After I testified before your Committee on Tuesday, I realized that the problems we were discussing are only a part of a broader picture, and that it might serve your purposes better if I made a statement dealing briefly with the main issue that confronts us.

There is an infinite variety of opinion as to how to bring about recovery, but all shades of opinion agree on the main objective, which is the restoration of a volume of industrial, trade, and agricultural activity that would result in full employment of labor and would give all Americans an opportunity to earn a decent livelihood. At this juncture we all want to concentrate our efforts on achieving this common objective and over the longer pull we want to prevent the recurrence of booms and depressions and of violent changes in the national income.

There are those, and I believe that they include some members of this Committee, who believe that the general objective can be achieved best by the issuance of additional currency by the United States Government, whether in the form of silver certificates or United States notes. I sincerely wish that the problem were as simple as that, because that would not be a difficult thing to do. But experience convinces me that the problem cannot be solved in this manner. Under our financial system and with the habits of our people, currency is used only to make minor payments and all the currency in excess of day-to-day requirements of the people finds its way back to the banks and is redeposited by them with the Federal Reserve banks. In other words, redundant currency would not stay in circulation. It would only add to the present huge excess of

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bank reserves and to existing demand deposits without creating an opportunity for the use of either these reserves or these deposits.

That prosperity does not depend upon the volume of currency is evident from the fact that we had considerably less currency outside of banks during the entire period of the 1920's -- when we had reasonably full employment and production -- than we have today. In 1929 currency outside of banks was \$3,600,000,000 and now it is \$5,700,000,000.

In our modern economy when we speak of money we mean not only coins and paper money, but also deposits at the banks, and we now have more deposits than at any other time in the history of the country. The amount of deposits subject to check is \$26,000,000,000 today, as compared with \$23,000,000,000 at the peak of the boom in 1929 and \$22,000,000,000 in 1926, which is generally considered a prosperous year.

Employment and national income depend not merely on the volume of money in existence, but also on the use that is made of this money. Today we have large holdings of idle deposits and currency which, if put to use by the owners, would employ all our workers and would produce a national income adequate for a reasonable degree of prosperity.

The crucial question, therefore, is how to make the existing abundant money supply function more effectively. On this question there are two opposite schools of thought. I belong to the school that believes that every possible encouragement should be given to private investment

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and private enterprise for profitable employment of the great surplus of idle funds, idle men and idle resources which we have in this country today. However, I believe that when private enterprise is unable or unwilling to do so, Government should help to put this idle money, some of the ten millions of unemployed, and idle facilities to work in non-competitive, socially and economically desirable public activities, including the building of roads, schools, hospitals, etc. This, of course, should be done as efficiently as possible and in a way that will stimulate and supplement private activity. Expenditures for these purposes and for pensions for the aged will increase the effective demand for the output of industry and thus not only sustain existing investments but provide profitable outlets for investment in new enterprise. This would increase the national income and the Federal revenue and thus ultimately bring about a balanced budget, which we all desire.

To my mind, this would be practising real national economy, for I believe that the failure to use these factors of production causes a great and irreparable waste.

When our productive capacity is in excess of current demand, as it is today, it does not make sense to me to expect that a reduction in the demand originating from Government activities is going to lead the makers of agricultural implements, the railroads, the automobile manufacturers, the textile industry or, for that matter, any other industry, to enlarge plant capacity, increase production and thus furnish employment. If the buying power of millions of people on WPA rolls or in public construction, or in shipyards and airplane factories is reduced, I do not

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see how we can expect more houses to be built and more capital expenditure to take place.

Another school of thought, however, believes that business confidence cannot be restored until a balanced budget is assured through reduction of government expenditure, that continued deficits are holding back private investment, that government employment is demoralizing and destructive of the moral fibre of our people, that the public expenditures are wasteful and are piling up a burden of debt which our children and grandchildren will have to pay off. Senator Byrd has stated that he believes that for every dollar the Government borrows and spends, private enterprise is deterred from spending two.

A similar viewpoint has been expressed by the United States Chamber of Commerce, by stockholders replying to a questionnaire sent out by the National Association of Manufacturers, by the New York State Bankers Association, and by the American Institute of Steel Construction, representing an important element in heavy industry. It is not too much to say, in fact, that this appears to be the prevailing point of view among business men and the public generally, as reflected by a recent Gallup poll, by innumerable resolutions of trade associations, by bankers' groups, and -- as I can testify from personal experience -- by the overwhelming majority of newspaper editorials.

A great majority of people appear to believe, therefore, that business confidence would be restored if the budget were balanced, and that the spurt of economic activity that would result would accomplish

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our common aim of recovery. It would appear that the majority of the business leaders on whom would fall the task of producing the activity necessary to recovery are convinced that the Government's expenditures compete with and discourage private investment in existing and in new enterprise. A majority in both houses of Congress have indicated that they also hold this view. While I am convinced that such a policy of retrenchment under present conditions would have disastrous results, we live in a democracy and, therefore, I believe that the viewpoint of the majority should promptly be made effective.

The country is entitled to a clear-cut and prompt determination of policy on this vital issue. Uncertainty and hesitation do not contribute to recovery. It is Congress that determines the rates and the nature of our taxes; it is Congress also that determines the amount of government money to be used for different purposes. If balancing the budget will bring about recovery, then Congress can instantly do so by reducing expenditures to the level of receipts. If, in addition, taxes were to be revised and cut as a further inducement for private enterprise, government expenses could be reduced still further to make up for the decline in tax receipts.

In order to effect sufficient economy and reduce taxes, Congress would have to reduce substantially practically all of the large items in the budget. Not much economy could be effected in the regular establishments of the Government, which in the aggregate absorb only about one-tenth

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of the national budget. Such items as works relief projects, CCC camps, roads and public works of all kinds, veterans' benefits, all farm benefit payments, and national defense, some or all of these would have to be drastically curtailed.

This would not be my program, but if, as would appear, it is the program of the majority, they should assume full responsibility for it and put it into effect without delay and without compromises for the benefit of any special groups.

TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE,
Thursday, March 23, 1939.

Press Service
No. 16-83

Secretary Morgenthau today made public the following letter from Senator Robert F. Wagner, Chairman of the Banking and Currency Committee of the Senate, and his reply thereto:

UNITED STATES SENATE
Committee on Banking and Currency

March 14, 1939.

My dear Mr. Secretary:

My interest in our monetary policy as Chairman of the Senate Committee on Banking and Currency has, of course, been intensified by the Committee's present consideration of my bill (S.910) to extend certain monetary powers. I should like your help in answering a number of questions which have arisen both before and during our consideration of the bill.

I ask these questions with no critical intent, but solely with the hope of clarifying the whole subject. I realize that they relate to problems which are somewhat complex and technical and that any comprehensive answer may of necessity be somewhat lengthy. Nevertheless, I feel that a satisfactory discussion of them would be very helpful to the Congress and the public and I would appreciate your going into some detail.

The questions that seem to me most pertinent are these:

1. Who owns the gold now in the Treasury?
2. How much of the gold in the Treasury has been purchased with funds obtained from the sale of interest-bearing obligations of the government?
3. Why has so much gold come to the United States in the past five years?
4. Is it true that gold comes here in large amounts because the Treasury is paying a higher price than other countries for gold and because it buys gold at a fixed price?
5. How much more gold do you think we will get?

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6. Why doesn't the Treasury stop buying gold?

7. Of what use to us is this large stock of gold? Is there any likelihood that we will get so much of the world's gold that we will "get stuck" with it?

8. Isn't it true that foreigners are getting shares of our productive industries and giving us in return gold that we have no use for?

9. What action, if any, should be taken with respect to the gold situation? Should we, for example, return to the gold standard of pre-1933?

10. Did devaluation of the dollar in 1934 have an unfavorable effect on our imports?

11. Who in England and France has the power of altering the gold value of their currencies and what is the extent of that power?

12. Is there any basis to the contention that the power to devalue operates to undermine the business man's confidence so as to deter him from making loans and investments in the United States?

I believe that you can supply more satisfactory answers to these questions than anyone else and I should therefore appreciate your replying to them at your earliest convenience.

Very sincerely yours,

(Signed) Robert F. Wagner

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

March 22, 1939.

My dear Senator:

In your letter of March 14 you ask several important questions. These and similar questions, relating to gold and foreign exchange, have been asked so frequently that I welcome this opportunity to answer them and to make clear the policy of the Government with respect to these matters.

As you say, the questions raised involve technical matters which cannot be adequately handled in a page or two. However, I shall be as brief as is possible with materials of such complexity.

1. Who owns the gold now in the Treasury?

Title to all gold held by the Treasury, now amounting to about \$15 billion, is vested in the United States.

A large part of this gold (\$12,336,858,533 on March 15, 1939) is held as security for gold certificates (or credits payable in gold certificates) issued to and held by the Federal Reserve banks pursuant to the Gold Reserve Act. Such gold certificates may be redeemed in such amounts of gold bullion as, in the judgment of the Secretary of the Treasury, are necessary to settle international balances or to maintain the equal purchasing power of every kind of United States currency.

The remainder of the gold held by the Treasury is accounted for as follows:

Gold Reserve - held pursuant to law as a reserve against
United States notes and Treasury notes of 1890 - \$ 156,039,430

Allocated to the Stabilization Fund 1,800,000,000

Gold in General Fund (against which gold certificates or credits have not as yet been issued)

(a) Balance of increment resulting from reduction in the weight of the gold dollar	\$ 142,288,196
(b) In working balance	547,899,564

The Treasury disposes of gold in the following ways:

(a) For use in industry, profession or art. Any person needing gold for any such purpose can purchase gold from the Treasury.

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- (b) For the purpose of meeting the international balance of payments. To this end the Treasury sells gold to the members of the Tripartite Accord and to their stabilization funds and fiscal agencies. The Treasury also may sell gold to foreign central banks upon application and under special conditions.

Neither Americans nor foreigners can obtain gold from the Treasury for the purpose of hoarding.

2. How much of the gold in the Treasury was purchased with funds obtained from the sale of interest-bearing obligations of the Government?

The Treasury pays for gold with the cash assets in the General Fund, specifically out of the Treasury's deposit account with the Federal Reserve Bank of New York. The account is normally compensated by the deposit with the Federal Reserve Bank of gold certificates or gold certificate credits issued against the gold then acquired.

Up to December 22, 1936, it was the policy of the Treasury to issue to the Federal Reserve Bank gold certificates or gold certificate credits against the full value of the gold acquired. Under this procedure the purchase of gold by the Treasury did not involve any increase in the Federal debt either directly or indirectly. Shortly after December 22, 1936, however, the Treasury Department adopted a different procedure with respect to new gold purchases. Gold purchased was placed in an "inactive gold" account and paid for from the general cash balance of the Treasury without issue of additional gold certificates against the new gold acquisitions.

This procedure was departed from several times, however, by the issuance of gold certificates against gold released from the "inactive" account or against gold acquired but not placed in the "inactive" account. The "inactive" account was discontinued in April 1938, and at that time the Treasury issued \$1,400 millions in gold certificate credits to the Federal Reserve banks against

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the gold released from the "inactive gold" account and thus increased its cash balance by that amount. Since that time the Treasury has followed a policy of issuing gold certificates periodically for additional gold acquired. Gold purchases are permitted to accumulate in the General Fund in varying amounts before gold certificates are issued against them. On March 15, 1939, there was in the General Fund \$548 million of gold purchases against which gold certificates had not yet been issued but which had been paid for by checks drawn on the Treasury account with the Federal Reserve Bank of New York.

3. Why has so much gold come to the United States in the past five years?

Gold comes into the United States in settlement of the balance of international payments arising out of all transactions between the United States and all foreign countries. These international transactions include exports, imports, shipping services, tourists' expenditures, capital movements, interest payments, etc. When the demand for dollar exchange increases more rapidly than the supply of dollar exchange resulting from these transactions, the price of dollar exchange on the foreign exchange market rises. It may rise to a rate at which it becomes profitable for bankers and dealers, foreign and American to ship gold to the United States, sell the gold to the Treasury for dollars, and then sell these dollars on the foreign exchange market.

Therefore, to answer the question why large amounts of gold flow to the United States it is necessary only to explain why United States dollar exchange is so much in demand.

A survey of our balance of payments for the last few years reveals at once that the greatly increased demand for dollar exchange which has taken place during the past five years is largely a consequence of the huge flow of capital to the United States and, more recently, of the large "favorable" trade balance. None of the other categories of items in our international transactions can be held responsible for the substantial net increase in the demand for dollar exchange during this period. In fact, for several important categories the net demand for dollar exchange decreased. It is the flow of capital to this country, particularly before 1938, upon which our attention must be focused if we are to understand the chief reason for the large gold inflow.

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The following figures show the contrast between the large recorded inflow of capital in the past five years and persistent and large outflow of capital in the years preceding:

1928	-850 million outflow	1934	+ 386 million inflow
1929	-217 " "	1935	+1,537 " "
1930	-752 " "	1936	+1,141 " "
1931	-490 " "	1937	+ 800 " "
1932	-192 " "	1938	+ 369 " "
1933	-336 " "		

The capital inflow in the years from 1935 through 1937 was the major factor responsible for the inflow of gold, for it amounted in total to \$3,500 million or 86 percent of the value of gold imported during that period.

The trade item did not become important from the point of view of gold inflows until the last quarter of 1937. From 1934 to 1937 the excess of our exports over imports averaged only \$250 million a year. (Incidentally, if silver imports were included in our merchandise imports, which is the procedure followed by many countries in the world, our excess of exports over imports would have amounted to only \$80 million a year in this period.) In 1938, however, the favorable trade balance greatly increased and was the dominant factor inducing the large flow of gold into the United States. The excess of exports over imports totaled \$1,134 million -- the largest we have had in seventeen years. This increased "favorable" balance of trade, together with other items, was responsible for the net inflow in that year of \$1.6 billion of gold.

Thus it is evident that because there was a large inflow of capital in recent years, and in 1938 a large excess of exports over imports, there was a great increase in the net demand for dollar exchange; and because of this large increase in the net demand for dollars there was a large inflow of gold. Therefore, in the final analysis your question: "Why has so much gold come into the United States?" reduces itself to the questions: "Why did so much capital come to this country during the past five years?" and "Why did we have so large a 'favorable' trade balance in 1938?"

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The answer to the first of these two questions, together with a description of the kinds of capital coming here, was given in some detail in my letter to Senator Vandenberg of September 22, 1936, a copy of which is enclosed for your convenience.

In Section 3 of that letter the causes of capital imports into the United States are set forth as follows:

- "(a) Capital withdrawn from abroad by American owners because of the greater security or the more attractive field for investment offered the capital at home. The return of these funds to the United States -- much of which left the country in 1930-31-32 -- is, of course, an indication of the relative strength of our recovery and of the prevailing confidence in the future of American industry and American financial institutions.
- "(b) Funds sent to this country by foreigners who likewise felt that American securities offered a more attractive or more secure investment opportunity than did investments available to them elsewhere.
- "(c) Repurchase by foreigners of some of the foreign securities which Americans had purchased during the post-war decade and were now glad to get rid of even at low prices. This was particularly true of the securities of certain countries where nominal high exchange rates were coupled with devices whereby the nationals of these countries were encouraged to repatriate these securities at an exchange profit to themselves, or where maintenance of debt service was provided for only internally but not for foreign holders.
- "(d) Need created by increasing foreign trade for larger working dollar balances to be kept in American banks by foreign banks and traders. Our international trade during 1934 and 1935 increased by one-third over the two years previous. It is to be expected that this greater volume of foreign trade transactions would call for larger working dollar balances.
- "(e) Fear prevailing in some countries abroad of confiscation of property or of loss through inflation of their local currencies led during this period to a

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Flight of capital from some of the countries whose economic and political situations have been threatened by disturbances with which you are doubtless familiar.

"(f) Lastly, funds sent to this country by speculators in the hope or expectation that an exchange profit will be possible if and when the currencies of their countries become depreciated in terms of the dollar.

"These are the causes which account for most of the capital inflows. Yet these capital inflows would not have resulted in such large sums being due to the United States were it not for the virtual cessation of foreign investments by Americans. Whereas in the years prior to the depression, annual foreign investments by Americans of more than a billion dollars were common, since 1931 the annual sums invested abroad have been negligible; nor does it appear that the United States will approach in the near future the predepression volume of foreign investment."

Since the above was written (September, 1936), nothing has occurred to alter substantially the trend of capital movements or the reasons for them. With the exception of one nine-month period, capital has continued to flow to the United States in large volume. During that nine-month period, October, 1937, to June, 1938, there was a net outflow of short-term capital of over \$1 billion, but the flow was reversed during the Fall of 1938, and more than a billion of short-term capital has since come to the United States.

Capital will continue to flow into the United States in large amounts so long as:

- (a) The opportunities for secure and profitable investment in foreign countries are not great enough to attract American capital abroad;
- (b) The prospects of continued recovery here appear satisfactory to foreigners;
- (c) The political situation abroad remains disturbed;
- (d) There is possibility of further depreciation of some foreign currencies.

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Whether the flow of capital into the United States will continue to take the form of gold or whether it will gradually assume the form of goods and services rather than gold depends upon the rapidity with which the mechanism of adjustments of international accounts operates. In earlier decades this adjustment process operated tolerably well and with fair speed to transform international movements of net balances into movements of goods and services. This adjustment process served to keep gold movements between countries relatively small in volume. In recent years, however, this mechanism has operated badly and haltingly. Moreover, it has had to operate under sudden and large capital and trade shifts which differed from those of earlier decades not only in magnitude but in character. To put it graphically, the mechanism of adjustment has had a heavier load to carry, the road has been uphill, and the incline has grown steeper.

The reasons and nature of this change taking place in the effectiveness of the so-called adjustment process of international accounts are matters too technical to warrant discussing in this letter. Suffice to say that because the numerous obstacles to rapid adjustment still prevail in virtually all countries with free exchanges any large movement of capital to the United States in the near future will doubtless take the form largely of an inflow of gold.

The significance of this fact as an explanation of the continuing flow of gold to the United States cannot be emphasized too strongly. As compared with the decades prior to 1930, there are now different relationships between international movements of capital and of gold, changes in domestic price levels, trade changes, contraction and expansion of credit, and changes in the volume of business activity. Realization of this basic economic change is necessary to appreciate the need for treating present day problems of gold and capital flows quite differently than was appropriate prior to 1929. Monetary experience of those years, particularly in its international aspects, does not suffice for safe guidance for present day policy.

4. Is it true that gold comes here in large amounts because the Treasury is paying a higher price than other countries for gold, and because it buys gold at a fixed price?

This is a question we frequently hear. Unfortunately it is not wholly clear just what is meant since the phrase a "higher price for gold" may be interpreted in two quite different ways, and the answer to each of the two interpretations would be arrived at through quite different lines of reasoning.

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If the question be interpreted to mean that gold comes to the United States in large amounts because we pay a "higher price" than other countries do in terms of a money price (i.e., in terms of dollars) then the answer is definitely "no". The United States pays the same price for gold, allowing for arbitrage and transportation costs, that any other country does -- no more and no less. We do not pay any higher prices for gold than does England or France or Belgium or India.

The price of gold that is permitted to move freely in international channels of trade is (and must be) virtually the same the world over. An Englishman who sells gold in London gets the same return in pounds and shillings for it -- with small variations to be explained in a moment -- as he would get were he to send the same gold to New York or to Amsterdam or to Paris or to Bombay to be sold. Right now, for example, he would get about 148 shillings for an ounce of gold in the London gold market. If he ships that gold and sells it to the United States, he gets \$35 an ounce (less 1/4 of 1 percent). When he converts the dollar proceeds of the sale of that ounce of gold back into sterling and deducts the expenses of shipping, he gets approximately the same amount of sterling as he would have obtained had he sold the gold at home -- namely, about 148 shillings. In other words, when a foreigner translates the dollars he gets from the sale of his gold back to his own currency, he finds that the price of gold is almost the same in London, Paris, Amsterdam, or Johannesburg. We pay dollars for gold, England pays sterling, Holland pays guilders, etc., but when conversion from one currency into another is made at the prevailing exchange rates we find that an ounce of gold brings approximately the same price in one country as in another.

I say approximately the same price. There are slight relative variations in the price as between different countries, variations which inevitably result from changes in the supply of and demand for foreign exchange. Any change, no matter how slight, in the relationship of the supply of foreign exchange to the demand will bring about a change in the price for foreign exchange. The fluctuations of exchange rates, together with the fluctuations in the price of gold in terms of foreign currencies, result in the occurrence of relative differences in the price of gold in different national money markets when computed in terms of a single currency, but these relative variations can occur only within narrow limits.

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These slight relative variations in the price of gold as among various markets which make possible a profit in shipping gold from one country to another would continue whether we paid \$10 an ounce for gold, or \$50, or \$60. Slight variations in the dollar-sterling, dollar-franc, dollar-guilder rates, etc., do give dealers small profits when selling gold in one market rather than another but these variations operate as among all countries and at all levels of prices for gold; they are not peculiar to the United States alone, nor to the \$35 price for gold. Exactly the same condition prevailed when the price of gold was \$20.67 an ounce and when other countries had a fixed price of gold. It is the normal mechanism which has always prevailed and must inevitably prevail as long as gold is the international medium of exchange.

To dispose briefly of another common misconception. It has been sometimes claimed that gold comes here because the United States pays a fixed price for gold, whereas other countries buy gold at varying prices. The mere fact of fixity of the price of gold in terms of any given currency has little to do with the movement of gold. For example, England does not have a fixed price of gold, and yet her net imports of gold in some of the past few years were greater than ours. Belgium has had a fixed price for gold for two years, yet her reported gold holdings are no higher now than they were three years ago. Moreover, our gold price, although fixed in terms of dollars, is not fixed in terms of other currencies. When, for example, an Englishman sells gold to the United States, the number of dollars he gets may be fixed, but the amount of sterling he gets, if he converts the dollars into sterling, is not fixed; it fluctuates with every change in the sterling-dollar exchange rate. The amount in his own currency which an Englishman or a Frenchman receives when he sells gold is not fixed whether he sells his gold in New York, London or Paris.

So far in answer to this question the discussion has been based on the interpretation of the phrase "higher price" as meaning a higher monetary price. If, however, the phrase is to be understood to mean — as is doubtless intended by many who put the question — a "higher price" in terms not of money but of goods and services, then the question becomes a quite different one. It should then be phrased as follows: "Is it not true that gold comes to the United States in large amounts because we give more goods and services for a dollar (or its monetary equivalent in foreign currencies) than does any other country?"

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The answer to this question is likewise "no", though less unequivocally so because adequate statistical data for a categorical answer are not available.

The purchasing power of the dollar in the United States in terms of goods can be compared with its purchasing power in other countries only very roughly and only with respect to those goods which do (or easily might) move from country to country. With respect to "services" comparison of the purchasing power of the dollar in the United States and elsewhere relates chiefly to shipping services and the expenditures by tourists.

Now it is extremely difficult to measure the differences in purchasing power of gold or currency as between different countries even with respect to such goods and services. Fortunately, for the purposes of the question we are examining, no such measurement is necessary. Were it true that an ounce of gold had a significantly higher purchasing power over American internationally traded goods than over foreign goods, indirect but definite evidence would be revealed in our trade figures. Our export excess would have so increased since 1933 that either we would have drained the outside world of all its monetary gold, or we would have forced other countries to adopt strict exchange or import controls or much higher tariff schedules. No such developments have occurred. Foreign countries still have large gold holdings; many of them have not significantly heightened their barriers against imports of the world.

Convincing evidence that we do not pay a higher price for gold than do other countries in terms of goods and services is contained in the record of our balance of international payments in current account. For the years 1934 to 1937, inclusive, the balance of payments with respect to the pertinent commodity and service items was in the aggregate unfavorable by \$1,200 million, as far as the records show. Unfortunately, however, our international accounts, though more complete and reliable than those of other countries, are still subject to a substantial margin of error. In each year there has been a substantial "residual" item (i.e., unaccounted for) which during the four years in question totaled approximately \$1-1/2 billion due the United States. Some portion of this favorable balance must be allocated to trade and services — how much it is impossible to know. But, even if we allocated the whole residual item to commodity and service items — which would be an extravagant allowance — there would result only a small balance due the United States for those items during the four years in question — \$400 million for the four-year period.

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This constitutes too small a sum relative to the magnitudes involved in our balance of payments to justify the claim that an ounce of gold can buy more here than elsewhere.

There is little basis, therefore, for the contention that an ounce of gold could in general buy more goods and services in the United States than elsewhere from the years 1934 to 1937, inclusive. Or to put it in simpler and more accurate terms, the United States did not achieve any special competitive advantage in international markets as a consequence of its external monetary policy. The change in the gold value of the dollar in 1933 merely helped the United States to regain its earlier position. In 1938 the trade situation appeared to change. We did experience a sharp increase in our trade balance. Exports, as pointed out earlier, exceeded imports in 1938 by some \$800 million more than in 1937. But most of this increase cannot be attributed to any changed relationship of the dollar to other currencies because the exports excess arose from a sharp decrease in imports, and not from an increase in exports. The recession in the United States more marked and earlier than in other countries caused a temporary decrease in our purchases from abroad greater than the simultaneous decrease in our exports. This gap may be expected to narrow as recovery proceeds.

The only sense in which it might be said that we give more for gold than other countries is that in addition to \$35 an ounce we also give peace, security, prospects of higher returns on investment, and better speculative opportunities, with the result that foreign capital funds flow here in the shape of gold. It is these values that constitute the chief factor conducive to a flow of gold to the United States.

5. How much more gold do you think we will get?

How much we will get depends upon the extent and direction of changes in our balance of trade and services, upon the output of new gold, and upon the trend of capital movements.

Since capital movements are so sensitive to international political and economic developments, one can only hazard a guess as to their future trend. At this moment it looks as though the European situation will remain so disturbed as to postpone for some time any substantial repatriation of foreign balances. It also appears as though early resumption of American lending abroad such as would cause a gold outflow is extremely unlikely.

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As for our balance on commodity and service items, the fear of war and the preparation for war by foreign nations are likely to sustain our exports and reduce American tourist travel in Europe and Asia — both developments making for additional gold inflows. On the other hand, continuance of our recovery here will tend to increase our imports and to increase American tourist travel in the Western hemisphere. I believe the latter trend will outweigh the other and that on commodity and service account the net balance due us will be less in 1939 than it was last year. On the other hand, capital inflows will probably be large so that, on the whole, it appears that in the near future the United States will continue to get gold, perhaps in as large volume as in recent years.

Current world gold production (outside the United States) now amounts to over one billion dollars per year. The bulk of this newly-mined gold can go only to a few countries. Most countries now utilize practically every available dollar of foreign exchange to purchase imports or to make additional payments on outstanding foreign debts. Much as they would like to acquire gold, and much as they need it, they want to acquire additional imports even more. Therefore, it is to be expected that until current hostilities and intensive preparedness for wars cease, and until the world economic situation improves, the bulk of the newly-mined gold will be added to the monetary stocks of only a few countries and the United States will get a substantial share of it.

6. Why doesn't the Treasury stop buying gold?

A simple way of stopping gold from coming into the United States would be for the Treasury to announce to the world that we will not buy any more gold for the time being. But, such a step, taken unilaterally, would have disastrous effects on our economy. It would disrupt the foreign exchanges and gold bullion markets and would very soon cause such drastic disturbances in international trade and even in the domestic sphere as seriously to impede the recovery of business.

Present relationships among the various leading currencies would be upset. The dollar probably would appreciate immediately in terms of other leading currencies. At present, when the demand for dollar exchange increases, foreigners need only obtain gold (either at home or on the London market), ship it here and obtain dollars in exchange. Thus an increased demand for dollar exchange

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relative to the supply is met. If, however, this means of securing dollar exchange were removed, dollars would rise in value indefinitely in terms of other currencies. While it is impossible to know in advance what rates of exchange would finally emerge, we can be certain of at least one thing -- that no country would benefit from the ensuing international monetary disruption.

Were the United States, moreover, to declare a complete embargo on gold imports, it might deal a serious blow to the value of gold as a monetary medium. (Such action coming at a period when there was discussion of the possibility of world overabundance of gold might have repercussions which would disturb the public's confidence in the value of gold.) The leading gold producing areas would be hard hit and some might even be involved in a major economic crisis.

A closely related question that has frequently been asked is: "Should not the price of gold be reduced? Is not \$35 an ounce too high a price for gold?" Possibly the simplest way to answer this question is to examine the consequences that would ensue from an increase in the gold content of the dollar (or, to phrase it another way, from a decrease in the monetary value of gold).

A reduction by Congress in the monetary value of gold would probably not be as calamitous as a complete embargo. It would limit the extent of possible depreciation of gold (or appreciation of the dollar in terms of foreign currencies) and the psychological disturbance caused by the change would not be as potent, yet it would have disadvantages serious enough to render resort to any such action most unwise. If the reduction made in the price of gold were small, our trade and service balance would not be much affected over the next year or so, nor would the inflow of capital cease. Once the drop in the price of gold was regarded by the rest of the world as definitive, the subsequent effect on capital imports would be virtually nil. Our securities would continue to be bought for the same reasons that they are bought now and dollar balances on foreign account would also continue to increase for the same reasons that they are increasing now. But,

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were a small decline in the price of gold to be regarded by numerous domestic and foreign investors and exchange speculators as being but the first of a series of drops, the result might well be to attract more, not less, funds to the United States, and to intensify the inflow of gold — the very thing it is designed to check. Speculators would rush to buy dollars and hold them here in anticipation of the next depreciation. Thus the effect in capital movements, both long-term and short-term, might more than offset the effect on trade and service items; instead of getting less gold we would find ourselves getting more.

On the other hand, were the monetary value of gold to be cut with one stroke substantially, and definitely — say, for example, to \$25 an ounce — the effect would be quite different from that described above. Such a step might reduce the volume of gold imports and perhaps give rise to an outflow of large dimensions; but, the economic effects on our economy of the change in the foreign exchange value of the dollar would be little short of disastrous. The 40 percent increase in the price of American currencies to foreigners would constitute a severe handicap upon our exports. Our exports play a role in the level of business activity much in excess of the magnitudes involved and so great an appreciation of our currency in terms of other currencies would be bound to curtail our exports seriously. In the past six months the dollar has appreciated in terms of other leading currencies by some 5 percent and price movements in the various countries have not been such as to offset this competitive disadvantage to us. The appreciation of the dollar has not been due to a change in the dollar price for gold but rather to a depreciation of foreign currencies in terms of gold. You will note that our exports during January 1939 were more than 40 percent less than they were in January 1938. Although it is too soon to evaluate the full significance of the decline, it is not unreasonable to assume that the loss favorable position of the dollar in terms of other currency (i.e., higher prices of foreign currencies in terms of gold) contributed to the drop in exports.

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Our imports on the other hand would, in the event of a reduction in the price of gold to \$25 an ounce, be 30 per cent cheaper. Our domestic producers would then be exposed to greatly sharpened competition in the American market from foreign producers both because the prices in dollars of imports would be less, and also because the numerous ad valorem duties would constitute smaller protection.

Foreigners would have a greater advantage in this market but unfortunately even this would be of dubious value to them. The ability of Americans to buy goods, whether imports or domestic goods, depends chiefly upon the state of business activity here. It is chiefly for that reason that our imports during the recession of 1938 dropped to almost one-half and that our imports began to increase in the Fall of 1938. Thus, though the sharp appreciation of the dollar would make foreign goods cheaper in this country, our imports might actually be less than during the previous period and instead of benefiting the rest of the world we would be hurting world business as well as our own.

Judging from past experience we could not expect the prices of domestic commodities and services to move either at home or abroad with sufficient rapidity to adjust quickly and fully to any substantial alteration in exchange rates. For many months, perhaps for years, the economic position of large groups of American producers, including farmers, would be worsened and there would be widespread unemployment. The combined effect on our domestic economy of a sharp drop in exports and of increasing competition in the domestic market would be keenly felt. Domestic prices would begin to fall. Many corporations would suffer loss of business and profits. In times such as the present these short-run effects — and by short-run we mean from a few months to several years — are of paramount importance. To brush aside, as some are prone to do, these short-run effects on the ground that in the long-run appropriate adjustments will take place is to ignore the unstable world in which we live and the real problems which confront us from day to day.

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Moreover, were we to reduce the price of gold and were it to result in an outflow of gold there is no reason to believe that the countries who most need gold would get it. On the contrary, were gold to leave the United States it would probably find a resting place in the very countries whose currencies would for the moment appear most secure. Certainly no gold would flow to Latin American countries in any substantial amount, nor would the Far East or the Balkans obtain more gold. The loss of gold by the United States would not correct the serious maldistribution. It would rather operate only to take away some from the United States which has too much and to add it to the holdings of other countries which likewise have too much.

Thus we are confronted with the fact that though we should like to receive less gold and even to get rid of substantial amounts of the gold we already have, there is, under the existing circumstances, no acceptable alternative to the policy we have been pursuing. In the case of all the proposals we have examined, the remedy has always been worse than the disease. The best way to reduce our gold inflow on commodity and service account is for us to have full recovery so that our imports will rise more rapidly than our exports.

7. Of what use to us is this large stock of gold? Is there any likelihood that we will get so much of the world's gold that we will "get stuck" with it?

Gold performs two monetary functions. First, it serves as a specie base for the monetary system. Secondly, it serves as the medium for settling international balances. These are distinct and separate functions. The present gold stock of the United States is about \$15 billion. The question you ask, therefore, is "is \$15 billion of gold more than enough to accomplish these two functions which gold now performs in our economic system?"

It is doubtless true that we have more gold than we need to provide a specie base for our monetary system. Our laws require that a 40 per cent reserve in gold certificates be held against Federal Reserve notes in circulation and a 35 per cent reserve in gold certificates or lawful money against deposits of Federal Reserve banks. These legal reserve requirements are based on the assumption that gold reserve requirements operate as a control of the volume of means of payment, as a protection against excessive issue of notes and expansion of bank credit. At present, however, gold and gold certificate holdings are so far in excess of these legal requirements that they can hardly

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be said to constitute a protection against undue expansion of our currency and credit. We now have enough gold to permit an enormous expansion of credit and currency even after generous allowance for the outflow of gold that might accompany such an expansion. Legal reserve requirements do not of themselves necessarily protect us against an undue expansion of the volume of money and the monetary authorities must be prepared, when and if the occasion arises, to apply appropriate supplementary control. This is especially likely to be true when gold holdings are as great as they now are.

But it is desirable that the reserves be above the minimum required by law. Otherwise in a period of business recovery the limitations on the expansion of notes and deposits which the gold reserve would impose would operate to curb the rise in business activity, or an outflow of gold would tend to initiate a contraction of credit, irrespective of the legitimate needs of business. It is clear, therefore, that some excess of gold above the legal minimum is needed to protect our domestic economy against effects of fortuitous inflows and outflows of gold. We now, however, have more gold than is necessary to insure this protection.

The second and more important monetary function of gold is its employment as a means of settling international balances among nations. Gold has been used for this purpose from time immemorial, and modern governments have as yet found no satisfactory substitute; nor is there any sign that a satisfactory substitute will be found in the near future.

Important commercial countries which carry little or no gold stocks have difficulties in settling their international payments. They have to see to it that their imports and exports are maintained in a certain relationship to each other. To achieve that and to keep their foreign exchange rates from fluctuating wildly they frequently have to maintain strict exchange controls so as to restrict merchandise imports and the movement of capital.

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Small countries, which are not precluded by political and prestige considerations from holding their reserves in the form of foreign exchange assets, can get along more or less satisfactorily without gold. But they can do so only because the countries whose currencies they hold as reserve assets do have large amounts of gold reserves.

Some countries (operating with very little gold or foreign exchange assets) have been pointed to as illustrations of the phenomenon that countries can carry on foreign trade and settle international transactions without resort to gold, and that gold is rapidly becoming obsolete even for this monetary role. Those who make this claim completely misread the experience of these countries. Those very countries do in fact need and prize gold more and seek it more anxiously, than do countries that use gold freely to settle balances of international payments. It is their inability to obtain gold which forces them to adopt a far less satisfactory alternative method of adjusting their balance of international payments, - namely, the adoption of strict exchange control, of clearing agreements, of barter schemes, and the imposition of severe penalties against evasion and all the other business and liberty destroying procedures necessary to make the system work. There is no one thing which demonstrates more effectively the superiority of gold as a means for settling international balances than the experience of those countries that have tried to get along without it.

Without either gold or exchange controls, exchange rates would be very unstable. Any change in the balance of payments would have to be taken care of by international borrowing or lending, or the exchange rates would have to move to the point where the sums to be paid and the sums to be received were equated. Because we have abundant gold reserves we do not have to apply exchange restrictions, and broad changes in our balance of international payments can take place without interfering with the stability of the dollar exchange.

All these points have been granted by some critics, but they maintain that to fulfill both these functions much less than \$15 billion worth of gold would suffice. There is some merit to that contention, yet the future of international political and economic relationships is much too uncertain to justify our taking the steps which would be necessary if we were determined to reduce our gold holdings.

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One important factor to bear in mind in considering our gold policy is the psychological reaction of the public to a continuing loss of gold. Should a country be undergoing loss of gold over a considerable period of time, there is likely to result impaired confidence in that country's currency and in the stability of its monetary system long before it has exhausted the gold it possessed in excess of legal or traditional reserve requirements. This has happened time and again throughout the world. Without greater ability to forecast future political and economic developments than is vouchsafed us, it is impossible to say with certainty that we have too much gold. We can say with some assurance, however, that we have enough gold to meet all likely contingencies, and that we are in a strong position to defend the stability of our credit structure and of the dollar against any quick change in our international balance of payments, including any large withdrawal of foreign capital.

The danger that gold will no longer be used as a medium of international exchange is so remote as not to merit serious consideration. Other countries will surely continue to accept gold in the settlement of favorable balances of payments, because gold is as important to them as it is to us. England has over \$3 billion of gold. France has almost as much; Holland, Switzerland, and Belgium and many other countries have what are for them large holdings of gold. It is in the interest of these countries as much as it is in our own interest to continue to rely on gold as an essential part of their monetary system. Moreover, we must not overlook the fact that nations producing substantial quantities of gold have important vested interests in the continuation of gold as a monetary metal. The British Empire alone produces about half the world's gold. Even countries that produce relatively small amounts of gold find that these small amounts are an important source of national income to them.

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8. Isn't it true that foreigners are getting shares of our productive industries and giving us in return gold that we have no use for?

The amount of American securities which have been recently acquired by residents of foreign countries has been much less than is generally supposed. During the past four years the total of net foreign purchases of American securities amounted to only \$1.2 billion, as follows:

1935	\$317 millions
1936	601 "
1937	245 "
1938	49 "

There was, in addition, an increase in direct investments by foreigners as reported by the Department of Commerce of about \$175 million during this period. Altogether, the total amount of investments by foreigners in American securities or directly in American industry during the past four years has been less than one-fifth of the gold sent here during these years.

These sums do not, of course, represent the total of foreign capital which has come into the United States. Short-term funds owned by residents of foreign countries increased by \$1.8 billion. The bulk of these were demand deposits, which do not constitute acquisitions of shares in American industry and which do not earn any interest.

The acquisition of American securities by foreigners paid for with gold represents a transaction which admittedly is, under existing circumstances, of dubious advantage to the United States. Yet, given the relatively minor importance of the problem to date, we have not been able to convince ourselves that any of the possible remedies which we have so far examined gave promise of sufficient benefit to the national economy to offset their disadvantages.

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On the other hand, it should be pointed out that if foreign holders of American securities liquidate their holdings and withdraw the proceeds, either gold or goods (and services) would necessarily be the resultant medium of withdrawal. If the vehicle of transmission were gold, its loss, in view of our large gold holdings could, of course, be regarded with equanimity. If the medium of transmission were goods, either because of direct purchases with the proceeds of the funds or because of the operations of the adjustment process, the resultant increase to our exports at a time when there exists a large volume of unemployed labor and other idle resources would have favorable effects on our economy.

9. What action, if any, should be taken with respect to the gold situation? Should we, for example, return to the gold standard of pre-1933?

The maldistribution of the world's gold is a reflection of the disturbed economic situation throughout the world and the chaotic international political situation. Redistribution can come only with progress toward the solution of the basic problems confronting world international relations.

In our study of this matter we have examined literally scores of proposals directed towards possible action to redistribute the world's gold. The major conclusion we have drawn is that any measure which would take the form of restrictions on the flow of gold into this country would have, at this time, detrimental effects upon our economy.

What disadvantages may be associated with the gold inflow are fortunately only of minor magnitude, and should, moreover, be attributed to the factors causing that inflow rather than to the inflow itself. Foreign ownership of American securities may, however, serve as a source of disturbance to our security markets in times of stress; similarly with short-term foreign capital sent here. On the other hand, the third factor responsible for the gold inflow to the United States — our export excess — does yield a gain.

The large inflow of gold in recent years has been a major factor in increasing excess bank reserves. These reserves do in some degree operate to stimulate an expansion of loans by banks and to keep the interest rate structure lower — both developments

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helping somewhat to promote a higher level of business activity. Nonetheless, the prospect of continued large inflows of gold has been a cause of some concern on the part of those who consider a large volume of excess reserves as constituting a potential danger of inflation, though I do not regard this problem as one of immediate import.

The only immediately disturbing aspect of the gold problem is the loss of gold by foreign countries. The countries losing gold may be adversely affected by the loss and some of the adverse effects would impinge indirectly on us. This is to be deplored, but the factors producing this situation are external to us and beyond our control, acting alone.

With respect to the suggestion that the United States return to the gold standard of pre-1933, I must state definitely that such a move would be harmful to the American people and of no value to the people of other countries. In the first place, a return to the pre-1933 gold standard would mean a return to the \$20.67 an ounce price for gold. This, in the absence of similar changes in the gold value of other currencies, would represent a depreciation of approximately 70 percent in all foreign currencies in terms of the dollar.

It is obvious that an increase in the cost of the dollar to the foreigner by 70 percent and a decrease in the cost of foreign currencies to the American importer by 40 percent would seriously disrupt our foreign and domestic trade. Price movements are not so general or so rapid as to adjust economic conditions quickly to changes in exchange rates, and such movements as would occur would take the form of falling prices, particularly prices of agricultural products and raw materials. From experience we know that such price movements have disastrous effects upon incomes, profits and the level of business activity. We might be precipitated into a depression rivalling the 1930-33 experience. There can be no question, therefore, of returning to a gold dollar with the pre-1933 content. The answer to question 6 above contains a full discussion of the foreseeable effects which would result from any substantial increase in the gold content of the dollar.

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Even if what were proposed were a return not to the old gold value but to a pre-1933 gold standard with the present gold content of \$35.00 an ounce, such a step would be unwise at this time. Our present monetary system differs from the pre-1933 gold standard in three respects other than gold content. First, our currency is not convertible into gold coin, secondly, there are government controls over the movement of gold in and out of the country, and thirdly, there is executive authority to change the gold content of the dollar.

Convertibility of currency would, in my opinion, have no substantial advantages. Virtually every country in the world has recognized this fact and has withdrawn the privilege. For in normal times there is nothing to be gained by the right to convert currency into gold, whereas at all times convertibility has the potential disadvantage of creating a possible source of internal gold drain which would come into play at the very time when it would be most injurious. Internal hoarding of specie reserves has been, in the experience of many countries, one of the most important reasons for the weakening of currencies. Though the prospect of such a contingency in the United States seems at this time remote, it would nevertheless always be a possibility under a convertible currency system. Moreover, in the event that there should develop an emergency situation calling for a further change in the gold content of the dollar, the existence of private gold holdings would create unnecessary difficulties.

At present the movement of gold out of the country is in effect subject only to the restriction that it must be for the purpose of settling international balances. Gold moves freely to satisfy legitimate commercial and financial needs. The present powers of control over the movement of gold provide a safeguard that can instantly be used in the contingency of an international crisis.

The power to change the gold content of the dollar should be lodged in an authority which can, in case of necessity, act swiftly and in a manner which will minimize the disturbances resulting from any change. This power should always be available; its existence contributes to the maintenance of stable exchange relationships, which make the exercise of the power unnecessary.

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It is important to realize that rumors of an impending change in the value of a currency, or any public discussion by responsible officials that such a change might be made, would in themselves be enough to induce large flows of capital either into the country or out of the country, depending upon whether the prospect is for an increase in the value of the dollar or for a decrease in the gold content of the dollar. Discussions in committees would be advance notice to speculators that such action might take place. The mere fact that it might take place would be sufficient to induce the flow of capital, because if the change did not actually occur, the speculation would have cost only the small charges attending any exchange transaction. Indeed, Congressional discussion would stimulate speculators to engage in activities of a sort which would of themselves tend to force Congress to take the action which had been in contemplation, even if on its own merits and in the absence of the situation created by the operations of the speculators, a negative decision would have been in order. The liquidation of foreign holdings of American capital might, under such circumstances, easily be powerful enough to disrupt the security exchanges and to introduce a chaotic situation in markets and in business generally. Since the prospect of devaluation would arise only under circumstances which were disturbing in any case, the outflow of capital would simply make bad things worse.

It therefore appears desirable that the Executive should have the power to alter the gold content of the national currency unit, in the public interest, and within clearly prescribed limits, as it is in most of the countries in the world, so that if an emergency situation should require its exercise, it could be exercised quickly, and without the necessity of prior public discussion and its concomitant invitation to speculative activities.

10. Did devaluation of the dollar in 1934 have an unfavorable effect on our imports?

Under one set of circumstances devaluation of a currency will induce an increase in imports and under a different set of circumstances it may decrease imports. Devaluation of the dollar in 1934 did contribute to an increase in United States imports.

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The value of American imports varies, in the main, with domestic business activity. When business is good in the United States, our imports are high; when business is bad, our imports are low. For example, between 1929 and 1932 imports dropped from \$4,400 million to \$1,300 million, a decrease of more than two-thirds. Again in 1938, owing largely to the recession which prevailed through most of that year, our imports dropped more than one-third. On the other hand, during the years of recovery - 1934, 1935, 1936 and 1937, our imports rose from the low of \$1.3 billion to over \$3 billion. Increases or decreases in the total value of a country's imports are due to changes in prices as well as to changes in quantity. A sharp drop in the prices of imported commodities which are competitive with domestic products has economic repercussions which are very disturbing to the country receiving the imports. At a time when business activity is declining, any potent source of further price declines serves only to lower still further the level of business activity and to increase unemployment.

The best way to increase our imports is to increase our national income. Any measure which serves to promote recovery increases our imports and contrariwise any measure which serves to reduce business activity operates to reduce our imports.

As a consequence of falling prices and declining business intensified by the widespread depreciation of other currencies in 1931-33, we bought less because our national income was less notwithstanding the greatly lowered cost of imported goods. Even though depreciation of the dollar made imported goods more expensive, the improvement in business activity which followed devaluation was one of the factors responsible for the rise in national income and the consequent increase in imports. Whether or not depreciation of a currency will lead to increased or decreased imports depends upon the conditions which precede such depreciation, and upon other measures which accompany it, as well as upon the reaction of other affected countries.

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11. Who in England and France have the power of altering the gold value of their currencies and what is the extent of that power?

In England the British Treasury has the power to alter the sterling price of gold through its operations in the gold market. There is no statutory restriction on the extent to which the British Treasury can change the sterling price of gold.

Similarly, the French Treasury, through the mechanism of its foreign exchange and gold operations, can alter the franc price of gold without any statutory restrictions. In addition, the Council of Ministers is authorized to fix ultimately by decree the gold content of the franc. As yet, they have not done so. The Council of Ministers, in other words, can decide whether or not there should be any statutory gold value for their currency and under existing law can fix that value at any amount it wishes.

12. Is there any basis to the contention that the power to devalue operates to undermine the businessman's confidence so as to deter him from making loans and investments in the United States?

A factor that more than any other will increase the confidence of businessmen in the future is the assurance that business will improve; a development contributing substantially to that expectation would be the prospect of a stable or moderately rising price level. What businessmen fear with regard to the dollar is not that the price level in the United States may remain stable or rise but that the price level in the United States may fall (i. e., that the purchasing power of the dollar may rise).

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From past experience we know that falling prices have disastrous effects upon our economic system. The national income declines, business profits disappear, the security of loans is undermined and the level of business activity falls. If the businessman could be assured that price levels will not fall sharply, he would have greater confidence that business profits and the value of investments would be maintained and consequently he would be more willing to make investments and loans. At no time in modern history have lenders hesitated to lend during times of stable or moderately rising prices and at no time has their desire to lend increased during a period of substantially falling prices. The power to devalue should thus constitute for the businessman an added assurance that prices will not be permitted to decline much or sharply in response to a marked depreciation of foreign currencies. This added assurance of domestic price stability should operate as an encouragement to investment.

The present attitude of the owner of capital towards the prospective value of the dollar is one of full confidence. This is borne out by the eagerness of the public to invest in long-term fixed interest bonds at almost the lowest interest rate in the history of this or any other country. The fact that people are willing to invest billions at low rates of interest, and run the risk of depreciation of the real value of the bonds which would accompany any sharp rise in the general price level, suggests that they have confidence in the way which counts most; namely, by their willingness to risk their capital.

The assertion that the continuance of the power to change the gold content of the dollar generates lack of confidence and hesitation in the business world is not, I am convinced, based on factual considerations. Rather, it seems to me, it stems from an effort to reestablish the validity of monetary theories that are ill adapted to the circumstances prevailing in recent years.

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Monetary disturbances in the world today arise from causes almost entirely outside our control. The effect of these disturbances on our monetary system has been such as to reflect greater confidence in the American dollar than in any other currency. This tribute to the soundness of the dollar, taking the form of huge transfers of funds to the United States, creates an unbalance which is the only factor in the situation which gives us any cause for real concern. The powers we possess have been sufficient to prevent any significant damaging effect on our domestic system. The monetary powers granted to the President by the Congress have been employed in such a way as to be powerful forces for stability rather than instability in the domestic economy and in the international field alike.

Sincerely,

(Signed) HENRY MORGENTHAU, JR.,

Secretary of the Treasury.

Honorable Robert L. Wagner,

United States Senate.

--oOo--

March 23, 1939
11:55 a.m.

Operator: Governor Harrison. Go ahead.

HMJr: Hello, George.

George
Harrison: Hello, Henry.

HMJr: How are you?

H: First rate, thank you. I hope you are.

HMJr: Pretty well.

H: When are you going off tomorrow?

HMJr: Tomorrow evening, five or six o'clock.

H: I see. Well, Henry, I don't know quite how to bring this up. I tell you, when I was in your office last time, I saw a blue card there which asked, "Does it contribute to Recovery?"

HMJr: Yeah.

H: And I know you're interested in it -- we all are.

HMJr: Righto.

H: And for a period of pretty nearly two years.....

HMJr: Yeah.

H: I've been -- on behalf of my directors -- conducting a correspondence with Marriner.

HMJr: Yes.

H: Giving our views of what we thought from time to time should have been done.

HMJr: Yes.

H: And only ten days ago we sent our last document down.

HMJr: Yes.

H: And I don't know -- I don't think they go much beyond his office, frankly.

HMJr: Well, I don't know because I've never seen one.

H: No you -- I don't think you have, because we've been trying to preserve the amenities, I haven't sent them to anybody except to him. But I thought that if you were interested and would ask me whether we had anything.....

HMJr: I -- I ask you now. If you....

H: I'd like to send the whole works down to you so that you might perhaps take them and read them at your leisure.

HMJr: I'd love to have you do it.

H: Well, may I just -- you understand, for the record -- just consider that you've asked me for....

HMJr: I am asking you now.

H: All right. Well, that's first rate, and then I'll send them down to you so that you will get them tomorrow.

HMJr: Righto.

H: I better address them just to the Treasury personally?

HMJr: If you will send them for the attention of Mrs. Klotz, I'll get them.

H: All right.

HMJr: Yeah.

H: All right. Well I'll do that today then.

HMJr: Thank you, George.

H: First rate.

HMJr: Good bye.

March 23, 1939.
12:00 noon.

Operator: Go ahead.

HMJr: Hello.

Alan T.

Goldsborough: Mr. Secretary.....

HMJr: Yes, Mr. Goldsborough.

G: The President asked me to get in touch with you and see if you knew of any reason why it would be better for me not to be sworn in right away.

HMJr: I don't know of any reason.

G: Uh-huh.

HMJr: I mean, there's.....

G: He was speaking of possible legislation. I -- I got in touch with him yesterday and told him that I was tentatively planning to be sworn in as Judge on April the 5th, and he requested me to get in touch with you and Mr. Steagall both,.....

HMJr: Well.....

G: And see if there was anything that you knew of that would probably come up that -- where my assistance would be needed.

HMJr: Well, I appreciate the courtesy of your asking me, but I have nothing in mind, Mr. Goldsborough.

G: I see. All right, thank you so much, Mr. Secretary.

HMJr: Wish you success.

G: Thank you very much. Good bye.

March 23, 1939.
5:04 p.m.

HMJr: Hello.

Operator: Secretary Wallace.

HMJr: Thank you.

O: Go ahead.

HMJr: Hello, Henry.

Henry
Wallace: Hello, Henry.

HMJr: Good evening.

W: I just thought I'd report on the progress on -- after passing on to Frank Sayre he suggested that -- he felt it necessary for him to report to Secretary Welles, who is his immediate superior in charge. Secretary Welles went over to see the President and they've got the matter held up until Secretary Hull returns on Friday morning.

HMJr: I see. Well.....

W: The other news is that Jesse Jones has definitely weakened.

HMJr: I see.

W: And I've been talking with Senator Smith about going along with the Oscar Johnson proposal, which I described to the President over the phone, and which he...

HMJr: Yeah. Well, it doesn't sound.....

W: The President said it was not satisfactory to him.

HMJr: It doesn't sound so good, does it?

W: But I haven't talked to Jesse since -- well, Jesse reported that to me and then I've gotten it from other quarters.

HMJr: Yeah.

W: I thought I best not talk with him. I haven't talked with him at all since I've seen you.

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- WJR: Well, don't you think that with Cordell Hull getting back that....
- W: I think it's going to clear the air.
- WJR: Yeah.
- W: Now on the other side Josh Lee called up and said that there was a considerable group up there that would go absolutely down the line on this.
- WJR: Uh-huh.
- W: I hadn't made any overture to Josh myself.
- WJR: Yes.
- W: He'd just gotten it from my presentation up there ten days or so ago.
- WJR: Yeah.
- W: And from what he'd read in the papers, and he said that the moment the Administration would come out with a clear-cut proposal, why he thought we would be in good shape.
- WJR: I see. Well, that's what I think. And....
- W: I talked -- Barkley called up to say that he'd gotten this Russell -- or this George resolution postponed until next week provided I'd agree we wouldn't export any cotton in the meantime with a subsidy. Well, I told him we couldn't very likely be exporting any cotton with a subsidy over the weekend.
- WJR: No.
- W: And -- so Barkley is -- agreed to call a meeting of some of the "key" people and I'll go up, I suppose maybe Tuesday, on such a matter, with a definite proposal, assuming in the meantime that the President has cleared it.
- WJR: Good. Well.....
- W: I just thought I'd better let you know how matters stood

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HMJr: Thanks, Henry.

W: I think it's coming -- really, my hunch is that it's just coming along fine.

HMJr: You and I -- you on your Cotton Plan, and I have my Tax Plan -- we're both whistling.

W: We're both what?

HMJr: Whistling.

W: Yes.

HMJr: I hope.....

W: We're whistling and I hope not in the dark.

HMJr: Well, me -- you and me both.

W: All right. Good luck.

HMJr: Thank you.

W: Good bye.

RE TAX REVISION TO AID BUSINESS

March 23, 1939.

11:05 a.m.

Present: Mr. Hanes
Mr. Tarleau
Mr. John J. O'Connor, Washington, D. C.
Mr. Blaine F. Moore, Washington, D. C.
Mr. Ellsworth C. Alvord, Washington, D. C.
Mr. Fred H. Clausen, Horicon, Wisconsin
Mr. Raymond H. Berry, Detroit, Michigan
Mr. Fred R. Fairchild, New Haven, Connecticut
Mr. H. B. Fernald, New York, N. Y.
Mr. Robert Lassiter, Charlotte, North Carolina
Mr. Roy C. Osgood, Chicago, Illinois

H.M.Jr: Mr. Hanes and I are glad to see you over here and I understand you people have a few suggestions, and we're more than pleased to listen. So if you would tell me just what you have, what you think will be helpful, why, I'm sure that it would be helpful to me.

Clausen: Well, Mr. Secretary, we have come in a cooperative frame of mind....

H.M.Jr: Good.

Clausen: ... and appreciate the opportunity of coming here to discuss a matter which is all-important. And we have assumed, we have a right to assume, our objectives are the same; and we want to deal with the thing realistically as we know how, with the appreciation of revenue needs and also the important idea that we've got to develop business to produce revenue. So from that basis we would like very much to discuss these matters with you and your Department, hoping there might be some common ground of agreement.

Hanes: Have you anything beyond the suggestions that I talked over and have seen, that Mr. O'Connor left with us? Is there anything in addition to this memorandum?

O'Connor: Yes, Mr. Hanes, as a result of our conference we have written a page or more on each one of those tax deterrent points from number 11 on, and that will be available for conference, as you suggested to Mr. Tarleau, this afternoon. They are largely technical phases of the Revenue Act.

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The first ten subjects are the major subjects, and on that we have not prepared any memorandum, hoping the opportunity would offer for a conference between a sub-committee - Mr. Alvord, chairman, who is here in Washington - and Mr. Hanes from time to time; in other words, the policy being one of not saying this thing is the one most important and this thing is less important, but trying to see it from the Treasury's point of view.

Maybe Mr. Alvord can

Hanes: We'll be delighted to discuss those things at any time you're willing to discuss those with us. But in the meantime I understand Mr. Harleau is going to take up with you today all of these technical questions.

O'Connor: Yes, sir.

H.M.Jr: I'd like just for the record, so that we all may know what these eleven points were - just run hastily through them.

Hanes: You're suggesting that we look over "the structure of the corporate income tax, particularly discriminations attaching to non-distribution of profits, relative size of earnings, and different types of business.

"2. Inability to carry net operating losses forward for a reasonable number of years.

"3. The capital gain and loss provisions (corporate and individual) with special reference to rate structure, limitations on deductions of losses and upon ability to carry losses forward.

"4. Height of individual surtaxes.

"5. Capital stock and related excess profits taxes, particularly in their present form.

"6. Treatment of intercorporate dividends.

"7. Treatment of dividends in the hands of stockholders." Here you're referring to the normal taxes.

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"8. Practical difficulties under some of the excise taxes."

Now, have you got some specific suggestions? We've been working on the excise taxes pretty carefully. If you've got some specific suggestions, give them to Mr. Tarleau. If you've got any we haven't got, we'd like to hear about them.

"9. The level of federal estate and gift taxes, their complexities, inadequate exemptions and widespread effects upon investments and upon going businesses."

Now, we ask you there the same question. What suggestions have you got on that?

"10. Denial of option to file consolidated returns."

"11. Recent limitations on foreign tax credits, including denial of suitable credit for taxes paid at the source, treatment of tax-exempt interest and intercorporate dividends in computing tax credit, and treatment of credit for taxes paid in 'blocked currency' countries."

O'Connor: And 12 - if you might just mention 12.

Hanes: 12 is: "Taxation of 'income' arising from purchase by a corporation of its own bonds at a discount."

O'Connor: Yes.

Hanes: Now, the remainder of these things are pretty much technical. You've got some 20-30-odd suggestions here, and from that point on they're practically all technical questions which Mr. Tarleau and the staff can work out with you and get the benefit of your suggestions on those.

O'Connor: We have an amplifying memorandum ready for the conference this afternoon on those points, and some of those break up into three or four sub-heads.

Hanes: As I understand it, the first twelve things are

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things you are vitally interested in and want Mr. Alvord and me at some future time to discuss.

O'Connor: That's right, - before the time we go to the Congress.

Hanes: Well, I have a pretty clear understanding of all the suggestions that you have made here, and I don't know that it's necessary to discuss any of those things at the present time, unless you had something you wanted to take up specifically with us. Have you, Mr. Alvord, any?

Alvord: I don't believe we have anything of a specific nature worth discussing this morning, with respect to the items set forth in the memorandum. We naturally are very much interested in attempting to assist the Treasury in proving that tax revision doesn't necessarily mean decreasing revenues.

We noticed in the papers that - we assumed that the papers are probably no more accurate in this respect than they are in many others - that there seems to be one test with respect to tax revision, even though it is directed toward recovery; that is that the existing revenues must not be diminished. And our general feeling - we'd like very much to assist you; I imagine this also is the Treasury feeling - would like to assist in getting the conclusion that tax revision doesn't necessarily mean decrease in revenues, and we feel quite strongly that a sound revision of the changes in those portions of the revenue bill which really do act as business deterrents will as a matter of fact increase revenues rather than decrease them.

Hanes: Well, all the proof that we can get on that particular point would be very helpful. That's sometimes a very difficult thing to prove. I think probably all of us have convictions along that line. I think everybody in the Treasury has some conviction on that same subject; but it is a difficult thing to prove.

Now, after all, we've got to make estimates and we've got to deal in figures, and there is the place where maybe you could be extremely helpful to us, if you could prove some of that: more revenue by encouraging business enterprise. If we can just get hold of proof

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of that fact, it would be very helpful.

Alvord: Well, I might start out, Mr. Secretary, by saying that I agree wholeheartedly with the statement in the recent budget that it is utterly impossible to make accurate estimates eighteen months ahead. I think everybody agrees to that - unless we happen to have stable economic conditions. I don't think any of us are sufficiently far-sighted to be able to predict the swings of economic trends, whether they go up or down - that is, the extent of the swing. We know about which way they're going and can make the best adjustments possible.

So that about the first point that it seems to me might well be made is that, if it is impossible to estimate with reasonable accuracy some eighteen or sixteen months ahead, speaking now of the fiscal year 1940, with respect to revenues under the existing law, then it seems to me as though the estimates that have been made aren't necessarily sound, absolutely reliable, and that the changes ought to be made with the appreciation that existing estimates are flexible; and if the economic trend which was predicted, which as I read the budget was up to quite a considerable extent over 1938 - if we can increase that trend by legislation, at least remove many of the brakes so that the trend itself will gain momentum, I think we could easily make up what more or less arbitrary estimates would now indicate might be a loss.

Hanes: Well, I think the Treasury estimates were somewhat conservative. I do think they were conservative.

Alvord: I think they were.

Hanes: But I'd rather be in error on that side than on the other side.

Alvord: I agree wholeheartedly; you're not to be condemned for being conservative.

O'Connor: Not for quotation, of course, but do you care to say anything about the prospects of estimates for the '39 fiscal year - I mean based on such evidence as has

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come in in the March 15 returns? Our calculations would show that your estimates for revenue for 1939 were conservative; in other words, your revenues for

H.M.Jr: In some cases can't tell what the taxes - the taxes on income will be up; I mean the actual revenues will be up - but we can't tell what will happen in the miscellaneous and the other ones. But the way we sit around here and work day and night on what we do with 250 million dollars worth of revenue - Mr. Marvin Jones comes out and says he will increase the benefits to agriculture to two billion dollars; and we spend so much time over 200 million dollars. "With a flip of the finger somebody will pass a bill spending 500 million dollars more.

And it isn't just - I think that for the moment - I mean I think too much emphasis is being put on the tax program and not enough on the appropriation bills as they go through, because over night somebody may pass something increasing expenditures by half a billion dollars. And here

O'Connor: You can't find leeway of a couple hundred million.

H.M.Jr: Well, it's less than that. I mean Mr. Alvord and our people might stay up all night arguing over a certain tax - might be 10 or 15 million dollars - and be worried about their professional standing if they miss it by 15 million dollars on one form of tax. And as I say, on the other hand, with a flip of a hand somebody increases it by 500 million.

So the only conclusion that I draw is, I think we'll do the best that we can and if we miss it by 5 or 10 percent it's no tragedy. That's what I mean. It's no tragedy if we miss it by 5 or 10 percent one way or the other, because where your base is not stable - it isn't like taking something where you've got a stable base to figure on - you just don't know what your volume of business is going to be.

So I'm not worried if you or Mr. Farlean or somebody else make an honest estimate and then we miss it either way 5 or 10 percent. Well, what the hell?

Alvord: I quite agree with you. That's very true, Mr.

Secretary.

H.E.Jr: I mean you can't do it, that's all.

O'Connor: And if you can say, "Go ahead," on a possible leeway of a few hundred million, it might be the means actually of saving some of those expenditures, as for instance, relief or some other direction, because the program has caught on, income is increased and by the same token employment increased, and the need for some types of expenditure decreased.

H.E.Jr: Still talking about taxes and not talking about the particular ones, I think you people would be interested that - I had a press conference and I said it, but I'd like to say it again here, as to what progress we're making. Now, I personally feel that we are making progress just as rapidly as we can under a democratic form of government. I mean you can't - it's the price you have to pay, and I take it we all pay it cheerfully, for the fact that we have this kind of a government.

But certainly in all the meetings that Mr. Hanes and I attended progress was made. There's no throwing down of any one program, because there isn't any one program.

The situation on the Hill is this, that until they have Social Security out of the way, the Ways and Means Committee can't hear anything else, and I don't know how much longer they'll be holding hearings on Social Security. Until that's out of the way, you can't get a tax program. Chairman Doughton is ill, and I suppose they're going to wait until he comes back. So it's a matter of two or three weeks.

And nobody is waiting on anybody else, everybody is attending to his business; in the meantime there is this talking back and forth. And it's just like this Social Security program; I got a notice yesterday I had to go up on the Hill tomorrow and the Administration had to make up its mind where we stood on the increase in taxes and on the reserve fund; and we had to take a position and I'm going up tomorrow and explain it. Well now, if Mr. Hanes and I had to

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go up Monday and testify on the tax bill, we'd have to make up our minds where we were and we could make up our minds and we could go up still with smiling faces. But we've got two or three weeks, and as you people know, in Washington when you've got two or three weeks you can do an awful lot of talking and horse-trading, and the columnists have got to make a living. So - a question ...

O'Connor: That's what they said this morning.

H.C.Jr: I question sometimes what kind of a living they make, but still they've got to make one.

So if we had to go up Monday, we'd be ready and we could go ahead. But you people will have to see a lot of talking, because - I mean it's something that everybody is interested in; but we're not disturbed.

And I hope what we do tomorrow on the bill on Social Security will be encouraging, and I think it will be, at least to show you the approach which we're going to use; and the one on the taxes will be similar. I mean we don't expect to go up and tell Congress, "This is the Treasury program." We never have, you know. I don't think any... - well, Mr. Mills did once, didn't he?

Alvord: Well, even then he qualified it.

H.C.Jr: He did it once, and Mr. Garner took great pleasure in throwing it down. I mean it's been the Treasury procedure to go up and be questioned and put the stuff at their disposal, but not to go up with a fixed program. I'm right, am I not?

Alvord: Yes.

H.C.Jr: We're going up, and we've got ideas, but we're not going to say, "This is the Treasury program; take it and like it." That would be silly. Anyway, there is a provision which says the Treasury Secretary shouldn't recommend.

But nothing has happened except just good old gossip and dirt around Washington.

O'Connor: The thing is still on the track.

H.M.Jr: I want you gentlemen to know it. Therefore, it's worth studying. I'm tickled to death that Mr. Hanes is doing this work with you, because it's a selling job and I'm delighted to have your cooperation and it will be most helpful.

O'Connor: Can we add one comment about taxes? Payroll taxes are not in that memorandum, and your reference to the Social Security measure brings it to mind. We'd like an opportunity, although it's not pertinent to the Revenue bill, to present some special memoranda on the payroll tax situation. We're finding some very interesting figures and some very strange effects from those payroll taxes.

H.M.Jr: Got to move awful fast.

O'Connor: I know we probably can't catch it in the House, but there may be some opportunity in the Senate.

H.M.Jr: I mean if you want to catch me. But

O'Connor: Oh yes. Well, it's obvious - if I might just illustrate the principle - that there's an amazing number of situations where the net income for business, say, runs one percent of gross sales. All right. Labor charges run 50 percent of gross expense. Net income would run roughly one percent of gross. Now then, a tax increase of one percent on payroll is a 50 percent increase so far as income tax is concerned - I mean if you'd think of it in that sense.

In other words, the weight and impact of the payroll taxes, and then to be added to that - another tax, really - it's not called a tax - which we have to consider: workmen's compensation, with these board awards on a relief basis running from 350 to 500 million a year. Add that to payroll taxes, and this country has had to find the means of financing out of business - payroll taxes, workmen's compensation, these other taxes - an enormous increase in the last few years, for Federal and state purposes. Which argues the point that one ought to be pretty

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conservative, probably, about - and there will be a reaction on labor, the effect will come on labor in time - one ought to be pretty conservative about proposing increases - looking at business recovery, I mean - in payroll taxes.

Hanes: Is it fair to say in general that the Chamber will take a position against the increase, as provided in the law, to one and a half percent each?

O'Connor: I think so, Mr. Hanes. I think we've got an awful lot to digest yet, a good many adjustments to be made. Let us say there are a lot of employers that are for the Social Security program who would take that position: Don't move it too fast. There are some of them who show their willingness to go on and stand the burden anyway. I can mention some off-hand who are voluntarily doing more than the basic program.

Hanes: Your opinion would be to delay the program for an increase of one-half a percent to some later date.

O'Connor: Yes. And it delays your employer.

Now, just the same way, take the \$6,000 income; take, after exemptions, \$4,000, so as to have no surtax; take the 4 percent normal tax: \$160. All right, you put in a one percent old age on the total and that will be one percent of the \$6,000, be \$60. Or you take one percent on \$3,000. There is \$30. Relate that \$30 to his already \$160 and think of it as coming out of that same income and you've got an appreciable increase in tax.

Now, by the same token, if the income is less than \$4,000 or \$6,000, the greater the increase; but if he is still a Federal - if he's still an income tax payer, that thing is still there.

I was talking with Matt Woll, Vice President of the American Federation of Labor. He says there are many in the labor crowd that aren't too eager to have this thing pushed too fast. Some want benefits paid earlier, things like that - disability. But a lot of them are pretty sober about it.

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- Hanes: I've just been interested in following the hearing up there. I notice that most of the business people that have appeared up there - none of them have suggested a delay in the increase in the tax. Swope, for instance - I was interested in Swope's ...
- O'Connor: Politically popular. They've been afraid to come out and express their minds too frankly on it. Although we've made a formal report recommending a delay.
- Hanes: You think by and large they'd recommend no increase at this time.
- O'Connor: I know that. And of course we won't go to the District, but you see even the report of the local administrator - you read his annual report, Mr. Darleau, where he is in effect saying the same thing for the District.
- H.M.Jr: For the District?
- O'Connor: Yes. In other words, the fund is accumulating in the District much faster than - it's built too high for District needs - much faster than any possible outgo.
- But we didn't put that in our memorandum, about payroll taxes; we're perfectly conscious of it.
- Hanes: Be interested in having that later if you're willing to give it.
- Now, as far as I'm concerned, I understand where we're going; be happy to meet with Mr. Alvord at his convenience. Mr. Darleau will do the same thing with the staff.

MEMORANDUM UPON TAX DETERRENTS
TO BUSINESS PROGRESS

In accordance with the request that we endeavor as fully as possible to identify tax deterrents to business progress, there are listed a number of subjects.

It is understood that it was not in contemplation that we indicate the subjects upon which major emphasis might be placed, nor submit at this time suggestions as to methods of treatment of any of the subjects listed.

The list of subjects, therefore, is not to be considered as arranged in order of relative importance, nor in consideration of the feasibility of adopting helpful modifications in every instance. Furthermore, we have not included various taxation subjects concerning which there are complaints but which in their nature are less directly related to business recovery, nor any deterrents that may exist in pending Congressional bills affecting taxes.

We are prepared to make special mention of the deterring effects of payroll taxes, but understand it is desired at this time to confine the list to such subjects as the income, estate and excise taxes.

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Specific

1. Structure of the corporate income tax; particularly discriminations attaching to non-distribution of profits, relative size of earnings, and different types of business.
2. Inability to carry net operating losses forward for a reasonable number of years.
3. The capital gain and loss provisions (corporate and individual) with special reference to rate structure, limitations on deductions of losses and upon ability to carry losses forward.
4. Height of individual surtaxes.
5. Capital stock and related excess profits taxes, particularly in their present form.
6. Treatment of intercorporate dividends.
7. Treatment of dividends in the hands of stockholders.
8. Practical difficulties under some of the excise taxes.
9. The level of federal estate and gift taxes, their complexities, inadequate exemptions and widespread effects upon investments and upon going businesses.
10. Denial of option to file consolidated returns.

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11. Recent limitations on foreign tax credits, including denial of suitable credit for taxes paid at the source, treatment of tax-exempt interest and intercorporate dividends in computing tax credit, and treatment of credit for taxes paid in "blocked currency" countries.
12. Taxation of "income" arising from purchase by a corporation of its own bonds at a discount.
13. Treatment of losses arising from worthless securities.
14. Treatment of inventories for income tax purposes, particularly the restrictions placed on the "last-in, first-out" principle.
15. Uncertainties attaching to transferees' liabilities, particularly the survival of federal tax liens against property in the hands of bona fide purchasers (see e.g. U. S. vs. Rosenfield, District Court for Eastern District of Michigan).
16. Uncertainties as to tax liability in connection with corporate reorganizations, including complications arising from the Hemler decision.
17. Uncertainty as to the proper valuation of large blocks of stock for income, estate, and gift tax purposes.
18. Uncertainties attaching to section 113; the provisions of subsection (a), affecting basis of property, and of subsection (b), affecting allowance for depreciation.
19. Failure to exclude land (or interest therein) used in trade or business from definition of capital assets.

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20. Recognition of taxable gain arising from cancellation of indebtedness by an insolvent debtor if the result is to produce solvency.
21. Provisions of section 820 that operate to the disadvantage of taxpayers.
22. Narrowness of present earned-income credit.
23. Exclusion of redemption of preferred stock from the capital gains provisions.
24. Effects of personal holding company provisions, including treatment of capital gains.
25. Recognition of gain or loss on foreclosure or voluntary surrender of property.
26. Failure to permit the declaration of deficiency dividends to offset deficiencies in the undistributed profits tax on 1936 and 1937 incomes.
27. Survival of federal tax liens for six years after discharge in bankruptcy.
28. The treatment of irremovable improvements by lessee as taxable income to lessor before disposition of property.
29. Establishment of new basis on loss sales between parties to whom losses are disallowed under section 24(b).
30. Failure to permit the deduction of all ordinary and necessary expenses paid or incurred in the taxable year in production of taxable income, even though not arising from trade or business.

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31. Imposition of stamp tax on transfer of securities to or from nominees; attachment of indefinite and uncertain liabilities upon transfer agents.
32. Detrimental effects of the pension trust amendment adopted in the Revenue Act of 1938.
33. Lack of mandatory requirement that Commissioner take cases through courts when he does not acquiesce in ruling of Board of Tax Appeals.
34. Lack of provision that waiver of statute of limitations should also extend time for filing claim for refund.

General

There are "tax deterrents" which fall under the heading of general policy in contrast to specific provisions of the Revenue Act.

In this general category may be noted:

The threat, arising year after year, of new and additional taxes and substantial changes in the rates and provisions of old taxes;

The unnecessary complexity of important provisions of the revenue laws;

The frequent inclusion of provisions or rates not primarily designed to produce revenues, particularly those clearly punitive in effect;

The failure of the tax law, in determining taxable income, to conform more closely to true income computed in accordance with accepted accounting practices.

Similarly, there is a category of "tax deterrents" arising from administrative policies and practices which are not clearly compelled nor clearly permitted by provisions of law.

While the intention is to limit this memorandum to identification of deterrents which arise in the specific statutory provisions, it would seem to be an omission not to call attention to the deterring effects of administrative policies and practices which:

Place unnecessary burdens of proof upon taxpayers;

Unduly favor the government.

These appear to exist particularly in connection with such matters as depreciation, depletion, determination as to year losses are incurred and undue reluctance to grant refunds, but also arise in other situations which permit of administrative discretion or which admit of more liberal interpretation of law.

March 23, 1939
4 p.m.

Present:

Mr. Chen
Mr. Lochhead

HM, Jr: Hello, Mr. Chen!

Mr. Chen: Hello, Mr. Secretary!

HM, Jr: How are you?

Mr. Chen: I am pretty well. I was sorry not to have seen you the other evening at the Ambassador's.

HM, Jr: I was sorry, but I was with the President.

Mr. Chen: I know you were engaged.

HM, Jr: Mr. Chen, I wanted to volunteer a suggestion, which may not be worth anything, but in reading the stories that come in -- our own stories that come in, the big question over there seems to be one of transportation and I don't get the feeling that they are making much progress. I am discouraged. Now I don't -- it's easy enough for me to sit here in Washington, 10,000 or 12,000 miles away or more, and make suggestions.

But I wondered if coming from me and going through both you and the Ambassador -- I want you to think it over -- I don't like to make suggestions to him, but you and I can talk as businessmen -- of getting the suggestion, if you thought well of it, to the Generalissimo who has sent messages to me that I think they ought to get, possibly, a commission, a mixed commission, and give them the whole problem of transportation and -- I can say this to you -- take it out of the realm of politics.

Mr. Chen: Yes.

HM, Jr: And give this commission a Chinese majority and a minority of English and French and possibly -- my thought was -- to engage some very important American as general manager.

Mr. Chen: Yes.

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HM, Jr: You see? An American as General Manager who would be the dictator of transportation.

Mr. Chen: Yes.

HM, Jr: So he could say, we will put all the trucks into one pool

Mr. Chen: Yes.

HM, Jr: but my job is to clear the goods and the Army can have so much, and commerce can have so much, but everything is pooled together and there won't be this idea of having Mr. Soong having a private transportation company. "Out the window!" as we say. He just can't have it. He can't be blocking the roads; can't have gasoline; this is a Government proposition. Trucks, railroads, everything is pooled.

Mr. Chen: Do you mean to have two commissions or one?

HM, Jr: One.

Mr. Chen: Just for the Highway?

HM, Jr: No.

Mr. Chen: Including Haiphong and Rangoon.

HM, Jr: Everything.

Mr. Chen: Haiphong is under French and British.

HM, Jr: I know, but where you receive it.

Mr. Chen: Receive from the border.

HM, Jr: No; I am talking about inside of China.

Mr. Chen: Mr. Secretary, I am always glad to have somebody to think this problem for us so that we have a quicker improvement because sooner we solve transportation problem, the better for China. Probabing beginning next month you will hear more about difficulties of transporta-

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tion because we are buying \$25,000,000 worth of goods and I want Chinese people to get full use of that, so transportation can give similar benefit. So we have got few problems. First: most of these roads are provincial roads, under some sort of semi-independent management; some provincial road tax too. So sometimes the Central Government cannot have full control of it.

HM, Jr: Of the roads?

Mr. Chen: Yes, because it's different organization.

HM, Jr: But they can have control so that they can say a private individual can't have a trucking company.

Mr. Chen: Yes. This is the point I am coming to. Second is question of management; how to control the private motor bus companies. And, then, I have brought a map with me, here, to show some of these highways. Red lines are highways. You take Yunnan, this is not a province of Central Government. Kwangsi is also under provincial government management. This is projected railways; not finished.

HM, Jr: The blue?

Mr. Chen: The blue. Under construction. Not quite finished. So we have so many highways. The control of that is rather divided at the present time, so a commission composed, probably, of several technical experts, not one man

HM, Jr: I am just making the suggestion because I can see the stuff isn't moving.

Mr. Chen: Yes. Yes.

HM, Jr: You buy the stuff here or other places and you take the docks at Haiphong -- they are loaded up with 50,000 to 60,000 tons of goods. You come with the stuff you buy here. You put it here, or at Rangoon, and they won't move it. You are better organized on the buying than on the transportation end.

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Mr. Chen: Rangoon end, can only move about 200 tons.

HM, Jr: But they keep unloading stuff there.

Mr. Chen: Accumulate stuff there.

HM, Jr: They ought to stop shipping. I think I am correct -- there is not one place, one central brain that says Haiphong, maximum they can handle, 10,000 tons a month; until we get those docks cleared we won't take any more goods there; we will send them somewhere else. But there is no sense. They have trucks there which had been so long there that when they tried to start them up, the batteries were gone; couldn't start to drive them away. And I hate to see

Mr. Chen: Yes, sir.

HM, Jr: waste.

Mr. Chen: Yes.

HM, Jr: And I think you have done a beautiful job at this end, but there -- for instance, I don't know; I think I mentioned this before -- why don't they make arrangements to send up the Irrawaddy River by boat? They can go up all the way from Rangoon to but I understand no arrangements have been made about boats.

Mr. Chen: I understand they are making arrangements to form company, half British, half Chinese, to get steamers to go there.

HM, Jr: I know.

Mr. Chen: This commission will be composed of British, French and Americans and Chinese? Is that the way?

HM, Jr: A mixed commission, with Chinese, of course, in control.

Mr. Chen: Yes. Yes.

HM, Jr: And then my thought was the employing of

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an American as General Manager.

Mr. Chen: Yes. That's the way they did to control this road, to get it out of the Ministry of Communications, so they have actual control. Unless they have actual control, it is not useful.

HM, Jr: What I am thinking of, they ought to have actual control and report direct to the Generalissimo and no one permitted, until this is better, to run private companies for profit.

Mr. Chen: I have to send cable together with Ambassador to Generalissimo.

HM, Jr: If you think well of it.

Mr. Chen: Because he will be very glad to receive such a message because it is helpful.

HM, Jr: Do you think it will be helpful?

Mr. Chen: Sure. Because there are some private companies

HM, Jr: I understand.

Mr. Chen: ... and there is the military transportation. We have bought large quantity of trucks. This is entirely separate. This will be in charge of Dr. Buck.

HM, Jr: Is that what it is going to be?

Mr. Chen: That's unknown. We wrote Dr. Buck few days ago if he is available to join the Fooching Company to take charge of this 1,000 trucks for the transportation of wood oil.

HM, Jr: There is so much. Just as long as there are private companies and the Army and then there's your company -- I mean, there will be a question of shortage of gasoline. Who's going to get the gasoline?

Mr. Chen: Yes.

HM, Jr: Who's going to get right of roads?

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Mr. Chen: The reason for the Fooshing Company to have the 1,000 trucks is because I want to make sure of transportation. If commission functions like this, I am willing to transfer these 1,000 trucks to the commission because if I give to other people I am not sure about delivery of wood oil.

HM, Jr: Do you think my suggestion is a good one?

Mr. Chen: I think it is very good one, because this way, getting unified control.

HM, Jr: That's it.

Mr. Chen: At friendly suggestion, who is taking kind interest in our welfare.

HM, Jr: That's right.

Mr. Chen: In other words, it's above our home politics.

HM, Jr: That's right. You have got it. I didn't want to say it.

Mr. Chen: There are three companies there, some private companies, and General ^{own} transportation company for transportation of ammunition, and then there's Minister of Communications, which is very weak and feeble.

But I will send this idea over of commission, mixed commission, probably composed of four Americans and, say, five Chinese; one mechanical engineer who can understand this truck business.

HM, Jr: You would make it Chinese and American?

Mr. Chen: Chinese-American, because, as I understand it, it is to be responsible for transportation from the border of Rangoon, of Burma, road, to Haiphong, of China.

HM, Jr: That's right.

Mr. Chen: So we will just make it Chinese-American.

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HM, Jr.: That's right. But my thought is five Chinese and four other Nationals. All Americans, so much the better because we have no selfish interests.

Mr. Chen: That would simplify it.

HM, Jr.: And put everything in a pool so they can move this stuff.

Mr. Chen: We are short of technical expert. We are short of man to help organize. This suggestion is just answer our very purpose we are trying to do.

HM, Jr.: If you think well of it, and only if you think well of it. You do?

Mr. Chen: I do.

HM, Jr.: And you can send it to the Generalissimo as my suggestion, but you have the idea.

Mr. Chen: I will send it together with my Ambassador.

HM, Jr.: Yes, I think so. Yes. I didn't want to say it to him for fear he might think what business is that of Morgenthau, trying to tell us how to run our Transportation Department, but I can say it to you because you are a business man, not a diplomat.

Mr. Chen: He always will consider your idea.

HM, Jr.: I think it is desperately needed.

Mr. Chen: I want to report to you progress I have made in New York. We have now 7500 tons of wood oil in New York and, of course, part of that is on road but which is practically in New York, because already left Hankow. Up to date we have purchased \$9,000,000 worth of American goods, trucks, gasoline. Gasoline will be, contract will be finished next week, half of which is Texas and part to Standard Oil.

HM, Jr.: Let me interrupt you. Mr. Moffett telephoned and said "We have been working with the Chinese on trucks and oil purchases, etc." I am not going to say that to you. He wants me to say to you

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that you should use other than American ships, but I will not. (Full text of the message is attached.)

Mr. Chen: But we will do best we can on account of delivery.

HM, Jr: If you can't get enough ships, we will go over to the Maritime Commission and tell them to put some ships on the route.

Mr. Chen: Could they do that?

HM, Jr: Sure! Sure! We could put ships on the route to go to Rangoon.

Mr. Lochhead: Question would be tankers.

HM, Jr: Well, I know; but before I am going to say to give it to any other than the United States, we will certainly put it up to the Maritime Commission to put ships en route from wherever it is, Houston or Los Angeles or wherever they are getting the oil, and ship it direct to Rangoon.

Mr. Chen: Some of this is American ships but British registry. Take some of the Standard Oil, American owned but British registry.

HM, Jr: I would have it under the American flag. You see, they don't want to pay their taxes. When you get ready, you talk to us and we will go over to the Maritime Commission and find out what's the trouble.

Mr. Chen: I am ready, because we conclude contract next week.

(At this point, HM, Jr placed a phone call for Admiral Land of the Maritime Commission.)

Mr. Chen: We have some other orders for copper, zinc, tools, road equipment, blankets -- two million pieces of blankets. I wish to thank you, Mr. Secretary, for the assistance given to me and the members of the company by Captain Collins and that's been very helpful.

HM, Jr: He's been helpful?

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Mr. Chen: Yes; very.

HM, Jr: That's fine.

Mr. Chen: You know, we have a million dollar law suit in New York. Have you heard about that?

HM, Jr: No.

(At this point, HM, Jr spoke to Admiral Land's secretary in Admiral Land's absence. Copy of their conversation is attached.)

HM, Jr: I am glad you came in and when I come back, in two weeks, I would like to see you again.

Mr. Chen: Yes.

HM, Jr: But certainly you want to talk to the Maritime Commission and you can talk rates to them and tell them this is a business proposition and do they want the business.

Mr. Chen: Yes; I will do that.

HM, Jr: But if you like that suggestion of mine ...

Mr. Chen: Yes, I do.

oOo-oOo

March 22, 1939.

To: Secretary Morgenthau
From: Mrs. Klotz

Mr. James Moffat telephoned and gave me the following message:

We have been working with the Chinese on trucks and oil purchases and, naturally, it provides that they must buy American oil and American trucks, etc., and in trying to work it out naturally the question of shipping came up.

It is very difficult, if we are going to expedite delivery of the oil, to find American ships that go across the Pacific. It would be very helpful if the Secretary could say to the Chinese that every effort should be made to use American steamers but if it is going to materially increase the cost and delay delivery that it would be agreeable to use foreign ships. Also tell them that we will do everything we can to use the maximum amount of American ships if they are not prohibitive in their charges, because we do not want to burden the Chinese with that expense.

March 23, 1939.
4:22 p.m.

HMJr: Hello.

Operator: Admiral Land is attending the Rivers and Harbors Convention and they don't expect him back today.

HMJr: Oh.

O: His secretary is there.

HMJr: All right.

O: Right.

HMJr: Hello.

O: Go ahead.

HMJr: Hello.

Secretary: Yes, sir.

HMJr: This is Mr. Morgenthau.

S: Yes, sir. I know you this time.

HMJr: Who is this?

S: This is the Admiral's secretary that I confused with Mr. McIntyre before.

HMJr: (Laughter) Now, I have Mr. K. P. Chen here of the Chinese Government who are going to have a lot of merchandise to ship to the United States....

S: Yes.

HMJr: To Indo-China and to Burma.

S: Yes.

HMJr: And they -- particularly oil.

S: Yes.

HMJr: And the question of -- comes up of shipping it under the American flag.

S: Yes.

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HMJr: And they are going to begin in a week or ten days and I told them before they give it to foreign registry ships I wanted to give Admiral Land a chance to see whether we could -- can't get the business.

S: Yes, sir.

HMJr: Now, could you give Mr. Chen an appointment for tomorrow to see Admiral Land?

S: Is that C-H-A-N-N-O-N?

HMJr: C-H-E-N.

S: C-H-E-N?

HMJr: K. P.

S: All right. Yes, I can. I am sure he'll be glad to meet him and then he'll want him to talk to our Director of Operations in Traffic.

HMJr: Yeah, but tell the Admiral to take a little interest in it himself.

S: I will. He.....

HMJr: Because I'm interested in it myself.

S: He -- he'll do....

HMJr: And I'd like to get the business, and I just don't want them to turn it over to somebody.

S: That's right.

HMJr: Please.

S: Well, now what would suit his convenience better, in the morning or tomorrow afternoon, do you think?

HMJr: Tomorrow morning.

S: Tomorrow morning?

HMJr: Please.

S: At a quarter to ten?

HMJr: A quarter of ten.

S: Uh-huh.

HMJr: And.....

S: Nine forty-five, because there's a Board meeting at ten o'clock.

HMJr: Fine.

S: All right, we'll look for him.

HMJr: Now that's the Maritime Commission?

S: Room 4842.

HMJr: 4842?

S: Yes, sir.

HMJr: Thank you so much.

S: Yes, sir.

CHINESE EMBASSY
WASHINGTON

MEMORANDUM

The Chinese Government has been much concerned to continue the debt service despite the unprecedented difficulties and only with the greatest reluctance announced on January 18, 1939, that it could no longer provide service of full customs obligations. In view of Japanese interference with the salt revenue, the Government now is obliged to apply similar measure in respect of salt secured debts. The salt administration has been provisionally instructed to act accordingly and also to set aside in special account in the Central Bank of China appropriate share of service of salt loans. This measure will be shortly announced and meanwhile is confidential.

The Chinese Government does not wish the situation resulting from these measures to continue without an effort to arrive at a reasonable arrangement to maintain debt service so far as practicable having regard to the abnormal conditions of obtaining vital necessities for prosecuting the war and to the pressing demand for financial and economic stability. The Chinese Government is therefore initiating negotiations with the representatives of the creditors in respect of the customs and salt secured loans.

The present debt situation is due solely to the war. Prior to July, 1937, China had been making great financial and economic progress. Adequate revenues were being developed,
financial

-2-

financial administration improved, currency stabilized, old debts in arrears mostly settled, and budget equilibrium within reach. Railways, roads and air communications were being improved and extended and industry developed. Japanese aggression destroyed over night this promise of a new era of progress.

Notwithstanding the disparity of resources and equipment, China has waged the one sided war much longer than expected, but until recently, she has been left to fight almost unaided other than by valuable aid from American silver purchases. She has no heavy industries and her export trade has been crippled; hence the import of essential supplies is largely against cash. Her economy is gravely disrupted by the Japanese and it is a matter for wonder that during recent months her financial organization has not broken down.

Nevertheless, the Government has made all efforts to maintain currency and credit, and feel entitled to recognition of its attitude toward debt in foreign currency which was fully maintained for eighteen months of war. The Government has reluctantly concluded that there is no alternative but to seek cooperation of the bondholders. It therefore proposes for the next twelve months to pay in exile foreign currency in respect of customs and salt secured loans held by public on coupon on loans receiving full interest, and half annual interest on loans paid under settlements providing for less than full interest. Reduction in payments is to be regretted, but the Government would point out that the bondholders have received more than would be usually expected under the circumstances of the past twenty months of war. This would be a temporary arrangement and it is intended to resume full service

-2-

service at earliest possible moment. Similar proposals are being made to appropriate creditors' representatives in other countries.

The Chinese Government appeals for sympathetic and favorable consideration of this offer by the friendly governments and peoples. In order to avoid delay the Government is putting forward in the first instance the utmost it can do and would make it clear that this is not a basis for bargaining. Half of annual interest on these loans is about \$4,700,000.00 in American currency and is roughly equivalent to the unoccupied area's share which would be about \$5,100,000.00 in American currency based on the Chinese Government receipts of about 20% of customs collection and, according to quotes, 35% of salt for which the collection data is still unavailable. The Government however does not relate the proposal to the share of this area because it is unwilling to imply any possible derogation of sovereign rights in the occupied area.

The Chinese Embassy,

Washington, March 23, 1939.

TREASURY DEPARTMENT
Office of the Secretary
Secret Service Division

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MEMORANDUM
March 23, 1939

To: Mrs. Klotz
From: Chief Wilson

For the information of the Secretary we attach copy of program of the visits of the King and Queen of Great Britain, the President of Nicaragua and party, the Crown Prince and Crown Princess of Norway, the Crown Prince and Crown Princess of Denmark and Iceland, and the Prime Minister of Ireland.

NOT FOR DISTRIBUTION OR COMMUNICATION TO THE PRESS

PROGRAM (FOURTH DRAFT, MARCH 16, 1939)

VISIT OF THEIR MAJESTIES THE KING AND QUEEN OF
GREAT BRITAIN--JUNE 1939MEMBERS OF THE ROYAL PARTY

THE KING

THE QUEEN

Lady Nunburnholme

*Lady Katharine Symour

Earl of Eldon

Earl of Airlie

*Mr. A. Lascelles

Surgeon Captain H. White, R.N.

Mr. G. F. Steward

Captain M. Adeane

*Lieutenant Colonel

The Honorable Piers Legh

Commander E. M. C. Abel-Smith, R.N.

) Ladies in Waiting

Lord in Waiting to the King

Lord Chamberlain to the Queen

Acting Private Secretary to King

Medical Officer

Chief Press Liaison Officer

Assistant Private Secretary to King

Equerry to the King

Equerry to the King

* * * * *

*Two valets

*Two maids

*Two detectives (body servants)

*To stay at the White House if possible.

-2-

Tuesday, June 6

The Secretary of State and Mrs. Hull, accompanied by the following officials, will proceed to the Canadian border at Niagara Falls to welcome the King and Queen on their arrival in the United States:

Sir Ronald Lindsay, British Ambassador

(?) Three Service attaches (British)

Mr. George T. Summerlin, The Chief of Protocol

(?) Sir Herbert Marler, Canadian Minister

The Major General and Rear Admiral assigned to the King
as Military and Naval Aides

Mr. Michael J. McDermott, Chief, Division of Current Information

Mr. Robert C. Bannerman, Chief Special Agent

Additional Special Agents

Wednesday, June 7

E.S.T.

9:30 p.m. The Royal train arrives at Niagara Falls, New York, over Suspension Bridge from Niagara Falls, Canada. The King and Queen will descend from the train and be welcomed at the station by the welcoming committee. The Secretary of State will present the members of the committee to the King and Queen. Immediately thereafter the Royal party and the welcoming committee will board the train. Plain clothes (?)

Thursday, June 8

11:30 a.m. Arrive Washington. The King and Queen will be escorted by the Secretary of State and the British Ambassador to the President's Reception Room at Union Station, where they

-3-

will be met by the President and Mrs. Roosevelt. The King will present his suite to the President and Mrs. Roosevelt and the President will present the members of the reception committee as follows:

The Vice President and Mrs. Garner

The Chief Justice and Mrs. Hughes

The Speaker and Mrs. Bankhead

The Secretary of the Treasury and Mrs. Morgenthau

The Secretary of War and Mrs. Woodring

The Attorney General

The Postmaster General and Mrs. Farley

The Secretary of the Navy and Mrs. Swanson

The Secretary of the Interior and Mrs. Ickes

The Secretary of Agriculture and Mrs. Wallace

The Secretary of Commerce

The Secretary of Labor

The Under Secretary of State and Mrs. Welles

Senator and Mrs. Pittman

Representative and Mrs. McReynolds

The Chief of Staff

The Chief of Naval Operations

The Commandant of the Marine Corps

The British Ambassador will present to the King and Queen Lady Lindsay and the members of his staff. Lord Eldon will

-4-

present the Ministers of South Africa, Canada and Ireland, with their staffs. In all there will be about 100 persons, 40 American and 60 British, to be presented to the King and Queen in the Reception Room.

Guard of Honor outside the station

Photographers. No broadcast

Members of the reception committee and of the Royal Suite will enter their automobiles while the President and Mrs. Roosevelt and the King and Queen are receiving the honors and the photographers.

Automobile procession to the White House, with military escort. Full dress.

12:15 p.m. Arrive at the White House

Diplomatic circle in East Room for the Chiefs of Diplomatic Missions and their wives. The British Ambassador as Dean of the Diplomatic Corps will present the Chiefs of Mission and their wives to the King and Queen.

(?) 1:15 p.m. Small luncheon at the White House.

2:45 p.m. Reception for the Press (Where?)

3:15 p.m. Visit to the rotunda of the Capitol where the King and Queen will meet the members of the Senate and House (?)

4:00 p.m. Garden party at British Embassy. Formal dress.

4:15 p.m. Leave Capitol and return to White House (?)

5:00 p.m. The King and Queen arrive at the British Embassy

-5-

8:00 p.m. State dinner at the White House. Full evening dress.
Reception with music. The King and Queen will remain at the White House for the night.

Friday, June 9

10:45 a.m. The King and Queen will leave the White House for the British Embassy.

11:00 a.m. The King and Queen arrive at the British Embassy where they will receive representatives of a number of British-American organizations including the British Legion, the British Chamber of Commerce and the president of the English Speaking Union.

11:30 a.m. The King and Queen will leave the British Embassy (for the White House or the Washington Navy Yard depending upon whether the President wishes to accompany them to the Navy Yard or meet them on board the U.S.S. Potomac.

12:00 M The King and Queen will arrive at the Navy Yard accompanied by their suite. Luncheon will be served on board during the sail to Mount Vernon. The King will lay a wreath at Washington's tomb at Mount Vernon. Return to Washington will be by automobile with a stop at the Tomb of the Unknown Soldier, Arlington Cemetery. A wreath will be laid by the King at the Tomb. Dress (?)

4:30 p.m. Informal tea at the White House.

8:15 p.m. Dinner at the British Embassy. Full evening dress.

11:00 p.m. The King and Queen will leave the British Embassy for Union Station accompanied by their suite and American aides.

11:30 p.m. The King and Queen will entrain for New York.

Saturday, June 10

D.S.T.

The Royal train will arrive at Red Bank, New Jersey, in the morning.

9:45 a.m. The King and Queen and other members of the Royal party will leave Red Bank station by automobile and proceed to Fort Hancock (Sandy Hook)

10:00 a.m. The Royal party will embark on board a destroyer from the wharf at Fort Hancock and proceed with naval escort up the bay to the Battery. Outaway and top hats.

11:00 a.m. The Governor of New York and the Mayor of the city of New York will welcome the King and Queen and other members of the Royal party at the Battery. (?) Ceremonies (?)

11:30 a.m. The Royal party will leave the Battery by automobile and proceed via the west side elevated highway with motorcycle escort to 110th Street, thence across New York City to the Tri-Borough Bridge and the Horace Harding Parkway to the New York World's Fair.

12:15 p.m. Arrive New York World's Fair. Visits to Fair headquarters and the United States Federal building.

1:00 p.m. Luncheon offered by the United States Commissioners in the Federal building.

2:00 p.m. Visits to British, Canadian and Irish exhibits. The King and Queen will receive representatives of the British Community and Garden Committee in the British pavilion.

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3:30 p.m. The Royal party leaves the Fair for Columbia University (?)
via the Tri-Borough Bridge, where it will halt for a view
over New York City.

4:00 p.m. Arrive Columbia University (?)

4:30 p.m. Leave Columbia University (?)

Drive by car via the Medical Center to Hyde Park

(?) 7:00 p.m. Arrive Hyde Park.

CONFIDENTIAL MEMORANDUM

March 17, 1939

The President of Nicaragua and Senora de Somoza and party (it is not yet known how many will be in the party) will arrive at New Orleans on the morning of May first. The party will be met at the pier and President Somoza will be greeted on the ship by an official of the Department of State and the party will then be escorted to the hotel where arrangements will have been made for the entire party.

Since the party will not be expected to arrive at Washington until May fifth, they will remain in New Orleans until the evening of May third when they will board a special car for Washington where they are scheduled to arrive at 11:20 a.m. Aides will join them at Richmond.

The following reception committee, with the President and Mrs. Roosevelt, will be in the President's Reception Room at the Washington Station to greet the party:

The Vice President and Mrs. Garner
The Chief Justice and Mrs. Hughes
The Secretary of State and Mrs. Hull
The Speaker and Mrs. Bankhead
The Members of the Cabinet and their wives
Senator and Mrs. Pittman
Representative and Mrs. McReynolds
The Under Secretary of State and Mrs. Welles
The Chief of Staff
The Chief of Naval Operations
The Commandant of the Marine Corps
The Staff of the Nicaraguan Legation

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After presentations:

The National Anthem
 The salute of the Guard of Honor
 Cameramen
 Carriages
 Procession to White House
 Diplomatic Circles at White House
 Family Luncheon
 (The President of Nicaragua and Senora de Somoza will be
 the only ones in the party who will spend the night--
 May 5--at the White House.)

Afternoon, May 5

(Tentative--awaiting return of Nicaraguan Minister
to Washington)

3:00 p.m. Motor to Mount Vernon - wreath
 4:30 p.m. Return to Arlington - wreath
 5:15 p.m. Return to White House
 8:00 p.m. State Dinner

May 6

11:00 a.m. Leave White House for Nicaraguan Legation

 Leave Washington by train for New York--date not yet fixed.

PR:OTS:CLW

CONFIDENTIAL MEMORANDUM

March 17, 1939

The Crown Prince and Crown Princess of Norway will arrive at New York on the morning of April 27 (accompanied by a small staff).

The Royal party will be met and greeted at Quarantine by a representative of the Department of State and escorted to the Waldorf-Astoria Hotel.

The Crown Prince will make a courtesy call on the Mayor of New York between twelve and one o'clock on the 27th.

At 9:30 a.m. April 28, the Royal party (of seven)* will board the U.S.S. Potomac at Pier _____, New York City, and proceed to Poughkeepsie, where they should arrive at 4:30 p.m., and thence go by motor cars to Hyde Park. They will remain at Hyde Park until 9:30-10 a.m. April 30, when they will motor to New York, via West Point for Chapel and luncheon with the Superintendent of the Military Academy, and an early parade after luncheon. The Minister of Norway has requested that they arrive at the hotel in New York about 5:30 p.m.

The Crown Prince will attend a luncheon ceremony at the World's Fair on May 1, and will dedicate the Norwegian Pavilion in the afternoon.

The party will leave for the West Coast by rail the evening of May 2.

July 6

Sail from New York.

* Also two American Aides and the Chief of Protocol.

PR:OTS:CLW

MEMORANDUM

March 17, 1939

VISIT OF THEIR ROYAL HIGHNESSES CROWN PRINCE FREDERICK
AND CROWN PRINCESS INGRID OF DENMARK
AND ICELAND

Crown Prince Frederik

Crown Princess Ingrid

Captain Commander Johan V. F. Vest) Chamberlain

The Minister of Denmark

Madame Wadsted

Countess Sybille M. L. Reventlow) Lady in Waiting

Captain Lieutenant Philip C. Weilbach) Aide-de-Camp

Mr. Karl I. Eakelund) Press Liaison Officer

There will be four servants attached to the party

(2 at Hyde Park).

The Crown Prince of Denmark will arrive at Los Angeles, Calif., on April 6 and visit the Golden Gate International Exposition at San Francisco, making a tour of the United States (see attached itinerary).

The President and Mrs. Roosevelt have invited the Crown Prince and Crown Princess to visit them at Hyde Park, where they will arrive on April 30 about 6 p.m., leaving May 1 at 10 p.m.

On May 2 they will dedicate the Danish pavilion at the New York World's Fair.

An informal and unofficial visit to Washington has been scheduled for May 6-8.

-2-

The following officers have been assigned as Military and Naval

Aides:

Los Angeles and San Francisco

Lt.Colonel Bernard Peyton, U.S.A.

Commander Ellis M. Zacharias, U.S.N.

New York

Lt.Colonel W. C. Crane, U.S.A.

Commander Lloyd J. Wiltse, U.S.N.

Accompaniment:

Itinerary

CONFIDENTIAL MEMORANDUM

March 17, 1939

Prime Minister de Valera of Ireland will arrive at New York on May 6.

He will be met and greeted by an official of the Department of State.

May 7

3:25 p.m. Arrive at Washington--to go to White House with Secretary from the Ministry of Foreign Affairs

Small reception committee at the Station--
President's Reception Room

Drive to White House

8:00 p.m. State Dinner

May 8

11:00 a.m. Leave White House.

PR:GTS:GLW



has been
revised
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THE SECRETARY OF COMMERCE
WASHINGTON

March 23, 1939

House

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

MA

Dear Henry:

I think you will be interested
in reading this.

Very sincerely yours,


Secretary of Commerce

C
O
F
Y
of
SPECIAL REPORT NO.
sp.Rep.#223

Mexico, D.F. Mexico March 17, 1939

Subject: BANKING SITUATION

Submitted by: Thomas H. Lockett Commercial Attache

VIA AIR MAIL

VERY CONFIDENTIAL

A number of things are militating at the moment to produce a rising demand for dollar exchange. During the past four or five days the demand for dollar exchange has shown a continuous increase. At the close of banks on March 17th., the purchase of dollars had not reached the point where it was giving unusual concern to officials of the Bank of Mexico. As of March 14th., the Bank of Mexico had a stabilization fund of 7,100,000 dollars which it intends to use to maintain its metallic reserve during the next five or six months. The 7,100,000 dollar "hidden" stabilization fund has been created since October 1, 1938 by excess dollar purchases made on the Mexican market with pesos. On March 16th., the Bank of Mexico was required to sell 75,000 more dollars than it bought on that day. In other words, the demand for dollars had reached the point where the Bank is being required to sell more dollars than it purchases.

During the conversations, officials of the Bank of Mexico today did not express any particular concern over the immediate rise in the dollar demand, but, they did display considerable concern over the outcome of the petroleum negotiations and the possible effect upon the monetary system of a failure in the negotiations. The officials of the institution said that they could cope with any measures which

might be taken by the oil companies, themselves, but that the financial system could not stand any severe economic or diplomatic pressure from the Government of the United States. The officers of the Bank asked the direct question as to whether or not President Roosevelt had approved the points which Mr. Richberg was using as his basis of discussion. They said the answer to that question would be of great assistance to them in determining what course to pursue. I inferred from the question that if the bases of discussion had been approved by Washington officials of the Bank of Mexico would consider a failure in negotiations as a much more serious matter for Mexico.

The reasons given for the increasing demand for dollars are:

- (1) A growing belief that the oil negotiations will be unsuccessful.
- (2) Political agitation in favor of various presidential candidates.
- (3) Increasing public utterances and publications of candidates and political parties opposed to the present administration.
- (4) Uncertainty over the continuation of the silver purchase policy and
- (5) the knowledge that the Federal Government is scraping the corners in order to meet its payrolls.

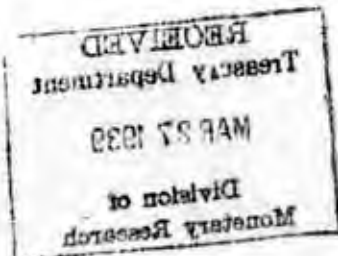
While the monetary situation has not yet become serious, it is quite evident that the tendency is unfavorable with a certain section of the public becoming concerned. One banker stated that a very steady demand for dollars was being made by professional politicians who are in position to know the progress of the oil discussions.

C
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SPECIAL REPORT NO.
Sp. Rep. #223

The reserves of the Bank of Mexico have been under a tremendous strain since September 1937. I do not believe that it could weather a very severe storm without employing some such measures as have been used by Germany and other countries. In other words, severe pressure upon the peso would undoubtedly cause the Bank of Mexico to immediately limit the sale of foreign exchange to the payment of imported merchandise. In fact, this was indicated today as a probable measure by one of the officials of the Bank of Mexico. So, it is well to bear in mind that severe restrictions probably will be placed upon foreign exchange in case the monetary system is driven too hard.

You will be advised by air mail or telegram as changes in the monetary system may warrant.

(Signed) Thomas H. Lockett
Commercial Attache



AMERICAN CONSULATE

Yunnanfu, China, March 23, 1939.

CONFIDENTIAL*Confidential*

SUBJECT: Report of trip over the Yunnan-Burma
Highway to Hsiakwan and Talifu.

The Honorable

The Secretary of State,
Washington.

Sir:

I have the honor to submit the following report of a trip made by me by motor car over the Yunnan-Burma Highway from Yunnanfu to Talifu for the purpose of ascertaining the present condition of the road, the extent to which it is now being used for the transportation of military supplies, and progress being made in constructing the Yunnan-Burma Railway which parallels the highway a great part of the way.

ITINERARY:

I left Yunnanfu at 9:15 a.m. on March 16 and arrived at Tsuyung 196 kilometers distant at 4:20 p.m. The first 70 kilometers of this road is in poor condition and is in urgent need of repair. The foundation of the road is exposed and will disintegrate unless the top dressing is replaced soon. In the gorge between Lufung and Ipinglang some culverts were being constructed and the road was

being

being widened in places. From Ipinglang to Tsuyung the road was in fair condition with the exception of the western side of the pass going into Tsuyung. During the day 400 workers engaged on the road were counted. Between kilometer 122 and 180 there were many culverts and approximately ten small bridges under construction necessitating the use of by-passes and short detours. Ten trucks of the Southwest Transportation Company carrying munitions towards Yunnanfu were passed during the day. The Yunnan-Burma Railway parallels the highway very closely as far as Lufeng and workers are engaged in building up the earthwork for the road-bed along almost the entire distance. In many places the earthwork is practically completed and the construction of bridges could be commenced at any time. There are small groups of workers in the Lufeng-Ipinglang gorge testing the earth formation for the right-of-way, and engineers were observed surveying the roadbed. No work on the railway in the Tsuyung plain was observed, but I was informed that a large staff of railway personnel was stationed at Tsuyung.

On March 17 at 8 a.m. I left Tsuyung for Yunnanyi 142 kilometers distant which I reached at 1:30 p.m. Shortly after leaving Tsuyung I came upon six trucks belonging to the Southwest Transportation Company carrying drums of motor fuel towards the west. For several hours it was impossible to pass these trucks and it gave me an opportunity to observe the manner in which they were run. They maintained a constant speed of approximately 30 kilometers an hour and appeared to be operated in a satisfactory manner. Nine additional trucks westward bound carrying drums of motor fuel were observed that day. Each

truck

truck carried from 12 to 15 drums of 55 American gallons capacity. No trucks were observed on that day bring munitions from Burma. Approximately 1500 workers were counted working on the road. The road between Tsuyung and Yunnan was in much better condition than that traversed on the previous day.

On March 15 I departed from Yunnanyi at 8:35 a.m. and arrived at Talifu at 12:30 p.m. The road was exceedingly good on this stretch. The laborers engaged in repairing the road numbered approximately 1,050. On this part of the road 15 trucks were counted carrying munitions from Burma and 16 trucks carrying drums of motor fuel to the west. At kilometer 350 the earthwork on the Yunnan-Burma Railway was again observed where the railway leaves the motor road and turns south towards Mitu.

At Hsiakwan the Burma highway turns to the west.. There being no satisfactory accommodations at Hsiakwan I turned north and spent the night at Talifu, about 15 kilometers distant. While at Talifu I visited the campus of the Kuomintang Political College which will in the future be located in this city.

Returning the next day I took occasion to visit the gorges below Hsiakwan where there is an excellent water-power site on the outlet to the Talifu lake. This lake is approximately 35 miles long by six miles wide and is surrounded by many mountains, 19 of which are reported to be over 14,000 feet high. I was there during the dry season but the flow of water from the lake was considerable. During the rainy season the flow must be much greater. At one place the gorge narrows down to a defile over which it is possible to step. A constant flow the year could doubtless be maintained by the construction of a small dam

due at the outlet of the lake.

On March 19 I returned to Yunnan¹ and on March 20 made the entire trip from Yunnan¹ to Yunnan², a distance of 337 kilometers in 9 hours driving time.

CONCLUSIONS:

Highway:-

With care and attention I believe that the road from Yunnan¹ to Hsienkwan can be maintained in operation the year round. It is a parent that it will be necessary however to keep gangs of workmen constantly at work on the road. It is also likely that a great many more culverts and bridges will have to be built. It is estimated that a maintenance crew of approximately 10,000 workmen should be engaged instead of approximately 3000 as at present.

Transportation:-

It is believed that an average of about 15 trucks of the South west Transportation Company pass in both directions each day over the highway. The trucks bringing munitions from Burma are not heavily loaded and probably carry not over 2 tons per truck. If the present schedule is maintained it is estimated that between 900 and 1,000 tons of munitions per month are now being shipped over this highway. This quantity could easily be increased four or five fold without causing congestion. No disabled trucks were observed along the road. About 50 percent of the trucks were diesel and the remainder whites. The Southwest Transportation Company maintains truck stations at Lufeng, Tzu²yang, Hsienkwan and Hsienkwan.

Yunnan-Burma Railway:-

Work on the Yunnan-Burma Railway is going forward with considerable speed. The number of workmen could not be counted as the railway at times was some distance from the highway, but it is believed that many thousand

-5-

workmen are engaged on this project. Neither at Yunnanfu nor to the west were any bridges observed under construction. It will doubtless require much longer to build bridges and culverts on the railway than to complete the earthwork, and therefore it is believed that the speed with which the earthwork is being done is no criterion that the railway will be completed at an early date.

Aviation School at Yunnanyi:-

At Yunnanyi I visited the Primary school of the Central Aviation Academy located at that place. The field at Yunnanyi is approximately 1,200 meters long and 800 meters wide. There are eighty planes on the field, and the cadets number approximately 200. Four American instructors are stationed at Yunnanyi. They informed me that they were just then solo-flying the cadets and that after six weeks training 111 cadets had flown solo successfully. About 35 were "washed out" in the test in addition to those who were not permitted to solo. The field is much too small for 80 planes, however, and a part of the school will be moved to Tsuyung where there is a field approximately the same size as the field at Yunnanyi. Local objection to the establishment of a flying school at Tsuyung is holding up the matter for the present. I was informed that there was a field in the country a short distance from Yunnanyi which was used in connection with the training at that place and as a refuge in the event of an air raid. The dimensions of this field were stated to be approximately 800 by 600 meters.

Respectfully

Respectfully yours,

Paul W. Meyer,
American Consul.

In quintuplicate.
Copy to Embassy at Chungking.
Copy to Embassy at Peiping.

800
PWA/Epy

RECEIVED

MAY 12 1938

THEATRE DEPARTMENT
Office of the Secretary
General
United States of America

A True copy
of the signed
original. *sm*

**FEDERAL RESERVE BANK
OF NEW YORK**

March 23, 1939.

Dear Henry:

When you talked with me on the telephone this morning, you asked whether I would not send you any material, which we might have, relating to the broad question of economic recovery. As I told you then, our views on this all-important question are best summarized and documented in a series of letters and memoranda which we have written over the past year and a half and sent to Chairman Eccles. In view of your request, I am sending you a copy of this correspondence, together with the supporting memoranda.

You may not agree with some of our thoughts or proposals, but at least the material which I am sending you represents a most earnest effort, on our part, to diagnose the problem and to outline what has seemed to us, in all the circumstances, to be the most effective and appropriate way of attacking it from time to time.

If, after you have had an opportunity to read this correspondence and the accompanying documents, you would like to talk to me, I would be glad to suit my convenience to yours.

Faithfully yours,

Gregg Harrison

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

Enc.

P.S. I am also sending you a marked copy of my recent annual report, which, I think, presents some interesting material on this same general subject.

FEDERAL RESERVE BANK OF NEW YORK

104

November 3, 1937

Dear Chairman Eccles:

Since the Presidents' Conference two weeks ago, we have been giving a good deal of further thought to the questions discussed at the Conference with the Board, concerning the implications of the recent decline in the securities markets and the less drastic but marked recession in business. My associates and I have discussed these problems with our directors and with others and, in the light of all the circumstances as we see them, there seem to be some steps which might now be taken to remove certain obstacles to business activity and further to encourage business recovery.

Perhaps no one can say with entire confidence whether the current economic recession may not become a serious depression. It is not necessary to recount the various opposing factors in the situation, of which you are aware, but one conclusion seems to stand out, namely, that at a time when the stimulus of government spending and credit expansion through government borrowing is coming to an end, the business spending which should take its place is at least partly blocked. The transition from public spending to private spending is evidently not being effected smoothly. I think we are all agreed that more government spending is not a feasible way out. The government and the people have set their faces against continued deficit financing. Indeed, in this atmosphere and at this stage of recovery, it is altogether doubtful whether it would work anyway. There has recently been evidence that added amounts of government securities might find the market reluctant. Renewed deficits would likely further discourage and longer postpone private spending.

The real problem is to get private spending going again and in sufficient amounts to fill the gap left by the sharp decline in the government's net income producing expenditures. There is plenty of private spending that needs to be done and there is plenty of money available. A beginning has been made, for the amount of private spending in 1936 was larger than in 1935, and even though the last quarter may be relatively poor, the full year 1937 will show larger private spending than 1936. But just now the machinery seems to be partly stalled.

Suggestions which we have received from others and which we have ourselves examined, as to what might be done to accelerate business activity, may be classified under three general headings; (1) the general atmosphere in which business is conducted, (2) specific business problems, and (3) problems of business financing, including taxation and general credit policy.

(1) I am sure I do not need to emphasize the fact that the business community is just now extraordinarily sensitive to every wind that blows from Washington. Whatever can be said or done to indicate the awareness of the Administration concerning the problems business now faces and to clarify its objectives as they relate to business is likely to be as effective as more specific action. Business is now hesitant about making long term plans partly because it feels it does not know what the rules of the game are going to be. If business were planning further ahead it would readily be employing more people and disbursing larger payrolls. To a great extent this is a problem of general atmosphere. The recent action of the Board of Governors in reducing margin requirements is proving helpful not solely or even largely because of its technical effects but more as an indication of understanding and a cooperative attitude.

(2) On the more specific business problems and more specific ways in which spending may be expedited and employment increased, the four fields

Hon. Harriner S. Eealee, 11-3-57.

which appear most promising are: (a) building, (b) public utilities, (c) railroads, and (d) general manufacturing and mining. The potential demand for new housing is generally attested, and in the other fields mentioned, there is reported to be large accumulated need for the replacement of obsolescent plant and equipment, making up deferred maintenance, and construction of plant for new or cheaper production.

(a) I hesitate to make any comments about building because you yourself know that field so thoroughly. Many had hoped that increased activity in building this year would be the chief aid in helping us over the transition period from government to private spending. But a hopeful beginning was interrupted by a rapid increase in building costs (both wages and materials) and latterly by the general uncertainty accompanying declines in the security markets. I do not have any specific suggestions to offer on this point beyond those which you have discussed from time to time, but any summary would be incomplete without the general suggestion that this field, in which actual output is still at least 50 per cent below any reasonable normal expectancy, is one in which much progress is still to be made. Time is, of course, working with us, for the shortage of proper housing is steadily increasing, and rents are rising, though evidently they are still not high enough to offer adequate inducement for building enterprise. It may be that some recession in building at this time will have been helpful as far as costs are concerned, for past experience seems to indicate that such a rapid run-up of costs as occurred in the first half of this year does not prove very rigid in the face of falling demand.

In the case of the utilities and the railroads, though the maximum potential demand is probably less than in building, spending could be more promptly released. In both cases we are informed, as we assume you are, that there are programs for maintenance and construction all prepared, which could provide a prompt basis for added employment.

(b) It is my own view, as I stated at the joint conference with the Board on October 19, that perhaps the best opportunity for an effective immediate release of productive forces is in the public utility field. From the best information we are able to obtain about the utilities, power consumption appears to have about caught up with present producing capacity. Maintenance and new equipment expenditures appear to be behind. The utilities estimate that they could spend, promptly, at least as much as \$1 billion and continuing amounts of about the same magnitude, over a period, if their immediate future were clarified on the one point of government competition. The utilities, and present and potential investors in their securities, are afraid that the government may set up competing subsidized distributive systems, and thus destroy all or part of the value of their properties. If they were affirmatively reassured on this one point, they could go ahead with plans now formulated and could tap the market for needed funds. Such a decision as to government policy, which it seems to us need not be in conflict with previous policy, would give business a quick impetus in an important capital goods industry and thus would readily open the way for a considerable amount of reemployment.

(c) The railroads are another possible field in which increased employment might be effected, though there is difference of opinion as to the speed with which this can be accomplished. Increased traffic, due to increased business activity in general, would of course be directly helpful. The railroads, however, have been caught between the pressure of advancing costs, due to wage increases, higher taxes, etc., on the one hand, and depressed and regulated income on the other. How much this difficulty can be remedied by rate revisions or what other steps might be necessary is a question to which prompt attention should be given. Anything that can be done to improve the position of the railroads would not only be importantly helpful to business in general, but would also help one large area of the securities market which is now most depressed and on which savings banks, commercial banks and insurance companies are greatly dependent.

(4) General manufacturing and mining concerns are now large spenders for maintenance and for new plant and equipment. For a number of months, for example, machine tool manufacturers have been working practically at capacity. Mr. Ferbergh of your staff has estimated that all such expenditures in manufacturing and mining will total over three billions of dollars this year. Clearly, this is a large enough sum so that even minor fluctuations have an important effect on employment. There may not be any single move in government policy which would influence this spending, but those more general moves which were mentioned earlier, and the more specific sorts of action just discussed, would be the kind of evidence as to the future of business which is calculated to replace the present hesitancy with renewed activity.

(5) Concerning the problems of business financing, perhaps the main point to be emphasized is the widespread belief, apparently leading to decisions by business men and investors, that certain of our present taxes inhibit the financing of business and promote disorder in security markets. A program to review and revise the tax system, particularly the undistributed profits tax and the capital gains tax, would be a constructive step, not only by the removal of possible defects in the tax system, but also by encouraging business initiative generally.

As I understand it, the System's philosophy with respect to these problems has been to bring about increased production and increased employment. Our assumption has been that our success eventually would depend largely upon a revival in the capital goods industries, which in turn demands that these industries have easy access to the capital market. We believe that anything which unnecessarily interferes with the further development of this process is contrary to all that has been done to try to improve the standard of living of the whole population.

I realize that this letter does not do much more than indicate what we deem to be the most likely points of attack on the problem of preventing the

- 6 - Hon. Marriner S. Eccles, 11-8-37.

current recession from becoming, perhaps, a real depression. I am enclosing a memorandum which Mr. Williams has prepared in the course of our discussions and which undertakes a review of the current situation from the historical and theoretical standpoints. We are also preparing other memoranda relating to business financing and the capital markets which I shall send along to you as they are finished. In the meantime, however, it has seemed to me to be worth while to give you this summary of our views. It will, at least, prepare the ground for further specific suggestions which we may develop, or for a common effort to answer some of the questions which have been raised, or for discussions at the next meeting of the Federal Open Market Committee, when many of these questions will likely form a part of our discussion of open market policy.

Faithfully yours,

George L. Harrison,
President.

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

Enc.

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COMMENTS ON THE PRESENT BUSINESS RECESSION
by
JOHN H. WILLIAMS

I

The purpose of this memorandum is to set forth in broad outline the kind of program which seems best adapted for dealing with the current economic recession. We begin with a reference to what has happened because it is difficult otherwise to get a fair perspective of the problem.

The great depression reached a double bottom in the middle of 1932 and February-March 1933. Until the fall of 1934, the recovery was very erratic. From then until September, 1936, there was a strong and wholesome upward movement, as is perhaps best indicated by the fact that production and employment rose comparatively much and commodity prices comparatively little. From September, 1936, to March, 1937, there was evidence that the recovery had entered upon an unwholesome phase, for this period was marked by a rapid rise of prices both here and abroad. There were evidences of an incipient boom such as wage-price spirals, forward buying, inventory accumulation, and the like. Labor disputes undoubtedly intensified these conditions.

The period just described marked the peak of the recovery. The Board's index reached 121 in December and 118 in March. Since March the stock market has receded, while business remained on a plateau until August. Since August there has been a succession of violent breaks in the stock market comparable in range, if not in volume, with the breaks in 1929. The decline from last March to the lowest point yet reached has been 40 to 50 per cent. The decline since August has been accompanied by some recession in business, the Board's index of production falling from 118 in August to 111 in September and to an estimated 108 in October. There is no current evidence that the recession has come to an end.

Whereas two or three months ago, we were considering the possibility of a business recession this fall, we are now faced with the definite fact that it is

under way. That some recession might be necessary and desirable for assurance of continuance of the recovery movement following the excesses of last winter and spring was foreseen at that time, but probably no one foresaw that it would be accompanied by so great and violent a decline in securities. As matters now stand, probably no one can say with entire confidence whether we are facing a minor or a major depression.

It is helpful, as bearing upon this question and also upon the question of what sort of recovery program is now needed, to compare our present situation with that following the downturn in 1929. There are important differences between the two periods which, if taken by themselves, would point to nothing more serious than a minor depression. These differences relate chiefly to 1) durable goods 2) speculation 3) banking. As regards durable goods, there is a striking difference in favor of the present. Our needs for housing, public utility equipment, railroad equipment, and industrial plant equipment, are all undoubtedly greater than in 1929. As regards speculation, there is now nothing comparable to the great volume of speculative credit in the security markets and in real estate, and to these should be added the difference in our foreign investment position. In banking, a large number of our weaker banks have disappeared, we have now Federal deposit insurance, and there is, perhaps, a changed attitude in bank examination. On these major grounds there is a strong presumption that we cannot now have a depression like the last.

There are, however, some other differences between the two periods which, partly because they are wholly new in our experience, greatly confuse any attempt at a forecast. One is the monetary situation. We have gone through the longest recovery in our history with continuing extreme ease of money. Broadly speaking, therefore, a policy of monetary ease cannot be counted upon as a corrective for depression as it used to be, though this does not mean that there may not be room for effective monetary action as we proceed. Probably an even more important

difference is the fact that we have had a public spending program of large proportions, which has been financed by government borrowing. A third difference is the present relation between government and business. We have been having a combined recovery and reform program for which there is no precedent in business cycle history. We do not know how compatible they are under conditions of business recession, or what adjustments will or can be made. Perhaps this is the largest question of the three.

There appear to be two main lines of procedure for a government policy designed to hold the recession to a minimum and hasten a resumption of recovery. One is a renewal of the policy of large budgetary deficits. The other is to encourage private investment by endeavoring to remove specific obstacles, while adhering to the announced policy of budget balancing. In our judgment, in the present circumstances, the latter policy offers much the better prospect of sustained success.

The most recent budgetary estimates, when adjusted for transfers to trust accounts and similar items not representing actual out-payments to the community, indicate an approximate balance of revenue and expenditure for the fiscal year 1938. If the administration adheres to this budget, and gets the revenue there estimated, there will be a decrease in the net income creating expenditure of the Government in this fiscal year of some two and a half to three billion dollars. Allowing for the secondary effects upon community spending, it seems conservative to estimate that the national income will be reduced by ten per cent compared with what it would be if the budgetary deficit were continued upon the scale of the fiscal year 1937. We must thus face the fact that if this change occurs in a year when private business activity has lost its recovery momentum, a business recession of considerable magnitude might not be avoidable except upon one or the other of the two hypotheses mentioned; either the unbalanced budget policy must be resumed or an alternative program designed to encourage business spending sufficiently to fill the gap must be devised.

In our judgment, the time has come to effect the transition from public deficits to private investment. The transition might well have been smoother had it been started sooner. If now the price of transition must be some minor recession of business, it seems the better course to pay that price. A minor recession after the longest period of recovery in our history, and particularly after the excesses of last winter, is not by itself to be regarded as a major economic calamity; and it should, if wisely handled, lay the ground work for a resumption of recovery upon a more normal, self-sustaining basis.

There appear to be serious objections, under present circumstances to a recovery policy based upon a renewal of the budgetary deficits. It would involve an abrupt change of the administration's recently announced and reiterated policy, which would shake confidence much more now than if the announcements had not been made. It would come at a time when the banks, after a long period of government security buying, have for more than a year been showing increasing resistance and have reduced their holdings substantially. The complaint is even now being made that sales of government securities by banks to private investors have been absorbing investment funds which would otherwise be available for private capital issues, and that this, in part at least, is what is wrong with the new issues market. As yet, this criticism is probably exaggerated, but if government borrowing were resumed on a substantial scale there would in all probability develop a difficulty of this kind.

A further difficulty would arise in interest rates. The policy during the recovery was progressively to lower interest rates in order to encourage first refunding and then new capital issues and mortgage financing. But there appear to be limits of time and magnitude upon this process. We have found that after a prolonged rise of government security prices, and when bank holdings of governments had become large, the banks developed a desire to sell governments though under no real reserve pressure to do so, in order to protect profits or avoid losses. For

this reason, probably, many banks have appeared more inclined to adjust positions through their long-term assets than through the short-term money market. Under these conditions, the structure of interest rates becomes increasingly unstable. Results which might have been achieved when bank holdings of government securities were smaller, and when these securities had had a lesser rise in price, become increasingly difficult to achieve or maintain. Any serious set-back in the government market, the possibility of which would become progressively greater as new issues were offered, then tends to dry up both refunding and new capital issues. There have been indications this year that we are approaching that kind of impasse.

II

We have dwelt at some length upon the problems of deficit financing because we regard it as essential to recognize that the policy of budget balancing in this year of business uncertainty does create a definite and substantial reduction in the national income which calls for a positive recovery program, but that this program ought not, under present circumstances, to take the form of a prolongation of the budgetary deficits.

There is, of course, the possible view that because of large latent demand for housing, utility, railroad, and plant equipment, comparative absence of speculative excesses, and better banking conditions than in the last depression, business recession will find comparatively little to feed upon and, after a short period, business will turn up again, as has happened many times before. We cannot, however, afford to rely entirely on this course of events. Virtually all such earlier experiences were accompanied by a change of monetary conditions, whereas this time money is easy and has been for a long time. Furthermore, former experiences have not included the important new factors now presented by the budgetary problem and by the failure of government and business to find a common ground on which to attack the problem. The fact that adverse factors present in the past

are not now present offers the real basis for hope that a constructive program of specific adjustments could now succeed; it would not justify, however, a failure to try to set up such a program.

During the recent recovery the main emphasis was upon increasing consumer income in the expectation that the consumer demand thus created would lead to increased investment in plant and equipment for the production and distribution of goods to meet that demand. At the present juncture, it seems probable that we could make better headway by a reversal of this emphasis, and it is of fundamental importance to recognize that the policy of budget balancing can be based only upon this assumption.

The kind of program here suggested should include, we think, some kind of general statement possibly in the form of a message by the President to Congress, giving indication of awareness of the current economic situation, clarifying objectives, and encouraging a spirit of cooperative attack upon the forces making for depression. It seems to us that this could be done entirely consistently with all major reform objectives, and that it is essential to the attainment of the major objective of a better standard of living for the whole population, which can only be achieved by a fuller use of the nation's factors of production.

The problem in its strictly economic aspects suggests primarily a program of study, and where feasible, of definite measures designed to remove specific obstacles to private investment. The following outline broadly indicates the objectives we have in mind.

1. Removal of obstacles to investment in four main fields

- a) Utilities
- b) Housing
- c) Railroads
- d) General plant and equipment

2. Removal of possible defects in tax system

- a) Undistributed profits tax
- b) Capital gains tax
- c) Social security taxes?

3. Removal of possible defects in financial machinery

- a) Stock market
- b) New capital issues market
- c) Building finance

The enumeration of items does not indicate necessarily that we think some action should or could be taken with respect to each item. Still less does it mean that we feel competent to indicate, in every case, what specific actions might best be taken. But we do feel that definite possibilities of helpful action lie within the area indicated.

The basic consideration, as has been earlier stated, is that in the main fields of investment, the possibilities and the need for expansion appear sufficiently real to give promise of substantial response. In the case of residential housing alone, which since the war has shown a range of from \$5 billion in 1925 to \$250 million in 1933, and in which the annual expenditure has now ruled far below the statistical average for eight years, there is room for expansion of sufficient magnitude to replace the gap resulting from removal of the budgetary deficit. Past experience seems to indicate that such a rapid run-up of costs as occurred in the first half of this year does not prove very rigid in the face of falling demand. Whether by subsidy, further improvements in finance, guaranteed annual wages for building labor, or by other devices, a substantial housing movement could be generated are questions requiring careful technical study, but over a period this appears to be the most promising field for recovery measures.

A more immediate point of attack upon the continuance of recession is the utilities. Here the need for equipment, though less in magnitude than in the case of housing, is more clearly defined and more pressing, and could probably be more promptly released. Whatever is to be the final outcome of present differences between the administration and the utilities, some means should be found, possibly through resumption of the President's Power Conference, to solve the existing state of fear and uncertainty, and to enable this industry to play its full part in

reviving industrial activity.

As regards the railroads, it may be that no substantial equipment buying will occur until a sufficient increase of traffic is brought about through expansion of other industries, but there are in addition the problems of burdensome debt structure and advancing wage costs, the question how far the latter can be compensated for through rate adjustment, or what other measures of adjustment may be feasible.

As to industrial plant and equipment, it has been estimated by Mr. Terborgh of the Board's staff that investment in this field in the current year is over three billion dollars, or roughly equal to 1928; but in considering the outlook for future years, allowance must be made for the long duration of the depression, the increase of population, and the development of new technique. The rise of wages is in itself a powerful stimulus to technological advance, if the latter is given reasonable encouragement.

There is now widespread complaint that our tax system, especially the undistributed profits tax in its present form, threatens seriously both to weaken initiative and to impair corporate savings, which in the past has been a major source of new investment. There is also complaint that the capital gains tax, in its present form, accentuates the instability of the stock market. A thorough review of these taxes - and I understand the Treasury is making such a review - would be a constructive step, not only for its direct results in tax revision, but also because of its favorable effect upon business sentiment.

The financial items of the program, though deserving further careful study, are probably secondary to those already discussed in their possibilities of providing immediately effective encouragement to revival. The thinness of the stock market, its great disorderliness, and the great extent of the decline, exceeding that of any previous year except 1929, may well mean that the regulations need some further modification. The same may be true of the capital issues market,

though the decline of the stock market and the uncertainty as to the future of business conditions would appear to be the major explanation of the drying up of new issues. Undoubtedly the best way to strengthen the capital markets would be through the development of some such program for encouraging investment as is here suggested.

As regards monetary policy, there is perhaps no occasion for detailed comment at this time, beyond the suggestion that at the next meeting of the Open Market Committee it would seem desirable to survey the major policies in the light of the current economic situation.

Federal Reserve Bank of New York,
November 3, 1937.

Board of Governors
of the
FEDERAL RESERVE SYSTEM
Washington

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November 15, 1937.

My dear Mr. Harrison:

Your letter of November 3d reviewing the business situation and enclosing a copy of John Williams' comments states in general terms about what my own conclusions are with regard to the basic problems which need to be dealt with promptly in order to stimulate private business and credit.

As you are probably aware, my principal point of departure from your summation relates to what seems to me to be the importance of sustaining government contributions to general purchasing power while the obstacles to private spending are being cleared away. I am quite aware, as you are, that this is a minority view, doubtless hopelessly so, and I recognize the psychological considerations involved. Nevertheless, it is going to take some time to repair the damage that has been done and to get the stalled machined started again.

While private spending was doubtless larger in 1936 than in 1935 and may be even greater this year than it was last, the amount has not been sufficient this year to make up for the reduced contribution of the Government. I note that John Williams' paper estimates that there will be a decrease in the net income creating expenditure of the Government in this fiscal year of some two and a half to three billion dollars. With the recession in this quarter already evident, increasing unemployment, hesitancy on the part not only of business but of individuals to buy, there is no doubt whatever in my mind that we are experiencing a precipitous decline in dollar purchasing power. For myself, I cannot be blind to the cumulative effects of deflationary forces after our experience in recent years, nor to the futility of talking again about balancing the budget by reducing Federal outlay at a time when private spending is rapidly diminishing and government revenues correspondingly drying up. To my mind this is the height of folly. To be sure, if a quick stimulus can be given to private business soon enough to start things going before the deflation has run too far, we may come out of it all right. I think it is a foolish risk to take. It would be far safer and also far cheaper in the long run not to take the gamble. I am the more convinced of this because Hoover took the gamble himself and lost.

However, I shall not undertake in the space of a letter to amplify this matter. Otherwise, I find myself rather generally in accord with your summation, which I think is excellent and well stated.

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I shall be interested in seeing the supplemental memoranda relating to business financing and the capital markets to which you refer.

Sincerely yours,

(Signed) M. S. Eccles

M. S. Eccles,
Chairman.

Mr. George L. Harrison,
President, Federal Reserve Bank of New York,
New York City.

COPY

November 17, 1957.

Dear Chairman Eccles:

I have received and want to thank you for your letter of November 15 in reply to my letter on the problems presented by the present business situation.

I am glad that in general our views agree with your own conclusions about the basic problems which need to be dealt with. I realize, however, that we do differ somewhat as to the best method of immediate attack. True, there may be some risk in sticking to the principle of a balanced budget if private spending is too slow in filling the gap caused by the diminution of the government's contribution. The question which is immediately raised in my mind, however, is whether a return to government spending might not renew and accentuate some of the uncertainties that are holding business back, and thus further postpone the time when private spending will supplant government spending. Is not the question really whether obstacles to private spending will be courageously and quickly enough removed to justify running the risk to which you refer? Some temporary recession, even admitting that it might be severe for the time being, might in the long run prove to be the cheaper price to pay. At least it seems to us that it is necessary to weigh against that price the risks inevitably involved in an abandonment of the administration's attitude about the budget

2. Hon. Marriner S. Eccles, 11/17/37.

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and an avowed return to government spending.

I am enclosing a memorandum which, in my last letter, I said that we were working on concerning the financing of business spending. It may be that some of the suggestions referred to are not, for one reason or another, possible of attainment at the moment. We thought, however, that it might be helpful in our study of ways and means of reopening the capital market if we made a careful and thorough survey of the financial machinery as we see it, and the steps which, at least, should be considered as a means of making it run more smoothly.

Perhaps, it will be possible more fully to discuss these matters at our meeting of the open market committee to be held the week after next. Whether or not an immediate return to government spending is resorted to as a means of avoiding a continuation of the recession, as I gather you think, it is important, in any event, to do all that we properly can, as soon as we can, to remove some of the apparent limitations or obstacles to a free flow of private investment.

Very truly yours,

(signed) George L. Harrison

George L. Harrison,
President.

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

Enc.

FINANCING OF BUSINESS SPENDING

It now appears to be generally recognized that a larger volume of business spending is needed to avoid a serious business recession. Expenditures of business for construction, machinery, and all those many items of equipment which make it possible for a factory, a hotel, a public utility, a gas station, or any other form of business to sell finished goods or services, take up normally a large part of the country's total production of goods, and normally employ a large part of the country's workers. Over a period of years the rapid growth in the standard of living in the United States has rested on large expenditures by business in scrapping old plant and machinery and building new and more efficient plant; in constantly finding new products or services to produce, and new ways to produce old products or services at cheaper prices. It is this process which has made possible a continued increase in real wages.

Capital expenditures have, however, been subject to wide fluctuations. During the late 20s business was making very large and in some cases excessive purchases of plant and equipment, but in recent years exactly the opposite has been true; the amount of business spending has not been adequate to maintain plant in good condition or to carry business into new fields. The process of research, experiment, and invention has been going forward steadily, but the results of research have not been fully exploited to satisfy human needs and comforts. At this time when the volume of government spending has been declining rapidly, there is both need and opportunity for an increased volume of business spending which will restore plant and equipment to efficiency, reach out into new fields in order to produce new goods or services to satisfy human need, and make old goods or services more widely available through cheaper production.

The existence at the present time of a large need for business spending is shown by the estimates of the savings of business enterprises prepared as a part of the estimates of national income made by the National Bureau of Economic Research.

These figures for the years 1919 through 1935 are as follows:

Net Savings of Business Enterprises*

In Millions of Dollars

1919	6,706
1920	3,722
1921	2,508
1922	663
1923	2,427
1924	2,141
1925	3,355
1926	4,777
1927	2,031
1928	2,810
1929	2,109
1930	- 1,656
1931	- 5,856
1932	- 8,751
1933	- 7,779
1934	- 3,354
1935	- 1,607

From 1919 through 1929 business was making large savings each year. Large amounts of earnings were being retained in the business and in part were being re-invested in plant and equipment. Other funds were being obtained from the sale of securities in the market and used for a similar purpose. Beginning with 1930, however, business suffered huge losses in capital. These losses took the form of the destruction or obsolescence of equipment, losses through reorganization, and revaluation of assets, and through out-payments for dividends and interest in excess of earnings.

While the figures shown above are, of course, somewhat rough, they indicate the large sums of money involved in business capital operations, the large increases in capital necessary to maintain a rising living standard, and the great reduction in capital in periods like the recent depression. They indicate a need for a large amount of business spending to restore business capital assets to a point where they will minister to human needs more effectively.

Specific obstacles to business spending in the fields of building, utilities, railroads, and general manufacturing and mining have been reviewed in

National Bureau of Economic Research, Bulletin 56, September 27, 1937.

Regarded Unclassified

Mr. Harrison's letter to Governor Eccles of November 3 and a memorandum of October 29 by Mr. Williams. It is the purpose of this memorandum to examine the mechanism for the financing of business spending, especially with a view to discovering whether there are in this area obstacles which are standing in the way of a more adequate volume of business spending.

For business generally there appear to be four sources of funds for expenditure for plant, equipment, and other capital uses:

- (1) Existing cash balances,
- (2) Current earnings,
- (3) The new issues market,
- (4) Bank credit.

These will be discussed briefly in order.

(1) Existing cash balances. While no complete figures are available the following table which is compiled by the Standard Statistics Company from the mid-year balance sheets of 140 large industrial concerns is a rough indication of changes in the aggregate cash position of industry.

	Midyear 1929	Midyear 1936	Midyear 1937	% Change 1936 to 1937
Inventories	\$2,069,000,000	\$1,074,000,000	\$1,427,000,000	+ 32.0
Receivables	575,000,000	484,000,000	590,000,000	+ 21.7
Cash	693,000,000	876,000,000	763,000,000	- 12.9
Cur. Liabilities	402,000,000	572,000,000	776,000,000	+ 35.6

The cash position of these industries is large, but has been reduced somewhat from 1936. It is interesting to note that an increase of \$459,000,000 in inventories and receivables appears to have been financed by the following changes:

Reduction in cash	\$113,000,000
Increase in current liabilities (mostly bank loans)	204,000,000
Balance, presumably from capital issues and earnings	142,000,000

This comparison suggests that while cash balances are sufficient to finance some increase in business activity they will have to be supplemented for any considerable expansion program. In many cases, especially among smaller concerns, cash balances are quite inadequate to finance expansion.

It should be added also that the willingness of a business concern to spend the cash which it has depends in part on the prospect of rebuilding its cash balances over a period through the retention of earnings or through sale of additional capital stock.

(2) Current earnings. Current earnings have in the past been a major source of business capital. It has been the practice of American business to plow back into the business a substantial part of each year's earnings. This is illustrated by the following table taken from an unpublished study of 213 leading industrial concerns by the Standard Statistics Company. It shows that in the period from 1922 to 1929 these concerns were retaining from one-third to more than half of their net income. For these particular concerns the total amount so retained in these eight years was over \$5,000,000,000. These retained earnings served the double purpose first, of enabling these companies to continue to pay dividends through the depression despite small earnings or deficits, and second, of providing funds for expansion, for the introduction of new machinery, for the development of new products, and in general for the utilization of the products of research to satisfy human need. These large concerns probably show a more favorable picture than the generality of business concerns.

DISPOSITION OF PROFITS - 213 CONCERNS

(Millions of Dollars)

Year	Net Profit	Fixed Charges	Net Income	Preferred Dividends	Common Dividends	Bal. after Dividends
1922	1,163.6	156.4	1,007.2	160.1	425.5	421.6
1923	1,439.6	163.3	1,276.3	166.3	564.0	546.0
1924	1,441.5	163.7	1,277.8	170.3	588.5	519.0
1925	1,861.2	159.6	1,701.6	175.0	693.8	832.8
1926	2,019.5	153.1	1,866.4	173.1	685.8	807.5
1927	1,763.3	172.5	1,590.8	161.4	1,007.9	421.5
1928	2,267.0	169.6	2,097.4	145.9	1,103.6	848.0
1929	2,652.9	172.2	2,480.7	148.4	1,322.9	1,009.4
1930	1,601.2	168.7	1,432.5	149.9	1,273.3	9.3
1931	685.9	162.7	523.2	140.7	1,016.3	d 633.8
1932	264.5	149.3	115.2	109.5	618.0	d 612.3
1933	676.9	133.4	543.5	81.9	517.9	d 56.3
1934	940.3	133.4	806.9	99.2	611.2	96.5
1935	1,322.1	120.6	1,201.5	102.9	704.1	394.5
1936	1,886.9	111.7	1,775.2	169.9	1,154.0	451.3

deficit

If we were to add to these retained earnings of leading industrial concerns similar figures for other industrial companies, for the utilities and for the railroads, it is clear that the result would be a substantial sum available in earlier years for business spending, the general size of which was shown by the table on page 2. In addition the amounts set aside for depreciation, depletion, etc., are available out of gross earnings for maintenance or new equipment.

Turning to the present situation, substantial sums are now gradually becoming available from these sources. One important question which arises, however, is the effect of the undistributed profits tax upon the utilization of these funds for increased employment. A comparison between the 1935 and 1936 figures in the preceding table shows that whereas net income of these corporations increased by \$573,000,000 between the two years, only \$57,000,000 of these added earnings was retained for utilization in the business. It is reasonable to assume that this reflects in some measure the effect of the undistributed profits tax which became effective in 1936.

The principal objections which have been raised from time to time to the undistributed profits tax are:

(a) That it penalizes and makes more vulnerable the company in weak position which is in debt or has inadequate reserve funds,

(b) That it shuts off the natural means of growth for the concern which is too small or unseasoned to go to the capital market for funds,

(c) That it makes for business instability by forcing large disbursements of dividends some years, with resulting small disbursements in other years, because business concerns are not able to set aside earnings to be disbursed as dividends or for capital improvements in lean years. It makes extremely difficult the maintenance of a reasonably stable dividend or capital expenditure policy, such as has been followed by the American Telephone and Telegraph Co., for example.

A further and different objection may be raised that in the present situation the tax makes very expensive funds set aside from earnings to be used for

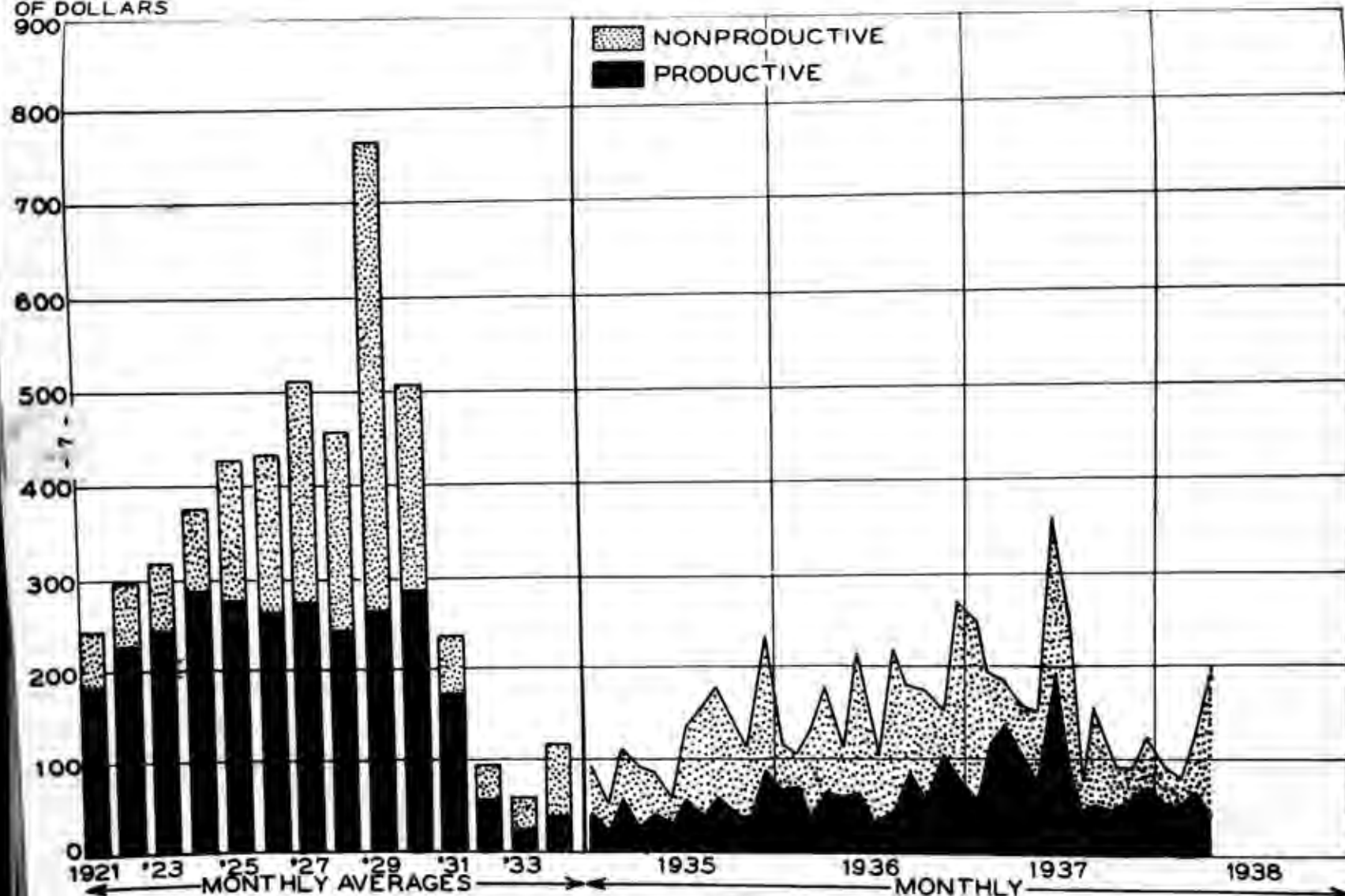
capital purposes in making available to the people the results of research and invention, for lifting employment, and the standard of living. Modification of the tax for the benefit of weak concerns or concerns in debt, or small concerns unable to go to the money market, while it would be generally helpful, would not meet this point at issue. To meet this point it would be necessary to modify the tax to enable concerns to retain without penalty funds needed for sound capital uses involving additional employment.

The undistributed profits tax was designed in part to prevent excessive savings and excessive building of plant capacity by industrial concerns such as may have occurred during the prosperity of the 1920s. Without discussing whether the tax was adapted to conditions of business at that time, the question may be raised whether it fits the present situation when there is no evidence of over-investment, but on the contrary, when investment has been greatly depleted during the period of depression. It may be adapted to a period of over-investment, but not suitable for a period of under-investment, such as the present.

One suggested method for dealing with this situation is to exempt from the tax funds actually spent for plant or equipment over some specified period. In any such plan it would be well to recognize that the willingness of concerns to spend will depend in part on their prospect over a period of years for making good out of earnings depletion of capital. Such a plan to be effective promptly should be made to apply to 1937 earnings.

(3) The new issues market. In addition to current earnings the major source of new funds for business enterprise has been provided in the past by the new issues market. This market used to provide in the 20s something like \$160,000,000 a month for what might be called productive corporate uses as distinguished from refunding or financial issues of one sort or another, in addition to about \$100,000,000 a month for capital use by States and cities. The figures for total productive issues are shown in the accompanying diagram. It is an interesting coincidence that this aggregate amount is about the same as the amount contributed to national income by the government in recent years through its net deficit.

MILLIONS
OF DOLLARS
900



Corporate and Municipal New Capital Issues, Excluding Refunding Issues
(Monthly Issues from 1921 to 1938)

During the period of the depression the new issues market was, of course, practically closed accompanying general disturbance in the securities markets. But in the past three years there has been some gradual revival of this market accompanying easy money conditions. Most of the issues, however, have been for refunding rather than for new money. The amount of new money, or what may be called productive issues, began to show some increase during the past year, reaching, as the attached diagram shows, an average of about \$50,000,000 to \$100,000,000 a month, but at the present time the market is practically closed except for relatively short term bonds or notes of the highest grade.

The reopening of the capital market for new money depends on a recovery in the general securities market, partly because the present yield basis on all securities except the highest grade is now so high that new capital is too expensive, and partly because under present conditions in the general securities market it would not be possible to sell substantial amounts of new securities. It is particularly desirable that a considerable part of the new capital which business uses for plant construction and the like should take the form of equity financing to avoid an overbalanced debt structure. It is, therefore, desirable for any considerable program of new capital issues that there be a recovery of the equity market as well as the bond market. For any reopening of the new issues market it is necessary to consider the various factors upon which greater stability in the security markets depends.

(a) The general business outlook. In the main the security markets are now reflecting general pessimism as to the business outlook, and particularly the outlook for the railroads, the utilities, and building construction. Specific action which would improve the situation in any of these fields would be most effective in reopening the capital market.

(b) Availability of funds. In view of the thinness and vulnerability of the market, question may be raised as to the volume of funds potentially available

for employment in securities involving risk. As far as institutional buyers are concerned, insurance companies are far and away the chief reliance of the bond market, and the volume of their purchases is steady and increasing. They are increasing their security holdings at the rate of about \$1,500,000,000 a year, largely bonds of high rating. Savings banks, ordinarily steady buyers, are now less active purchasers than formerly because of a slower growth of deposits. Both of these types of institutions, however, are strictly limited in the types of their investments, and have recently been more than usually conservative both as to types and amounts of purchases because of lack of confidence in security price levels and other uncertainties.

The commercial banks are ordinarily the most erratic buyers of bonds. At one time they are heavy buyers, at another, heavy sellers, reflecting the changes in the business demand for funds, in their reserve positions, and in the outlook for bond prices. Since July, 1936, they have been sellers.

It should be added that some institutional buyers, like college endowments, and some trust funds which used to confine their purchases to bonds, have in recent years, under what they considered the threat of inflation, purchased substantial blocks of common stock.

Possibly the greatest change in recent years has been in the status of individuals with large incomes who are perhaps the largest holders of common stock. At the present time the total volume of incomes of \$10,000 or over, as reported in the Federal Statistics of Income, is about half what it was in the middle or late 20s. For 1936 it may be estimated that this total is in the neighborhood of \$5,000,000,000, whereas in 1926 and 1927 it was in the neighborhood of \$10,000,000,000. The Federal tax on these incomes now averages 15 per cent, compared with 7 or 8 per cent in the 20s. Thus, smaller amounts of income are currently available for investment in the market, though the number of shares listed has increased some 40 per cent in the past ten years. A smaller volume of these funds currently available,

partly because of high individual surtaxes and the capital gains tax, is perhaps one substantial reason for greater sensitiveness of the equity market to other influences.

(c) Capital gains tax. The capital gains tax is cited repeatedly by those in charge of the management of large private funds as preventing the use of those funds in enterprise or securities representing enterprise, and it is generally believed that a modification of this tax would tend to increase the amount of funds available for enterprise and would tend to have a stabilizing influence in the securities market by providing a larger volume of buying when the market was low, and selling when the market was high. There is also some reason to believe that the return to the government would not be materially reduced because there would be more activity and less avoidance with a lower tax.

(d) Restrictions on "insiders." Section 16 of the Securities Exchange Act which places restrictions on trading in securities by directors and officers and principal stockholders has been mentioned by many people as a reason why they themselves would not buy the stocks in which they themselves were interested. In addition to not wanting to tie themselves up for six months, they do not want to incur the notoriety involved in the publication of their names and special inquiries of one sort or another. The S. E. C. has the power by rules and regulations to exempt any transaction or transactions which it may consider as not comprehended within the purpose of this subsection which was "preventing the unfair use of information." The S. E. C. thus has power to give a little more leeway for this class of stockholder.

(e) Market regulations. The detailed regulations by the Board of Governors with respect to margins and of the S. E. C. with respect to other phases of market practice, are frequently mentioned as causes of irritation and impediments to the fluidity and stability of the market. A revision of these regulations in

the direction of liberalization would probably have no major effect on the general situation, but would make for a more smoothly operating financial mechanism and lessen the causes of irritation and pessimism. A number of detailed suggestions as to changes in the regulations of the Board of Governors were contained in this bank's letter of September 24, 1937. The Board's action in revising its margin requirements has already proved helpful, not simply for its direct effect but for its indication of an attitude of flexibility, understanding, and cooperation. The Board is understood to be considering the issuance at an early date of revised Regulation T. The existing regulation, and also the draft of the proposed provision sent with the Board's letter of July 28, 1937, include many provisions which have been or would be irritating to the market, and in some instances provisions with which full compliance is difficult. Many of the provisions of the regulation which are objectionable from the point of view of the security markets are of relatively small importance so far as the control of credit is concerned. Events which have transpired since the preparation of this bank's letter of September 24 emphasize further the desirability of a reconsideration of all phases of the regulation with a view to determining whether the results to be achieved from the point of view of the control of the use of credit, which is the Board's primary responsibility, are sufficient to offset the difficulties which they create in the market.

(4) Expansion of bank credit. A certain amount of business spending is financed by bank credit, both directly in the form of commercial loans, and indirectly in the form of bank purchases of securities through the open market. Through the loan channel a considerable amount of funds has latterly been flowing into business use, but largely for current operations rather than for capital expenditures which are needed now.

Bank investments as indicated earlier have been decreasing and this movement has had some real influence on the bond market. To the extent this is due to uncertainty as to the future of interest rates it is not unusual at this

stage of the business cycle, when commercial demand for funds begins to be felt, and the only sound reassurance is the gradual stabilization of yields at a somewhat higher level than that of a year ago. But to the extent that bank sales of bonds may reflect changes in their reserve position the whole question of monetary policy is raised. That goes beyond the scope of this memorandum.

CONCLUSIONS

1. Business spending offers at present the most effective method of avoiding severe business recession.
2. Funds for business spending come from four sources,
 1. Cash on hand
 2. Current earnings
 3. New capital issues
 4. Bank credit.
3. Business concerns hold larger cash balances but not large enough for a large capital program. Willingness to spend cash depends on ability to recoup.
4. The present tax on undistributed profits penalizes the use of current earnings for capital expenditure.
5. To make funds more freely available for business through the capital market the following proposals should be considered:
 - a. Specific action to relieve difficulties in the railroads, utilities, and building.
 - b. Revision of capital gains tax.
 - c. Modification of restrictions on buying of securities by "insiders."

d. Liberalization of Federal Reserve and

S. E. C. regulations.

6. Making bank credit available for business through bank investments would raise the question of monetary policy as affecting bank reserves, a subject beyond the scope of this paper.

Federal Reserve Bank of New York
November 17, 1937.

Chart brought up to date as of April, 1938.

FEDERAL RESERVE BANK
OF NEW YORK

November 17, 1937.

Dear Chairman Eccles:

In my letter of November 3rd, concerning the present business and credit situation, I referred, among other things, to the importance which should be attached to an improvement in the position of the railroads, and I stressed the help such improvement would give to a large area of the securities market, which is now most depressed, and on which savings banks, commercial banks and insurance companies are greatly dependent. What is true of railroad securities, of course, is true in some degree of practically all kinds of corporate securities found in bank and other investment portfolios.

When the decline in the securities markets reached serious proportions, we made a quick survey to determine the effect of drastically reduced prices upon the position of the most vulnerable member banks in this district. It has occurred to me that you and the Board will be interested in the results of this survey. It was made as of October 15th, and as, in the aggregate, there has not been much net change in security prices since that date, the survey results still give an approximate picture of the position of the banks included in the study. These were the banks having security portfolios equal to or in excess of 400% of net sound capital as shown by the most recent examination reports.

There were 173 such member banks out of a total of 777 member banks in the district. These 173 institutions held, in the aggregate and at book value, \$1,441,842,000 United States Government securities; \$343,746,000 other bonds, and \$23,215,000 stocks. Applying to their individual holdings the percentage changes in the most appropriate available security price indices, between the respective examination dates (running back, on the average, perhaps five months) and October

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15th, we were able to get some idea of the shrinkage in the quoted market value of their security portfolios and of the effect of this shrinkage upon the apparent capital position of each institution. Estimated in this way their aggregate holdings showed a decline of \$16,290,000 in market value of United States Government securities, and of \$65,240,000 in market value of other bonds and stocks. A summary of the findings in individual banks shows the following changes in the ratio of net sound capital to deposit liabilities:

Number of banks in group (investments in excess of 400% of net sound capital).....	173
Banks whose ratio of capital to deposits was below 10% before decline in security prices.....	48
Banks whose ratio of capital to deposits was below 10% after decline in security prices.....	141
Banks whose ratio of capital to deposits was below 5% before decline in security prices.....	2
Banks whose ratio of capital to deposits was below 5% after decline in security prices.....	22

Two aspects of this situation are of direct concern to us, the position of our member banks and the reactions of that position upon the capital or new issues market:

1. We estimate that the capital position of all of the institutions included in our study could be restored, so that the ratio of their net sound capital to deposit liabilities would be 10%, either by the bringing in of new capital or by recoveries in market values of securities, in the amount of \$23,160,000. We do not believe that private capital in sufficient amounts could now be found for investment in the stock of such banks, nor would we urge seeking it at this time. We understand that the Reconstruction Finance Corporation is making no new commitments for loans or investments in the preferred stock of banks. Restoration of a more appropriate capital structure for these banks, therefore, seems to rest largely upon a recovery in the value of their assets, which in turn

depends upon the completion of the present recession in business and a recovery in security prices.

- 2, These banks are not in a position, nor probably in the mood, to play the customary part of banks in helping to finance business through the new issues market. The data assembled for these banks indicate, as do other banking data, that many banks have tended to concentrate their security investments in United States Government securities, and that there has been some disinclination to purchase private corporate issues. There are various reasons for this tendency, but in some part it is due to the experience of the banks during the depression years, when many banks sacrificed or were led by necessity or by admonition of supervisory authorities to sacrifice corporate securities on a declining market, and thus to fix losses which subsequent recoveries in the market values of their securities would have erased. The effect of the tendency upon the maintenance of a healthy capital market is obvious.

Consideration of both of these aspects of the problem leads us to the belief that this is a time for the adoption of a reasonable and liberal attitude by bank supervisory authorities. In all the circumstances, it seems to us that the supervisory authorities could take the position, in examining security portfolios of banks, that no chargeoffs will be required because of market fluctuations in prices of securities which are paying their interest regularly, and with respect to which ultimate payment of principal, in accordance with the terms of the securities, is reasonably assured. Furthermore, it seems to us, they should try to avoid precipitating widespread liquidation of other securities at times when selling by banks will not only fix losses for the banks concerned, but will also further depress a weak market, and thus unfavorably affect the position of all banks. Unless some such formula is adopted, or unless there is a substantial and prompt recovery

#4.

Chairman Eccles,

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in market prices of securities, we are likely to be faced with a series of examination reports which place before us paper capital difficulties, which neither we nor the banks will be able to correct, and the existence of which may force or encourage further liquidation of securities and thus further impede the reopening of the private capital market.

Faithfully yours,

(signed) George L. Harrison

George L. Harrison,
President.

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

FEDERAL RESERVE BANK
OF NEW YORK

May 20, 1938.

Dear Chairman Eccles:

Last November I sent you two letters with supplementary memoranda setting forth our views about the depression and possible recovery programs. Since that time, the directors and officers of the bank have had many further discussions of these problems. We think it may now help to clarify our own ideas, and be of some possible assistance to the Board of Governors, to review the course of events during the past six months and to comment on the recovery efforts which have been made and the problems still before us.

The decline of the Board's index of production by about thirty per cent between last August and December was probably unprecedented, for so short a period. Since then the index has fallen only moderately, the figures being 117 for August, 84 for December, and 77 for April. The marked fall in security prices which accompanied the great decline in production came to an end in November and was followed for several months by a sidewise movement. But in March stock prices broke through the November low point. This renewed fall was variously interpreted. It was probably due in part to a growing realization that there would be no upturn of business this spring. By the advocates of a new spending program it was interpreted as confirmation of their fears that without such a program the decline of production and employment would be resumed. By the advocates of a policy of rapprochement between government and business, it was interpreted as the result of a growing

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conviction in the business community that no such cooperation could be expected.

On April 14 the President announced his recovery program consisting of a large increase in excess reserves by reducing reserve requirements and desterilizing the gold held in the inactive account; loans to industry by the Reconstruction Finance Corporation; continuation of work relief expenditures at the current level; and a renewed and enlarged program of public works. The policy of balancing the budget, which had been announced a year previously and repeated last October, was definitely abandoned.

It is difficult to measure what the immediate response has been to the announcement of this program or to estimate what its later effects will be. From the low point of March 31, there has been a recovery in common stocks of about 20 per cent, and this has been accompanied by a rise in prices of lower grade bonds, as well as prices of government and other high-grade securities more directly subject to monetary influences. But a day-to-day analysis would seem to suggest that much of the rise may have been in response to events not related to the monetary and spending program. On the other hand, the announcement of the program may have had some general effect by creating a mild inflationary expectation for the more distant future. The behavior of commodity prices has been much less encouraging. They have not shared in the recovery of security prices but have established new lows for the depression.

As I pointed out in my letter last November, our view has been that there are substantial reasons for hoping that this depression need not be a repetition of the last. The banking situation is stronger, though in need of constructive treatment as regards bank examinations and the capital position of banks along lines which both we and the Board have favored. There ought not to be a

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repetition of the credit collapse and the hoarding which were the main causes of the deflationary debacle of 1931-33; and it is interesting to note that the index of production is now down to about the point from which that collapse dragged it to much lower levels. The speculative condition in the security markets is also much better than in 1929. Probably most important of all, the outlook for potential need and demand for some kinds of durable goods, provided it can be made effective, appears to be greater than in 1929. For these reasons we continue to believe that, even though, as now seems very probable, there may be some further contraction of production in coming months, a recovery movement could be begun from roughly the current level if proper measures are taken.

The first question, therefore, is how effective the President's program is likely to be and how soon the effects will occur. On the purely monetary parts, I shall reserve further comment until later. As to the lending and spending features, one important question is whether the figures announced, aggregating over \$4,500,000,000 including the R. F. C. program already authorized, may not create an undue expectation, not only in the country but also in Washington, as to the amount of stimulation which can be given to the economy by these measures. How fast can this program be made effective? How much money, for example, will actually be spent or lent through these channels in the next year? Of the \$1,500,000,000 authorized to be loaned by the Reconstruction Finance Corporation, some authorities estimate that the actual loans made in the next year may not amount to more than \$300,000,000 to \$500,000,000; and judging by past experience, the public works program, despite the new device of non-interest loans, may not, within the next year, absorb over \$500,000,000 of the increased authorization.

There is thus a real possibility that the amount of stimulation toward recovery provided by this program during the next twelve months may not be very great. It is, of course, very probable that with the continuance of depression the

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budget would become further unbalanced, beyond these sums, by the further increase of relief expenditures and the decline of revenue. But the decline of revenue will occur mainly next year rather than in the present year. And concerning relief expenditures, the question may be raised whether they are not mainly a response to depression, rising only as depression deepens and employment declines, and serving thus more as a brake upon the forces making for further contraction of national income than as a positive expansive force.

The occurrence of this new depression has thrown significant light upon the use of fiscal policy as a compensatory mechanism. One lesson, which accords with experience in the monetary field, though presenting much more difficulty, is the importance of proper timing. The tapering of budgetary deficits should have begun sooner than it did, as we argued in the memoranda sent to the Board in the summer of 1936, and it should have occurred more gradually. The payment of the bonus in 1936 is, of course, the sort of occurrence which upsets all technical calculation, though it does show the difficulties of operating this kind of policy in a democracy; but quite apart from the bonus, there is the significant fact that no substantial reduction of expenditures was undertaken until the spring of 1937, when the boom was already over. Reliance was placed almost entirely upon the increase of revenue. Then there is the further complication that the social security taxes, which quite clearly had been devised without reference to their relation to the compensatory fiscal policy, have been permitted to operate in the new depression as a major deflationary force. At the present juncture, we face a new timing difficulty, in that the new spending program cannot act fast enough to provide an early corrective for depression.

One further important lesson from this new depression is that fiscal policy can be nullified by the behavior of prices and wages, and that indeed it tends to intensify, unless adequate preventive steps are taken, the price and cost movements which defeat it. We therefore welcome the President's proposal for a thorough

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study of monopoly practices and tendencies in industry, but think it ought clearly to include equally a study of similar tendencies in organized labor. The rise of wages and prices in these sectors of our economy in the winter and spring of 1936-37 seems to us a major cause of this depression.

For reasons such as these, the difficulties of timing changes in policy and of achieving results with sufficient promptness, the effects upon costs and prices, the limitations imposed by the political processes of a democracy, and the limitations imposed by the effects of deficit financing upon the interest rate structure and upon the character and composition of bank assets to which we have referred in our previous memoranda, we are increasingly inclined to believe that too much reliance ought not to be placed upon compensatory fiscal policy as the single or main corrective for depression.

It therefore appears to us, and this was the chief point of my earlier letters, that the main problem is still that of finding the means of providing more direct encouragement to private enterprise and investment, in part through specific measures, and in part by creating an atmosphere more conducive to business confidence. Indeed, whatever may be the merits or the limitations of the program announced by the President last month, I think it is increasingly recognized that it must be supplemented by, and must in large measure be dependant for its success upon, a program which will further encourage private initiative and employment.

Some progress has already been made. The amendments to the Federal Housing Act appear to have had a moderately helpful effect on residential construction, which may be increased later on under more favorable economic conditions. The tax revisions, as finally agreed upon in Congress, will, we think, have a salutary, though probably not an immediate, effect upon business and investment, partly because of the nature of the revisions themselves and partly because they represent a concession of the kind which the business community itself has most strongly and

uniformly emphasized as necessary to its proper functioning.

The President's call upon all parts of the community to cooperate for recovery, his recognition that such cooperation is essential to the success of the new program, the evidences which have since appeared that there are important forces in both government and business seeking to promote a better understanding of mutual problems, and finally the indications that a way may be found to clarify the relations between public and private industry in the utility field are all, it seems to me, encouraging signs that this kind of solution is now being sought. In connection with the utility problem, it would seem important that care be taken that the solution being sought is not nullified by P. W. A. grants to municipalities under the new spending program.

There is no need to attempt a formal outline of a recovery program of this nature. Its elements, I believe, are now fairly generally known and agreed upon. Those already mentioned and some others were referred to in my letters last November. There is still needed, I think, some important revision of our tax system, including the placing of social security taxes on a pay-as-you-go basis, reduction of the schedule of surtax rates on incomes, and the removal of tax exemption on government securities as has already been recommended by the President. These revisions we regard as of more fundamental importance than those already made.

There is need for a clearer and more equitable determination of the responsibilities which should be imposed, upon labor as well as management, in collective bargaining. There is also a grave question whether the Wages and Hours Bill may not represent a serious confusion between reform and recovery considerations, so that provisions which from a longer run standpoint may be socially and economically desirable, may have harmful short-run effects. From this point of view may this not prove to be one further expression of the fallacy, which has never been clearly faced, that we can increase national income and employment by raising

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costs of production faster than efficiency and volume of production.

There is obviously a need, as we said in November and as has become increasingly more apparent, to find a solution of the railroad problem. In this industry, which constitutes a major segment of our economy, conditions are now worse than in the worst quarters of 1932 and '33, and it is becoming increasingly difficult to see how we can have a real and lasting recovery so long as we disregard the need of a thorough-going attack upon its problems, which appear to involve such fundamental questions as financial and physical reorganization, abandonment of non-essential mileage, equitable conditions of competition with non-rail transportation, a revision of the technical rules and conditions of work which have apparently become a serious obstacle to operating efficiency, reductions of wage rates as you suggested in your Atlantic City address and even probably of the numbers employed, and a thorough reconsideration of the tax burdens now resting on the industry.

Finally we think it very desirable to continue to explore, as I know you have been specially interested in doing, the ways in which government may offer financial aid, not in the form of a pump-priming program intended to work through consumers' incomes, but in the form of assistance to housing, railroads, utilities or other major industries, or in the form of economically desirable public investments of a kind which would not compete with private industry but on the contrary, would encourage that recovery of private investment upon which our economy fundamentally depends.

I have left to the end the consideration of purely monetary policy. In my statement last November I expressed the view that excess reserves were already adequate and that no change of monetary policy was called for. When the President announced the recovery program in April, excess reserves amounted to approximately one and a half billion dollars; there had been an upturn in bank deposits following the moderate decline which occurred in 1937, the quantity of deposits and

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currency was substantially above that of 1929, and interest rates subject to monetary influence were at a very low level. In these circumstances there did not seem to be any occasion for increasing excess reserves except possibly as a means of creating inflationary sentiment; and in this respect, as I have already stated, the effects do not appear thus far to have been very great. On the other hand, for the sake of this doubtful advantage, we have recreated some difficult problems for the future.

The new program will have the effect of increasing excess reserves to approximately \$3,800,000,000, which is well in excess of the previous high point. The immediate problem which this action presents is the rise in the prices of government securities and other highest quality obligations. Some Treasury bill issues are now on a no-yield basis, while prices of longer notes and bonds have been bid up in some instances to new record highs. There is thus presented the danger that at some later time we may have to face a renewal of the difficulties which appeared in the government security markets last spring. Mention must surely be made of the fact that even prior to this program increasing excess reserves, the Open Market Committee was endeavoring by switches in the portfolio to curb the rapid rise in government securities, which even then had been going on for some months. It was in the hope of making this policy more effective that I recently proposed to the Open Market Committee that, in view of the new program, authority should now be given to vary the size of the portfolio in order more effectively to exert our influence toward orderly conditions in the government security markets. Our responsibilities as a central banking system are just as great during a period of advancing security prices as during a period of declining prices. Too rapid or too prolonged a rise will surely increase the size and difficulty of the problem of central bank management on the subsequent decline, not to mention the problem of capital losses by member banks which will result from any substantial decline in the

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bond market.

Looking to the longer future, I think we must recognize that the handling of these large excess reserves will present much more difficult problems than those which had existed previously, problems, both of methods of control and of administration and jurisdiction, which raise too many questions for treatment in this letter but about which I hope to write you at some time in the future. But our immediate problem is clearly that of recovery from the depression in which the country now again finds itself, and it is in the hope that we may make some contribution to the solution of this problem that this letter is sent.

Faithfully yours,

(Signed) George L. Harrison

George L. Harrison,
President.

Honorable Marriner S. Eccles,
Chairman, Board of Governors
of the Federal Reserve System,
Washington, D. C.

BOARD OF GOVERNORS
of the
FEDERAL RESERVE SYSTEM
Washington

May 26, 1938.

Dear Mr. Harrison:

This is to acknowledge receipt of your letter of May 20th reviewing the course of events during the past six months and commenting on the recovery efforts which have been made and the problems still before us.

Your analysis indicates that we are much closer in accord than we have been on some occasions. In general, I am in agreement with what you have to say. However, with regard to the longer future, I doubt whether our thinking is running parallel, for I do not regard reduction of surtax rates as of fundamental importance.

On the contrary, I cannot agree that if you just keep the capital markets open you will get new production and consumption on anything like an economically and socially adequate basis under conditions now prevailing in this country and throughout the world. I would be interested to know whether you disagree with conclusions reached by a number of academic and professional studies, such, for example, as those by the Brookings Institution, which bring out very clearly, it seems to me, that we can no longer fall back on the assumption that as savings accumulate they will be put to productive rather than speculative use.

However valid this theory of automatic conversion of savings into productive enterprise may have been during most of our history when we had a relative scarcity of investment capital and borrowed a good deal of it from abroad, I cannot escape the conclusion today that our problem is very different and that we are faced with the necessity for maintaining a much better balanced relationship between the three factors of savings, consumption and capital formation. I recognize that recoveries in the past have characteristically been led by new capital investment and I am fully in accord with the need for keeping the capital markets open, but this is not enough at this juncture in our economic development, as I see it.

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You could remove all of the so-called inhibitions and scrap most of the taxes on capital and it would not, in my judgment, automatically flow into desirable new production unless tariff and trade barriers were removed, the foreign debts cleared away, industry and agriculture put on an equal footing, and monopolistic practices of organized industrial and labor groups broken up. In other words, in a free world economy or a free competitive market, it seems to me theoretically possible at least that conditions might be re-created under which capital formation would, as has been the case in the past, lead the way to recovery by going into production and thereby giving employment. Much as that permanent road appeals to me, as a practical matter these days I see no very encouraging hope of traveling that way fast enough.

The alternative, as I see it, is that the government will be compelled in the end to maintain a high rate of taxation, including not only retention of the surtaxes but a broadening of the entire tax base.

The prevailing conditions which I mention include the slow rate of increase in the population, restricted immigration, the disappearance of the frontier in the west and south, and restricted world trade due to tariffs and quotas, exchange controls and fluctuating currencies. Confronted with these factors, I cannot help but feel that it would be to the interest of capital to advocate such taxation on a broad income tax base as would in effect sustain buying power and thus make for a sustained and expanding production. This, in turn, would serve not only to protect existing capital investment, but also to provide a productive and profitable outlet for accumulated private savings.

The idea is by no means new or untried, for we have an example of its application in England and some of the other capitalistic democracies, where taxation has been applied in such a way as to make possible various public expenditures which in turn tend to maintain a reasonably even flow of purchasing power and thus to keep production at continuously high levels. It seems to me that this is very much in the interest of the capitalist because he is better off in the end since the products of the mill and factory continue to find a market and the return in profits to the

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owner of capital, after paying high income taxes including surtaxes, is far greater than would be the case if the economy were allowed to generate speculative and other unbalanced conditions leading inevitably to the closing down of plants and the depreciation of investment.

I realize, of course, that the execution of such a policy would have to be very skillfully managed and well timed, and that there must be at the same time every encouragement for the employment of capital in new production—that there must always be an ample supply of funds for that purpose. Likewise, I have felt all along that fiscal and monetary policy should go hand-in-hand and that taxation should be keyed at all times to encourage new production and, accordingly, that taxes on consumption certainly should be reduced or removed in depressed times.

I cannot go along with the idea, however, that there is any shortage of investment funds now and that surtaxes should be lifted for that reason. If the purpose of lifting them is to encourage capital to go into new enterprise, then it seems to me you are approaching the problem from the wrong end and that the lack here is not of capital but of ability of the general public to take off existing inventories, let alone new production in any important volume.

This subject is too ramified and complex to be dealt with adequately by letter, but I felt that I could not pass it by entirely in reply to your summation, with which, as I have said, I am generally in accord as far as it goes.

Sincerely yours,

(Signed) W. S. Eccles

W. S. Eccles,
Chairman.

Mr. George L. Harrison, President,
Federal Reserve Bank of New York,
New York City.

WAC 1604 12-1-55
FEDERAL RESERVE BANK OF NEW YORK

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June 9, 1938.

Dear Chairman Eccles:

I have read your letter of May 26, in reply to mine of May 20, with great interest. I am delighted that we are so much in accord with respect to current recovery problems, though I feel you have misconstrued our reference to income tax revision. I had not intended in my letter to deal with the longer range future, with which much of your letter is concerned.

What the valid conclusions for policy are in this complex field is still, we feel, very much an unsettled question. We plan to do some further work on it, and if we reach conclusions which we feel may be helpful, we hope to send them to you later.

Faithfully yours,

(Signed) George L. Harrison

George L. Harrison,
President.

Hon. M. S. Eccles, Chairman,
Board of Governors of the
Federal Reserve System,
Washington, D. C.

FEDERAL RESERVE BANK OF NEW YORK

March 4, 1939.

Dear Chairman Eccles:

In the discussion at the recent meeting of our board of directors, which you attended, I mentioned the fact that for some weeks we had been reviewing our ideas on fiscal policy and recovery. As you will recall, we sent to the Board of Governors letters and supplementary memorandums, explaining our views on this subject, in November 1937 and May 1938. The presentation of the President's budget message in January of this year, and the public discussions of recovery policy which have ensued, have seemed to us to offer an appropriate opportunity for a re-statement of our views, in the hope that they might be helpful in the formulation of a recovery program. A memorandum of our present views is enclosed.

I will not attempt to summarize the memorandum, which we have tried to make as brief as possible, but I do want to stress its main conclusions and the conclusions reached by our directors in discussing it. Briefly, we believe, as we stated in our earlier communications, that it is important that there should be relatively less emphasis and reliance on public spending, and a more positive program of encouragement to private investment; that effective encouragement of private investment at this time involves concerted action by the Administration on a positive program, and not merely individual statements of recognition of the importance of private investment. Finally, we believe that the effectiveness of present public spending and the prospect of encouraging private investment

2.

Chairman Eccles,

March 4, 1939.

will be substantially increased by a fiscal program which looks toward a gradual approach to a balanced budget, through the tapering off of expenditures as well as through an increase in receipts, instead of a fiscal program which relies mainly upon an automatic balancing of the budget when full recovery is achieved.

In recent weeks there have been indications of a growing realization of the need for such a well-rounded program, and of a growing recognition that public spending, by itself, cannot be relied upon to produce a full and lasting recovery. We wish to urge that such a program be pressed forward and we would be glad to cooperate, by any means within our power, in helping to formulate it in more detail and in putting it into effect.

Faithfully yours,

(Signed) George L. Harrison
President.

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

Enc.

*On 4 March 1939, I
have received in reply
to this letter.*

In December, 1937 and May, 1938, this book sent to Mr. Coolidge, as Chairman of the Board of Governors, letters and memoranda setting forth our views about recovery. The recent discussions of budgetary policy and the presentation to Congress of the budget estimates for the fiscal year 1940 are desirable, we feel, some further expression of our views.

Undoubtedly, most thoughtful people agree that some underbalancing of the Federal budget was an unavoidable necessity of the great depression. The decline of revenue from \$4 billion to \$2 billion between 1929 and 1932 as the national income was falling from \$61 billion to \$40 billion, the need of a governmental loan program to sustain the banks and other institutions, the unemployment relief problem and the growing impoverishment of the state and city governments, which made them less able to maintain their previous expenditures, to say nothing of carrying this added burden, the condition of agriculture with falling prices and large fixed debt charges, - these are other aspects of the depression provide, we believe, a convincing explanation of the necessity of some amount of deficit.

In refutation of this view, the point is often made, and it has been referred to in recent discussions, that England came through the depression with a balanced budget, and virtually no increase of expenditure until the adoption of the new armament program in 1936; and that England has had a larger and a better sustained recovery than we have had. But we must recognize some important differences in the economic experiences of the two countries during the past decade. The depression in England was less severe. Security speculation had been more moderate and the ensuing fall of security prices was less destructive. The absence of a banking collapse and the existence of a well-developed system of unemployment relief both helped to prevent deflation from going so far as in this country. The decline of agricultural prices, far as a major evil, gave England cheap imports. Finally, and of special importance, England had had no

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building boom since before the war and was able to achieve recovery, in large part, through building activity whereas our recovery between 1933 and 1937 was marked by an almost complete absence of expansion in building.

These are adequate reasons, we think, why the budgetary experience of England in the past decade cannot be taken as proof of our error in permitting budgetary deficits. We think it must be conceded also - taking our current economic situation as we find it, with a new depression just behind us and the outlook still unclear - that those who now insist upon the necessity of a substantial deficit for the fiscal year 1940 have a reasonably strong case. But recognition of the depressing effects of a sudden and drastic reduction of the deficit does not mean that no steps should now be taken toward balancing the budget, even though it be true that with a hoped for national income of \$60 billion, revenue would increase sufficiently, under the present tax structure, to cover expenditures at their present level.

After ten years of deficits, without as yet a satisfactory recovery, there is a growing feeling, we believe, that the time has come to put the main emphasis for recovery elsewhere than on public spending. This was the chief point of our earlier letters, which expressed our fear that a new spending program, unless accompanied by other measures such as we outlined, would be interpreted to mean that we were taking the easy and avoiding the hard way, and might lead to a progressive loss of confidence in our ability to achieve a genuine recovery within the framework of our existing institutions. We believe that at the present time one effective means of indicating to the country that public spending is not regarded as the sole or the main reliance for recovery would be to embark now upon a carefully considered program designed to effect a moderate and gradual decrease of expenditures and increase of revenue.

The essential issue today is not between fiscal orthodoxy and compensatory fiscal policy. Surely no one who favored deficits on theoretical grounds contemplated ten years ago that by July, 1940, we would still have a deficit,

that the expenditures of this year and next would be the highest of the entire decade, exceeding even those of the year (1938) in which the soldiers' bonus was paid, or that for the entire decade the yearly revenues would average only sixty per cent of the expenditures, and this in spite of the fact that the revenue had been tripled since the bottom of the depression, with new taxes imposed and tax rates raised, and is now about 60 per cent greater than in 1929 though the national income is about 25 per cent less. No amount of reference to our ability to bear debt, or to achieve an eventual automatic balancing of the budget through recovery of national income to a "normal" level actually achieved only in the late twenties adequately disposes of these facts.

There is an inescapable human tendency to rationalize experience, and it is not surprising, under such conditions as those of the past decade, that we have found ourselves progressively shifting our ground. When the deficits first began they were clearly not the product of any conscious policy, but simply of the great decline of revenue during the depression. The expenditures of the Reconstruction Finance Corporation, begun in 1932, were not conceived in terms of any theory of compensatory spending, and even the relief expenditures were not regarded, in their inception, as primarily a recovery measure. For at least a year after March, 1933, the main emphasis for recovery was on monetary measures, especially the devaluation of the dollar, and upon the B.R.A. program which was later abandoned. But as the deficits continued, despite substantial increases in revenue, and as interest in other recovery measures waned, the "pump-priming" theory came increasingly into vogue. This theory, in the earlier versions, implied that the net public spending would be comparatively small, or at any rate would last a comparatively short time and it contemplated not only deficits in depression but surpluses in prosperity, with an even balance for the business cycle as a whole. Now, with a new depression and a new spending program, less in heart of "pump-priming" in the more limited sense, and practically nothing in heart of surpluses, now that expenditures have mounted to more than

double their level in the late twenties. The proponents of public spending now find themselves defending the proposition that the budget can eventually be balanced if the national income recovers to the highest level it has ever previously attained, and that any attempt to balance the budget before that level is reached would do more harm than good.

There are today various schools of thought which rationalize our experience of long continued deficits in terms which suggest they may last much longer or should be even larger. Different writers emphasize different things: chronic over-saving, a contracting economy with insufficient outlets for investment, a growing rigidity of our economic system. Pessimistic forebodings of this general nature have been characteristic of every major depression of the past hundred years, and no one could in the past, or can now, say how correct they might prove to be. But as the President said in his message, though with perhaps a different meaning, we are indeed working against the clock; if we would continue to have substantial deficits and should not achieve a satisfactory recovery within a reasonable period, arguments would not be lacking to explain and defend this further failure, and no one can say what the next phase of our experience might be.

Summing up our present attitude, it is our belief, even more strongly than when we sent our earlier communications, that one of the chief lessons to be learned from our experience during the past decade is that it is unwise and unsafe to place reliance upon deficits as the main instrument of recovery, if such reliance has in practice the effect of diverting attention from specific problems and conditions retarding private investment, in the comfortable assurance that it is possible to "spend our way out of depression", to use the popular phrase.

There has been much reference in recent years to "lack of confidence". It seems to us indubitable that there has been a serious, and in many respects an unnecessary, impairment of confidence, and that it has been two-fold, a lack of confidence by business in government and by government in business. To a

considerable extent, we believe, the continuance of deficits has brought the result and the symbol of this actual loss of confidence.

We, therefore, attach great importance to the statement in the President's message to Congress that the major reform program, with much of which we have been in sympathy, can now be regarded as completed; and the outline of the specific problems to be solved, which was contained in that message, is similar to that which we have advocated in our earlier communications. That we now advocate is that a program of encouragement to private investment be actively pressed forward, and we add the suggestion that it should be accompanied by a fiscal program which, without producing sudden or drastic changes, would nevertheless give clear evidence not only that we expected within a reasonable period to achieve a balanced budget, without relying entirely upon an automatic balancing when full recovery is reached, but also that we have now some confidence that recovery can be attained by other means than deficits.

If progress can be made with this kind of recovery program and mutual confidence between government and business restored, we believe that the prospects for recovery through private employment and investment are now as favorable as at any time since the great depression began. Of fundamental importance is the potential demand for durable goods. It seems noteworthy that building activity, which contributed little to the recovery from 1933 to 1937, declined in the new depression relatively less than general business, and has responded relatively better than production in general to the resumption of recovery since the middle of 1938. Moreover, many of the weaknesses and excesses which were responsible for the worst aspects of the great depression, and without which it probably is not possible for this country to sink to such a low level, have been removed or greatly improved. The banking structure is definitely much stronger, and security and other forms of speculation have been moderate. The labor difficulties, which played a major part in bringing on the new depression in 1937,

appear to have greatly lessened and to offer a good prospect of a constructive solution through modifications of the National Labor Relations Act and further experience with its administration. There is some evidence of a more favorable attitude toward public utility investment if the conflict in that area can be resolved, and there appears to be a more general appreciation by all interests of the need for a fundamental solution of the railroad problem. With respect to taxation, business and investment sentiment have undoubtedly been improved by the virtual abandonment of the undistributed profits tax and the modifications of the capital gains tax; and the Administration has given evidence of its desire to improve the relative attractiveness of private investment by recommending the removal of tax exemption from public securities and by suggesting further study of taxes with a view to encouraging private investment.

With respect to fiscal policy, we feel it needs a much more detailed and objective analysis than it has yet received before it is possible to form a mature judgment of its usefulness and importance, relative to other means of attempting to achieve economic stability at a high level of income and employment. Much has been written in recent years on the monetary aspects of expenditure, but the economic effects of taxation remain, even in the theoretical literature, almost a virgin field. Even the monetary theory of expenditure, despite the growing volume of literature, remains highly controversial ground.

Of actual experience there is little to turn to besides our own. Reference is often made to Sweden as a country that has so managed its budget as to have deficits in the last depression and surpluses in the ensuing recovery. The facts are that it did so manage its ordinary budget, though the amount of unbalance was only about one per cent of its national income as against five to ten per cent here. But on the other hand, it incurred a net debt in its so-called capital budget in every year, whether of depression or recovery; and its total budget position was one of deficit in every year. Thus, Sweden is sometimes

cited to prove that we can have a truly compensatory business cycle budget, and at other times to prove that we need permanent public spending or investment to make up for the inadequacy, under modern conditions, of outlets for private investment. And at the same time, the Swedish economists themselves agree that their recovery was due mainly to depreciation of the krona when England went off gold; and admit that their budgetary experience has been mainly useful as preparation for future policy, though which it is of the two quite different lessons referred to above that they have learned, they are perhaps not altogether clear.

England is sometimes referred to as a country which has been able to maintain a high degree of economic activity, within a balanced budget, by means of a structure of revenue and expenditure which stimulates and sustains consumption without impairing either the supply of funds available for private investment or the willingness to invest them. We suspect that the superiority of the English fiscal system over ours is exaggerated and that the main reasons for England's more favorable experience in the past decade are those already mentioned, along with the fact that the relations between government and business have not involved the mutual impairment of confidence. This is, however, an interesting and significant approach to the fiscal problem, because it stresses the need of studying the economic effects of different types of expenditure or revenue, rather than relying upon the more purely quantitative and rather mechanical type of solution through budgetary deficits.

From our own experience it is doubtful what conclusions can be drawn beyond those already mentioned, but an intensive study would, of course, embrace many questions of technical character, which cannot be considered in this memorandum. There are, however, two aspects of the problem which seem to us especially pertinent to the views we have already expressed. One is the political aspect. Can a compensatory fiscal policy be operated in a democracy, with sufficient flexibility and sufficient freedom from special interests and political consid-

derations of whatever sort, to achieve the desired economic objective? Is it possible, for example, in a democracy to reduce expenditures as well as to increase them or to raise tax rates and impose new taxes as promptly and effectively as the policy may require? The payment of the bonus in 1936, is, of course, the sort of occurrence which upsets all technical calculation, though it does show the difficulties of operating this kind of policy in a democracy; but quite apart from the bonus, there is the significant fact that in the long recovery period from 1933 to 1937, no substantial reduction of expenditures was undertaken until the spring of 1937, when the recovery was already over.

The other, and related, question is that referred to earlier, whether in practice a compensatory fiscal policy would result in surpluses as well as deficits or would achieve a balanced budget only at some level of national income so high as to suggest boom conditions or, at any rate, to present "bottle-neck problems" of the kind in evidence two years ago. This is the question which we must now face, if we rely upon an automatic balancing of the budget through recovery of national income to a level of \$80 billion. During the last recovery, we argued for a gradual tapering of the deficits. Had that policy been pursued and had fiscal policy been supplemented by other measures of the kind that we suggested in our previous communications, it is possible (always excepting the bonus) that the boom conditions of 1936-7 and the depression which followed might have been avoided. We are now embarked upon a new recovery. Must we not consider seriously whether budget balancing by the "automatic" method may not again be a prelude to a new depression and a new series of deficits?

MINISTÈRE DES FINANCES

LE MINISTRE

Paris, le 23 Mars 1939.

Monsieur le Ministre,

J'apprends, par mon Attaché Financier, l'appréciation favorable que vous avez bien voulu porter sur l'oeuvre de redressement financier accomplie depuis quelques mois par la France.

Je n'ai pas besoin de vous dire combien je me réjouis de voir nos efforts appréciés aux Etats-Unis alors que les circonstances rendent plus que jamais indispensable une étroite collaboration, dans tous les domaines, entre les deux pays amis.

Je retiens avec grand intérêt votre suggestion tendant, pour attirer l'attention de l'opinion américaine sur l'amélioration des conditions monétaires en France, à faire effectuer

Mon Excellence Monsieur MORGENTHAU
Secrétaire d'Etat au Trésor.
WASHINGTON.

S.S.A.

...

quelques transferts symboliques d'or de
Etats-Unis en France. Mais, comme vous
même, je pense qu'il est préférable
d'attendre que les remous provoqués par
les récents événements se soient un peu
apaisés.

Je suis particulièrement sensible
à l'esprit de collaboration amicale
dont s'inspire votre suggestion et je
vous prie de vouloir bien agréer, avec
mes vifs remerciements, l'assurance de
ma très haute considération.

A handwritten signature in dark ink, appearing to read 'M. Reynaud'. The signature is fluid and cursive, with a large initial 'M' and a long, sweeping tail.

Translated by M
Division of Mon
April 12, 1939

read ~~the~~ ^{Wed}

The Honorable Mr. Morgenthau,
Secretary of the Treasury,
WASHINGTON,
D.C.

Ministry of Finance

Paris, March 23, 1939

Dear Mr. Secretary:

I have learned through my Financial Attache of the favorable appreciation you have kindly conveyed of the work of financial recovery which France has accomplished in a few months.

There is no need for me to tell you how much I rejoice in seeing our efforts appreciated by the United States at a time when more than ever circumstances render indispensable a close collaboration between the two friendly countries in all spheres.

It is with great interest that I retain your suggestion aiming at having some symbolic transfers of gold from the United States to France effected in order to draw the attention of American opinion to the improvement in French monetary conditions. But, like yourself, I think it is preferable to wait for the eddies provoked by recent events to have calmed down a little. I especially appreciate the spirit of friendly collaboration which inspires your suggestion and I ask you kindly to accept, with many thanks, the assurance of my highest consideration.

(signed) P. Reynaud

His Excellency Mr. Morgenthau
Secretary of State at the Treasury
Washington
U.S.A.

Translated by Mr. S. Adler
Division of Monetary Research
April 12, 1939

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S. A. SA:lrs
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