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9:30 group meeting.

November 9, 1939

Present:

Mr. Hanes
Mr. Gaston
Mr. Foley
Dr. Haas
Dr. White
Mr. Harris
Dr. Viner
Mr. Stewart
Mr. Bell
Mr. Thompson
Mr. Graves
Mr. Cotton
Mr. Cochran
Mr. Duffield
Mrs. Klotz

HM,Jr: I have to do my homework here, if you don't mind. I'll read this now. (Memo from Mr. Foley to HM,Jr, letter from HM,Jr to President and proposed message to Congress separating FCA from Agriculture and restoring it as an independent agency.)

Do I have to read your memorandum, Ed?

Mr. Foley: No, sir.

HM,Jr: What does your memo say?

Mr. Foley: It discusses the agencies involved.

HM,Jr: Should it go with this to the President?

Mr. Foley: No. The message that accompanies the letter explains the plan of reorganization.

Mac has been over there. It's all right with Mac.

HM,Jr: Good!

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Mr. Foley: And it has been cleared with Peyton Evans over at FCA.

HM,Jr: I am seeing you (Hanes) at eleven.

Mr. Hanes: Is the Chinese fellow coming in?

HM,Jr: Yes. He made his speech and got half way through. Told him to talk to Cochran; that it was in his backyard. Getting around to borrowing some cash to help their exchange. Told him it was useless. Would give them all we could from Export-Import, that's all we could. Had a very satisfactory talk with White. White had promised \$100,000,000 to stabilize their exchange. I said it wasn't enough.

Herbert, all set?

Mr. Gaston: Almost. Do my homework today.

HM,Jr: Alsop and Kintner coming at 2:15?

Mr. Duffield: Yes.

HM,Jr: You (Gaston) might be here at 2:15 too, because I don't want to tell them what you did on the BREMEN; much rather have you tell them.

Mr. Gaston: I have forgotten; can't tell them very accurately.

HM,Jr: Ed, did you come back to the office after you left me?

Mr. Foley: Yes, sir.

HM,Jr: I was afraid you did that.

Mr. Cochran: Sterling went down to 3.91 in New York yesterday. It's 3.87 $\frac{1}{2}$ in Amsterdam.

HM,Jr: I have left and that's Hanes' and White's responsibility.

Dr. White: Got to have an understanding on that matter before you go.

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HM, Jr.: Is that so! I am gone. I am full of time tables.

Dr. White: I will wait until it comes around to my turn.

Mr. Cochran: I won't start anything else!

HM, Jr.: Cotton?

Mr. Cotton: Nothing.

HM, Jr.: Do you (Viner) want to bring up this matter of a hat pool?

Dr. Viner: I am not going to speculate any more. Besides it sounds too risky.

HM, Jr.: Viner said I would be on the phone twice a day and I told him if he was a fair sport to take up a hat pool and I bet I won't call up ten times.

Dr. White: On the latter part I will take your side.

HM, Jr.: All right. I think I will manage it. Sounds better.

HM, Jr.: I know if McReynolds was here he would take the whole thing.

Dr. Viner: In any case, if Harry insists on getting an understanding I will take it.

HM, Jr.: You work it out on the pari-mutuel. It's legal in New York. I am sure Mrs. Klotz will come in with two chances.

Dr. Viner: She has to or we won't know whether you phoned or not.

HM, Jr.: She has to make up her mind which side she is on.

George?

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Dr. Haas: Nothing.

HM,Jr: George, don't send me any more memorandums for at least ten days on how the bond market is.

(To Mr. Harris) You might, I think it would be nice inasmuch as I think you have the only Treasury authority down there in Nogales who ranks -- does Customs rank the Border Patrol or vice versa? -- there is a fellow, they tell me, at Nogales by the name of Captain Edwards. I don't know whether he's the top fellow. He might like to know I get in at 6 something, 6:29, tomorrow morning at Tucson. But you have the only fellow down there, whether it's border patrol or customs or whoever it is. God being willing!

Mr. Harris: O. K.

HM,Jr: You all straightened out on your ships; your twenty ships?

Mr. Harris: (Laughs) Why that industry has been kicked around so, they can stand a few more.

HM,Jr: I talked to Huntington Cairns last night about ten and he said he and the Attorney General are drawing up -- he and Judge Townsend are drawing up a memorandum. Has that gone over to State?

Mr. Foley: Really, Mr. Secretary, it isn't ready yet. We are still working on it.

Mr. Gaston: I think the regulation has to come out under the authority of the State Department.

Dr. White: That industry has more money per capita than any industry in the United States.

Mr. Harris: I am on your (HM,Jr) side. Let's gang him.

Mr. Hanes: I have been in it^a/long time and never saw anybody get anything out.

HM,Jr: All right, children. Now were we were?

Dr. White: We were 3.87, Sterling.

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HM,Jr: What do you want to know?

(To Harris) It's moving, isn't it?

Mr. Harris: Yes. We all agreed it's up to the State Department. I think the Attorney General will pass on it in the next five or six months.

HM,Jr: Which way is he going to pass?

Mr. Harris: Against it, undoubtedly.

Dr. White: Trouble about Sterling.

HM,Jr: You want to stand up?

Dr. White: I may have to. The amount of transactions which are being conducted are far in excess of what the commercial needs might be, so that it is possible we don't know, without further information. It is possible that all commercial transactions are being conducted at the unofficial rate which means -- in other words, so far as we are concerned, the significant rate is dropping and while you are away it may go -- don't know, and we would like to know ahead (a) how far we want to let it go without saying something; (b) I would like to suggest we ask for information right away, to indicate our interest and also to get some further information.

HM,Jr: All right. Tell you what to do. You, Viner, Stewart, get into a huddle and come back here at three o'clock today and see Hanes and I will be here at three o'clock. White (1), (2) Stewart, and (3) Cochran and come back, I hope with a program, but if not, an alternate program and Hanes and I will see the four of you and I think you might consider inviting Feis in, or at least be here at 3 o'clock. Have him up to date and I think it might be a good idea to bring him into the picture.

Dr. White: Also the Legal Division, did you say?

HM,Jr: Oh, absolutely! How can we live without them! If we need any publicity, Gene Duffield will handle it. Butterworth may even be here by that.

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And you are going to talk with these two gentlemen not only what we can do about Colombia and Mr. Hanes will call a meeting if and when you fellows need one or he feels it is necessary.

Dr. White: There is a meeting at 11 o'clock.

HM, Jr: These two gentlemen are available for consultation.

Harold?

Mr. Graves: Nothing to say except that I have not been able to think of anyone better qualified than the man you called me about last night.

HM, Jr: Kansas City, that is. You have not been able to think of anyone better qualified than he?

Mr. Graves: No.

HM, Jr: Well, you have ten days to still think about it.

Mr. Graves: I have a great deal of respect and admiration for that man.

HM, Jr: Who was our man who actually worked with him? Who is the Treasury fellow?

Mr. Graves: Hartmann, special agent, St. Louis.

HM, Jr: I would bring him here. He worked with them. I think it's a great advantage to have the fellow who worked with the Treasury people.

Mr. Graves: It occurred to me that this man's availability might be affected by the venue of the case.

Mr. Foley: He would have to get out, and this is big enough for him to resign.

HM, Jr: Is it?

Mr. Foley: Sure! Or maybe a satisfactory leave

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of absence could be arranged whereby at the end of six months or a year he would go back to that job, but if that could not be arranged, if he's the right fellow, it's big enough for him to want to resign and handle this. Certainly can be paid more and make a bigger reputation.

HM, Jr: But you are very much sold on him?

Mr. Graves: Yes, indeed!

HM, Jr: Did he build up a good staff around him?

Mr. Graves: You mean in his own office? I don't know.

HM, Jr: He certainly was under terrific pressure politically.

Mr. Graves: Yes, he was. And of course he had done a good deal on election fraud cases in Kansas City, apart from this case, that were very well done.

HM, Jr: Milliken is the man we are talking about. He did narcotic cases subsequently.

Mr. Graves: I did not know about the narcotic cases in Kansas, but if there were he did.

Mr. Gaston: Two or three newspaper men here know Milliken very well.

HM, Jr: Dan?

Mr. Bell: I have nothing.

HM, Jr: You ready to defend yourself against the Comptroller General at ten o'clock?

Mr. Bell: Oh, I guess so.

HM, Jr: What do you mean you guess so?

Mr. Bell: Ed and I have not been together.

HM, Jr: Well, for gosh sake! get together. You

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have ten minutes.

Mr. Bell: You knew the Federal sold about seven or eight hundred thousand yesterday so the market went up pretty fast and as soon as they sold a few blocks stocks went off a little.

HM, Jr: Net sales?

Mr. Bell: Yes.

HM, Jr: Are they selling particular securities? Any great demand or just sell ad lib?

Mr. Bell: The Federal Reserve Bank in New York has a lot of flexibility in their operation and only sell where there is great demand. I think they are operating all right as long as they leave it in their hands.

HM, Jr: Norman?

Mr. Thompson. I have nothing.

HM, Jr: For the benefit of the gold players, I expect to be back a week from Monday morning.

Could that fellow that we had at the house from Commerce -- after all this is business; we have never done this before -- be helpful on the Sterling thing?

Dr. White: Domeratzky? Not he, but they have a man who could be. New man. Just took him from Harvey Gilbert.

HM, Jr: For team play, if he's a good man and you agree, why not bring Commerce in on this?

Dr. White: I think we will have to bring his Chief, who is Thorpe.

HM, Jr: I am leaving it in your hands. I think for team play it's a good move.

Dr. White: I think it is important and you ought to act through the Acting Secretary.

HM, Jr: Well, Hanes will take care of it, but I think here is Sterling and the question of commerce, I mean I like my idea of bringing somebody in. If you want somebody he will call up Noble and say we have this idea -- it's new, my idea -- we want to work closely with them and send somebody over.

oOo-oOo

November 9, 1939
2:03 p.m.

HMJr: Hello.

Operator: Go ahead.

HMJr: Hello.

Jesse Jones: How are you?

HMJr: Jesse?

J: Yeah.

HMJr: I want to add a wing to my cow barn. Can I borrow 3 thousand dollars?

J: You bet you can.

HMJr: O. K.

J: Where are you going? I understand you're going away.

HMJr: Yeah. I'm going out tonight to a place called Tucson, Arizona.

J: Good.

HMJr: Where they tell me it -- the mail is only delivered three times a week.

J: Yes, sir. Well, are you going to be gone some time?

HMJr: Ten days.

J: Well, you'll have a nice time.

HMJr: I think so. Everybody says it's nice.

J: Yeah.

HMJr: The people are nice, good weather.

J: Are you going on a ranch or are you going to a hotel?

HMJr: No, we're going to a ranch.

J: Going to a ranch.

HMJr: Yeah. Mrs. and I.

J: Who's going with you?

HMJr: My wife.

J: I see. Where's your boy?

HMJr: My boy?

J: Yeah.

HMJr: Henry?

J: Yeah.

HMJr: I've got one boy in Chicago with Louis Brownlow.

J: I see.

HMJr: And I've got one boy at Amherst.

J: I see. Well the boy that I knew then is with Brownlow isn't he?

HMJr: That's right.

J: Yeah.

HMJr: When are you going to go away?

J: Well, I'm going along about the last of Thanksgiving, not the first.

HMJr: I see.

J: I'm due in Texas for that football game on the 30th day of November.

HMJr: Uh-huh.

J: And I want to go down there for about ten days then.

HMJr: Right.

J: I was in New York yesterday and

HMJr: Oh, did you?

J: And tried to make a little New Deal medicine.

HMJr: Uh-huh.

J: Talked about the good things that have happened, and so forth and so on.

HMJr: Good.

J: And they are numerous.

HMJr: Good.

J: Well, I just heard you are going away and I wanted to call you up and say.....

HMJr: Well that's nice, Jesse. Everything -- I think things will be quiet for a week or ten days.

J: Oh, I'm sure they will, Henry.

HMJr: And.....

J: I don't think you could have picked a better time.

HMJr: I -- I know I'm tired.

J: Yeah.

HMJr: Well, be good.

J: All right, and have a nice time.

HMJr: Thank you for calling.

J: Goodbye.

November 9, 1939
3:38 p.m.

Operator: Go ahead.

HMJr: Hello.

James
Farley: Have you got anything to report as to what happened to Hitler?

HMJr: (Laughs) Listen, can't you -- couldn't you fix the time bomb so it went off right?

F: Well, they didn't tip me in advance.

HMJr: I see.

F: What are you vacationing for? I see in the papers where you're going vacationing. You know, you're not tired or anything like that are you, brother?

HMJr: (Laughs) I'm -- I'm.....

F: You're not celebrating the result of Dutchess County, are you? (Hearty laughter)

HMJr: (Hearty laughter) You go to hell. I saw that the President had a fireside parade.

F: I called him up and I said, "Well now don't talk to me about the Supervisor, what about the Sheriff? You were going to elect a Sheriff."

HMJr: Yeah.

F: Well, he said he couldn't give me much of an explanation on that one, see? He was talking about the Supervisor in the Highway Commission. I said, "The hell with that; those are only cheap officers."

HMJr: Yeah. How are you, Jim?

F: Well, I'm all right. When are -- when are you going away, Henry?

HMJr: Tonight.

F: Well, how long are you going to be away?

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HMJr: Just ten days - I'll be back a week from Sunday. That don't sound long, does it?

F: Well, I think that's all right. I think -- meanwhile I'll try to hold the lines for you.

HMJr: Now Listen, what I want to know, which side is Wallace on?

F: Well, he's coming in in the morning and I'm going to try to find out.

HMJr: What?

F: (Laughs) In the morning I'm going to try to find out. I'm -- I just picked up "News Week" coming down in the train. According to Lindley I'm against the third term.

HMJr: You're against it?

F: According to the "News Week", yes. I'm turning.....

HMJr: Well, find out where Wallace is.

F: I'm trying to get everybody to come out against it according to Lindley.

HMJr: I see.

F: He -- he has a candidate, you know, in the person of your friend, Mr. McNutt. I don't know whether you know that or not.

HMJr: No!

F: Oh, yes, that's Lindley's.

HMJr: Is that Lindley's?

F: Oh, yes. Of course, he's for the boss, but after that he's for McNutt.

HMJr: Your old pal McNutt.

F: My old pal McNutt. The old captain man.

HMJr: Right.

F: What did you do with him? Did you give him the foot?

HMJr: (Laughs) I don't think the President could stand a combination of McNutt and Carmody.

F: Apparently not. Apparently not. Jesse -- Jesse had to suffer because of that.

HMJr: Right.

F: O. K. Well, take -- take care of yourself.

HMJr: Thank you, Jim.

F: Say by the way, you didn't just -- I'm not concerned at the moment but just out of curiosity now, I'm just going to -- did you do anything on that other thing I talked to you about about.....

HMJr: The report on -- what's his name, Foley?

F: Flynn -- Flynn.

HMJr: I left word that when it came to send it over to the President. It will be terrible.

F: Sure.

HMJr: On Flynn.

F: Oh, it's bound to be.

HMJr: And I'm just sending it over to the President.

F: Yeah, the thing to do is hold the whole thing until the first of the year anyway, I think.

HMJr: Well, I -- is -- that's what -- that's an appraiser, is it?

F: Yes.

HMJr: Well.....

F: If you made any move at all I think the thing to do would be to move Foley up and then if you have to move somebody in that.....

HMJr: I'll talk to Basil Harris about it.

F: Beg pardon?

HMJr: I'll talk with Basil Harris.

F: O. K.

HMJr: And Gaston.

F: O. K.

HMJr: Righto?

F: The smart -- the smart thing to do is to do nothing until the first of the year.

HMJr: Well, if we put Foley in there could we abolish the other position?

F: As far as I'm concerned you could.

HMJr: As far as you're concerned?

F: Sure. I don't want to know anything about it but it's all right with me.

HMJr: Well, if we put Foley -- there's one position up there too much.

F: If you put Foley in, if you want to abolish, that's your business.

HMJr: And then abolish the position of whatever the surveyor, I guess.....

F: I don't give a damn.

HMJr: What?

F: I don't care. I wouldn't be concerned.

HMJr: All right.

F: O. K., Henry.

HMJr: Thank you.

TREASURY DEPARTMENT

17

INTER OFFICE COMMUNICATION

DATE November 9, 1939.

TO Secretary Morgenthau

FROM Mr. Cochran

Mr. Knoke telephoned me at 10:05 this morning and mentioned the sharp drop which had taken place in sterling. At that hour he said the rate was somewhere between 3.82 and 3.79, after closing last night at 3.91. He said that of the order given him yesterday by the Bank of Rumania to sell \$612,000, he had sold yesterday \$240,000, retaining the balance which he will endeavor to dispose of today.

When I asked Knoke's opinion about this morning's market, he repeated to me his personal opinion expressed some time ago that ultimately, after the war, sterling will be much lower than it is now. Knoke believed, however that after the present special selling is over the rate may swing back toward or around 4.00. The special selling he referred to was that by Japan and Rumania. He agreed with me that part of the weakness today was psychologically resulting from: (1) the realization that with the Neutrality Act having been passed disbursements by the British Government on this market will increase and augment the strain on sterling and (2) the German threat of early attack, possibly through Belgium and the Netherlands. Knoke told me that he would be speaking with Bolton later in the morning.

At 10:15 I met with the economists and the question of sterling was discussed. When I returned to my office at 10:45 I telephoned Knoke. He said that he was to phone Bolton at 11:45. I told him that we were anxious to know the results of his conversation, but offered no suggestions therefor. It was assumed that he would naturally get what information from Bolton he could in regard to sterling's weakness and British policy in relation thereto. Knoke will call me back after the conversation.

Knoke let me know that the Chase Bank had received last night another order to sell \$500,000 for Rumania. The Chase Bank stated this morning that its selling orders in sterling exceeded its buying order by \$400,000. Incidentally the Chase mentioned that the Rumanian Minister had visited that bank recently and intimated that his country would have to open large commercial credits in the United States. The belief was that since Rumania had obtained \$5,000,000 in credit from Great Britain to cover purchases on the British market, the situation had so changed that much of these purchases would have to be made on the American market, with a consequent requirement for dollars. At the hour Knoke spoke with me, Japanese sales of sterling were drying up.

It was Knoke's opinion that the greater part of British exports to the United States was invoiced in dollars and most of British imports from the United States invoiced in sterling. We know that grain and cotton bills are in sterling. Of course, the British control gives dollars against sterling on permitted exports.

B. M. R.

TREASURY DEPARTMENT

18

INTER OFFICE COMMUNICATION

DATE November 9, 1939.

TO Secretary Morgenthau

FROM Mr. Cochran

STRICTLY CONFIDENTIAL

At 4:45 on November 7, the Secretary telephoned me from the fact that he had discussed with the President at lunch the question of setting up a committee with representatives from the Army, Navy and Treasury Departments to report to the President, through Mr. McReynolds, in regard to the plans of foreign governments for war materials purchases in the United States. The Secretary told me that he would discuss this upon his return the following morning and that we would draw up a memorandum for transmission to the President. In answer to my report that both Pinsent and Leroy-Beaulieu desired an appointment for November 8 to present Mr. Purvis and Mr. Bloch Iainé, respectively, the Secretary instructed me to tell them that he would be glad to receive the two financial counselors at 3 o'clock on the 8th, but that they should come unaccompanied. That is, he desired to see only the usual representatives until this matter had been definitely straightened out.

By telephone at 5 o'clock, I told Messrs. Pinsent and Beaulieu that the Secretary would receive the two of them the following afternoon at three o'clock.

At the staff meeting on November 8, the Secretary instructed Mr. Graves and myself to meet that afternoon with Captain Collins and Mr. McReynolds in his office. At the afternoon meeting, the Secretary told us the plan which he had discussed with the President in regard to a liaison committee. He asked us to draw up a memorandum and submit it to him in finished form this morning for delivery personally by him to the President at 11 o'clock.

After the meeting, the four of us reviewed our conversation with the Secretary, and Mr. Graves drafted a paragraph thereon. I prepared two other paragraphs and then worked over Mr. Graves' paragraph and consolidated them into one memorandum which, after approval by Mr. Graves, was submitted by me to the Secretary this morning and received his signature. The Secretary delivered it to the President this forenoon.



TREASURY DEPARTMENT

19

INTER OFFICE COMMUNICATION

DATE November 9, 1939

TO Secretary Morgenthau

FROM Mr. Cochran

Mr. Irigoyen, formerly Financial Counselor of the Argentine Embassy in this city, called me from Buenos Aires at 12:45 noon today. He had no business to take up with us, but sought information with respect to the decline in sterling, the outlook for that currency, and the general situation in the United States, with particular reference to industrial activities, commodity prices and United States security levels. I gave such information as I had in what I thought an appropriately guarded manner.



TREASURY DEPARTMENT

20

INTER OFFICE COMMUNICATION

DATE November 9, 1939

TO Secretary Morgenthau
FROM Mr. Cochran

The sterling rate was again under pressure with the turnover in transactions exceeding the record established yesterday. In Amsterdam sterling was quoted at 3.91-1/4. The opening quotation in New York was 3.86-3/4. Shortly thereafter, it was reported that there was some small scattered selling. In addition to the selling reported, the Federal Reserve Bank of New York had \$367,000 representing the unexecuted balance of the Rumanian order received on November 8. The Chase Bank also reported that they received an order to sell \$500,000 at best from Rumania. The rate declined rapidly and about mid-morning was quoted at 3.77, the low for the day. After that good commercial buying came into the market and the rate steadily appreciated to 3.85 about mid-afternoon. It closed at 3.84-1/2.

The discount on forward sterling widened and was quoted as follows:

1 month - 1-1/8% per pound, discount = 3-1/2% per annum.
3 months - 4-1/2% per pound, discount = 4-3/4% per annum.

Rumania has sold in this market approximately \$2,400,000 since November 3. If their disposal of sterling should now be completed and no large selling orders are received, sterling, in all probability, will regain some of the loss which it sustained during this week.

Sales of sterling by the reporting banks in New York and the Federal Reserve Bank of New York totaled \$1,321,000 from the following sources:

Commercial concerns.....	\$ 142,000
Foreign banks (Europe, Far East and South America).....	\$ 812,000
Fed. Res. Bk. of N.Y. (For Rumania).....	\$ 367,000
Total	\$1,321,000

Purchases of sterling amounted to \$1,264,000, as indicated below:

By commercial concerns.....	\$ 693,000
By foreign banks (Europe, Far East and South America).....	\$ 571,000
Total	\$1,264,000

The banks also reported that the British Control purchased sterling amounting to \$66,000 at the official rate of 4.02. All of this sterling represented cotton bills.

CONFIDENTIAL

The French franc and the belga again declined. The guilder and Swiss franc were fairly steady. For comparative purposes, the closing quotations of the important currencies on November 2 and today are listed below:

	<u>NOVEMBER 2</u>	<u>NOVEMBER 9</u>
Sterling	4.00	3.84-1/2
French franc	.0227	.0218-1/4
Guilders	.5311	.5308
Swiss franc	.2244	.2242
Belgas	.1669	.1643
Canada	10% discount	11-1/2% discount

Acting on instructions received from the Netherlands Bank, the Federal Reserve Bank of New York continued to purchase guilders for it at a certain rate.

The Chinese yuan, during the past few days, receded from its recent high of .09-1/4 to .08-5/16 today.

We purchased from the National Bank of Belgium \$2,575,000 in gold from its earmarked account.

The Netherlands Bank advised us that it wishes to sell gold valued at \$3,500,000 on November 10 and \$11,600,000 on November 13, the gold to be released from its earmarked account. These transactions will be reported on the dates they are consummated. The Netherlands Bank has been a consistent seller of gold to us and these operations are to provide dollars in connection with their stabilization of the guilder.

We received, through the Federal Reserve Bank of New York, a request from the Central Bank of Argentina to purchase \$2,000,000 of gold to be added to their earmarked account, which request was approved.

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

\$5,000,000 from Japan, consigned to the Yokohama Specie Bank, San Francisco, for sale to the U. S. Mint at San Francisco.
 2,087,000 from South Africa, consigned to the Federal Reserve Bank of New York, to be earmarked for account of the Netherlands Bank.
 2,060,000 from the Netherlands, consigned to the Federal Reserve Bank of New York, to be earmarked for account of the Netherlands Bank.
 564,000 from Canada, consigned to the Royal Bank of Canada, New York, for sale to the U. S. Assay Office at New York.
 195,000 from Canada, consigned to Goldman Sachs & Co., New York, for sale to the U. S. Assay Office at New York.
 63,000 from England, consigned to the Chase National Bank of New York, for sale to the U. S. Assay Office at New York.
 \$9,969,000 Total

In New York we made five purchases of silver totaling 300,000 ounces under the Silver Purchase Act.

B. M. S. **CONFIDENTIAL**

FEDERAL RESERVE BANK
OF NEW YORK

73(0)

22

OFFICE CORRESPONDENCE

DATE November 9, 1939.

TO CONFIDENTIAL FILES

SUBJECT TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

FROM L. W. Knoks

1/ I called Mr. Bolton at 12:40 today. We had had a very hectic market, I told him, with sterling opening at 3.86, dropping to 3.77 and then recovering to the present rate of 3.82. Selling for Rumanian account had continued with about £700,000 in the market this morning, which were left over from yesterday's orders. In addition, selling orders seemed to have been received from South America and from the Far East; Japanese selling seemed to be drying up. Buying had almost been absent for awhile. Bolton inquired whether there had been any selling from Brazil. I replied "Not to my knowledge," but why did he ask. He replied that they understood that the Brazilians had come into possession of sterling recently. "I don't know whether we can do anything much about the market," Bolton continued. As regards the Rumanian selling, they were going to take the matter up with Rumania. I suggested that this selling might have to do with the British credit of May of this year but Bolton refused to think so. I stated that the market here certainly was disturbed and completely upset; that in a normal market today's selling would have been absorbed but in prevailing circumstances the result had been a break in the rate. This seemed to me unfortunate because I still believed that the selling was of a temporary character and that with a little buying the situation could have been corrected in a hurry. Bolton asked how much sterling in my opinion, was still hanging over the market and I suggested that might be in the neighborhood of £400,000. Bolton simply thanked me

FEDERAL RESERVE BANK
OF NEW YORK

23

OFFICE CORRESPONDENCE

DATE November 9, 1939.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

FROM L. W. Knoke

2

for the information. He could tell me nothing new at all as to conditions in Europe; Holland seemed to be getting worse. Regarding Belgium, they had no information today, not having been able to reach Brussels on the telephone. /

I referred to Bank of England's cable No. 1074 of November 8 which, as received by us, made no sense. We assumed, I said, that it contained advice to the effect that our account No. 2 with the Bank of England had been credited £612,500 by order of the Banque Nationale de Roumanie in Bucarest. Bolton, after looking into the matter, confirmed that our assumption was correct and I requested that they send us a new cable correcting their No. 1074. This he promised to do.

LWK:KW

HSM

PLAIN

London

Dated November 9, 1939

Rec'd 1 p. m.

Secretary of State,
Washington.

2318, November 9.

FOR TREASURY.

One. Another small increase in the note circulation by £406,000 is shown in today's Bank of England return which also reveals a heavy switch from bankers' deposits which declined from £12.9 million into public deposits which increased by £10.7 million while other accounts declined by £1.5 million. Government securities in the banking Department decreased by £3.1 million and other securities including discounts and advances by £292,000.

Two. The dullness of the gilt-edged and other stock markets yesterday and today is attributed to the implications of the Belgium-Dutch peace plea rather than to any effects of the national loans bill announcement reported in my No. 2305, November 8. War loan closed today at 91-3/4 having been over 92 two days ago.

KENNEDY

DDM

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Rome, Italy

DATE: November 9, 1939, 7 p.m.

NO.: 500

Reference is made to telegram of June 30, No. 243, from the Embassy.

Today announcement was made that the exchange guarantee of the Italian Government covering trade between Germany and Italy will again be available to exporters after the twelfth of November; this guarantee had been suspended the first of July.

The following is confidential: This action means that the debit merchandise balance has been reduced, and that the clearing between Germany and Italy will function as it did before. On the first of September, Italy reportedly had an active balance of as much as two billion lire. The clearing balance made up about five hundred million of this total. Evidently Italy thought, when Germany went to war, that it would be wise to restrict exports to Germany until there had been a reduction in the payment balance by Germany; they had been demanding cash for their exports since that time.

In view of the above-mentioned announcement, it would seem that Germany has found a way of reducing its adverse balance. That Germany has been exporting considerable quantities of coal to Italy is known; 300,000 tons, calculated

at

- 2 -

at a value of about 40,000,000 lire, has been exported to Italy in the last two months. The transfer of the German population out of the Upper Adige has probably brought about a substantial reduction in their debit balance; Italian authorities take over the property and goods of these Germans when they leave the region, and the value of such property and goods is applied to the credit of Germany. It is estimated by a reliable informant that to date about 300,000,000 lire have already accrued to Germany from this source.

The reopening of the clearing will to some extent stimulate trade between Germany and Italy, it may be taken for granted; nevertheless, there has not been any change in the basic factors, because the operation of the British control is making it difficult for Italians to supply substantial quantities to Germany even when cash payment in free exchange is made.

PHILLIPS.

EA:LWW

JI

PLAIN

Berlin

Dated November 9, 1939

Rec'd 9:30 p.m.

Secretary of State

Washington

2004, November 9, 4 p.m.

FOR TREASURY

In place of the usual decline in the bill portfolio which occurs the first week of the month the Reichsbank report for November 7 shows bill holdings of 9625 million marks as compared with 9358 million marks on October 31. The increase is assumed to be the result of banks taking advantage of their rediscount facilities in order to provide funds for the 500 million mark State railways loan subscriptions which opened and closed on November 3.

Contrasting with the increase in the bill portfolio the Reichsbank's holdings of eligible securities decreased from 1440 million marks on October 31 to 1218 million on November 7. As is usual the first week of the month the item "miscellaneous assets" declined, from 1874 million marks to 1628 million marks,

-2-2004, November 9, 4 p.m., from Berlin

marks, and the Reichsbank note circulation fell from 10819 million marks on October 31 to 10583 million on November 7.

The bank's hoard of silver coin which has been increasing due to the replacement of silver coin in circulation by one, two and five mark notes of the Rentenbank increased by 12 million marks to a new record figure of 344.8 million marks.

KIRK

ROW

0 11 13 1949
PER 1 10

JI

GRAY

Paris

Dated November 9, 1939

Rec'd 6:22 p.m.

Secretary of State

Washington

2707, November 9, 7 p.m.

FOR THE TREASURY.

Reynaud delivered his address before a large and enthusiastic audience which included several other cabinet ministers, our Ambassador, the Governor of the Bank of France, etc. The speech was more political than financial in nature and we presume it is being covered fairly fully in the American press. He began by referring to the well known progress made by France in the year since he last addressed the club, progress made necessary by the menace of war. "In fact" he said "it's a long time since we were really at peace". He then passed to the causes of the war - Germany's "return to the law of the jungle" - and referred to the events of the past several years beginning with the assassination of Dollfus and ending with the destruction

-2-2707, November 9, 7 p.m., from Paris

destruction of Poland. Hitler's request for a breathing space to digest his victims he said to (?) the French army a few months from now to a surprise attack which possibly leave the Nazis absolute masters of Europe could not be accepted.

(END SECTION ONE)

BULLITT

NPL

JI

GRAY

Paris

Dated November 9, 1939

Rec'd 6:29 p.m.

Secretary of State

Washington

2707, November 9, 7 p.m. (SECTION TWO)

War is a test of strength and France was prepared to make the sacrifices required. He said he doubted if we in the United States realized the extent of those sacrifices: five million men taken from their homes to fight, thousands of families forced to seek refuge in other provinces of France, the economic life of the country passing from a regime of peace to that of war, the imposition of heavy new taxes. "Many of you will be surprised if I tell you that the wage of a French soldier is one and a half American cents per day and even in the front line it is less than a quarter of a dollar. The wife of the French soldier with three children receives on the average fifty cents a day. France knows that new efforts are required

-2-2707, November 9, 7 p.m. (SECTION TWO) from Paris

required to replace her five million soldiers and to revive the economic life of the country to a maximum. This willingness to sacrifice is the certainty of victory. The recovery of yesterday in time of peace is the measurement of tomorrow's recovery in time of war". As an example of this recovery he gave the fact that the return of capital since the war in spite of "gigantic payments" has resulted in an increase in reserves of foreign exchange of one billion francs (our telegram No. 2587, October 26, 7 p.m.)

(END SECTION TWO)

BULLITT

NPL

LM3

GRAY

Paris

Dated November 9, 1939

Rec'd 6:12 p. m.

Secretary of State,
Washington.

2707, November 9, 7 p. m. (SECTION THREE)

After paying brief tribute (lip service) to the mutual cooperation and the pooling of resources between Britain and France, he turned to the United States. "America has declared herself neutral. All of you who are here at least know that if American neutrality is ever compromised, it will not be due to France or her allies. You know that it is not men that the French Republic and the British Empire need, it is arms, raw material, machinery. This poses a problem, that of exchange between our countries." He recalled our policy, of which the tripartite agreement was an evidence, of increasing the exchange of wealth between nations -- "one of the aspects of liberty". "What was true before the war is all the more true today. Let us not forget the recent lessons of the last war, the

' economic

LMS 2-No. 2707, November 9, 7 p. m., Sec. 3, from Paris.

economic crisis without precedent in history which it engendered. If in the present war we commit the error of allowing ships which have come full from the United States to return empty, we shall sow the seeds of a new post-war crisis. It is by French labor that supplies from America must in large part be paid. It is necessary for the well-being of both countries. It is not sufficient just to think of the war, we must also think of after the war.

(END SECTION THREE)

BULLITT

NK:NPL

LMS

GRAY

Paris

Dated November 9, 1939

Rec'd 7:22 p. m.

Secretary of State,
Washington.

2707, November 9, 7 p. m. (SECTION FOUR)

When peace comes, the legitimate economic needs of peoples must be taken into consideration. In the work of reconstruction, the role of your country will be great. I think that when we have real peace, reconstruction will be much more rapid than is generally believed. For the collapse of Europe's finances before the war -- with Germany at the head -- was due to enormous military expenditures. That and nothing else is why Germany economy was about to die when the war struck. Think of what would be possible for the well-being and health of peoples if the formidable mass of military credits could be turned to living works or to extend the social reconciliation of today."

In conclusion he reiterated that France in the words of Daladier and Chamberlain is at war today "because the aggressor, rather than give up his enterprise,

LMS 2-No. 2707, November 9, 7 p. m., Sec. 4, from Paris.

enterprise, preferred to renounce his own ideal after having renounced ours. France will not carry on the war imposed upon her by half-way measures. Our enemy has wished a total war. What we want and what we are determined to obtain is a total peace."

(END SECTION FOUR)

BULLITT

NK:NPL

PARAPHRASE OF SECTIONS FIVE AND SIX, TELEGRAM NO. 2707
OF NOVEMBER 9, 1939 FROM THE AMERICAN EMBASSY, PARIS

At the lunch our Bank of France friend was our guest. In strict confidence he told us that at an early date it is planned to ship considerable gold to the United States by the method described in telegram No. 2660 of November 5, the second paragraph. The steamships used in this way will constitute an important part of the convoy protecting airplane shipments on the way back. In strictest confidence we innocently learned that the Bank of France has been asked by the second country mentioned in the eighth paragraph of strictly confidential telegram No. 2316 of October 5 to receive the subject matter thereof - which is a highly significant reversal of the position of this country as set forth in that telegram.

The smoother operation of the exchange control system seemed to please our friend, as well as the easing up of the physical pressure with some of the personnel having been returned. During several days recently the fund had lost on balance, but it has continued to gain once more. After the fifteenth of November - the date on which are to be based the declarations of holdings abroad - he expects that the return of capital will dry up. Our friend remarked that sterling is unfortunately what is coming in for the most part.

Next to us at the lunch was Fournier. He told us that subscriptions to the armament bonds are coming in at a very satisfactory pace now. In this regard Fournier thinks that there

- 2 -

there will be some help from the publicity campaign which will be undertaken by the recently organized national committee. One of the slogans of this committee is that "an armament bond is a bank note which pays interest". With reference to our telegram of November 5, No. 2660: Fournier confirmed what we had been told by our friend as well as Rueff and Couve de Murville - that there is not likely to be any immediate upward bound in ^{French} payments for war purchases. He said that there would be a very gradual increase in payments, in view of the time lag between the placing of the orders, the manufacturing and so on, and delivery F.A.S. port of embarkation. Fournier said that as yet it is not possible to make even a general estimate of how much is involved or the rate of increase, since there are so many unknown factors depending on the tempo and the nature of the war, et cetera.

END SECTIONS FIVE AND SIX.

BULLITT.

EA:LWW

FAP

GRAY

PARIS

Dated November 9, 1939

Rec'd 7:27 p.m.

Secretary of State

Washington

2707, November 9, 7 p.m. (SECTION SEVEN).

The public is reminded by a communique issued today by the Bank of France that the bank directly as well as through approved intermediaries for transacting exchange operations is alone qualified to purchase gold in bars, ingots, et cetera, and French and foreign gold currencies, that the purchase price is 47,608 francs per kilogram for fine gold and that the value of coins will be calculated upon the same basis. It is also recalled that gold held abroad may be repatriated and that the services of the Bank of France may be utilized for this purpose.

(END SECTION SEVEN).

BULLITT

NFL

PAP

GRAY

PARIS

Dated November 9, 1939

Rec'd 7:30 p.m.

Secretary of State

Washington

2707, November 9, 7 p.m. (SECTION EIGHT).

Further, the public is informed that in order to facilitate exports of French products so urgently desired the Bank of France is itself prepared directly to discount or to accept for collection, bills of exchange and checks made out in foreign currencies; the public is informed that the branches of the bank will furnish all necessary information as concerns the currencies and the countries regarding which discount in foreign currencies is authorized. The communique adds that discount of bills of exchange in foreign currencies will be definitely calculated in francs based on the official rate of the day of negotiation.

Finally it is pointed out that the discount of bills of exchange expressed in foreign currencies will release exporters from all formalities with the Foreign Exchange Office, as the Bank of France will take the necessary steps to secure the passage of the relevant documents through the office.

HFD

BULLITT

NPL

JR

GRAY

Paris

Dated November 9, 1939

Rec'd 8:10 p.m.

Secretary of State,
Washington.

2707, November 9, 7 p.m. (SECTION NINE)

An arrete published in the Journal Official of today provides for the institution of a fund for the equalization of the prices of lead, zinc, antimony and cadmium. The stated object of this measure is to reduce important difference between (a) price of various imports of these metals and (b) the price of the same metals produced by local foundries selling on the basis of the price fixed by the Minister of Public Works. The value of imported metals will be based on the bills presented to this equalization fund and on relevant contracts.

The statement of the Bank of France dated November 2 published today shows the usual monthend changes. It also reveals however that the state has drawn on its authorized 25,000,000,000 franc advance for a further 2,300,000,000 to a total of 7,300,000,000. Commercial discounts are down 1,461,000,000 francs to 6,855,000,000. Advances against securities increased 87,000,000 and thirty day

-2- #2707, November 9, 7 p.m. (SECTION NINE) from Paris.

day advances were up 308,000,000. Note circulation increased 2,213,000,000 to a total of 147,000,000,000. Current and deposit accounts decreased 670,000,000. The Treasury account was up 14,000,000 to a total of 121,000,000. Open market operations showed a decrease of 35,000,000. The ratio of gold cover was 59.80 as against 60.35 per cent.

BULLITT

RR

PARTIAL PARAPHRASE SECTION TEN, TELEGRAM NO. 2707
OF NOVEMBER 9, 1939 FROM PARIS.

43

Deposits in Paris savings banks during the week ending November 4 totaled 12,790,000 francs and withdrawals 3,166,000.

Yesterday's weaker tendency on the securities market was evident again today. Rente issues were down from 50 centimes to one franc and variable revenue securities showed moderate losses. There is a general feeling here, shared by those with whom we talked today, that the invasion of Holland (and possibly Belgium though the feeling in this respect is somewhat divided) is but a matter of a few days. This feeling seems to be partly vindicated by what we learn confidentially of identified German troop concentrations - in particular the fact that Germany has concentrated her shock troops and main motorized divisions near the frontiers of Belgium, Luxemburg and the Netherlands. There is general belief here likewise that last night's Munich explosion was engineered by the Gestapo as a means of inciting German opinion against England.

The only change in official exchange rates was a further weakening of the belga to 724 - 730 as against the previous 728 - 724.

END MESSAGE.

BULLITT.

EA:LWW

COPY

THE WHITE HOUSE
Washington

November 9, 1939

MEMORANDUM FOR THE SECRETARY OF THE TREASURY:

One of the obstacles to the proper equipment of our country for national defense is the disparity between the rate of production of airplane motors and that of the airplanes themselves. This must be synchronized as soon as possible.

You are hereby directed to work out a policy of depreciation allowance by which the abnormal investment in plant expansion that will be required of the airplane motors manufacturers will be absorbed over the life of the contracts or during the emergency period.

You are further directed to consult with the appropriate committees of the Congress for the purpose of devising a permanent program whereby the facilities thus created will become a permanent part of the national defense.

(Initialed) F D R.

COPY

November 8, 1939

To: The Files
From: Mr. Hanes

Meeting in the office of Assistant Secretary of War Louis Johnson from 11:00 to 12:30. Present were: Under Secretary of the Treasury Hanes, Under Secretary of Commerce Noble, Assistant Secretary of War Johnson, Admirals Stark, Towers and Furlong, Colonels Byrnes, Rutherford and Schultz, General Arnold, and Mr. Green of State Department.

The first problem brought before the meeting was the recommendation of the Acting Secretary of Navy and the Assistant Secretary of War that the Munitions Control Board be augmented by representatives from State, Treasury and Commerce. Mr. Johnson said that this recommendation had not been approved by Navy Department as yet, but when it is he plans to send it to the President and request that the Committee be enlarged to five members, including Hanes, Johnson, Edison, Noble and Green.

The second item brought up for discussion was the terrific lack of coordination between the British and French in the matter of purchases. The British have refrained from placing orders in this country during the period of debate on the Neutrality Act, whereas the French have been making enormous orders for airplane engines with the Curtiss-Wright and the Pratt and Whitney Companies. We were told that our present capacity to produce airplanes in this country amounts to a total of 18,000 planes per year, and that our production of engines still falls short of this figure by about 6,000 motors a year. The task, therefore, is to get the motor manufacturers to increase their capacity to produce by a minimum of 6,000 motors annually.

I suggested that the problem seemed to me to be relatively simple because in the last analysis the motor manufacturers would not increase their investment in plant account and machinery for war purposes without having some assurance that this added investment could be written off completely through depreciation during the life of the contract or during the period of emergency. I, therefore, suggested to Assistant Secretary Johnson that the first step would be to have the President authorize the Treasury to conclude closing agreements with these manufacturers on the best basis possible.

On the morning of November 9th the President signed a memorandum, copy of which is attached hereto, which I prepared and brought to him authorizing the Treasury to proceed along the lines as suggested above.

Nov. 9, 1939

Neutrality Act, Atty Genl decides controversy
between State and Treas as to applicability
of Neutrality Act in favor of Treas; telegrams
to be sent to all Collectors of Customs

November 9, 1939

Memorandum to Pres recommending setting up
of com of representatives from Treas, War
and Navy, to report to Pres through McReynolds,
on purchase of war materials by foreign govts

(See page 117 of this volume)

MOVIE CASES

- (1) Memorandum to Secretary Morgenthau from Mr. Foley, dated November 7, 1939, outlining a summary of the procedure recommended by Mr. Foley, based upon reports submitted to the Secretary by the special advisers in the movie cases.

ANNENBERG INVESTIGATION

- (2) Memorandum to Secretary Morgenthau from E. H. Foley, Jr., dated April 14, 1939, informing the Secretary that Nationwide News Service is planning to sell its assets to a new corporation for the purpose of divorcing Nationwide News Service from the Cecelia Company to avoid possible anti-trust litigation by the Department of Justice.
- (3) Letter to Secretary Morgenthau from William J. Campbell, United States Attorney, Chicago, dated August 31, 1939, requesting that the services of Mr. Samuel Klaus in the Annenberg investigation be extended until after the trial of the cases.

THE BANK OF AMERICA

- (4) Memorandum to Secretary Morgenthau from Herman Oliphant, General Counsel, dated May 26, 1938, in reference to an attached suggested draft of a memorandum from the Secretary to the Acting Comptroller of the Currency, and an attached suggested draft of a letter to the examiner of the National Labor Relations Board advising him that confidential information can only be furnished by direction of the President, in reply to a request for information on items relating to the Bank of America.
- (5) A letter to Secretary Morgenthau from M. S. Eccles, Chairman, Board of Governors of the Federal Reserve System, dated December 22, 1938, enclosing for the Secretary's confidential information a copy of the attached memorandum, which was sent to the President for his comment. The memorandum relates to removal of the restriction of the bank holiday.
- (6) Memorandum to Secretary Morgenthau from Mr. Foley, Acting General Counsel, dated January 18, 1939, outlining, for his information, the gist of the Complaint in the Bank of America suit against the SEC.

- (7) Letter to the Secretary of the Treasury from William O. Douglas, Chairman, Securities and Exchange Commission, dated January 20, 1939, requesting copies of the rules and regulations which various Secretaries of the Treasury have promulgated with respect to disclosure of information contained in the files of the Treasury, and affidavit concerning the present and past policy of the Treasury with respect to furnishing such information to governmental agencies, such as disclosing information contained in the reports of an examination of a national bank.
- (8) Letter to the Secretary of the Treasury from William O. Douglas, Chairman, Securities and Exchange Commission, dated January 20, 1939, requesting an affidavit of the Comptroller of the Currency to the effect that he does not regard himself as authorized by law to prescribe the accounting methods and practices to be followed by national banking associations and the maintenance of their own books and records, for use in the suit instituted by the Bank of America National Trust and Savings Association to enjoin the Commission. "Request approved H. Morgenthau, Jr. January 21, 1939."
- (9) Letter to the Secretary of the Treasury from William O. Douglas, Chairman, Securities and Exchange Commission, dated January 27, 1939, requesting certified copies of the rules and regulations with respect to the disclosure of departmental information which have been promulgated by various Secretaries of the Treasury.

EUROPEAN WAR SITUATIONS

- (10) Memorandum to Secretary Morgenthau from Herman Oliphant, dated September 16, 1938, outlining the things which might be necessary for the Treasury to do immediately if a general European war breaks out.
- (11) Memorandum to Secretary Morgenthau from E. H. Foley, Jr., Acting General Counsel, dated March 21, 1939, in reference to the power of the Secretary of the Treasury, under Section 1 of the Espionage Act of June 15, 1917, 40 Stat. 220 (U.S.C., title 50, sec. 191), with the approval of the President, to make rules and regulations governing the anchorage and movements of

any vessel, foreign or domestic, in the territorial waters of the United States. It is stated that the proclamation and the regulations have been drafted and can be put before the President at any time.

- (12) Memorandum to Secretary Morgenthau from E. H. Foley, Jr., dated September 4, 1939, supplementing his memorandum of the same date, suggesting that as an alternative to the use of the American President Lines, Inc. there might be employed in the Normandie transaction as purchaser the Panama Railroad Company. A typewritten copy of the charter and by-laws of the company is attached.
- (13) Letter to the Secretary of the Treasury from George L. Harrison, President, Federal Reserve Bank of New York, dated September 16, 1939, acknowledging receipt of the Secretary's letter of September 15, referring to his earlier letter of September 6, requesting the bank to make available to examiners of the Securities and Exchange Commission certain documents filed, showing the amounts of short-term assets in Germany.
- (14) Memorandum to Secretary Morgenthau from Mr. Foley, dated October 30, 1939, in reference to the statement made by Senator Pittman on October 27 that the pending neutrality bill prohibited the making of loans to belligerent governments by governmental corporations, such as R.F.C. and the Export-Import Bank. Copy of statement from Congressional Record of October 27, 1939, p. 1655, attached.

COUNTERVAILING DUTIES.

- (15) Confidential memorandum to Secretary Morgenthau from F.D.R. stating "To speak to me about and in the meantime do what you can". Photostatic copy of a memorandum for the President from "C.H.", the Secretary of State, re present and prospective attitude of the Government of Italy toward the proposed imposition of countervailing duties by the Treasury, and photostatic copy of telegram to Secretary of State from Phillips, dated June 1, 1939.
- (16) Memorandum to Secretary Morgenthau from Herman Oliphant, dated November 23, 1938, re countervailing duties on German imports. Attached is proposed

letter to the Secretary of State; letter addressed to the Secretary of State from the Secretary of the Treasury, dated October 31, 1938, together with memorandum of law referred to therein; proposed letter to the President; copy of Secretary Hull's letter to the Secretary of the Treasury, dated November 19, 1938; proposed Treasury Decision.

STABILIZATION FUND

- (17) Memorandum to Secretary Morgenthau from Mr. Foley, Acting General Counsel, dated February 6, 1939, submitting an attached draft of a letter in the event that Senator Reynolds follows up his last request for information about the stabilization fund.

ECONOMIC ASSISTANCE TO LATIN AMERICAN COUNTRIES

- (18) Memorandum to Secretary Morgenthau from E. H. Foley, Jr., Acting General Counsel, dated March 8, 1939, in reference to the attached material relative to economic assistance to Latin American countries. Attached is copy of letter to the President from the Secretary of the Treasury, dated June 7, 1938, enclosing a copy of draft of bill; photostatic copy of memorandum to the Secretary of the Treasury from F.D.R., dated June 10, 1938, sent from Mr. Oliphant to the Secretary, concerning the President's memorandum of June 10; copy of memorandum dated November 3 from Messrs. Oliphant and White; copy of proposed letter to the President for the Secretary's signature.

PRIVATE CAPITAL IN PUBLIC HOUSING PROGRAM

- (19) Letter to the Secretary from Nathan Straus, Administrator, United States Housing Authority, dated December 2, 1938, in regard to proposal for enlisting private funds in the public housing program. Attached is memorandum to Administrator, United States Housing Authority.

R.F.C. BORROWING

- (20) Memorandum to Secretary Morgenthau from E. H. Foley, Jr., Acting General Counsel, dated January 17, 1939, outlining material with reference to borrowing by the R.F.C.

UNIFORM HANDLING OF IDENTICAL BILLS

- (21) Letter to the Secretary of the Treasury from Robert H. Jackson, Acting Attorney General, dated February 27, 1939, transmitting a revised draft of the proposed "Plan for Uniform Handling of Identical Bids for all Departments".

ADVISORY COMMITTEE ON ADMINISTRATIVE PROCEDURE

- (22) Letter to the Secretary of the Treasury from Frank Murphy, Attorney General, dated March 16, 1939, requesting that he designate a representative as a member of the Advisory Committee for each administrative board, agency, or commission under his authority.
- (23) Letter to Mr. Hanes, Acting Secretary of the Treasury, from Frank Murphy, Attorney General, dated April 4, 1939, acknowledging receipt of his letter of March 29, 1939, in which it was advised that Mr. E. H. Foley had been designated to represent the Treasury Department on the Advisory Committee in the study of administrative procedure.

MOUNT RUSHMORE NATIONAL MEMORIAL COMMISSION

- (24) Letter to the Secretary from Gutzon Borglum, Director, Mt. Rushmore National Memorial Commission, dated May 22, 1939, commending the work of Mr. Herman Oliphant, and making an appeal that his interest in the memorial be continued.

THE MEAD BILL

- (25) Memorandum to Secretary Morgenthau from Mr. Foley, dated June 5, 1939, discussing the views of Marriner S. Eccles, Chairman of the Board of Governors of the Federal Reserve System, with respect to the Mead Bill, as expressed before a Subcommittee of the Senate Committee on Banking and Currency.

EXECUTIVE REORGANIZATION BILL

- (26) Letter to Mr. Morgenthau from Sumner Gerard, dated March 11, 1938, urging defeat of Executive Reorganization Bill.

TAX REVISION

- (27) Memorandum to Secretary Morgenthau from Harman Oliphant, dated January 7, 1938, asking whether the

Secretary would want him to appear in case he is called before one or both of the Congressional committees concerning tax legislation.

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE November 9, 1939

TO Secretary Morgenthau

FROM Mr. Foley

Based upon the reports submitted to you by the special advisers in the movie cases and for the purpose of carrying out their recommendations, the following is a summary of the procedure which I recommend.

AS TO ZANUCK

A. Civil Action.

1. The Commissioner issue a notice of deficiency for income tax, with fraud penalty, due by reason of the receipt by Zanuck in 1935 of the 10 per cent excess stock in Twentieth Century-Fox Film Corporation pursuant to the merger.

2. If Zanuck petitions the Board of Tax Appeals regarding the assessment recommended above on the theory he received 30 per cent of Century's outstanding stock in 1934 (when he admits having received a 20 per cent interest in Century (20 shares) on which he paid a deficiency in 1936), and if the Board should believe Zanuck, then the Commissioner should issue a notice of deficiency for income tax, with fraud penalty, due upon the 10 per cent of stock (10 shares) received by Zanuck in 1934.

B. Criminal Prosecution.

1. Zanuck be prosecuted for making false statements or affidavits knowing the same to contain fraudulent or fictitious statements in connection with the investigation of his tax liability.

2. Zanuck be prosecuted for causing Kadis, an Internal Revenue Agent, to be bribed.

AS TO SCHENCK

A. Civil Action.

1. The Commissioner issue a notice of deficiency for income tax, with fraud penalty, due from Schenck for the year 1935 for taking a false deduction of about \$175,000 based on a loss resulting from a sham sale of stock in a Mexican corporation in December, 1935 to Roland West (then held on suspicion of the murder of Thelma Todd), Schenck arranging for a loan to West of \$50,000 to buy the stock which had paid over \$33,000 dividends in 1935, and later discharging West's debt.

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2. The Commissioner issue a notice of deficiency for income tax, with fraud penalty, due from Schenck for the years 1935, 1936 and 1937 for deducting large items as business expense which were clearly personal living or household expenses.

B. Criminal Prosecution.

1. Schenck be prosecuted for willfully attempting to evade or defeat income taxes.

2. Schenck be prosecuted for making false statements or affidavits knowing the same to contain fraudulent or fictitious statements in connection with the investigation of Zanuck's tax liability and the merger of Century with Fox.

3. Schenck be prosecuted for causing Kadis, an Internal Revenue Agent, to be bribed.

AS TO GOETZ

A. Civil Action.

Neither of the special advisers find any civil liability on the part of Goetz or on the part of the Mayer Family Trust. I agree fully.

B. Criminal Prosecution.

Neither of the special advisers makes any distinction between the criminal culpability of Goetz and Zanuck. I agree fully. Consequently, the discussion above concerning the criminal prosecution of Zanuck applies to Goetz. It is expected by those familiar with Goetz, however, that he will testify for the Government ultimately.

AS TO KADIS AND OTHERS

A. Civil Action.

No civil action is contemplated against Kadis at this time.

B. Criminal Prosecution.

1. Kadis should be prosecuted for colluding to defraud the United States, willfully neglecting to perform his duties, doing or omitting to do acts with intent to enable other persons to defraud the United States, and accepting money for adjusting alleged violations of law and related offenses.

2. Kadis should be prosecuted for willfully assisting in the preparation and presentation of false affidavits in connection with the respective stockholdings of Zanuck, Schenck and Goetz.

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AS TO A GRAND JURY INVESTIGATION

After being requested by you to re-examine the so-called movie cases, I submitted to you a "Statement of Facts" on November 1, 1939, in which the only argument made was to the effect that there ought to be a Grand Jury investigation for the purpose of detecting the true facts.

I now wish to renew this recommendation, with the further suggestion that it be conducted by the United States Attorney for the Southern District of New York.

Mr. Knollenberg is in accord with this recommendation.

Mr. Greenbaum is also in accord with this recommendation.

It is not the function of the Treasury Department to make definite and certain that particular persons have committed particular crimes against the Government before a Grand Jury investigation is made. In our legal system, examination of witnesses by a Grand Jury need not be preceded by formal charges against particular individuals.

It is my recommendation to proceed in accordance with this memorandum as soon as the Department of Justice returns the cases to us. Assistant Attorney General Sam Clark has indicated he expects to do this in the near future. When the cases are returned, our next move would be to reply outlining our proposed course of action and making recommendations concerning the submission of the criminal phases of the cases to the United States District Attorney in the Southern District of New York for a Grand Jury investigation.

E. W. H.

Approved:

THE RECOMMENDATIONS OF

Foley
Greenbaum
Knollenberg

ON THE MOVIE CASES

November 8, 1939

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TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE November 8, 1939

TO Secretary Morgenthau
FROM Mr. Foley

Based upon the reports submitted to you by the special advisers in the movie cases and for the purpose of carrying out their recommendations, the following procedure is recommended:

AS TO ZANUCKA. Civil Action.

1. The Commissioner issue a notice of deficiency for income tax, with fraud penalty, due by reason of the receipt by Zanuck in 1935 of the 10 per cent excess stock in Twentieth Century-Fox Film Corporation pursuant to the merger.

Comment. Mr. Greenbaum's memorandum of November 8, 1939, on page 3, §3, after referring to the disparity in the proportion of stock received by Zanuck, states: "Even in the absence of positive proof at the present time, I feel that under the peculiar and unusual circumstances in this case the Bureau should send Zanuck a notice of deficiency (90 day letter) in regard to his 1935 return."

Mr. Knollenberg's memorandum of November 8, 1939, on page 6, ¶1, states: "I think that there is ground for the view that the excess Fox stock was received by Zanuck as additional compensation for the services to be rendered by him to Fox under the employment contract entered into with Fox. Furthermore, if the affidavit * * * was true, there is strong ground for the view that the excess Fox stock was given to Zanuck in liquidation of an enforceable claim for additional Century stock which he had against Schenck and Goetz, in which event the excess Fox stock was received by Zanuck not in exchange for his Century stock, but for property, i.e., his claim against Schenck and Goetz."

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"I think that a deficiency should be asserted against Zanuck for 1935 based on the value of this excess Fox stock. The value of this stock doubtless exceeded 25 percentum of the amount of gross income as stated in Zanuck's 1935 return, and therefore an additional tax can be assessed, or a ninety day letter sent out, any time up to March 25, 1941 - even though no fraud charge can be maintained."

Statute of Limitations. The 3 year statute of limitations would have expired [I.R.C. §275(a)] but for a waiver which extended until March 15, 1940, the time for assessment. [I.R.C. §276(b)] This assumes the return itself was not fraudulent in which case the statute never runs. [I.R.C. §276(a)]

2. If Zanuck petitions the Board of Tax Appeals regarding the assessment recommended above on the theory he received 30 per cent of Century's outstanding stock in 1934 (when he admits having received a 20 per cent interest in Century (20 shares) on which he paid a deficiency in 1936), and if the Board should believe Zanuck, then the Commissioner should issue a notice of deficiency for income tax, with fraud penalty, due upon the 10 per cent of stock (10 shares) received by Zanuck in 1934.

Comment. Mr. Greenbaum's memorandum of November 8, 1939, on page 4, at the end of the 1st paragraph states: "If it be a fact that Zanuck did own 30 per cent of the stock prior to the reorganization, there must have been a taxable gain to him at the time when his interest was increased from 20 per cent to 30 per cent. No such gain has been reported by him and his tax liability for the gain is clear."

Mr. Knollenberg's memorandum of November 8, 1939, on page 7, ¶1, states: "It is conceivable that Zanuck may contend that the alleged right to receive the additional 10 percent of Century stock constituted additional income at the time that Schenck and Goetz promised him the additional 10 percent. If the promise was made in 1934, the statute would still be open (for reasons explained above in connection with 1935) without reference to the question of fraud. If the alleged promise was given before 1934, additional taxes could be collected only if it is possible to establish that Zanuck was

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fraudulent in failing to report income on account of the receipt of the promise for additional stock, in the year in which the promise was given."

Statute of Limitations. The three year statute of limitations has expired and no waiver has been executed by Zanuck; but, even in the absence of fraud in connection with the 1934 tax return, an assessment may still be made because Zanuck omitted from gross income an amount properly includible therein in excess of 25 per cent of the amount of gross income stated in his return. Because of this the statute will not expire until 5 years after the 1934 return was filed which would allow us until the spring of 1940. [I.R.C. §275(c)]

B. Criminal Prosecution.

1. Zanuck be prosecuted for making false statements or affidavits knowing the same to contain fraudulent or fictitious statements in connection with the investigation of his tax liability. [R.S. §5438, Crim. Code §35, as amended, 18 U.S.C. §80]

2. Zanuck be prosecuted for causing Kadis, an Internal Revenue Agent, to be bribed. [R.S. §5451, Crim. Code §39, 18 U.S.C. §91]

Comment. Mr. Greenbaum's memorandum of November 8, 1939, on page 2, ¶1, states: "Although these and the other known facts, some of which are referred to in Mr. Knollenberg's memorandum, are insufficient to establish the guilt of parties other than Kadis, they do furnish ample basis for a Grand Jury investigation, in which further evidence should be uncovered implicating those who gave the bribe"; and, again on page 4, ¶4, states: "It is recommended that criminal prosecution be initiated in the Southern District of New York and it is in connection with such a Grand Jury presentation under §35 that I feel that further evidence can be developed on the bribery charges against Kadis and others referred to above."

Mr. Knollenberg's memorandum of November 8, 1939, on page 6, ¶3, states: "Turning to the question of prosecution of Zanuck, I think there is not sufficient ground for criminal proceedings based on the view that he filed a false and fraudulent return for 1935. I am even inclined to think that there is not sufficient ground for asserting civil fraud. The whole question of whether stock received by an employee was to be

regarded as taxable income at the time received or at the time sold was still in the field of doubt in March 1936, and it is entirely conceivable that Zanuck was not acting in bad faith in having failed to return any taxable income on account of the receipt of the excess Fox stock", but goes on to say on page 9, ¶1: "There is considerable evidence that one or all of Schenck, Goetz and Zanuck were instrumental through Fox or Dover or directly in bribing Mr. Kadis in 1937 and 1938. It seems to me highly advisable that further evidence be sought on this point with a view to prosecution, probably in California."

Statute of Limitations. A three year statute of limitations applies to both the above crimes. [R.S. §1044, 18 U.S.C. §582] The statute will run on or about November 11, 1939, as to the alleged bribery in the Waldorf-Astoria in New York City; however, there is evidence Kadis was also bribed in Los Angeles in 1938. The false affidavits of Zanuck were also filed in 1938. If a Grand Jury investigation is conducted as herein recommended in the Southern District of New York, it is believed that sufficient information will be secured from that investigation to warrant the presentation before a Grand Jury in Southern California, and there is sufficient time for such an investigation.

AS TO SCHENCK

A. Civil Action.

1. The Commissioner issue a notice of deficiency for income tax, with fraud penalty, due from Schenck for the year 1935 for taking a false deduction of about \$175,000 based on a loss resulting from a sham sale of stock in a Mexican corporation in December, 1935 to Roland West (then held on suspicion of the murder of Thelma Todd), Schenck arranging for a loan to West of \$50,000 to buy the stock which had paid over \$33,000 dividends in 1935, and later discharging West's debt.

2. The Commissioner issue a notice of deficiency for income tax,

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with fraud penalty, due from Schenck for the years 1935, 1936 and 1937 for deducting large items as business expense which were clearly personal living or household expenses.

Comment. Mr. Greenbaum's memorandum of November 8, 1939, on page 5, under point 5, states: "In my opinion, there seems ample justification for an additional assessment against him [Schenck] by reason of the alleged loss of stock in 1935 and false deductions for 1935, 1936 and 1937. I likewise feel that the facts warrant a fraud penalty and criminal prosecution."

Statute of Limitations. A waiver extending the statute of limitations until December 31, 1939, has been executed by Schenck for the year 1935. The statute of limitations for the years 1936 and 1937 has not expired and waivers could be secured, if necessary, before an assessment is made.

B. Criminal Prosecution.

1. Schenck be prosecuted for willfully attempting to evade or defeat income taxes. [Revenue Acts of 1932 and 1934 §145(b), 26 U.S.C. §145(b)]

Comment. In addition to Mr. Greenbaum's recommendation that Schenck be prosecuted for income tax evasion (as quoted in the Comment next preceding), Mr. Knollenberg's memorandum of November 8, 1939, on page 9, ¶3, states that the case against Schenck "seems to be strong."

Statute of Limitations. The statute of limitations for income tax evasion is six years from the commission of the offense. [Revenue Act of 1932 §1108, 18 U.S.C. §585]

2. Schenck be prosecuted for making false statements or affidavits knowing the same to contain fraudulent or fictitious statements in connection with the investigation of Zanuck's tax liability and the merger of Century with Fox. [R.S. §5438, Crim. Code §35, as amended, 18 U.S.C. §80]

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3. Schenck be prosecuted for causing Kadis, an Internal Revenue Agent, to be bribed. [R.S. §5451, Crim. Code §39, 18 U.S.C. §91]

Comment. Schenck seems to be the chief malefactor. Schenck (with Zanuck and Goetz) had a written agreement to indemnify Fox for tax liability resulting from the merger. He may also have had a similar secret arrangement to indemnify Zanuck for any tax liability resulting from the excess shares of stock received by Zanuck. Schenck may also be motivated by the desire to conceal from Zanuck the fact that Zanuck did not receive in reality 30 per cent of the preferred stock in Twentieth Century-Fox.

Statute of Limitations. The statement on this point in connection with the discussion of Zanuck's criminal culpability (B, 2 as to Zanuck above) also applies here.

AS TO GOETZ

A. Civil Action.

Neither of the special advisers find any civil liability on the part of Goetz or on the part of the Mayer Family Trust. I agree fully.

B. Criminal Prosecution.

Neither of the special advisers makes any distinction between the criminal culpability of Goetz and Zanuck. I agree fully. Consequently the discussion above concerning the criminal prosecution of Zanuck applies to Goetz. It is expected by those familiar with Goetz, however, that he will testify for the Government ultimately.

AS TO KADIS AND OTHERS

A. Civil Action.

No civil action is contemplated against Kadis at this time.

B. Criminal Prosecution.

1. Kadis should be prosecuted for colluding to defraud the United

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States, willfully neglecting to perform his duties, doing or omitting to do acts with intent to enable other persons to defraud the United States, and accepting money for adjusting alleged violations of law and related offenses. [R.S. §3169, 26 U.S.C. § 1828(e)]

Comment. Mr. Greenbaum's memorandum of November 8, 1939, on page 2, ¶2, states that the advisability of proceeding under the section cited above against Kadis with a conspiracy charge so far as others are concerned should be considered because, as Mr. Greenbaum declares: "As stated in a memorandum of Elmer Irey dated October 30, 1939, the persons responsible for the bribery and the conspiracy should not should not escape punishment." Mr. Knollenberg's memorandum of November 8, 1939, on page 9, ¶1, also points out the advisability "that further evidence be sought on this point with a view to prosecution, probably in California."

The apparent failure of the present Grand Jury investigation to develop evidence of bribery can not be given much weight. In his memorandum of November 8, 1939, Mr. Greenbaum, on page 2, ¶3, puts the matter bluntly as follows:

"The original recommendation of the Bureau in this respect is fully warranted by the known facts. Although this task will be made more difficult by reason of the rather perfunctory Grand Jury investigation already made, the situation is sufficiently serious to warrant further action. The Grand Jury investigation only took one hour and twenty minutes, and consisted of calling two hostile witnesses whose testimony might have been helpful, but who were given the opportunity to see the Government's hand and to put white-washing denials in the record. In spite of this, it is recommended that further action be taken, and it is believed that this can be done in connection with the prosecutions hereafter recommended."

Statute of Limitations. The six year statute of limitations for certain crimes under the internal revenue laws applies to some of the offenses by Kadis referred to above. [Revenue Act of 1932 §1108, 18 U.S.C. §585] Even if the general three year statute of limitations for offenses against the United States applies, Kadis committed the same right up to May of this year when he was separated from the service. [R.S. §1044, 18 U.S.C. §582] Consequently, even though the three year statute will have expired on or about November 11,

1939 on the bribery alleged to have occurred in the Waldorf-Astoria in New York City on or about November 11, 1936, Kadis is still subject to prosecution on the bribery in Los Angeles alleged to have occurred in Mr. Goetz' office in 1938, and for his other unlawful acts as a Revenue Agent.

2. Kadis should be prosecuted for willfully assisting in the preparation and presentation of false affidavits in connection with the respective stockholdings of Zanuck, Schenck and Goetz. [Revenue Act of 1926 §1114(c), 26 U.S.C. §1693(b)]

Comment. Mr. Greenbaum's memorandum of November 8, 1939, on page 2, states: "Kadis actively participated in the preparation of [these] affidavits" which were intended to mislead the Government, and indicates that Dover (then Zanuck's business agent) was a participant. In addition, Nayfack (a nephew of Schenck who is also a lawyer in New York) also participated in the preparation of the false affidavits and both of them should also be prosecuted on this charge.

[N.B. There are other minor figures in addition to Dover and Nayfack who are involved in one or more of the alleged crimes but their criminal culpability has not been analyzed by me since they are only paid satellites of Schenck and Zanuck. A general charge of conspiracy to defraud the United States out of income taxes would appear warranted against Schenck, Zanuck, Goetz, Dover, Nayfack, Kadis and Moskowitz (who prepared Schenck's returns) and would bring in these other participants. (R.S. §5440, Crim. Code §37, 18 U.S.C. §88)]

Statute of Limitations. The statute of limitations for aiding in the preparation or presentation of false affidavits does not run until six years after the affidavit is filed and the time during which the person who commits such offense is absent from the District wherein the same is committed is not included as part of the time. [Revenue Act of 1932 §1108, 18 U.S.C. §585] The same is true of offenses involving defrauding or attempting to defraud the United States, whether by conspiracy or not, and consequently there is no problem relative to the statute of limitations on this phase of the case.

AS TO A GRAND JURY INVESTIGATION

After being requested by you to re-examine the so-called movie cases,

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I submitted to you a "Statement of Facts" on November 1, 1939, in which the only argument made was to the effect that there ought to be a Grand Jury investigation for the purpose of detecting the true facts. The third paragraph of page 4 of such Statement says:

"Were it not for the disproportionate distribution, the nontaxability of the reorganization would probably not be questioned. But this fact, considered in the light of such events as the withholding of Exhibit E from the plan of merger submitted for a ruling by the Commissioner of Internal Revenue, the attempts to conceal the telegraphic communications between Zanuck and Schenck showing the true nature of the transaction, the submission of apparently false and misleading affidavits to the Bureau of Internal Revenue, the obvious evasiveness of Zanuck and Schenck when questioned at the Department of Justice, the evidence of the bribery by Zanuck's former business agent of the Internal Revenue Agent who first found that Zanuck had failed to report his 1934 income properly, and similar indications of intent to conceal, warrants a grand jury investigation for the purpose of shedding more light on the criminal aspects of the case."

I now wish to renew this recommendation, with the further suggestion that it be conducted by the United States Attorney for the Southern District of New York.

Mr. Knollenberg is in accord with this recommendation. In his memorandum of November 8, 1939, on page 9, ¶4, he said:

"Although I would wish to give the matter further consideration before making a final recommendation my present view is that the case against Schenck for 1935 on account of items other than the Fox stock is so strong that the case ought to be presented to the Grand Jury in New York, where Schenck's income tax return for 1935 was filed. There is, however, no occasion to make an immediate decision on this point since the statute will not run for several years. In the course of the Grand Jury investigation on the 1935 return I believe that a great deal of other important matter may well be brought out, including evidence to support our belief that Kadis has been bribed by Schenck, et al."

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Mr. Greenbaum is also in accord with this recommendation. In his memorandum of November 8, 1939, on page 4, ¶2, he said:

"* * * Many of these acts occurred in New York, the place where Schenck and the Corporation filed their returns. It is recommended that criminal prosecution be initiated in the Southern District of New York, and it is in connection with such a Grand Jury presentation under Section 35 that I feel that further evidence can be developed on the bribery charges against Kadis and others referred to above."

And on page 6, ¶1, he also said:

"Although I do not agree that the known facts bear out the Bureau as to its contention that tax liability resulted to Messrs. Schenck and Goetz by reason of the reorganization, I do agree fully with the recommendations of the Bureau heretofore made that the facts called for criminal prosecution. Indeed, it seems to me that on the basis of the Bureau's investigation, it would have been derelict in its duty if it had not made a recommendation for action by the Department of Justice."

It is not the function of the Treasury Department to make definite and certain that particular persons have committed particular crimes against the Government before a Grand Jury investigation is made. In our legal system, examination of witnesses by a Grand Jury need not be preceded by formal charges against particular individuals.

The Grand Jury has always been, as the Supreme Court of the United States has declared:

"* * * a grand inquest, a body with powers of investigation and inquisition, the scope of whose inquiries is not to be limited narrowly by questions of propriety or forecasts of the probable result of the investigation, or by doubts whether any particular individual will be found properly subject to an accusation of crime. As has been said before, the identity of the offender, and the precise nature of the offense, if there be one, normally are developed at the conclusion of the grand jury's labors, not at the beginning." Blair v. United States, (1919) 250 U.S. 273, per Pitney, J. (underlining mine)

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It is my recommendation to proceed in accordance with this memorandum as soon as the Department of Justice returns the cases to us. Assistant Attorney General Sam Clark has indicated he expects to do this in the near future. When the cases are returned, our next move would be to reply outlining our proposed course of action and making recommendations concerning the submission of the criminal phases of the cases to the United States District Attorney in the Southern District of New York for a Grand Jury investigation.

E.H.Fh.

Approved:

Secretary of the Treasury

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Mr. Edward S. Greenbaum's
memorandum of recommendations

285 Madison Avenue,
New York, New York.

November 8, 1939

RE: JOSEPH M. SCHENCK, DARRYL F. ZANUCK, WILLIAM GOETZ, WILLIAM B. DOVER AND HARRY KADIS.

I concur in Mr. Knollenberg's memorandum dated November 8, 1939 but think it may be helpful to submit the following comments in amplification:

1. The bribery of Revenue Agent Kadis in November, 1936.

As stated by Mr. Knollenberg, the Department has not sufficient evidence at the present time to warrant an indictment for the act of bribery alleged to have occurred in November, 1936. However, this does not mean that no criminal action should be taken in connection with the bribery charge, including this specific act. The facts indicate clearly that Agent Kadis was bribed and warrant presentation to a Grand Jury. Such presentation should be as part of an investigation into other related matters, as hereafter indicated, and not as an isolated fact.

The following are some of the known facts presently susceptible of proof: Special Agent Kadis accepted substantial favors and gratuities from the taxpayers, including the use of a limousine automobile at a cost to Twentieth Century-Fox Film Corporation of almost \$3,500; he secured the employment by this company of a young lady of his acquaintance at a compensation of \$100 a week, which employment lasted for several years up to and including February, 1939; he was assigned to a further field investigation in 1938 and promptly notified Dover of this assignment,

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whereupon, Dover cabled Zanuck, who was then in Paris, that he had received a telephone call from Kadis, "our tax man New York", who explained that he had been assigned to the case and felt that this was an "unusually good break falling into his hands instead of others"; Dover, who was neither an attorney or tax expert secured a power of attorney from Mr. and Mrs. Goetz, who had their own counsel, and proceeded to New York for the preparation of affidavits; and Kadis actively participated in the preparation of these affidavits.

Although these and the other known facts, some of which are referred to in Mr. Knollenberg's memorandum, are insufficient to establish the guilt of parties other than Kadis, they do furnish ample basis for a Grand Jury investigation, in which further evidence should be uncovered implicating those who gave the bribe.

Consideration should also be given to the advisability of proceeding under I.R.C. Section 4047(e), R.S. 3152, so far as Kadis is concerned, and with a conspiracy charge so far as others are concerned. As stated in a memorandum of Elmer Irey dated October 30, 1939, the persons responsible for the bribery and the conspiracy should not escape punishment.

The original recommendation of the Bureau in this respect is fully warranted by the known facts. Although this task will be made more difficult by reason of the rather perfunctory Grand Jury investigation already made, the situation is sufficiently serious to warrant further action. The Grand Jury investigation only took one hour and twenty minutes, and consisted of calling two hostile witnesses whose testimony might have

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been helpful, but who were given the opportunity to see the Government's hand and to put white-washing denials in the record. In spite of this, it is recommended that further action be taken, and it is believed that this can be done in connection with the prosecutions hereafter recommended.

2. Failure to report taxable profit on exchange of Century stock for Fox stock in 1935.

I agree with Mr. Knollenberg that the reorganization did not result in taxable profit to Messrs. Schenck and Goetz. The criminal liability of Messrs. Schenck, Goetz and Zanuck will be discussed in item 4. The tax liability of Zanuck will be discussed in point 3.

3. Failure of Zanuck to report as taxable income the value of certain of the Fox stock received by him in 1935.

As pointed out by Mr. Knollenberg, Zanuck would have no taxable gain if the stock he received in the new company was in pursuance of the plan of reorganization "solely for" his Century stock. (Section 112(b)(3)). The documentary evidence as to whether part of this stock was actually received in return for other benefits, such as a more favorable employment contract, is not yet available for our examination. Disparity in the proportion of stock received is indicative that this may be the fact and, if established, would warrant the Bureau in asserting a deficiency against Zanuck for 1935. Even in the absence of positive proof at the present time, I feel that under the peculiar and unusual circumstances in this case the Bureau should send Zanuck a notice of

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deficiency (90-day letter) in regard to his 1935 return.

If this cannot be ultimately sustained, nevertheless, affidavits furnished by Messrs. Zanuck, Schenck and Goetz furnish basis for assessment in 1934. In these affidavits dated December 23, 1938, they state, under oath, that Zanuck owned 30 per cent of the old Century stock (I have not seen these affidavits, but assume that the excerpts furnished are correctly quoted). If it be a fact that Zanuck did own 30 per cent of the stock prior to the reorganization, there must have been a taxable gain to him at the time when his interest was increased from 20 per cent to 30 per cent. No such gain has been reported by him and his tax liability for the gain is clear.

4. Making a false statement in affidavits filed in 1938.

I agree that Section 35 of the Criminal Code is applicable but doubt whether conviction could be obtained if there was no original tax liability. For the reason stated above, however, I feel that such liability on Zanuck's part exists and if that be a fact then I recommend presentation to a Grand Jury of the evidence concerning the acts of Messrs. Schenck, Goetz and Zanuck and other persons whose acts may have violated the provisions of Section 35. Many of these acts occurred in New York, the place where Schenck and the Corporation filed their returns. It is recommended that criminal prosecution be initiated in the Southern District of New York, and it is in connection with such a Grand Jury presentation under Section 35 that I feel that further evidence can be developed on the bribery charges against Kadis and others referred to above.

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5. Schenck's liability on his 1935, 1936 and 1937 returns.

As pointed out by Mr. Knollenberg, there is strong evidence, wholly apart from the reorganization question, that Schenck filed fraudulent income tax returns for 1935, 1936 and 1937. This is the subject matter of a letter from the Bureau to the Department of Justice dated July 14, 1939. Although we have had no opportunity to go into this matter fully, my examination of the available papers indicates that in 1935 Schenck took a false deduction of \$173,228.33 on an alleged loss resulting from the sale of stock in a Mexican corporation. This stock was alleged to have been sold by him in December, 1935 for \$50,000, although in that year he received dividends of \$33,853 on that stock. The alleged purchaser of the stock apparently was without funds and Schenck provided him with funds to make the so-called payment of \$50,000. In this 1935 return, Schenck took deductions for expenses of which over \$28,000 seemed to be clearly false. Although his contract with the corporation entitled him to reimbursement for "reasonable traveling and living expenses while away from home" he made deductions in his personal return, for what he called business expenses and for such items as an automobile purchased for a lady friend, flowers, salary of his valet, personal barber, etc. In his returns for 1936 and 1937 similar deductions appear. In my opinion, there seems ample justification for an additional assessment against him by reason of the alleged loss of stock in 1935 and false deductions for 1935, 1936 and 1937. I likewise feel that the facts warrant a fraud penalty and criminal prosecution.

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General Comments

Although I do not agree that the known facts bear out the Bureau as to its contention that tax liability resulted to Messrs. Schenck and Goetz by reason of the reorganization, I do agree fully with the recommendations of the Bureau heretofore made that the facts called for criminal prosecution. Indeed, it seems to me that on the basis of the Bureau's investigation, it would have been derelict in its duty if it had not made a recommendation for action by the Department of Justice.

Although it may be beyond the scope of this memorandum, nevertheless, I am taking the liberty of making a further suggestion. It is my feeling that where the Bureau makes a recommendation for criminal action arising out of a tax situation, it should send notice of deficiency against the taxpayer prior to the institution of criminal proceedings. Such action should, of course, not be taken without consultation with those officials in the Department of Justice who will be charged with the responsibility of conducting the criminal proceedings.

I am cognizant of the difficulties in connection with the adoption of such a new procedure and understand the reasons why it has been long established policy to postpone such action until after the criminal proceeding. However, I feel that the Supreme Court's decision in the Mitchell Case overruling the Coffey Case eliminates

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many of the objections that heretofore existed. Prosecution without a prior assertion of tax liability furnishes the taxpayer with an opportunity to cry "persecution" by alleging that he is being criminally prosecuted without establishment of such liability and opportunity to pay. Such an argument might prove a weighty one before a jury in a prosecution under Section 35. It is believed that if the facts warrant an assessment, such an assessment should be made not only to remove the inference referred to above but also to make available the implications which would strengthen a prosecution under Section 35, and, indeed, any prosecution arising out of a tax fraud.

Respectfully submitted,

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Mr. Bernhard Knollenberg's
memorandum of recommendations

Yale University
Library (Librarian)
New Haven, Conn.

November 8, 1939.

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POSSIBLE CRIMINAL LIABILITY OF JOSEPH M. SCHENCK, DARRYL F. ZANUCK,
WILLIAM GOETZ, WILLIAM B. DOVER AND HARRY KADIS

Throughout the day of November 2, 1939, Messrs. Greenbaum, Knollenberg, and Messrs. Foley, Wenchel, Ireys, Oftedal and Kades, conferred concerning the possible criminal liability of any, or all, of Messrs. Schenck, Goetz, Zanuck, Dover and Kadis, with respect to the following questions:

1. Bribery of Revenue Agent Kadis in November, 1936.
 2. Failure of Schenck, Goetz and Zanuck to report taxable profit on exchange of Twentieth Century Pictures Corporation (hereinafter called "Century") stock for Twentieth Century-Fox Film Corporation (hereinafter called "Fox") stock in 1935.
 3. Failure of Zanuck to report as taxable income the value of certain Twentieth Century-Fox Film Corporation stock received by him in 1935.
 4. Making a false statement in affidavits filed in 1938 by Schenck, Goetz and Zanuck in a matter within the jurisdiction of the Treasury Department, namely the investigation of their income tax liability for 1935.
- These points will be discussed in the order named.

1. Bribery of Revenue Agent Kadis in November 1936.

Prior to August 22, 1935, Messrs. Schenck, Goetz and Zanuck owned all of the stock of Century in the following amounts:

	<u>Preferred</u>	<u>Common</u>
Schenck	35,000	40
Goetz	35,000	40
Zanuck		20*

In July, 1935 arrangements were made for a statutory merger of Century with Fox, and on or about August 22, 1935 Schenck, Goetz and Zanuck received for their Century stock the following shares of Fox stock:

	<u>Preferred</u>	<u>Common</u>
Schenck	55,000	214,000
Goetz	55,000	214,000
Zanuck	22,000	183,000

It is conceded that the value of the Fox preferred and common stock received by each of the Century stockholders was far in excess of the cost basis of his Century stock, and that, therefore, if the exchange was not a tax exempt exchange, a large taxable profit was realized. None of the Century stockholders reported any taxable

 * - These were the record holdings. As brought out later, Schenck, Goetz and Zanuck filed affidavits with the Bureau of Internal Revenue in 1938 stating that the beneficial ownership of the Century common stock in August, 1935 was 35-35-30 shares respectively.

profit on the exchange in their income tax returns for 1935 on the theory that the exchange was a tax exempt exchange under section 112(b)(3) of the Revenue Act of 1934 which was in force in 1935.

In 1936, Kadis, a Revenue Agent attached to the Upper District of New York, audited the 1935 income tax returns of Century and Fox, which were, I think, New York corporations, and, in some way not yet ascertained*, was assigned the duty of auditing the return of Schenck who filed his 1935 return in the Upper District of New York, and also the returns of Goets and Zanuck who filed their returns in the Los Angeles District.

On December 1, 1936 Kadis submitted his report on his audit of each of the individual taxpayers, in which he said:

"On August 22, 1935 the taxpayer exchanged all of his stock in the Twentieth Century Pictures, Inc., which name was changed to the S. G. Z. Corporation, for stock in the Twentieth Century-Fox Film Corporation in pursuance to a plan of reorganization which the Bureau held to be non-taxable. *** "

Mr. Kadis made no mention of the extraordinary fact, which his investigation must have disclosed, that Zanuck had received a considerably larger proportion of the total Fox stock issued to the Century stockholders than was representative of his proportionate stock holding in Century.

* - A complete story should be obtained as to how Kadis happened to have assigned to him the audit of each of these returns, including the Fox and Century returns.

It is believed that Kadis made no mention of this fact because he had been bribed by Dover to make a favorable report on or about November 11, 1936, when Kadis is known to have been alone with Dover in the latter's room at the Waldorf-Astoria in New York City. Dover is Zanuck's business manager and attends to his financial affairs.

There is no direct evidence whatsoever that Dover gave Kadis any money or property in November, 1936, or at any other time. There are various indications that Schenck, Goetz, and Zanuck, through Fox, or Dover or both, bribed Kadis in 1937 and 1938, but such bribery probably took place in California rather than in New York. The immediate question is whether the Department of Justice should be asked to have the United States District Attorney in New York secure an indictment of Dover and Kadis (and possibly Zanuck, Schenck and Goetz on the supposition that Dover was acting as their agent) on the ground that Dover paid, and Kadis received a bribe at the Waldorf-Astoria on or about November 11, 1936. There is a three year statute of limitations on the crime of bribery so that unless the indictment is secured before November 11, 1939, it would be impossible to indict Dover or Kadis even though it is definitely ascertained after November 11, 1939, that Dover bribed Kadis in the course of Kadis' visit to Dover at the Waldorf-Astoria.

It seems to me beyond the possibility of doubt that the Treasury Department does not have sufficient evidence of bribery in November, 1936 to request an indictment on that ground.

I understand that all at the conference agreed with this view.

2. Failure to report taxable profit on exchange of Century stock for Fox stock in 1935.

Section 112(b)(3) of the Revenue Act of 1934 provides:

"Stock for stock on reorganization. — No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

Messrs. Schenck, Goetz and Zanuck maintain that the exchange of their Century stock for Fox stock falls squarely within the exemption provided for by Section 112(b)(3). They contend that there is nothing in sub-section (3) (unlike sub-section (5)) which makes the exemption conditional on the stockholders receiving stock of the new corporation in proportion to their holdings in the old.

It appears to me that this position is well taken, and that no taxable profit was realized by Messrs. Schenck, Goetz and Zanuck on their exchange of Century for Fox stock.

If no taxable profit was realized, it is obvious that there was no criminal offense in having failed to report in their returns for 1935 that the Fox stock had been received.

3. Failure of Zanuck to report as taxable income the value of certain of the Fox stock received by him in 1935.

It has been noted that Zanuck received Fox stock in excess of the number of shares reflecting his proportionate interest in Century.

The Treasury Department maintains that the value of these excess shares is taxable on the ground that they were received not in exchange for Zanuck's Century stock but as compensation for services or in exchange for property.

I think that there is ground for the view that the excess Fox stock was received by Zanuck as additional compensation for the services to be rendered by him to Fox under the employment contract entered into with Fox. Furthermore, if the affidavit referred to under the next heading was true, there is strong ground for the view that the excess Fox stock was given to Zanuck in liquidation of an enforceable claim for additional Century stock which he had against Schenck and Goets, in which event the excess Fox stock was received by Zanuck not in exchange for his Century stock, but for property, i. e., his claim against Schenck and Goets.

I think that a deficiency should be asserted against Zanuck for 1935 based on the value of this excess Fox stock. The value of this stock doubtless exceeded 25 per centum of the amount of gross income as stated in Zanuck's 1935 return, and therefore an additional tax can be assessed, or a ninety day letter sent out, any time up to March 25, 1941 - even though no fraud charge can be maintained.

Turning to the question of prosecution of Zanuck, I think there is not sufficient ground for criminal proceedings based on the view that he filed a false and fraudulent return for 1935. I am even inclined to think that there is not sufficient ground for asserting civil fraud.

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The whole question of whether stock received by an employee was to be regarded as taxable income at the time received or at the time sold was still in the field of doubt in March 1936, and it is entirely conceivable that Zanuck was not acting in bad faith in having failed to return any taxable income on account of the receipt of the excess Fox stock.

It is conceivable that Zanuck may contend that the alleged right to receive the additional 10 per cent of Century stock constituted additional income at the time that Schenck and Goetz promised him the additional 10 per cent. If the promise was made in 1934, the statute would still be open (for reasons explained above in connection with 1935) without reference to the question of fraud. If the alleged promise was given before 1934, additional taxes could be collected only if it is possible to establish that Zanuck was fraudulent in failing to report income on account of the receipt of the promise for additional stock, in the year in which the promise was given.

4. Making a false statement in affidavits filed in 1938.

On December 23, 1938, Schenck, Goetz and Zanuck caused to be delivered to the Treasury Department's investigating agents at Los Angeles affidavits stating that:

"The common and preferred stock of the reorganized company which they received upon the exchange of their common stock of the old Twentieth Century Pictures, Inc., was on the exact pro rata basis of their actual ownership of common stock of said old Twentieth Century Pictures, Inc., to wit, 35% to Schenck, 35% to Goetz and 30% to Zanuck."

It is believed that the statement in the affidavit and the other similar statements were untrue and that Zanuck in fact had only a 20 per cent in the Century common stock. The principal ground for this view is that on May 5, 1935, Zanuck telegraphed Louis B. Mayer:

"Our present division of 40-40-20 is okay now because Joe furnished releasing organization and Billy furnished finance and I produced pictures. But now that is all over and it seems only fair that in the new deal we should all share equally as certainly my job and new responsibility entitles me to at least get what they get."

No dividends were paid on the common stock of Century, so that this important indication of stock ownership is not available.

Mr. Wenchel suggests that the action of Messrs. Schenck, Goetz and Zanuck in misrepresenting the facts concerning the stockholdings in Century was in itself a crime under Section 35 of the Criminal Code, as amended (U. S. C. Title 18, Sec. 88), which provides that:

"Whoever shall *** make *** any *** affidavit *** knowing the same to contain any fraudulent or fictitious statement *** in any matter within the jurisdiction of any department *** of the United States *** shall be fined not more than \$10,000, or imprisoned not more than 10 years, or both."

The context of the language quoted might lend some support to the contention that Section 35 applies only to the making of claims against the United States, but offhand, I agree with Mr. Wenchel that Section 35 is applicable to affidavits filed with the Treasury Department in the course of an investigation by the Department of tax liability. If so, the fact that no tax liability was avoided because none actually exists does not, in my opinion, render the statute inapplicable, and

this view is sustained by the decision of the United States Circuit Court of Appeals in the Second Circuit in United States v. Mellon, et al., 96 F. (2d) 462 (1938); cert. denied 304 U. S. 586.

Other Points Not Fully Discussed.

There is considerable evidence that one or all of Schenck, Goets and Zannuck were instrumental through Fox or Dover or directly in bribing Mr. Eadis in 1937 and 1938. It seems to me highly advisable that further evidence be sought on this point with a view to prosecution, probably in California.

There is strong evidence in support of the view that Schenck filed fraudulent income tax returns for 1935, 1936 and 1937 (wholly apart from the Fox stock matter).

We did not go into the details of these additional points and I shall, therefore, not discuss them at this time beyond stating that the case against Schenck for additional taxes, civil fraud and probably criminal liability — particularly for the year 1935 in connection with a loss claimed on an apparently fictitious sale of stock — seems to be strong.

Although I would wish to give the matter further consideration before making a final recommendation my present view is that the case against Schenck for 1935 on account of items other than the Fox stock is so strong that the case ought to be presented to the Grand Jury in New York, where Schenck's income tax return for 1935 was filed.

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There is, however, no occasion to make an immediate decision on this point since the statute will not run for several years. In the course of the Grand Jury investigation on the 1935 return I believe that a great deal of other important matter may well be brought out, including evidence to support our belief that Kadis has been bribed by Schenck, et al.

file
November 9, 1939

To: The Files

From: Mr. Hanes

Conference between the President, the Secretary of the Treasury and the Under Secretary of the Treasury at 11:30 A. M. today

The President was in a splendid mood when we entered. The Secretary told him that we had come mainly to discuss the budget and tax problems, and said that he had asked the Under Secretary to come in order to make a complete report and to post the President on what had happened since their last meeting on tax questions in June. The Under Secretary made the following report to the President on the chronological order of events since that time:

1. Bob Doughton and Jere Cooper had asked the Under Secretary to meet them in Doughton's office at 8:30 on November 4th. They had a long conversation about the program for continuing the studies on the tax structure and Mr. Hanes outlined his position to them as follows:
2. The House of Representatives passed a resolution last summer authorizing the Ways and Means Committee to make a thorough study of the administrative and legislative features of the Revenue Law.
3. The Ways and Means Committee directed its subcommittee to comply with that resolution.
4. As a result, Chairman Jere Cooper in the last two weeks of the last Congress conducted a series of meetings with the staff of the Treasury and the staff of the Joint Committee of the Ways and Means and of the Senate Finance.
5. As a result of those meetings the subcommittee instructed the Joint Committee staff to work with the staff of the Treasury in the study and preparation of data upon some 75 specific items of the Revenue Law.
6. The Under Secretary of the Treasury was authorized to conduct on behalf of the subcommittee of the Ways and Means Committee informal hearings here in Washington or elsewhere with taxpayers and the public generally, with a view of getting from all groups interested as much information as possible on the practical approach of the tax law and its effect upon the economy in general.

7. Following these instructions the Under Secretary of the Treasury sent a letter to approximately 1500 people, representing labor, agriculture, industry, the professions, and as well, the general public.

8. The response to this appeal for assistance was instantaneous and the good will developed thereby has become increasingly apparent. More than 283 individuals have appeared in person at a series of informal hearings conducted in the Treasury and we have collected a mass of very valuable data which I hope will form the nucleus for a permanent record for the future. I might add that the Treasury staff has done a magnificent job in their sympathetic approach to the individuals who have visited the Treasury during the past 60 days. It has been a tedious task and I believe has definitely created the impression throughout the entire country that the Treasury is trying to do a sincere and earnest job.

9. I told Messrs. Doughton and Cooper that in my opinion the worse thing that could possibly happen from our viewpoint was for the subcommittee to pass over this cooperative effort lightly as it would mean that the Treasury would never be taken seriously again by those who have given so willingly of their time.

10. This brings me to a concrete recommendation that the subcommittee meet next week in accordance with their schedule and that the Joint Committee staff and the Treasury staff submit to them such data as has been compiled. The Treasury is not in a position nor is it our desire at this time to make specific recommendations for change in the tax structure. We are, however, prepared to lay before the Joint Committee a completely impartial study of all the items assigned to us by them.

11. I told Messrs. Doughton and Cooper, when asked for my personal opinion, I was not at all sure that it would be desirable to open up the tax question at this time, that I felt definitely that this was a question to be weighed very carefully between the leaders in both Houses, together with the Secretary of the Treasury and the President of the United States. However, at this time it is not necessary to cross that bridge, since the study which they have been authorized to make may continue for an indefinite period.

12. At no time during this conference nor during any other conference has the Treasury ever made reference to specific recommendations for changes of any kind. We have not been authorized to do so and shall not do so until we have been authorized or instructed by the Secretary of the Treasury on each and every step.

The Under Secretary was careful to point out to the President that the study now being conducted by the Treasury is on an unbiased and impartial plane, and that no conclusions have been drawn from these studies

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for the benefit of the subcommittee of the Ways and Means Committee. The President said that he was pleased with the report and that he had been giving a lot of thought to the subject of deficits which he was going to try to work down to a figure of \$2,800 million. The President stated that at the present time the Director of the Budget had informed him that the deficit figure for 1941 rested at \$3,200 million and that he had instructed the Director to reduce that figure to a maximum of \$2,800 million. We reported to the President preliminary revised estimates from the Treasury on Internal Revenue increased from \$5,500 million to \$6,300 million. These figures should serve to reduce the deficit still further.

The President then outlined his thinking for the moment to be as follows: that he would go before the country on the radio and state that by hard work we have reduced the deficit from approximately \$4 billion to \$2,800 million, that estimated revenue is increasing and appropriations for things like post offices, rivers and harbors, etc., were being eliminated. However, it would be necessary to spend more money immediately for national defense and any increased expenditures for national defense should be paid for out of increased taxes.

The President further said that he was thinking in terms of working out a program, which could not be opposed by Conservatives, Liberals, and Radicals, that would embrace some plan similar to the La Follette program of broadening the base. He said that he was heartily in favor of the Treasury's psychological approach to the tax problems, that he thought it had a good effect on the minds of business men, but at the same time concurrently with the elimination of inequities in the present tax bill, he was anxious that we not overlook any loopholes that might exist in the present structure. He seemed to feel rather strongly that there were loopholes in the present law which should be closed up. We told him that the Treasury would make a complete study of this phase.

The President said that when the Secretary returns from Arizona he would want to sit down with us for some length of time to discuss this whole problem and try to arrive at a definite policy. He further said that he would want to discuss this matter thoroughly with the leaders of both Houses of Congress and that he was not willing at this time to arrive at any conclusion or make any statement as to policy.

After finishing the discussion on the tax problems, the Secretary of the Treasury handed to the President a memorandum which he had drawn up recommending a concrete method of procedure between this Government and foreign governments in the matter of purchases. The President said, "That's fine."

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The Secretary also handed the President a memorandum concerning the Farm Credit Administration and the President said he would read.

The last item taken up with the President was the recommendation by the Secretary that we be instructed to negotiate with airplane motor manufacturers a satisfactory arrangement on depreciation and obsolescence in order to induce them to increase their production by 6000 motors per year. This, because of the fact that we are equipped to make 6000 more airplanes than the engine manufacturers are able to supply motors therefor. The President signed the memorandum of instructions to the Secretary to proceed in accordance with his recommendation, copy of these instructions is attached hereto (see p. 44)

J. W. H.

THE WHITE HOUSE
WASHINGTON

November 5, 1933

MEMORANDUM FOR THE SECRETARY OF THE TREASURY:

One of the obstacles to the proper equipment of our country for national defense is the disparity between the rate of production of airplane motors and that of the airplanes themselves. This must be synchronized as soon as possible.

You are hereby directed to work out a policy of depreciation allowance by which the abnormal investment in plant expansion that will be required of the airplane motors manufacturers will be absorbed over the life of the contracts or during the emergency period.

You are further directed to consult with the appropriate committees of the Congress for the purpose of devising a permanent program whereby the facilities thus created will become a permanent part of the national defense.

A. H.

No. 11

AMERICAN CONSULATE

Hanoi, Indochina, November 9, 1939

AIR MAIL

SUBJECT: Contemplated Measures to Remove Congestion of Freight
at Haiphong.

THE HONORABLE
THE SECRETARY OF STATE,
WASHINGTON.

SIR:

I have the honor to refer to my despatch no. 5 of October 13, 1939, and to other despatches and telegrams, in which reference is made to the congestion of cargo at Haiphong and to the various plans of the agencies engaged in transportation of freight to China for the clearing up of this congestion. In this latter connection the following information may be of some interest to the Department.

During a conversation with Mr. Chen Tea Chen, of the Southwest Transportation Company, and Mr. Shao, Manager of the Bank of China at Hanoi, allusion was made to the fact that recent arrivals at Haiphong and other ports of Indochina of freight destined for China apparently approximately balance the amount of freight being transitted to China, thus militating against the clearing up of the congestion of cargo at Haiphong.

Mr. Shao agreed that such was the case but pointed out that during the last month, October, an exceptional amount of freight had arrived and that the Indochina-Yunnan Railway had carried only a fraction of its normal capacity of freight, due to landslides and other traffic interruptions in Yunnan. Inter alia it is understood that no new cargo was accepted by that railway between September 29 and November 1.

Mr. Chen then outlined the various measures in operation or contemplated which are aimed to speed up transportation and to relieve the congestion at Haiphong. He remarked that he proposed, as a further measure, to curtail freight arrivals during December and January, adding, however, that the curtailment would not apply to petroleum products.

As petroleum products comprise a large percentage of arrivals at Haiphong and at Saigon, I do not see how this plan can accomplish a great deal. Nor do I see how Mr. Chen can bring about this curtailment without the cooperation of foreign shippers and/or the French authorities. The

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latter might cooperate as there is no doubt but that they would like to see Haiphong cleared of the accumulation of freight. Nevertheless, the plan must be accepted with a certain amount of watchful scepticism, perhaps as wishful thinking on the part of the Chinese who are faced with the tremendous task of moving the freight now at Haiphong, a matter of some 6 to 8 months.

Respectfully yours,

CHARLES S. REED II,
American Consul.

Original and 2 copies to the Department
Copy to Embassy, Chungking; Consulate General, Hongkong
Copy to Embassy, Peiping; Consulate, Saigon

815.6

Z-188

ADDRESS AT THE
25th ANNIVERSARY OF THE OPENING
OF THE
FEDERAL RESERVE BANK OF ST. LOUIS
NOVEMBER 9, 1939

BY
MARRINER S. ECCLES
CHAIRMAN OF THE BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

FOR RELEASE IN MORNING PAPERS OF
FRIDAY, NOVEMBER 10, 1939

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I am glad that I could be here this evening to join with you in observing the 25th anniversary of the establishment of the Federal Reserve Bank of St. Louis. The quarter of a century that has passed has put the Federal Reserve System to the test of war and of peace, of the greatest boom and the worst depression in our history. Throughout this period the System has rendered an essential public service. Those who have played a part in making this public contribution have reason to look back over the years with a sense of pride in what has been achieved, notwithstanding the limitations in our banking laws and those inherent in the powers of monetary authorities to achieve by themselves that state of economic welfare to which we all aspire. We may say in fairness, I think, that the record of the Federal Reserve System is a creditable one; its shortcomings, as I see them, have been largely reflections of the times in which we live.

The Reserve System is no longer an experiment. It has justified the expectations of its creators. It is an established institution that is vital to the functioning of our economy. If it were done away with, other machinery would have to be created to furnish the services and perform the functions of the present System. Throughout its history, the Reserve System has been fortunate in attracting to its service many men of outstanding ability and a desire to be of public service. This applies not alone to the officers and staffs of the twelve Federal Reserve banks and their branches and to the Board in Washington, but to the men who have served and have regarded it as an honor to serve on the directorates of the banks and branches and as members of the Federal Advisory Council.

Inevitably the System has often been a target for political attack because it is a convenient scapegoat when the economic machine gets into trouble. This is in large part because of the persistent, but erroneous, belief that we can produce and maintain prosperity simply by pulling a few monetary and credit levers. The System has successfully withstood recurrent waves of political assault, largely, I think, because of the high character of the men who have been associated with it in all parts of the country, and because informed opinion was aware of the limitations on its powers and did not expect the impossible.

As the world has changed, as new conditions have arisen, the Reserve System inevitably has faced new problems and has been obliged to develop new means and to ask for broader powers in order to deal with changed conditions. It has not remained static in a changing world and it cannot do so and survive. I have found comfort in the reflection that those who resist change so often not only become reconciled but approve once it has come about. The effort to establish the Reserve System was stoutly opposed by influential financial and business groups that later became its defenders. Senator Glass recounts in his book, "An Adventure in Constructive Finance", that: "The fight for better banking methods and for an effective currency system was no holiday fray; it was actually a savage contest, in which entrenched power and privilege resisted at every point of attack." The battle for better banking methods and a sounder credit and currency system goes on. It can never be permanently won in this changing world. But enlightened men can lead the way to continuous improvement.

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This Bank in St. Louis, as a part of the System, came into being on the eve of the outbreak of war in Europe in 1914. It is a somber fact that this 25th anniversary is being observed as another European War casts its shadows across the Atlantic. Those who constructed the Federal Reserve System out of long experience and study could not foresee the changes that were to be so quickly wrought after 1914. They were men whose experience had been with the operations of a gold standard world and with the rise of industrialism in the era of great expansion in this country.

While the Reserve System was conceived as a mechanism designed primarily for a peaceful, gold standard world, it proved capable of rapid adaptation to a world suddenly transformed from peace to war, and from a gold basis to a managed currency basis. The System discharged with great credit the heavy responsibilities that were thrown upon it, particularly in connection with financing our own participation in that struggle. But the System has never had an opportunity to operate in the kind of universe for which it was originally created. It is true that during the Twenties the leading nations, ourselves included, undertook to reestablish the economic premises and practices of pre-war conditions, without appreciating that the conditions had been radically altered. We had emerged as a creditor nation, but we continued to behave like a debtor nation. The gold standard was restored in name; it was in office but not in power, and it was not and could not be the pre-war standard. As we discovered too late in the Twenties, it could neither save us from nor rescue us once we were plunged into economic disaster.

It appears to most of us now that since the armistice of 1918 we have had what is more a truce than a peace. We cannot foresee now, any more than we could at the outbreak of war in 1914, what the future will bring forth, but all of us are necessarily concerned with the effects of foreign war upon our domestic economy. We can see the broad line of defense that we must take to minimize the disruptive consequences to our own people.

We are already experiencing the initial impact of war conditions abroad. In the forward movement in economic activity that has taken place recently, there is much that represents anticipatory buying and the accumulation of inventories without a corresponding rapid increase in consumption or purchasing power. Fortunately, there appears to be a more widespread recognition that as a matter of self-interest, restraint should be imposed by business and labor leadership to prevent a recurrence of the price distortions and inventory boom that led to the sharp relapse beginning in the middle of 1937.

To that end, business men appear more ready to cooperate in price restraints and in spreading out production. Even though there may be a glut of orders in some lines, including the steel industry, production and deliveries should be evened out over longer periods than has been the case under past practice. There is also a more rational policy in regard to liquidation of foreign holdings of American securities so that it may have a minimum of disturbing effects upon our markets and to the timing and spacing of foreign demand with a view both to more orderly production and the avoidance so far as possible of conflict between foreign and domestic needs for essential materials.

All of this is to the good, but in the brief time I have this evening, I want to call attention more particularly to some of the longer range problems as I see them from the standpoint of the bankers and the Federal Reserve System.

I doubt whether there are exact figures on the amount of cash resources that are available to belligerent governments for expenditure in the United States. Such figures as I have seen are at best estimates. They indicate that for the British Empire and France alone dollar balances in this country amount to about \$1-1/4 billions, and readily salable securities have an estimated market value of about \$1-1/2 billions. In addition, other resources and investments which are not so readily marketable aggregate another \$1-1/2 billions. Beyond this, the British Empire and France have gold resources of close to \$6 billions and they have an annual gold production of about three-quarters of a billion dollars.

No one, of course, can foresee how long the war will last or how much of these resources would be used for purchases in our markets. We should not delude ourselves, however, into supposing that whatever the volume of such expenditure may be in our markets, it would be just so much velvet for us. The fact is that our favorable trade balance during the last few years has been sustained through our willingness to accept large quantities of foreign gold and silver at high prices in exchange for our goods and services. We have been unwilling to exchange goods for goods. Fortunately, we have not extended foreign credits, as we did throughout the Twenties, which, while they sustained our foreign trade, were largely uncollectible. Looking to the future, my personal view--speaking unofficially--

is that our country would be far better off if, so far as possible, foreign purchases were to be paid for out of the sale of their goods in this country and out of the proceeds of the liquidation in this country of American securities held by foreigners rather than through further acquisitions of foreign gold and silver for which we have no present or prospective use, because they would only increase the present unprecedented volume of unused excess reserves and deposits of the banking system. Even the present volume of excess reserves, if used as a basis for credit expansion, would create a dangerous inflationary situation entirely beyond the present powers of the Federal Reserve to control. We do not need a further increase of our supply of bank deposits or currency. What we do need is a more effective use or turnover of our existing money supply. ?

This has an immediate bearing upon our banking and economic problems generally, and upon the question of interest rates which are of so much concern to bankers and investors. But I find that not many of my banker friends have analyzed the reasons why interest rates have been and are likely to continue to be at unprecedented low levels. Some, I have discovered, had a vague, but mistaken, notion that the Federal Reserve System was responsible and that I, in particular, am culpable because I have advocated since the depths of the depression what, for want of a better name, has been labeled as an easy money policy.

The facts of the case, however, are clear on the record. We have today more than \$5-1/2 billions of excess reserves among member banks. This is a figure never before approached and the prospects are that it will con-

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tinued to grow. A credit expansion of fully \$30 to \$40 billions could, in theory at least, be built upon this enormous base. Now, you cannot have such vast stocks of potentially loanable funds pressing upon the market, and such a volume of investment funds as has been and still is accumulating without having interest rates at extremely low levels.

I want to emphasize the fact that the rise in excess reserves in the past few years has resulted almost entirely from the vast inflow of gold and to a lesser degree from silver purchases. A strenuous, though unsuccessful, effort was made in the Banking Act of 1935 to obtain for the Federal Reserve System authority to absorb excess reserves. Under the limited powers actually granted, the Board of Governors of the Federal Reserve System absorbed approximately \$2-1/2 billions of excess reserves. In other words, the present volume of excess reserves, large as it is, is \$2-1/2 billions less than it would have been if the Reserve Board had not increased reserve requirements by using most of the authority granted in the Banking Act of 1935.

This action was not taken for the purpose of constricting credit or reversing the policy of monetary ease pursued by the System. It was taken for the purpose of putting the System in the position it had traditionally occupied and the position still occupied by central banking organizations in other leading countries, where, through open-market operations and discount policy, it could ease credit conditions if the situation required or adopt a reverse policy if necessary to restrain inflationary credit expansion through the banks. Unfortunately, this position could not be maintained because the great volume of gold and silver that was subsequently permitted to flow into the excess reserves again lifted them to levels beyond reach of the System's control.

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I do not wish to be understood as favoring high interest rates at the stage of recovery so far reached or while we have a large volume of unemployment and unused resources. I favor relatively low interest rates as a continued encouragement to capital expenditures, including housing, and as a means of keeping down costs and stimulating consumption. But I am convinced that it is essential for the monetary authorities to be in a position to influence the availability and cost of credit in order to discharge their proper responsibilities. What purpose do they serve if they are powerless in their particular field of responsibility?

At the present time investment funds are accumulating in the hands of individual and corporate savers much faster than outlets develop for the profitable employment of these savings in new investment. The result is an intensified competition for the existing supply of investments--a supply so inadequate relative to the volume of funds seeking investment that, notwithstanding the great increase in the public debt during the past decade, the demand greatly exceeds the supply.

Foreign war will not correct this situation, but is likely to make it worse. The remedy must be found at home. It would be most unfortunate if the anticipation of profits from a so-called war boom were to obscure this and other unbalanced relationships in the domestic picture.

There has been recently some increase in the demand for bank loans for commercial purposes. This has given earnings to banks and somewhat lessened their need to invest in long-term governments. However, it is not reasonable to suppose that the demand from business and industry for

increased bank credit accommodation will be sufficient to absorb any substantial amount of excess reserves. For one thing, most of the larger and many of the smaller corporations of the country have accumulated large cash reserves which, in some cases, have been invested in Government obligations since they could not be profitably used for increased production and plant expansion. In many industrial lines which have been operating far below capacity a great increase in production could take place without necessitating going to the capital markets or to the banks for more funds for plant or for operating purposes. Production can be stepped up greatly because of the rapid technological advances which require less plant expansion and less man power than was needed under old methods.

For another thing, under the terms of the neutrality legislation advocated even by those who opposed the sale of arms, it is proposed that only cash payments shall be made for such products as are purchased by belligerent buyers. Extension of credit is specifically barred. There is thus no present prospect of outlet for investment funds in foreign loans. Accordingly, I am unable to see that through the prospective operations of business and industry there will be a sufficient absorption of investment funds or of excess reserves to alter materially the present disproportionately large volume of such funds relative to the outlets for them. Therefore, I would not expect interest rates to rise and maintain levels that are higher than has been the average over the period in which we have had the combined effect of heavy excess reserves and slack demand for credit and for funds for new investment. We have witnessed, since the outbreak of war abroad, a readjustment from the low levels that prevailed earlier in the year, but the trend is again in the opposite direction.

All indications point to the continued piling up of excess reserves, and the longer war is continued and foreign governments obtain dollar exchange through the process of sending us gold, the greater the excess will become. If the effects of this were merely to add to bank deposits, which for a considerable period now have been greater than ever before in our history, it would be serious enough, but gold and silver acquisitions also add to excess reserves which are a basis for a multiple expansion of bank credit and bank deposits.

The other principal factor in the growth of bank deposits has been the Government's borrowing from the commercial banks. To the extent that this process restored our money supply after it had shrunk by about one-third as a result of the deflation after 1929 it was, to my mind, desirable and, in fact, essential for recovery.

We may as well face the facts of this question of interest rates and idle deposits frankly. I want to repeat that I do not favor restrictive money conditions and high interest rates while we still have millions of idle men and unused resources. Tightening of money rates is an appropriate weapon against unsound expansion of bank credit that threatens an inflation. It is wholly inappropriate at the present stage of recovery or at any time as a remedy for unsound developments of non-monetary origin.

While bankers and investors generally want higher rates, it should be evident that we cannot go on indefinitely having gold and silver purchases piling up both excess reserves and bank deposits and expect interest rates to rise. The effects of such additions to the money supply are bound to be just

the opposite--the more so when at the same time billions of individual and corporate savings are piling up annually, although outlets for the profitable employment of these savings in new investment, or in foreign loans, are much less than was the case during the Twenties.

Are we willing to deal with the factors that are adding to the already unprecedented accumulations of excess reserves and bank deposits, and if we are not willing to deal with these factors, are we willing to approach the problem from the other side and take steps adequate to put these funds to more productive, profitable use? My own experience, in being unable in the Banking Act of 1935 to obtain adequate means of dealing with the excess reserve problem, and three years ago when I ventured to point out the effects of continued capital acquisitions from foreign sources, does not encourage me to think that as a country we are yet prepared to deal with the causes or effects of this growth in excess reserves and bank deposits.

Turning to the question of putting the supply to greater use, we find a field of the greatest confusion and conflict of opinion. I shall undertake here only to outline again what I believe to be the sound way of getting a wider, more profitable use of the accumulations of idle funds that are weighing down the interest rate structure and preventing the balancing of the Federal budget.

In my judgment, the time is here, if it is not overdue, to take certain steps that will increase domestic consumption, diminish the pressure of idle funds on the investment markets, and begin to close the gap between Government income and outgo. My longer objective would be to sustain existing investment and pave the way for as much new investment as can be profitably undertaken. That is in the interest of the banking system, the insurance companies and

all other fiduciary institutions--looking beyond them, it is to the interest of all those whose savings are at stake.

We are hearing today proposals that the Government should reduce some of the present expenditures, particularly for agricultural benefits and for work relief, in order that funds for an expanded armament program may be provided without an increased deficit or an increase in taxes. In my opinion, it would be unfair, and unsound economically, to pass increased armament costs on to those of the low income groups who would profit the least out of foreign or domestic expenditures for armament, who are the least able to bear the costs and whose increased purchasing power is essential to our economic welfare.

Instead, in my opinion, we should follow the unpopular, but necessary, course of imposing additional taxation in order to meet the added costs of our armament program and to reduce the deficit, without sacrificing the low income groups whose sustained and increasing purchasing power is needed to sustain and increase production. Accordingly, additional taxation should be levied, not alone upon war profits, but upon those income groups now relatively undertaxed among whom the greatest proportion of savings that are unable to find profitable outlet today are now accumulating. At the same time, I favor increasing domestic purchasing power by decreasing consumption taxes.

It is beyond dispute that the great majority of our people at the bottom of the income scale would consume far more if they had the purchasing power. One way to increase their purchasing power is by lowering consumption

taxes, such as excise and sales taxes, which have been heavily increased over the past few years. We need to understand more clearly just where idle funds accumulate, where our tax burdens fall, and how they may be better distributed with a view to increasing domestic consumption and hence increasing a home market for American business and industry, so that they will not have to rely upon the precarious circumstance of foreign wars and armament programs in order to utilize our resources and man power and thus to make profits.

I have been much interested in studies of the National Resources Committee which show that in 1935-1936, 59 per cent of our families had incomes of \$1,250 or less. They had no savings, but incurred deficits of \$1-1/2 billions which were partly made up by hundreds of millions of dollars of contributions from other private groups and public sources. It is on this majority group of our people, comprising nearly 60 per cent of our population, that consumption taxes, including social security assessments on those fortunate enough to have jobs in private industry, bear too heavily and have been substantially increased in recent years.

The next higher income group, that is, those families with incomes of from \$1,250 to \$5,000 a year and comprising 38 per cent of our population, was able to save \$2.8 billions. The next higher income group with incomes of from \$5,000 up, but representing less than 3 per cent of our families, saved \$4.8 billions.

Our income tax rates applying to these groups with incomes of from \$5,000 to \$50,000 are much lower than the rates, even before the war, in England, France and most other countries. Moreover, our income tax structure

has a much narrower base than that in other nations. I am in favor of spreading it out. The time has arrived, I think, when this should no longer be delayed, when additional revenue should be derived from the intermediate income groups that I have mentioned. The effect will be to offset continued over-accumulation of idle funds, to add less to bank deposits through the process of deficit financing, and to help close the gap between Government receipts and expenditures.

As part of a national policy of encouraging consumption, I have, over a long period, urged revision of our system of old-age and unemployment insurance, which at the present time is increasing rather than diminishing the volume of funds that must find investment outlets. If we are to accumulate reserves for old-age pensions, they should be built up in good times when their collection through taxes will tend to moderate unsound boom tendencies and will not have an adverse effect upon consumption. We have made the mistake, in my judgment, of accumulating a vast reserve in times of large unemployment, taxing it not out of those best able to pay or those whose savings are idle, but out of payrolls mainly of those who otherwise doubtless would have kept the funds moving in the income stream. The more we have taken out of consumption by this process at the time when we need above all to increase consumption, the greater the need has been to unbalance the budget still further in order to increase consumption. Other countries have built up social security programs and have adjusted their taxing and financing methods to the countries' economic needs by paying out in social security benefits sums much larger than they currently take in from contributors.

The volume of taxes on consumption, including social security taxes as well as sales taxes, excise taxes and tariffs, is at present much higher than at any previous time. We should undertake a far-reaching revision of our federal and state tax structures so as to cut down these consumption taxes and to increase taxes on funds which would otherwise remain idle.

Also as a part of the general program, I would favor applying taxes that will have the effect of discouraging over-accumulation of so-called rainy day reserves which are being set aside in excessively large amounts, particularly by the larger corporations. These sums come out of the income stream and unless put back into the stream through being paid out in dividends to stockholders or spent for plant modernization or expansion are bound to diminish consumption, then employment and finally production. It would be profitable if these excessive accumulations were avoided in the first instance by reducing prices to consumers or by increasing the wages of the lower income groups of workers. If this is not done, then it is not logical to oppose taxation that will keep these funds that are unused for plant or for dividend purposes moving in the income stream. They cannot be taken out of the income stream without reducing it and thus reducing employment and production.

I opposed at the time and would continue to oppose application of corporate surplus taxes to the small businesses which do not constitute the heart of this problem of idle funds. But we should also consider increasing the normal income tax of corporations and revision of the inheritance tax, particularly a reduction of the present exemptions, to help pay for an improved armament program.

The broad effect of the tax policies I have outlined would be not only to reduce the deficit and ultimately balance the budget as national income reaches the levels we should and can have in this country, but to sustain and increase purchasing power and reduce the pressures of funds that cannot find adequate profitable outlets in new investment at this stage in our national development. Such a tax program would do much to keep otherwise stagnant funds moving in the income stream in a way that will augment consumption and thus not only sustain existing investment but open the way for new investment.

If we are unwilling to deal with the underlying factors that make for a continuing piling up of our money supply, now beyond the powers of the Reserve System to control, we should at least deal with the problem of idle funds and the stagnation in the turnover of existing deposits. In my judgment, we should deal with the problems of money supply as well as its use, but, in any event, we cannot ignore both sides of the picture. The banking and investment community cannot expect to do nothing about the piling up of idle funds on the one hand and, on the other hand, have the interest rates and earnings which they so much desire. It is the old story-- you can't have your cake and eat it too.

I have sought to indicate in a general way what I believe to be a practical approach to some of these questions. I hope that none of us will be deluded into imagining that the tragic accident of European War will in the long run solve or even ameliorate our fundamental domestic problems. War cannot cure, but may make worse, the unbalanced relationships between tariff-protected industrial prices on the one side and, on the other, agri-

cultural prices and incomes that are determined by foreign demand and foreign markets. War cannot cure, but may make worse, the monetary and credit problems arising from the continued swelling of bank deposits and excess reserves which, in turn, are a vital factor in the level of interest rates.

We cannot profit from disaster to other peoples. We can be alert, however, to protect our economy to the extent of our abilities from the dislocating effects of international chaos and destruction. We can, if we have the perception and the courage, put our own house in better order and keep it functioning so that it will produce and distribute a maximum of goods and services, under our political and economic system, for the benefit of all of our citizens.

November 9, 1939.

STRICTLY CONFIDENTIAL

To: The President.
From: The Secretary of the Treasury.

The following paragraphs deal with three categories of business relations between the United States and foreign countries:

(1) The Chancellor of the British Exchequer has informed the Secretary of the Treasury that he readily accepts the latter's proposal that a special account be opened with the Federal Reserve Bank of New York, and agrees that the Secretary of the Treasury personally and confidentially have access thereto. This message was received through the British Embassy following conversations in which it was indicated that, as a matter of administration policy, the Treasury would be pleased to see the British Government's account for war purchases in the United States carried with the Federal Reserve Bank of New York, by and in the name of the Bank of England, into which account funds of the British Government would be deposited and from which account official payments would be made. It was stipulated that such account should be exclusively for the purchase of war materials. The desirability was suggested of having a British official in this country designated to draw checks against this war materials account. The British Government has already made a transitory arrangement with the Federal Reserve Bank of New York whereby members of the British Purchasing Commission now in this country are authorized to direct limited payments from the regular account of the Bank of England with the Federal Reserve Bank of New York. The final and definitive arrangements for the special account should be consummated shortly. The French Government has approved such a plan in principle and is perfecting the details for its own special account.

(2) The Chancellor of the Exchequer is sending to the United States a London banker to assist the British Ambassador in arranging details regarding the above mentioned account, and also to act as the British Security Expert in discussing with the Secretary of the Treasury and the Securities and Exchange Commission the question of the disposal of British owned dollar securities on this market. This Government had informed the British Government of its desire that the Treasury and the Securities and Exchange Commission receive daily reports in suitable detail, and be kept informed of prospective plans, with

respect to the disposal of those dollar securities which the British Government contemplates selling in the United States. The British Government has stated that one of the Canadian banks in New York will be appointed the British agent for the actual liquidation of such securities. It is desired that arrangements similar to those of the British Government be made if and when France, Canada or other belligerent countries may plan to sell their United States dollar securities.

(3) The following arrangement is suggested to govern the contacts between the interested foreign governments and representatives of this Government with reference to the purchase of war materials in the United States: An informal committee will be established to represent the American Government, consisting of the following: (a) The Director of Procurement, Treasury Department; (b) The Quartermaster General of the Army; (c) The Paymaster General of the Navy. This committee will serve as the exclusive liaison with reference to procurement matters between this Government and the interested foreign governments. It will hold sessions at least once weekly, and at such more frequent intervals as may be necessary. At these sessions, it will receive an accredited representative of the embassy of any interested foreign government for the purpose of giving information to the requirements of such government for supplies, equipment, and materials, in relation to (a) availability of the desired articles, (b) priorities, and (c) prices. The committee will submit a complete report of its proceedings, notes and recommendations, at least weekly, to the President through Mr. McGeheys.

THO/HURRY

W. M. F. - 261

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE November 9, 1939.

TO Secretary Morgenthau

FROM E. H. Foley, Jr.

For your information

I thought you would like to know that the Attorney General has just decided the controversy between State and ourselves as to the application of the Neutrality Act in our favor. Telegrams are being prepared notifying all Collectors of this ruling.

E.H.F.

NOV 8 1938

My dear Mr. President:

You will recall that some months ago we discussed the advisability of reestablishing the Farm Credit Administration as an independent agency and consolidating in it all agricultural credit activities of the Government. The objective was to establish a single lending institution to which the agricultural interests of the country could go for credit. Gradually such an agency might be developed to a point where it would be self-supporting. It is my recollection that you were in sympathy with such a plan.

It has just come to my attention that Secretary Wallace has asked Governor Hill for his resignation. I understand that the Secretary's purpose in taking such action is to provide for closer integration of the functions of the Farm Credit Administration with the other activities of the Department of Agriculture. It appears to me that the action of Secretary Wallace, if consummated, might very well render completely ineffectual the purposes underlying the proposed reorganization which we discussed.

After our talk, I took the liberty of preparing a draft of a reorganization plan embodying my suggestions as to the

scope and details of the proposed organization. I am attaching, for your consideration, a draft of a reorganization plan and a suggested message of transmittal to Congress.

Faithfully yours, *est*

(Signed) E. W. Genthan, Jr.
Secretary of the Treasury

The President

The White House

Attachments

Retyped 11/8/39

REORGANIZATION PLAN NO. _____

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Prepared by the President and transmitted to the Senate and House of Representatives in Congress assembled, January __, 1940, pursuant to the provisions of the Reorganization Act of 1939, approved April 3, 1939.

REORGANIZATION OF AGRICULTURAL CREDIT AGENCIES
AND FUNCTIONS

SEC. 1. Reestablishment of Farm Credit Administration as an independent agency.—The Farm Credit Administration (including the Federal Farm Mortgage Corporation and all other agencies, corporate or otherwise, under the jurisdiction or supervision of the Farm Credit Administration, to the extent that they are under such jurisdiction or supervision) and all its functions, together with its personnel, records and property (including office equipment) is hereby transferred from the Department of Agriculture and reestablished as the independent agency which it was prior to July 1, 1939, the effective date of Reorganization Plan No. 1 issued pursuant to the provisions of the Reorganization Act of 1939. All functions of the Secretary of Agriculture or of any other officer or employee or agency of the Department of Agriculture not transferred by this section, which functions relate to the administration of the Farm Credit Administration, its functions and activities, are hereby transferred to, and shall be exercised by, the Governor of the Farm Credit Administration.

SEC. 2. Transfer of Rural Electrification Administration to Farm Credit Administration.—The Rural Electrification Administration and all its functions, together with its personnel, records and property (including

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office equipment) is hereby transferred from the Department of Agriculture to the Farm Credit Administration and shall be administered in that Administration by the Administrator of the Rural Electrification Administration under the direction and supervision of the Governor of the Farm Credit Administration.

SEC. 3. Transfer of other agricultural credit functions to Farm Credit Administration.—(a) The following functions of the Secretary of Agriculture and the Department of Agriculture are hereby transferred to the Farm Credit Administration and shall be administered in that Administration under the direction and supervision of the Governor of the Farm Credit Administration:

1. All functions of the Secretary of Agriculture and the Farmers' Home Corporation under Title I of the Bankhead-Jones Farm Tenant Act (U.S.C., title 7, secs. 1001-1006).

2. All functions of the Secretary of Agriculture and the Farmers' Home Corporation under Title II of the aforesaid Act (U.S.C., title 7, secs. 1007-1009).

3. All functions of the Secretary of Agriculture and the Farmers' Home Corporation under sections 41 to 55 of Title IV of the aforesaid Act (U.S.C., title 7, secs. 1015-1029), to the extent that such functions may relate to, and be necessary to the carrying out of, the functions under Titles I and II of the aforesaid Act transferred above.

4. All functions of the Secretary of Agriculture and the Farm Security Administration of the Department of Agriculture

under section 3 of the Emergency Relief Appropriation Act of 1939 to the extent that such functions relate to farm debt adjustment service, the making of loans and the extension of credit to farmers, and to the servicing and adjustment of loans made or credit extended to farmers under said section or prior law.

5. All functions of the Secretary of Agriculture and the Farm Security Administration under the provisions of the Act of August 7, 1939 (Public No. 307, 76th Congress).

(b) So much of the personnel, records and property (including office equipment) of the Department of Agriculture, the Farmers' Home Corporation, and the Farm Security Administration of the Department of Agriculture as the President may determine to be necessary to the efficient performance of the functions transferred by this section shall be transferred to the Farm Credit Administration.

SEC. 4. Transfer of funds.—(a) So much of the unexpended balance of appropriations, allocations, or other funds available (including those available for the fiscal year ending June 30, 1941) for the administrative expense of any agencies or functions transferred by sections 2 and 3 of this Plan as the Director of the Bureau of the Budget shall determine, shall be transferred to the Governor of the Farm Credit Administration for such use; and the Director of the Bureau of the Budget shall allocate to the Governor of the Farm Credit Administration from such funds such sums and in such proportions as he may find necessary for the administrative expenses of the Governor in connection with the agencies and functions transferred by sections 2 and 3 of this Plan. In determining

the amount to be transferred, the Director of the Bureau of the Budget may include an amount to provide for the liquidation of obligations incurred against such appropriations, allocations, or other funds prior to the transfer. The use of the unexpended balances of appropriations, allocations, or other funds transferred by this subsection shall be subject to the provisions of section 4(d)(3) and section 9 of the Reorganization Act of 1939.

(b) All unexpended balances of appropriations, allocations, or other funds, other than those mentioned in subsection (a) of this section, available (including those available for the fiscal year ending June 30, 1941) for the use of the Rural Electrification Administration shall be transferred with such agency and shall remain available to it for the exercise of its functions.

(c) So much of the unexpended balances of appropriations, allocations, or other funds, other than those mentioned in subsection (a) of this section, available (including those available for the fiscal year ending June 30, 1941) for the exercise of the functions transferred by section 3 of this Plan as the Director of the Bureau of the Budget shall determine shall be transferred with such functions and shall be available to the Governor of the Farm Credit Administration for the exercise of such functions.

END. 5. Personnel.—Any of the personnel transferred by this Plan when the Governor of the Farm Credit Administration shall find to be in excess of the personnel necessary for the administration of the functions transferred by this Plan shall be returned under existing law to other positions in the Government, or separated from the service subject to the provisions of section 10(e) of the Reorganization Act of 1939.

STREETS
10/24/39

MESSAGE

FROM

THE PRESIDENT OF THE UNITED STATES

Transmitting

REORGANIZATION PLAN NO. ____

To the Congress of the United States:

In my message to the Congress on April 25, 1939, transmitting Reorganization Plan No. I, and again in my message of May 9, 1939, transmitting Reorganization Plan No. II, I stated that it had not been possible to complete my investigations then in progress with respect to the organization of all agencies of the Federal Government, or to determine immediately what changes were necessary to accomplish the five major objectives of the Reorganization Act of 1939.

I also pointed out in my message of April 25, 1939, that I proposed to accomplish that task as speedily as possible in several steps, and that out of the many groupings and regroupings proposed in that message a few of the individual agencies could conceivably be placed elsewhere. I added, however, that if in the future experience showed that one or more of them should be regrouped it would be wholly possible for the President and the Congress to make the necessary changes.

As you will recall, Part IV of the plan to which I have just referred was designed to accomplish a grouping of the many

lending agencies of the Federal Government. The agencies established for the purpose of stimulating and stabilizing the financial, social, and industrial enterprises of the Nation were grouped in the Federal Loan Agency, under the Federal Loan Administrator, whose duty it is to supervise, administer and be responsible for the coordination of the functions and activities of those agencies, all of which had previously operated independently.

The agencies which had been established from time to time for the purpose of providing loans directly or indirectly for the stimulation and stabilization of agriculture were grouped with other agricultural activities of the Government in the Department of Agriculture.

On May 9, 1939, I transmitted to the Congress the Second Plan on Government Reorganization, which contained a provision transferring to the Department of Agriculture the Rural Electrification Administration, which was engaged in certain lending activities in rural areas throughout the United States.

Shortly before the First and Second Reorganization Plans became effective I authorized the issuance of a statement by the Secretary of Agriculture, in which he said that on and after the effective date of Reorganization Plan No. 1 the Farm Credit Administration, including the Federal Farm Mortgage Corporation, would not become an integral part of the Department of Agriculture, and that the responsibility for carrying out the many Federal Statutes, which formed the basis for the extension of several types of farm credit,

would remain with the Governor of the Farm Credit Administration. He stated also that the Governor would report to the Secretary of Agriculture rather than to the President, and with that exception the Farm Credit Administration would continue to operate as an autonomous agency as theretofore. The Secretary made the further statement, with which I concurred, that the Farm Credit Administration, supervising as it does many different types of organizations, was not adapted to complete identification with the Department of Agriculture, and should continue its present method of operation, with the Secretary of Agriculture exercising a coordinating supervision in only the broadest and most general way.

Our recognition of the differences in responsibility of the Secretary and the status of the agencies concerned was dictated by several considerations. While the supervision of credit facilities in the farm field is closely related to the other agricultural land use activities of the Federal Government, the supervisory authority over these facilities must be coordinated with the work of the Treasury Department, and has an important relation to the functions of the Federal Loan Agency. Furthermore, not all of the functions of the institutions and corporations, some 8,000 in number, under the supervision of the Farm Credit Administration, are exclusively governmental in character. The Administration exercises over them a type of supervision unlike the usual Federal supervision, where the organizations and controls are wholly governmental.

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Since the First Reorganization Plan became effective certain legal and practical difficulties have arisen in connection with preserving the activities of the Farm Credit Administration as an autonomous agency. Believing, as I do, that these considerations, to which I have referred, are important, and that the individuals engaged in agriculture are as much entitled to an independent credit organization, as are those engaged in financial, commercial, and industrial enterprises, I propose to regroup all of the agricultural activities of the Federal Government dealing with agricultural credits in an independent agency. The plan which I now transmit to accomplish this purpose I shall describe briefly as follows:

The Farm Credit Administration was created originally by an Executive Order, issued by me, which was submitted to the Congress on March 27, 1933, and became effective on May 27, 1933. This order accomplished the consolidation within one organization of the powers and functions of all Federal agencies which were then dealing primarily with agricultural credits. These were the functions of the Federal Farm Loan Board, including those of the Farm Loan Commissioner, whose title was changed by act of Congress to Land Bank Commissioner; the functions of the Federal Farm Board, except those relating to stabilization operations; the functions of the Reconstruction Finance Corporation pertaining to the management of the Regional Agricultural Credit Corporations; and the functions of the Crop Production and Seed Loan Offices of the Department of Agriculture.

Subsequently, the Emergency Farm Mortgage Act, the Farm Credit Act of 1933, and the credit acts of subsequent years enlarged the resources of existing lending institutions under the Farm Credit Administration, and provided for the establishment of new facilities which now constitute a permanent cooperative credit system. This system is designed to meet the credit needs of farmers in their production, marketing, and purchasing operations.

Under the order of May 27, 1933, the Governor of the Farm Credit Administration was made directly responsible to the President and was vested with all powers, and authority and duties of the officers, executive agencies and the heads thereof, which were transferred to the Farm Credit Administration.

I now propose to reestablish the Farm Credit Administration as an independent agency, directly responsible to the President as it existed and with the same functions which it possessed prior to July 1, 1939. This will include the restoration of the Federal Farm Mortgage Corporation and all other agencies, corporate or otherwise, under the jurisdiction of the Farm Credit Administration to the same status which they occupied in the Farm Credit Administration prior to that date.

While the Rural Electrification Administration has certain duties and functions which are educational in character, its primary activity is that of extending credit to the residents of rural districts, and should therefore be administered in coordination with the other agricultural credit activities of the Federal Government. With those

considerations in mind, I propose to transfer the Rural Electrification Administration from the Department of Agriculture to the Farm Credit Administration to be administered under the direction and supervision of the Governor.

The principles of good administration would indicate the necessity for repeating the functions of the Secretary of Agriculture and of the Department of Agriculture under section 3 of the Emergency Relief Appropriation Act of 1939, which deal primarily with the giving of assistance through rural rehabilitation and relief of needy farmers and others, in the form of grants, from those functions dealing with the extension of credit.

The important work of the Department of Agriculture in providing assistance to needy farmers and other persons, as well as the prosecution of projects, such as Greenbelt and other similar activities of the Farm Security Administration, should be continued for the present and possibly in some instances be expanded. This type of assistance to the needy should continue to be administered in the Department of Agriculture. On the other hand, the functions of the Secretary and of the Department involving the extension of credit should be administered and coordinated with the other lending agencies of the Federal Government.

I am firmly of the opinion that the present work of the Farm Security Administration, in the lending of money to deserving farmers for the purpose of rehabilitation, and the farm tenant program

should be continued and expanded, as recommended by me to the Congress at its last session.

In order to accomplish the separation of these functions, I propose to transfer to the Farm Credit Administration all of the functions of the Secretary of Agriculture and the functions of the Farmers' Home Corporation, provided for in Titles I and II of the Benihend-Jones Farm Tenant Act and all the functions of the Secretary of Agriculture and the Farmers' Home Corporation under Title IV of the same legislation, to the extent that such functions may relate to, and be necessary to carry out, the functions and duties provided for under Titles I and II of that Act. This will not involve the abolition of the Farmers' Home Corporation but will merely mean that the Farm Credit Administration will have the same powers with respect to farm acquisition loans and rural rehabilitation loans (Titles I and II, respectively, of the Benihend-Jones Farm Tenant Act) as the Secretary of Agriculture and the Farmers' Home Corporation (to which he is authorized to delegate his powers in this connection) now have under these two titles, and under Title IV of the same Act which contains, among other things, a number of general provisions applicable to the administration of Title I and Title II (as well as Title III functions). The plan will not transfer the functions of the Secretary of Agriculture under Title III, which provides a land utilization and land conservation program, since these are not credit functions. Similarly, it will not disturb his general functions and powers under Title IV in so far as they relate to the carrying out of his functions under Title III or any other

- 8 -

functions vested in him by the Act and not transferred by the plan to the Farm Credit Administration.

Similarly, I propose to transfer to the Farm Credit Administration all functions of the Secretary of Agriculture and the Farm Security Administration under section 3 of the Emergency Relief Appropriation Act of 1939 to the extent that such functions relate to farm debt adjustment service, the making of loans and the extension of credit to farmers, and to the servicing and adjustment of loans made, or credit extended to farmers under said section or prior law.

I further propose to transfer to the Farm Credit Administration the functions of the Secretary of Agriculture and the Farm Security Administration under the Act of August 7, 1939 (Public No. 307, 76th Congress), which relates to the development of farm units on public lands under Federal reclamation projects with funds loaned by the Farm Security Administration.

As a necessary corollary to the foregoing transfers of functions, the plan will transfer to the jurisdiction and control of the Farm Credit Administration so much of the personnel, records and property, including office equipment of the Department of Agriculture, Farmers' Home Corporation, and Farm Security Administration of the Department of Agriculture as I may determine to be necessary to the efficient performance of the functions transferred.

I believe from my investigation that this division of functions and regrouping of agencies and activities is necessary in order to

further the major purposes and objectives of the Reorganization Act of 1939.

In this connection I believe that the placing of all rural credit activities of the Federal Government under one responsible head will bring about a reduction of expenditures, increase the efficiency of the organizations involved, and promote the consolidation of such agencies, according to their major purposes. I am also confident that the proposal will eliminate the overlapping and duplication of effort which now exists. The plan presented represents the result of extensive study and experience gained through actual operation of the agencies involved. The plan conforms to methods of administration adopted by the Government with respect to its other lending activities, and will permit the President to exercise closer supervision and control over important fiscal operations and policies of the Government. The reduction in administrative expenditures which it is probable will be brought about by the taking effect of the reorganizations specified in the plan is estimated at \$50,000 per annum. While some of these economies can be brought about immediately, others will require a gradual readjustment in machinery and business practices of the agencies and functions effected.

I trust, therefore, that the Congress will view the plan as a further step in improving the executive administration of the Government of the United States.

ESB:lp
10/24/39

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

135

DATE 11-9-39

TO Secretary Morgenthau
FROM Mr. Foley

At Mr. McReynolds' request we have for some time been working on a proposed reorganization plan which would consolidate in a new independent agency all farm credit activities of the Government. The objective, as outlined by Mr. McReynolds, is to establish a single lending institution, to which the agricultural section of the United States can go for its credit, which could gradually be developed to a point where it will be self-supporting.

At Mr. McReynolds' request we have worked with Peyton Evans, General Counsel of the Farm Credit Administration, on this matter. Mr. Evans is the only person outside of the Department with whom the matter has been discussed.

Attached for your consideration are (A) a draft of such a reorganization plan and (B) a draft of a message to accompany the plan. Both have been cleared with and approved by Mr. Evans. This Plan (1) reestablishes the Farm Credit Administration now a part of the Department of Agriculture as the independent agency which it was prior to July 1, 1939, when Reorganization Plan No. I transferring it to Agriculture became effective; (2) transfers the Rural Electrification Administration (another independent agency which was transferred to Agriculture by Reorganization Plan No. II) together with all its activities, to the new independent Farm Credit Administration; and (3) transfers the lending functions of the Farm Security Administration of the Department of Agriculture to the new independent Farm Credit Administration.

These comprise the farm acquirement loan functions under Title I of the Bankhead-Jones Farm Tenant Act, the rehabilitation loan functions under title II of the same Act, and the Farm Security Administration lending functions authorized and appropriated for by section 3 of the Emergency Relief Appropriation Act of 1939.

I wish to raise several questions of policy in connection with the attached Plan for your consideration.

(1) Set-up of new agency. There are two major possibilities with respect to the set-up of the new Farm Credit agency. A brand new agency, such as the Federal Works Agency or the Federal Security Agency established by Reorganization Plan No. I, could be established and the Farm Credit Administration and the other agencies and functions within the scope of the Plan transferred to it. The other alternative is the one adopted by the attached Plan, that is, to reestablish the Farm Credit Administration as an independent agency and then transfer the Rural Electrification Administration and the other functions to it. The Farm Credit Administration itself was originally established by consolidating a number of independent boards and agencies. To create a new independent agency with an administrator and other new officials at the head, and transfer the Farm Credit Administration to it, would result in creating three steps of officialdom (i.e., the original board and agency heads of the Farm Credit Administration, the governor, and the new administrator and his assistants); would create a great deal of confusion as to where responsibility lay; and would be administratively cumbersome.

(2) Exclusion of Commodity Credit Corporation. The Commodity Credit Corporation has not been included in the attached draft among the agencies to be transferred. It appears that its functions are essentially price

- 3 -

stabilizing and not credit functions and would not therefore properly fit into this reorganization picture. Moreover, it is doubtful whether the new agency could ever be self-supporting if it had the Commodity Credit Corporation under its roof.

(3) Only lending functions of Farm Security Administration transferred.

The non-lending functions of the Farm Security Administration and other branches of the Department of Agriculture are not transferred by the attached Plan.

This will leave in the Department of Agriculture the relief functions of the Farm Security Administration, all work in connection with land conservation and land utilization, and the resettlement projects which it administers.

This has been done because it has been thought that the essentially agricultural credit character of the newly reorganized agency would be obscured if relief and other non-credit functions were transferred to it.

E. W. FH

(COPY: 12/1/39)

No. 13

AIR MAIL

AMERICAN CONSULATE

Hanoi, Indochina, November 10, 1939.

Subject: Transit of Commodities to China during
October, 1939.

The Honorable

The Secretary of State,

Washington.

Sir:

I have the honor to acknowledge the receipt of the Department's telegraphic instruction, a paraphrase of which was received under cover of a letter from the Consulate General at Hongkong dated November 7, 1939, in regard to the submission of a report on the first of each month as to (1) the amount of freight at Haiphong awaiting transit to China, (2) the amount of freight transitted to China during the preceeding month, (3) the percentage of this freight which is destined for the Chinese Government, and (4) the general conditions obtaining at Haiphong.

So far as I have been able to ascertain there were at the beginning of October, 1939, at least 220 thousand tons of freight at Haiphong and in other parts of Indochina awaiting transit to China. By the end of October, due to the measures mentioned in my despatches nos. 5 and 10 of October 13 and 27, 1939, this total had been reduced somewhat insofar as Haiphong itself was concerned. But the total for all Indochina has remained approximately the same. In other words, arrivals at Haiphong and in Indochina of freight destined for unoccupied China approximately equalled shipments of freight to China.

It is estimated, there being no available sources of accurate information, that between 13 and 14 thousand tons of freight were transitted to China during October. Of this about 85 per cent was destined directly for the Chinese Government or would ultimately be diverted to the use of the Chinese Government or quasi-governmental organizations. The Department may be interested in the estimate that of the 13 or 14 thousand tons at least 7 or 8 thousand consisted of shipments of petroleum products, chiefly gasoline. Of this amount about 3 thousand tons are believed to represent shipments under the Universal Trading Company loan.

Insofar

Insofar as conditions at Haiphong are concerned, reference is made to my despatches nos. 5 and 9 of October 13 and 22, 1939. Little change has been noted in conditions at Haiphong since the mailing of those reports, save that the congestion of freight is somewhat less conspicuous than previously reported, although this effect has been obtained mainly by moving a part of the freight to places less in the public eye. The situation at Haiphong is still characterized by a lack of efficient organization, and confusion and disorder are still in evidence. A serious effort is being made to bring order out of confusion and to speed up the transit of freight to China. But much remains to be done - and there is no doubt but that some of the freight at Haiphong is no better for being stored in the open and under unfavorable climatic conditions.

The information set forth above has been obtained through conversations with various reputedly well-informed sources, and without giving publicity to the interest of the United States Government in such information. In this connection, I must say that there are no readily available sources of statistical data, as mentioned in the Department's telegraphic instruction, and that an estimate is arrived at from entirely unrelated and often inconsistent sources. The most accurate estimate is that pertaining to the shipment of petroleum products.

Respectfully yours,

CHARLES S. REED II,
American Consul.

Original and 2 copies to the Department
Copy to Embassy, Chungking
Copy to Embassy, Peiping
Copy to Consulate General, Hongkong
Copy to Consulate, Saigon

815.4

CSA/car

Paraphrase of Telegram Received

FROM: American Embassy, Paris, France

DATE: November 10, 1939, noon.

NO.: 2712

The following is personal for Secretary Morgenthau:

Reference is made to your telegram of October 21, No. 1289 and to telegram of November 2, No. 2634 from the Embassy.

The French have not yet straightened out as the Finance Ministry had hoped the question of the suggested procedure for handling war purchases in the United States. Yesterday our Bank of France friend talked frankly with us about the position of the Bank. He said that the Bank had unwittingly been caused some embarrassment by the procedure which you desired worked out. Unfortunately the Bank of France could not spare a responsible officer to send to the United States to be responsible for drawing on the account or accounts to be carried in its name with the Federal Reserve Bank of New York - in this connection the British were more fortunate in that a responsible officer was on a mission in Canada and could be given this task.

Our friend explained that the relations between the Bank of France and the French Finance Ministry have not always been of the best, although at present they are excellent. Through the years, an excellent reputation for integrity, responsibility and independence has been built up by the Bank quite free from any of the political coloring of changing ministries

- 2 -

ministries of finance or the evidence of irresponsibility or corruption which have crept into the Finance Ministry at times. It is because of this that the Bank of France is extremely reluctant to make the "unprecedented" move of permitting a Finance Ministry representative or representatives to draw on the account of the Bank with the Federal Reserve Bank of New York.

Our friend told us that he himself has been able to stop payment on questionable contracts in four or five cases. He cited one example of a sizeable order for shoes from the United States some time ago. The appropriate ministries had approved the order, and a relatively unknown French intermediary was handling it. At the time the intermediary came in to discuss the order with our friend, the latter suggested that payment be handled through the bank of the former. The intermediary replied that he has no bank nor any connection with a bank; this plus the man's bad credit rating, produced by our friend, and the fact that in large part the thousands of American surplus shoes which had been ordered for the French Army were women's sizes, enabled him to stop the transaction.

Our friend indicated that the Bank of France would prefer to handle important amounts itself directly, although he said the Bank might be willing to permit an official from
the

- 3 -

the Ministry of Finance to draw on the Bank's account for sums say up to \$50,000. He added that the Bank could handle the important amounts without delay, and admitted frankly that the Bank feared the possibility of being unwittingly involved in some scandal on purchases on a large scale. Of course he realized, he said, that the Federal Reserve Bank felt it could not carry a checking account for the Ministry of Finance directly.

We had a talk with Couve de Murville last evening, who confirmed to us the jealous anxiety of the Bank to guard its independent position, and its fear that it would be a "dangerous precedent" and opening wedge for the Ministry of Finance to be permitted to draw on the Bank's account. From Couve de Murville we gathered that the Ministry feels the Bank of France is being over-conservative and unreasonably so in the present war crisis, and that the Ministry is still hopeful that a solution can be worked out.

END SECTIONS ONE TO FIVE INCLUSIVE.

BULLITT.

EA:LWW



DEPARTMENT OF STATE
WASHINGTON

November 10, 1939.

My dear Mr. Secretary:

I enclose three copies of paraphrase of sections one to five, inclusive, of telegram No. 2712 of November 10 from Paris, transmitting a personal message for you.

Sincerely yours,

Herbert Feis

Herbert Feis
Adviser on International
Economic Affairs

Enclosures:

3 copies, paraphrase,
sections 1-5, No. 2712
of November 10.

The Honorable

Henry Morgenthau, Jr.,

Secretary of the Treasury.

RECEIVED

NOV 10 1939

TREASURY DEPARTMENT
Office of the Secretary
Technical Assistant to the Secretary

PARAPHRASE OF TELEGRAM SENT

TO: American Embassy, Paris

NO.: 1378

DATE: November 10, 1939

STRICTLY CONFIDENTIAL FOR THE AMBASSADOR.

2783 - 11-15
1417 - 11-20
2830 - 11-25
1447 - 11-26
2828 - 11-25
2829 - 11-25

I have been requested by the President to inform you that according to his judgment, the problem with which this country is faced is as follows: At the same time that the French and British Governments are attempting to purchase goods in this country, it will be necessary for the United States Government to purchase similar goods. It is his opinion that separate (emphasize separate) purchasing agencies should be established by France and Great Britain but that those two Governments should make plans for the responsible heads of their respective purchasing agencies to have continuing contact and coordination with each other so that the purchases made by the two agencies will be satisfactorily synchronized, and above all, he believes that there should be effective synchronization of the purchases which these two agencies will make with the purchases which the United States Treasury Department will be making.

HULL
(CWG)

EA:EB

HSM

PLAIN

London

Dated November 10, 1939

Rec'd 12:50 p. m.

Secretary of State,
Washington.

2327, November 10.

FOR TREASURY.

1. With reference to the third paragraph of my No. 2305 of November 8, it is announced today that the Chancellor of the Exchequer will broadcast on National savings on November 22 at 9:15 p. m. Greenwich time.

2. Press comments this morning on yesterday's Bank of England return reported in my No. 2318 of November 9 attribute the decline in bankers' deposits to the excess of payments of new Treasury bills over maturities and also note that an increase in public deposits during November is usual in preparation for the December 1 war loan interest payments.

3. Meanwhile the October clearing bank statements have become available showing an increase in bill portfolios of £53 million and in money at call and notice of £13-1/2 million, while cash is down by £12 million and the cash ratio reduced from 11.74 percent to 10.98 percent. Deposits have increased by another £132 million; investments show

little

ham -2- No.2327, November 10, from London

little change, increasing by less than £3 million, while advances rose by about the same amount. The increase of £68.3 million in the combined figure of bills and call money being in excess of the expansion in the Treasury bill issue which rose by £55 million in the month tends to confirm the suspicion that the banks have been fed with tap bills from official quarters in recent weeks.

4. At today's Treasury bill allotment the syndicate obtained 61 percent of its applications and the average rate for the tender was approximately £1.3s.1-1/2d. as compared with £1.3s.4.39d. last week.

5. The further decline of sterling in New York yesterday still receives no comment in the TIMES while in the FINANCIAL TIMES it is attributed to "the nervousness of the market in New York". The FINANCIAL NEWS writer Einsig renews his plea for the tightening of loopholes especially the ability of importers to pay for goods in sterling which is then transferable by the foreign holder.

6. Though the official rate for the Dutch guilder has not moved the belga continues to weaken, the rate being fixed at 24.05-25.00 yesterday and 24.20-50 today. The Argentine rate was fixed 17.00-17.50 today having stood at 16.90-17.40 since October 11. Other officially fixed rates are unchanged. Many of the free rates have moved adversely to sterling today. The Danish and Finnish rates hardened slightly

hsm -S- No. 2327, November 10, from London

slightly to 20-1/4 bid and 216 bid respectively, and the Italian lira continues to appreciate being quoted today 75-76 having been 77-1/2-78-1/2 on Monday. The yen has also appreciated to 1s.2-5/8d.-21/32d. as compared with 1s.2-3/16d.-7/32d. on Monday.

7. The Stock Exchange reflected the uncertainties of the international situation with both gilt-edged and industrial markets weak. War loan ~~was~~ down 5/8 at 91-1/8 at the close.

KENNEDY

RR

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PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris

NO.: 2714

DATE: November 10, 1939, 2 p.m.

SECTIONS ONE, TWO, THREE AND FOUR.

FOR THE TREASURY

Yesterday we talked with the Manager of the B.I.S., Roger Auboin, who came back from Basel only a few days ago. Mr. Auboin said that an arrangement had been worked out by President Beyen and him by which he will keep his title as Manager of the B.I.S. so that he can maintain a certain "control" over the activities of the bank; he said that in practice, however, a "neutral" will perform his duties. (It is our understanding that Mr. Auboin will hold an important post in the set-up for France's war purchases. He seems pleased that he is to get away from the relative inactivity of the B.I.S. in wartime.) He told us that the position of the bank is not such a difficult one as is generally supposed. General opinion here is that the Bank will not be able to meet its operating expenses if Germany ceases to pay interest on the investments of the Bank. He stated that this was an exaggerated statement of the situation and that the Bank would be able to continue but that it would have to reduce its personnel greatly

greatly. He said that the Bank was aware that since the beginning of the war its position was a delicate one. Of course/^{by this time} France and Britain had withdrawn all the funds they could. For the purpose of avoiding as much criticism as possible, the Bank had voluntarily agreed that it would not conduct any operations for the central banks of belligerent countries. He also said that although this restriction which the B.I.S. had imposed on itself was "technically neutral", in practice it worked one-sidedly because it was scarcely likely that the Bank of England would desire to carry on transactions in Reichsmarks but there was a possibility that in certain cases the Reichsbank might care to carry out through the B.I.S./^{certain transactions in sterling.}

Auboin said that so far the attitude had ~~not~~ been taken by his German assistant and also by the authorities of the Reichsbank that a real war did not exist, that the affair was just an occurrence in Poland, and that business should be carried on in the usual way. Of course Auboin was not able to subscribe to this attitude and an even firmer position was taken by the British; however, it was more difficult to arrange a completely neutral manner of functioning for the B.I.S. because of the German position. The Germans are now making punctual payments on the investments which the Bank has made in Germany

-3-

Germany; we asked Auboin how long he thought they would keep on doing so. He stated that it was difficult for him to say but he felt that for reasons of a personal nature the personnel of the Reichsbank wished to cooperate with the B.I.S. as long as the leaders of the Nazi party would permit them to do so. He added that many of the personnel of the Reichsbank were afraid that there would be eventually a turnover in the Reich and they considered that their associations in the B.I.S. were somewhat of an "ace in the hole" for the future and that they constituted a safeguard against complete isolation.

Auboin informed us that the new President, Mr. McKittrick, would arrive at Basel by way of Genoa around the 20th of November (you have probably been informed of this) but theoretically he was not scheduled to take office until January.

We inquired of Auboin whether he had any definite idea with reference to German economic conditions. He made answer that there was great difficulty in forming an opinion that was really well based but he said he did not believe that conditions in Germany were as bad as was generally pictured in Great Britain and France. He said that one weakness in the German position was that although it is supposed that considerable stocks of supplies

~~-4-~~

plies necessary for carrying on the war are owned by the Government, there is an extremely small amount of stocks in the hands of industries, firms and individuals. Of course, the holdings of the German Government would be somewhat offset by this fact.

EA:EB

(PARTIAL)

PARAPHRASE OF SECTIONS FIVE, SIX AND SEVEN OF TELEGRAM NO. 2714 OF NOVEMBER 10, 1939, 2 P.M., FROM THE AMERICAN EMBASSY, PARIS, FRANCE:

He remarked to the Minister for Air, Guy la Chambre, in this regard, that, upon his return from a neutral nation that is subject to rather rigid rationing, he was shocked to discover that France, one of the belligerents, does not have true rationing; nor does the public realize that it is important that waste should be avoided. Guy la Chambre said he was completely in accord; he himself was surprised and also concerned at the stream of motor traffic, especially on Sundays, on roads which lead out of the city of Paris. This traffic is almost like the week-end pleasure and tour traffic of normal peacetime. The Minister for Air went on to say that the waste of gasoline must be reduced drastically from the point of view of both needed aviation stocks and wasted resources of foreign exchange; furthermore, while he recognizes it to be desirable that the matter of rationing should proceed gradually, he will insist that unnecessary allowances in gasoline be greatly reduced. Referring to telegram no. 2148 of the 23d of September, 1939, 1 p.m.:— There hasn't been any real pinch on the public here such as that which exists in ~~other~~ belligerent and neutral countries elsewhere, although, as you know, gasoline cards have been required here since November 1. In the matter of reduction in non-essential
gasoline

-2-

gasoline allowances, Guy la Chambre stated that one plan for its accomplishment, which some favor, would be to raise the price of gasoline by extra taxes; however, he believed that were this put into effect, the legitimate commercial users of gasoline would be too heavily penalized and that the wealthy people who drive for pleasure would not feel the pinch. In this respect we said we believed that French newspapers and the French information center were mostly responsible for the attitude of the public towards waste, because they are constantly stressing the "glowing" contrast between French abundance and the privations in Germany in food and other things. Both of them agreed regarding this matter. We were informed yesterday by Reynaud's Directeur de Cabinet, Palewski, that the French public should be brought to realize the importance of making greater sacrifices and reducing waste; and great efforts should be made to convince the French people in this respect. A requirement that, from now on, bread must contain rye flour to the extent of 2% was published in the Journal Officiel this morning.

Tomorrow Reynaud, together with his staff of experts, will proceed to London for the purpose of discussing the whole question of financial cooperation in the war by Great Britain and France, with Sir John Simon and some other British authorities; war purchases and credits to
friendly

-3-

friendly nations and allied nations will be included in this discussion.

The Swiss National Bank statement for the week ended November 7 shows a reduction in gold reserves of 41.2 million francs to 2,253.3 millions. Foreign exchange holdings are up 25.2 millions to 316.4 millions. Note circulation is down 34.7 millions to 2,001.5 millions. Sight obligations are up 17.6 millions to 852.3 millions. Gold coverage is 82.46 percent as compared with 83.40 percent.

BULLITT

EA:MSG

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Rome, Italy

DATE: November 10, 1939, noon

NO.: 502

Confidential information has come to me that within a few days there will be a change in the conversion rate for remittances from Italian emigrants to Italy; the new rate will be \$4.05 per hundred lire, where formerly it was \$4.55. It is a matter of conjecture whether this action presages a further devaluation of the ordinary rate for dollar exchange.

PHILLIPS.

EA:LWW

RECEIVED

NOV 10 1939

TELETYPE UNIT
U.S. DEPARTMENT OF STATE
WASHINGTON, D.C.



OFFICE OF
COMMISSIONER OF INTERNAL REVENUE

ADDRESS REPLY TO
COMMISSIONER OF INTERNAL REVENUE
AND REFER TO

IT:P:CA
CAA

TREASURY DEPARTMENT

WASHINGTON

156

November 10, 1939.

REPORT FOR SECRETARY MORGENTHAU:

In regard to closing agreements which have been requested, the following applies:

Colt's Patent Fire Arms Manufacturing Company:

This agreement has been completed and the contractor's copy was mailed to the company on November 8, 1939.

De Laval Steam Turbine Company:

The contractor filed application with the Navy Department for a certificate. Action by such department is awaited.

The Midvale Company, Philadelphia, Pennsylvania:

There have been no further developments. Action by Navy Department (re certification) is awaited.

New Matters:

Inquiries for information regarding Press Release 18-79 have been received from North American Aviation Company and American Optical Company and have been answered (orally).


Commissioner

British Amb interested
in wood oil ship-
ments thru Rangoon
& offered facilitate
such shpts,
Pled at Gen's speech

Telegraphic Address
" 9095 "
Telephone 2539

復興商業公司
FOO SHING TRADING CORPORATION
SUN SUN GARDEN
CHUNGKING

57
CODES:
BENTLEY'S
ACME

10th November 1939.

Secretary Henry Morgenthau, Jr.,
Treasury Department,
Washington, D.C.
U.S.A.

Dear Mr. Morgenthau,

The British Ambassador, Sir Archibald Kerr Clark Kerr, asked to see me recently. During the interview, he mentioned his interest in wood oil passing through Rangoon and offered to facilitate such shipments if any problems arose. He is very sympathetic to China's cause and states that he hopes to see every Japanese soldier off Chinese soil. He was very pleased with Ambassador Grew's speech in Tokyo and stated that actions of that kind on the part of America greatly stiffened the British backbone and that Britain would follow America in any steps curtailing Japan.

With best personal regards,

Sincerely yours,

J. Lossing Buck
J. Lossing Buck.

JLB:MC

1945
RECEIVED BY
ARCHIVAL & COMMUNICATIONS SECTION

J. Lossing Luck,
Foo Shing Trading Corporation,
Sun Sun Gardens, Chungking.

Secretary Henry Morgenthau, Jr.
Treasury Department,
Washington, D.C.
U.S.A.

AIRMAIL REGISTERED
VIA CLIPPER *Europe*

R	Chungking
	No. <i>9</i>

THE UNDER SECRETARY OF THE TREASURY
WASHINGTON

November 10, 1939

Dear Henry:

I send you clippings from today's newspapers. I wonder if it would not be possible to get someone to tell Mr. Eccles to mind his own damn business.

Best regards,

Sincerely,

Johnnie

The Honorable Henry Morgenthau, Jr.

The Secretary of the Treasury.

NOV 10 1939

TAX ON SMALL MAN SOUGHT BY ECCLES

He Also Proposes Bigger Levy
on Large Corporations to
Help Balance Budget

SEES WAR NO HELP IN END

Asks Less Exemption for Single
Man Under \$1,000 and for
Family Head Under \$2,500

ST. LOUIS, Nov. 9 (AP)—Merriner S. Eccles, chairman of the Federal Reserve Board, called tonight for higher taxes on small individuals and big corporations to finance national defense expenditures, balance the budget and solve the problem of money.

In a speech prepared for the observance of the twenty-fifth anniversary of the St. Louis Federal Reserve Bank, Mr. Eccles also scouted any idea that war business would be of any long-range benefit to the United States.

"I hope," he said, "that none of us will be deluded into imagining that the tragic accident of European war will, in the long run, win or even ameliorate our fundamental domestic problems."

The armament orders and other war business, he asserted, will only aggravate the investment problem caused by the piling up of \$5,350,000,000 in the nation's banks.

Program Suggested

Here is the program put forward by Mr. Eccles, a close White House adviser:

1. Reduce exemptions that enable single men earning less than \$1,000 and family heads earning less than \$2,500 to escape Federal income taxes.
2. Increase tax rates on persons earning from \$5,000 to \$50,000.
3. Increase the "normal" income tax on corporations to take away a share of "war profits."
4. Put extra taxes on "rainy day reserves" piled up in "excessive amounts" by large corporations.
5. Reduce consumer taxes, such as the excises on automobiles, gasoline and theatre tickets.
6. Adjust social security and unemployment insurance taxes so that they will not exceed benefit payments, at least until times are much better.

"We are hearing today," Mr. Eccles said, "proposals that the government should reduce some of the present expenditures, particularly for agricultural benefits and for work relief, in order that funds for an expanded armament program may be provided without an increased deficit or an increase in taxes."

"In my opinion, it would be unfair and unsound economically to pass increased armaments cost on to those of the low-income groups who would profit the least out of foreign or domestic expenditures for armament, who are the least able to bear the costs and whose increased purchasing power is essential to our economic welfare."

The chairman was referring to views such as have been expressed by influential Senators in recent weeks, and his rebuttal was the first reaction from the Administration's inner circle.

Urges More Taxes

Instead of slashing relief and farm funds, Mr. Eccles continued, "we should follow the unpopular but necessary course of imposing additional taxation in order to meet the added costs of our armament program and to reduce the deficit without sacrificing the low-income groups, whose sustained and increasing purchasing power is needed to sustain and increase production."

"Accordingly, additional taxation should be levied, not alone upon war profits, but upon those income groups now relatively undertaxed, among whom the greatest proportion of savings that are unable to find profitable outlet today are now accumulating. At the same time, I favor increasing domestic purchasing power by decreasing consumption taxes."

He said his plan for taxing "rainy day reserves" of big corporations was not the unpopular undistributed profits tax that the last Congress repealed after three years of controversy. He said the proposed tax would not apply to small business men at all, and would not apply to big corporations if they used their surplus profits to pay dividends or to modernize or expand their plants.

Rather than pile up huge surpluses, he said, corporations ought either to reduce prices to consumers or increase wages, but if they did neither it was necessary for the government to tax the excessive surpluses. Such levies, he asserted, would discourage corporations from withdrawing money from the nation's "income stream."

Not "Pay-as-You-Go"

Mr. Eccles did not urge the "pay-as-you-go" idea of social security frequently advocated by Republican leaders, but he agreed with the critics who opposed building up large reserves of payroll taxes in hard times.

"We have made the mistake, in my judgment," he declared, "of accumulating a vast reserve in times of large unemployment, taxing it out of those best able to pay or those whose savings are idle, but out of payrolls mainly of those who otherwise doubtless would have kept the funds moving in the income stream."

The time to build up social security reserves, he said, is in days of prosperity, so that in hard times credit payments can exceed the taxes. This philosophy is similar to the Treasury deficit theory that Mr. Eccles has advocated for years. He has urged the Administration to incur deficits in hard times deliberately in order to increase public purchasing power.

The banker said his tax program indirectly would solve the idle-money problem by taxing funds that otherwise would be saved and by stimulating investment to use up some of the already existing idle money.

Slimes Gold Inflow

He said the present fund of idle money was caused almost exclusively by the huge influx of foreign

Continued on Page Thirtysix

TAX ON SMALL MAN SOUGHT BY ECCLES

Continued From Page Thirty-five

gold in recent years, and added that the "cash and carry" Neutrality Act would aggravate the problem by making it necessary for Europe to send more gold here to pay for goods.

Because idle money can be re-loaned by banks several times, Mr. Eccles estimated that the present volume of such funds could theoretically be the basis for \$30,000,000,000 to \$40,000,000,000 in loans—an inflation about which the Federal Reserve Board has worried for several years.

Although he had no exact figures on how much money France and England could spend in the United States, Mr. Eccles estimated they had about \$1,250,000,000 of cash deposited in this country, owned about

\$1,500,000,000 of readily salable securities, and had other resources and investments marketable here worth about \$1,500,000,000. In addition, he said, the Allies have about \$6,000,000,000 worth of gold, and their territories produce an additional \$750,000,000 of new gold each year.

Reserve Head Urges Curb on Corporate 'Oversaving,' New Levies

Asks War Profit Impost, Broader Income Base, Re- vival of Profits Surtax

U. S. Must Pay for Armaments

From THE WALL STREET JOURNAL ST. LOUIS, Tuesday

ST. LOUIS—A drastic revision of the federal tax structure, designed to increase consumption, reduce "oversaving" and to narrow the "gap between government income and outgo" was advocated here last night by Maurice E. Eccles, chairman of the Board of Governors of the Federal Reserve System.

Mr. Eccles spoke at the 25th anniversary of the opening of the Federal Reserve Bank of St. Louis.

The principal tax changes urged by Mr. Eccles were the following:

1. Additional taxation, including levies on war profits, to pay for increased armament expenditures, without curtailing outlay for agricultural benefits, work relief and similar social expenditures.

2. Reduction in consumption taxes, both state and federal, and revision of old-age and employment insurance, apparently in the direction of reduced payroll taxes and increased benefits.

Broader Tax Base

3. Broadening the income tax base and raising tax rates on incomes of between \$5,000 and \$100,000.

4. Increasing the normal corporation income tax and reducing present exemptions on the inheritance tax "to help pay for an increased armament program."

5. Revival of taxation similar to the undistributed profits surtax in order to discourage "over-accumulation of so-called rainy day reserves which are being set aside in excessively large amounts, particularly by the larger corporations." Mr. Eccles opposed, however, the application of such taxes to small businesses.

Increased Outlets

Mr. Eccles endeavored to tie up these proposals with the general desire of the banking fraternity for increased outlets for funds and higher money rates.

"Such a tax program would do much to keep otherwise stagnant funds moving in the income stream in a way that will augment consumption and thus not only sustain existing investment, but open the way for new investment," he declared. "The banking and investment community cannot expect to do nothing about the piling up of idle funds on the one hand and, on the other hand, have the interest rates and earnings which they so much desire. It is the old story—you can't have your cake and eat it too."

Mr. Eccles predicted that interest rates in the near future will not exceed the average for the past years "in which we have had the combined effect of heavy excess reserves and slack demand for credit and for funds for new investment." The foreign war, he maintained, will not correct this situation but "is likely to make it worse."

"The remedy must be found at home," he asserted.

'Over-Saving' Theory

Throughout his address, the Federal Reserve Chairman stressed the "over-saving" theory of the economic troubles of the United States, which also has underlain his previous advocacy.

Please turn to page 7, column 2

Eccles Tax Plan

Continued from First Page

of deficit spending by the Federal Government in support of this theory, Mr. Eccles cited last night the findings of a recent report by the National Resources Committee which showed that the 2% of the families with incomes of more than \$5,000 saved \$1,600,000,000 a year in 1936 and 1937 as against \$2,800,000,000 for the 32% of the families with incomes of between \$1,250 and \$5,000 and as against the 55% of the families which had no savings.

Increased taxation on the "relatively under-taxed" families with incomes of between \$5,000 and \$50,000 would "offset continued over-accumulation of idle funds, add less to bank deposits through the process of deficit financing and help close the gap between government receipts and expenditures," Mr. Eccles contended.

In discussing the immediate business situation, Mr. Eccles said there was evidence of better voluntary control to prevent a runaway situation and subsequent collapse.

Conceding that the recent rise in industrial activity is based in considerable degree on anticipatory buying and inventory accumulation, he declared that "fortunately, there appears to be a more widespread recognition that as a matter of self-interest, restraint should be imposed by business and labor leadership to prevent a recurrence of the price distortions and inventory boom that led to the sharp relapse beginning in the middle of 1937."

Business Cooperation

To that end, business men appear more ready to cooperate in price restraints and in spreading out production," he continued. "Even though there may be glut of orders in some lines, including the steel industry, production and deliveries should be evened out over longer periods than has been the case under past practices."

Mr. Eccles also cited the "more rational policy" being pursued in the liquidation of foreign holdings of American securities in order to reduce the market disturbance to a minimum as well as in the timing and spacing of foreign war orders with a view "both to more orderly production and the avoidance so far as possible of conflict between foreign and domestic needs for essential materials."

He expressed the personal and "unofficial" view that the country will be "far better off if, as far as possible, foreign purchases were to be paid out of the sale of their goods in this country and out of the proceeds of the liquidation in this country of American securities held by foreigners rather than through further acquisition of foreign gold and silver for which we have no present or prospective use, because they would only increase the present unprecedented volume of unused excess reserves and deposits of the banking system."

Renews Recommendations

Mr. Eccles renewed his previous recommendations for expanded authority for the Federal Reserve System to control excess bank reserves. While stating that he favored continued low interest rates under existing conditions, he asserted his conviction that "it is essential for the monetary authorities to be in a position to influence the availability and cost of credit in order to discharge their proper responsibilities."

Despite recent increases in commercial bank loans, Mr. Eccles expressed doubt that the industrial demand for credit will be sufficient to absorb any substantial amount of excess reserves. He declared that corporation cash reserves together with existing surplus plant capacity and improved production methods requiring less plant expansion and less man power than would have been needed under old methods would limit the demand for new funds.

November 10, 1939

Dear Mr. Alsop:

Your letter of November 9th arrived after Secretary Morgenthau had left for Arizona. He expects to return to Washington in about a week and I shall be pleased to bring your letter to his attention at that time.

Sincerely yours,

H. S. Klotz
Private Secretary

Mr. Joseph Alsop,
1106 National Press Building,
Washington, D. C.

JOSEPH ALSOP AND ROBERT KINTNER

The Capital Parade

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1108 NATIONAL PRESS BUILDING
WASHINGTON, D. C.
TELEPHONE: NATIONAL 2304

WITH AMERICAN
UNION ALLIANCE

November 9, 1939

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

Dear Mr. Secretary,

After our long and rather wearing talk, for which you so generously gave of your time, there are two things I should like to say on paper so that they may be completely clear. First, Bob and I are now very sorry that we were so vehement. Being a sympathetic person, I am sure you will realize why we felt badly treated. Equally, we realize that the difficulty between you and us arose almost wholly from mutual incomprehension.

Second, now that you know what we want and we know what you are willing to give, my understanding of our agreement is as follows. With the exception of one or two secret matters you will make the record of the incidents in which we are interested fully available to us on a personal and strictly confidential basis. We will then prepare a précis of the record, exercising our own most careful editorial discretion. The précis will show you what we would like to print. It will be submitted to you, and if our editing seems anywhere inadequate, you will edit it freely yourself. Only when you have laid aside your blue pencil, will we be free to use the remaining material for our proposed magazine articles.

This arrangement seems to me eminently fair and practical. It will surmount the difficulty presented by the other plan of your having to select material, except in a broad way, ~~and~~ giving us access to it. At the same time, it will assure you of the most complete safeguards against the publication of any statement which you might think dangerous. I should add, that after you have edited the précis, it is my purpose to have it copied off in its final form, and to return to you the original version and all other notes.

JOSEPH ALSOP AND ROBERT KINTNER
The Capital Parade

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NORTH AMERICAN
NEWSPAPER ALLIANCE

1106 NATIONAL PRESS BUILDING
WASHINGTON, D. C.
TELEPHONE: NATIONAL 2304

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I cannot close without apologizing for taking so much of your time and for trespassing so long *greatly* your good will and helpfulness. As always, you have been most kind to Bob and to me.

Gratefully,

Joe Alsop.

November 10, 1939

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Private Secretary

Mr. Joseph Alsop,
1106 National Press Building,
Washington, D. C.

November 10, 1939

105

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H. S. Klotz
Private Secretary

Mr. Joseph Alsop,
1106 National Press Building,
Washington, D. C.

November 10, 1939

To: The Files
From: Mr. Hanes

Cabinet meeting - 2:00 P. M.

The following persons were present: The President, Messrs. Hull, Woodring, Murphy, Edison, Ickes, Wallace, Noble, Hanes, Madam Perkins.

The President opened the meeting by stating that he had been in close touch with the State Department and the Belgian and Netherlands Embassies, that he believed the next move contemplated by the Germans was to invade Holland, occupying a strip of land as a corridor to the Sea, between the West bank of the Rhine and the Scheldt River. He said the object of course in doing this was to establish submarine, naval and air bases 60 miles from the English Coast. He said the best information he had was to the effect that there was a good deal of sentiment in Holland to submit to the German demands without fighting; that there was no indication that Germany would violate Belgian neutrality at this time. Secretary Hull discussed this same problem and said that undoubtedly the Germans had made other demands upon the Dutch which had not been made clear as yet to the State Department.

The President asked me what the Treasury's plans were for financing between now and spring. I told him that I did not think the Secretary had definitely made up his mind, but that in general the idea was to get as much of the financing behind him as possible at the first opportune moment before any further crises may upset general market conditions, which at this time seem favorable. I reported to him that having successfully concluded refunding of the December notes and the RFC financing, that I thought the Secretary would like to take the first advantageous moment to refund the \$1,300 million March maturities and probably ask for \$500 million additional cash, which would leave the market entirely free in 1940 for corporate financing. The President seemed to indicate a desire to let the Treasury cash position run down, mentioning a figure of \$800 million as an amount which he would deem adequate. The rest of the meeting was short, the President taking up with each Department head detailed matters upon which they had something to report.

Secretary Woodring discussed airplane developments, Secretary Edison talked about Navy personnel, Messrs. Murphy, Farley, and Ickes had nothing to report. Under Secretary Noble reported on the export situation and Madam Perkins spoke for a few minutes on the labor situation. When these routine matters had been dispensed with the President devoted about 15 minutes to the subject of change of flag from America to Panama in connection with the request of the U. S. Lines.

The President stated that the matter was first brought to his attention on Tuesday evening, November 7th, after the approach had been made to the Maritime Commission and agreed to by them. He said that on Tuesday evening he had spent two or three hours on the telephone from Hyde Park with Secretary Hull and Admiral Land that he had come into the situation cold without background. He said the Secretary of State was exactly right in his statement to the effect that this was a circumvention of the Neutrality Law, that he saw no legal obstacle in the way of doing what the U. S. Lines wanted to do. He did not say directly that he would not approve it, but from the conversation I gathered he had made up his mind not to do so. He spoke at some length about how he intended taking care of the 5000 seamen who would be "beached" due to the removal from the North Atlantic of 20 to 30 vessels. The President asked the War and Navy to figure out as many things as possible that they could buy from distant countries for the "stock pile" in order that we might send these vessels into neutral waters and pick up such cargoes and return them to America. The meeting ended at 3:45.

JWH.

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE November 10, 1939.

TO Secretary Morgenthau

FROM Mr. Cochran

Before deciding upon the draft and initialing today's telegram to the Federal Reserve Bank of New York in regard to the BIS — Turkish arrangement on gold, I telephoned Mr. Knoke at 3:30 p.m. I discussed with him the general question of loans against gold held under earmark with the Federal Reserve Bank of New York. We referred to the point raised a few days ago by Bolton in regard to a British commercial bank making the Central Bank of Uruguay a loan against gold held under earmark with the Federal. At that time we had both agreed that a transaction involving banks other than a Central Bank or the BIS, having a lien against gold earmarked with the Fed., should not be countenanced. We had taken this same position in September when the National City Bank of New York desired to use gold earmarked with the Federal by the Royal Treasury of Thailand as collateral for a loan by the National City Bank to Thailand.

Knoke confirmed that his Bank did make loans of 90 days, renewable twice for similar periods, to Central Banks against gold under earmark with the Federal, after specific approval by the directors of the New York Bank and the Board of Governors of the Federal Reserve System. Such a loan is actually outstanding to the Central Bank of the Republic of Turkey.

Knoke saw no reason whatever why the BIS should not be permitted to have gold earmarked with the Federal which was pledged to the BIS as collateral for a loan by it to the Central Bank of Turkey. That is, he saw no reason why the action requested by the BIS should not be carried out. Knoke said that he and Mr. Cameron had discussed the matter and that it had also been referred to Mr. Tiebout, who could be reached by our lawyers. Mr. Bernstein came to my office with the draft, which had been considered by Messrs. Foley and Pable, and while he was here Mr. Dietrich telephoned Mr. Cameron. The latter confirmed that Knoke, he and Tiebout were all in agreement that the transaction was a proper one.

Before talking with Knoke, as above recounted, I had asked Dr. White to meet with Mr. Bernstein and myself. Dr. White offered no objection to the transaction if our counsel saw no legal reason for denying it.

Since this case constitutes somewhat of a precedent, and particularly since it concerns the BIS, I took pains to obtain advice from the several sources above indicated before taking the decision. It will be recalled that I mentioned the matter to the Secretary shortly before he was leaving Washington, and the Secretary left the decision to me. After considering all sides of the question, I am convinced that the Treasury runs absolutely no risk; that the precedent is not likely to be an embarrassing one; and that a change in policy could be easily made if changed circumstances warranted it. On the other hand, I think we are doing a useful service in letting the transaction be carried

out. It is permitting some small part of the gold held earmarked in this country to be utilized for the basis of a credit to a Central Bank. We have not put ourselves out to build up the BIS, but when it is able to intervene as the intermediary in such a transaction as this, I feel that we should not block its efforts to be helpful unless we have a very valid reason for our position.

F. M. R.

EXCHANGE STABILIZATION FUND
November 10, 1939

FEDERAL RESERVE BANK OF NEW YORK

NEW YORK NEW YORK

RE CABLE TO YOU OF NOVEMBER EIGHTH FROM BIS REQUESTING TRANSFER OF GOLD
FROM BIS ACCOUNT #2 TO BIS ACCOUNT #4 STOP IN THIS CASE YOU ARE HEREBY
AUTHORIZED TO MAKE THE TRANSFER REQUESTED AND TO HOLD THE GOLD UNDER EARMARK
PURSUANT TO LICENSE NUMBER NY EIGHTEEN DASH ONE ISSUED BY THIS DEPARTMENT
STOP THIS DECISION SHOULD NOT BE INTERPRETED AS A GENERAL RULING OF THE
DEPARTMENT.

(Signed) John W. Hanes
Acting Secretary of the Treasury.

JWP:Mgt 11/9/39

November 8, 1939.

Bank for International Settlements
Basel

Your \$448 noted.

Federal Reserve Bank of New York

Phoned to Mr. Dietrich
from Mr. Weber

From: B.I.S., Basle, Switzerland

To: Federal Reserve Bank of New York

Date: November 5, 1939

#448.

Please obtain license to transfer approximately 1,000 kilos fine gold from our Account #2 to an Account #4 containing gold owned by Banque Centrale de la Republique de Turquie, Ankara, and pledged in our favor to secure commercial credits.

Bank for International Settlement

Rec'd by phone from Mr. Laddy, F.R.B. N.Y., Nov. 8/39, 3:35 P.M.

Copy for the Secretary.

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November 10, 1939.

Acting Secretary

Mr. Cushman

Some days ago I told the Secretary that Dr. Randolph Burgess, while talking with me by telephone in regard to another matter, mentioned the interest of the National City Bank in any financial arrangements that touch upon the finances and debts of Latin-American countries, particularly, Colombia, Peru and Panama. Dr. Burgess was concerned lest the short-term banking credits might be lumped together with the long-term loans in the settlements. Before such a procedure is considered, either he or Mr. Bentschler, or perhaps both of them, would like very much to come to Washington and present to the Secretary or yourself such information as they have in the premises. Burgess spoke to me again this morning on this point, since he had noted that a representative from Colombia had arrived in this country. I told him I would mention the matter to you.

B. M. S.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE November 10, 1939.

TO Secretary Morgenthau

FROM Mr. Cochran

Reference is made to my memorandum of November 9 which dealt with the weakness in sterling.

It will be recalled that I mentioned the early weakness at the staff meeting yesterday and that Mr. White requested that the Secretary give us instructions on the policy which we should pursue vis-a-vis the British during his absence. The Secretary requested four of us to meet together, Messrs. White, Riefler, Viner and myself, and to report back to him at 3 o'clock, bringing in Dr. Feis of the State Department, and a representative from the Department of Commerce, if we might consider the latter desirable.

Our group of four held two meetings, one before noon and the second shortly before meeting with the Secretary at 3:10 p.m. Mr. Glasser was present at the second meeting. Dr. Feis joined us shortly before we entered the Secretary's office.

Mr. White favored the idea of a message to our Embassy in London seeking certain information from the British authorities in regard to their sterling policy. If this initial inquiry did not evoke full and satisfactory information, and if the sterling rate did not please us within the next few days, Mr. White desired that further questions be asked of the British. It was my frank opinion that nothing should be done at once. I made this point at the morning meeting since Mr. Knoks was to call the Bank of England around noon and might obtain for us some information of interest. At the second meeting, I let the group know what information Mr. Knoks had given me at 12:55 with respect to his call which had just been terminated. Mr. Knoks has today provided me with a transcript (dated November 9) of that conversation, from which I reproduce the pertinent paragraph:

"I called Mr. Bolton at 12:40 today. We had had a very hectic market, I told him, with sterling opening at 3.86, dropping to 3.77 and then recovering to the present rate of 3.82. Selling for Rumanian account had continued with about £700,000 in the market this morning, which were left over from yesterday's orders. In addition, selling orders seemed to have been received from South America and from the Far East; Japanese selling seemed to be drying up. Buying had almost been absent for awhile. Bolton inquired whether there had been any selling from Brazil. I replied 'Not to my knowledge,' but why did he ask. He replied that they understood that the Brazilians had come into possession of sterling recently. 'I don't know whether we can do anything much about the market,' Bolton continued. As regards the Rumanian selling, they were going to take the matter up with Rumania.

I suggested that this selling might have to do with the British credit of May of this year but Bolton refused to think so. I stated that the market here certainly was disturbed and completely upset; that in a normal market today's selling would have been absorbed but in prevailing circumstances the result had been a break in the rate. This seemed to me unfortunate because I still believed that the selling was of a temporary character and that with a little buying the situation could have been corrected in a hurry. Bolton asked how much sterling, in my opinion, was still hanging over the market and I suggested that might be in the neighborhood of \$400,000. Bolton simply thanked me for the information. He could tell me nothing new at all as to conditions in Europe; Holland seemed to be getting worse. Regarding Belgium, they had no information today, not having been able to reach Brussels on the telephone."

Particularly in view of the fact that I had received the above mentioned information from the Federal Reserve Bank, our fiscal agent, which had appropriately inquired of the Bank of England, I thought nothing further should be done for the present. I told our group that I thought the British were still confused themselves in regard to an exchange policy, and that we were giving them information in regard to the New York market to help them formulate their policy. Seeing such factors as the Japanese selling (following the recent decision of Japan to detach the yen from sterling and to purchase dollars) and the heavy sale of sterling by Rumania (to complete their acquisition of dollars sufficient to buy gold requested from us) and the new factor of a threatened German attack through the Netherlands, I counseled patience. The rate improved in the early afternoon. If a decision should be taken to get some message across to the British, I thought that the mildest channel would be that which we had already followed, namely, through the Federal Reserve Bank. The next choice would be through a conversation with Pincent. I did not want to do anything prior to consultation with Butterworth who was due to arrive in the middle of the afternoon.

At the meeting with the Secretary, we were instructed that Butterworth's arrival should be awaited. If the situation then warranted it, we should meet with Mr. Eanes and decide what steps should be taken. The Secretary was not willing to give the instructions requested by Mr. White for a line of action in the Secretary's absence.

After Butterworth arrived and talked with the Secretary, the latter confirmed his decision to take no action now. Sterling has further improved today.



TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE November 10, 1939

TO Secretary Morgenthau
FROM Mr. Cochran

The foreign exchange market was much quieter with greatly reduced volume in sterling transactions. In Amsterdam, sterling was quoted between 3.82-1/2 and 3.86-7/16. In New York it opened at 3.85. Shortly after the opening, there was some small scattered selling and at about 10 o'clock it was quoted at 3.81-3/8, the low for the day. After that, a demand for sterling appeared and the rate gradually improved to the high of 3.88-1/2 at about mid-afternoon. Late in the afternoon there was some selling by Japanese banks and the rate closed at 3.86-3/4.

Sales of sterling by the four reporting banks in New York totaled £427,000 from the following sources:

By commercial concerns.....	£ 116,000
By foreign banks (Far East and Europe).....	£ 311,000
Total.....	£ 427,000

Purchases of sterling amounted to £626,000, as indicated below:

By commercial concerns.....	£ 220,000
By foreign banks (Europe, Far East and South America).....	£ 406,000
Total.....	£ 626,000

The banks also reported that the British Control purchased sterling amounting to £57,000 at the official rate of 4.02. All of this sterling represented cotton bills.

The belga was under great pressure today and closed at the low of .1608 as compared to yesterday's close of .1643.

The closing quotations of the other important currencies for yesterday and today are listed below for comparison:

	November 9	November 10
French francs	.0218-1/4	.0219-1/4
Guilders	.5308	.5308
Swiss francs	.2242	.2242
Canada	11-1/2% dis.	13-1/2% dis.

CONFIDENTIAL

The Federal Reserve Bank received approximately \$85,000 for the account of the Bank of Brazil. The Brazilian bank requested that this amount be converted into gold under the agreement of July 15, 1937. We have now sold to Brazil a total of \$6,085,000 in gold under this agreement.

We purchased the following amounts of gold from the earmarked accounts of the banks indicated:

\$15,040,000	from the Bank of France
5,730,000	from the National Bank of Belgium
3,500,000	from the Netherlands Bank
<u>\$24,270,000</u>	Total

The Federal Reserve Bank reported to us a shipment of \$835,000 from England, consigned to the National City Bank of New York, for sale to the U. S. Assay Office at New York.

I talked with Mr. Knoke this forenoon and again this evening in regard to the belga. The Federal Reserve Bank of New York has today received from the National Bank of Belgium a cabled inquiry in regard to assistance from the Federal in arranging freight and insurance on between 9 and 10 million dollars of gold, the gold to be moved from British ports and the insurance to be in U. S. dollars. The Federal is working on this.

The equivalent of today's London spot silver price was 40.66¢ and the forward price, 40.45¢. Handy and Harman's price for foreign silver remained unchanged at 34-3/4¢. The Treasury's price was also unchanged at 35¢.

In New York we made three purchases of silver totaling 150,000 ounces under the Silver Purchase Act. We also purchased 120,000 ounces of silver from Canada under our regular monthly agreement.

B. M. R.

CONFIDENTIAL

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE November 13, 1939

TO Secretary Morgenthau
FROM Mr. Cochran

The foreign exchange market was small with the rates for several currencies showing improvement. On Friday, sterling closed in this market at 3.86-3/4, and on Saturday it was quoted in Amsterdam at 3.87-1/2. This morning the Amsterdam quotation was 3.88-5/16. At the opening here, the rate was 3.88-1/8; as some small scattered buying appeared, it gradually improved to 3.94-1/2 at about noon time. After that, there was very little interest in sterling and the rate receded to close at 3.93-1/8.

Sales of sterling by the four reporting banks in New York totaled £496,000 from the following sources:

By commercial concerns.....	£221,000
By foreign banks (Europe, Far East and South America).....	£275,000
Total.....	£496,000

Purchases of sterling amounted to £627,000, as indicated below:

By commercial concerns.....	£301,000
By foreign banks (Europe, South America and Far East).....	£326,000
Total.....	£627,000

The banks also reported that the British Control purchased sterling amounting to £28,000 at the official rate of 4.02. All of this sterling represented cotton bills.

The French franc and the Canadian dollar both recovered some of the loss sustained by those currencies last week. The belga, which was under heavy pressure the latter part of last week, recovered to about the approximate gold import point. This recovery probably was due to increased purchasing of belgas by the Belgian Control.

Some idea of the tremendous pressure on the guilder can be gathered from the amount of gold released today by the Netherlands Bank in order to provide dollars in support of the Dutch exchange.

The closing quotations for the important currencies, exclusive of sterling, for November 10 and today are as follows:

	<u>November 10</u>	<u>November 13</u>
French francs	.0219-1/4	.0223-1/4
Guilders	.5308	.5310
Swiss francs	.2242	.2243
Belgas	.1608	.1637
Canadian dollar	13-1/4% disc.	12-5/8% disc.

The Bank for International Settlements cabled to the Federal Reserve Bank of New York to apply for licenses to transfer approximately \$562,000 in gold from its Account No. 2 to its Account No. 4, and \$985,000 from its Account No. 3 to its Account No. 2. Account No. 2 is the B.I.S.'s own account, Account No. 3 represents gold owned by the National Bank of Hungary and Account No. 4 is gold owned by the Central Bank of Turkey. Permission to make the transfers requested was granted. The transfer of \$562,000 to Account No. 4 represents the sale by the B.I.S. to Turkey of gold which is, in turn, held by the B.I.S. as collateral for commercial credits granted by it to the Central Bank of Turkey. The transfer of \$985,000 in all probability, represents the sale of gold by the National Bank of Hungary to the B.I.S., or may be payment in liquidation of obligations owed by the Hungarian bank to the B.I.S.

We purchased the following amounts of gold from the earmarked accounts of the banks indicated:

\$24,500,000 from the Netherlands Bank
 10,000,000 from the National Bank of Switzerland
 1,785,000 from the National Bank of Belgium
 350,000 from the Bank of the Republic, Colombia
\$36,635,000 Total

We received, through the Federal Reserve Bank of New York, a request from the National Bank of Rumania to purchase \$5,688,000 in gold to be added to its earmarked account, which request was approved.

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

\$2,248,000 from England, consigned to the Federal Reserve Bank of New York, for account of the National Bank of Switzerland, the disposition of which is unknown at the present time.
 50,000 from England, consigned to Brown Bros. & Co., New York, for sale to the U. S. Assay Office at New York.
\$2,298,000

We have received cable advice from the American Consul at Sydney, Australia, that the following amounts of gold have been invoiced for shipment to this country:

\$5,100,000 shipped by the Commonwealth Bank of Australia, Sydney, consigned to the Federal Reserve Bank of San Francisco.
 389,000 shipped by the Bank of New South Wales, consigned to the American Trust Company, San Francisco.
\$5,489,000 Total

It is assumed that these shipments of gold will be sold to the U. S. Mint at San Francisco.

The equivalent of today's London spot silver price was 41.03¢ and the forward price, 40.82¢. Handy and Harman's price for foreign silver remained unchanged at 34-3/4¢. The Treasury's price was also unchanged at 35¢.

In New York, we made three purchases of silver totaling 250,000 ounces under the Silver Purchase Act.

B. M. F.

November 13, 1939

Welles' ltr advising HM, Jr of message from Colombia that Dr. Jaramillo has been designated as representative of Colombian government and is due to arrive in NY today. Jaramillo told American Amb that upon his arrival in DC he would try to reach settlement of Colombia's foreign debt held in US on basis of 3% interest payments with provision that such payments will be increased to 4% over period of years

THIS LETTER IS FILED AS OF 11/22/39, 10am, date of meeting in HM, Jr's office and is attachment to transcript of that meeting

BSM

PLAIN

London

Dated November 13, 1939

Rec'd 11:05 a. m.

Secretary of State,
Washington.

2355, November 13, 4 p. m.

FOR TREASURY.

1. With reference to paragraph 4 of my 2327 of November 10 the actual rate of the Friday tender was £1.3s.4.66d. Applications totalled £95.5 million indicating a slight falling off in outside demand. Though during the last war doubtless higher totals of bills were sold in a week over the counter (weekly tenders were discontinued between 1915 and 1921), next week's offer for £65 million of bills represents a record for a weekly tender offering and will be £35 million in excess of maturities bringing the total tender bill issue to £630 million on November 18.

2. Except for a further depreciation of the belga which was fixed 24.50-80 on Saturday there have been no changes in the official rates since my 2327 of November 10.

KENNEDY

KLP

HSM

GRAY

London

Dated November 13, 1939

Rec'd 1:02 p. m.

Secretary of State,
Washington.

2342, Thirteenth.

FOR TREASURY.

Invoices certified tenth and thirteenth covering
108,702 fine ounces gold, value 913109 pounds as follows:
National City Bank, London, to same New York 23,725 fine
ounces price 168 shillings fine ounce; Bank of England,
London, to Federal Reserve Bank, New York, 84,977 fine
ounces same price, by PRESIDENT HARDING fifteenth.

KENNEDY

DDM

RECEIVED

NOV 17 1939

TO THE SECRETARY OF STATE

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris

NO.: 2736

DATE: November 13, 1939, 3 p.m.

FOR TREASURY

Last evening we had dinner alone with our friend, Professor Rist. He told us that the Franco-British blockade is working in a smooth and satisfactory manner. He confirmed reports which have been current recently that the blockade will be extended to German exports as well as imports into Germany. He said that although it was his feeling that in reality the only thing which the neutrals would be giving up would be their profits as intermediaries, the mechanics of putting into operation a blockade of this kind on exports would be rather "delicate". He said that it was extremely important, on the other hand, that all possible sources of foreign exchange be shut off from Germany and that they prevent any chances from being offered which would enable Germany to increase her imports, through exports, from countries on the continent which are still open to her, for which imports Germany would not otherwise be able to make payment.

He

He stated that frankly he was not optimistic with reference to French exports. He emphasized, as has been done in recent telegrams from us, that a heavy burden has fallen on the French economy as a result of the general mobilization and by reason of the fact that the military authorities are loath to release citizens to supply the demands for labor and in particular technical and executive personnel, which are so necessary to the functioning of the export industries of France. The present discouraged attitude of most of the exporters is also occasioned by difficulties and lengthy delays in obtaining permits for raw material imports, and the lack of transport facilities.

Professor Rist said that for the present he is not greatly worried regarding payments for French purchases abroad. He believes, however, that it is very important to keep the franc from sliding; he feels that this can be readily done. If the franc were to fall, lack of confidence and excessive inflation would be the result, which in turn would cause the financing of the war to be much more difficult, would, of course, increase the cost of war supplies from abroad, would cause leaks in the closed capital circuit which would be very hard to eliminate. Although he stated frankly that he had been too much
occupied

occupied with his own work to stay in close touch with financial questions, he foresaw no serious trouble in financing the war internally. Like our Bank-of-France friend, he believes the treasury bills and bonds to be a great deal sounder than advances directly from the Bank of France to the government; of course, too, they are ^{nearly as} not/apt to be inflated excessively; in this connection, and referring to our friend at the Bank of France, see telegram 1780 of September 4, 1939, 7 p.m. The effect isn't inflationary seriously, to the extent of armament bonds, as well as other government issues, being actually taken up out of savings by the public--this is a distinction from Government loans which are financed by banks through loans to customers either directly or indirectly.

The British, he continued, are trying in every way possible to pay in sterling, rather than in dollars, for making their war purchases and buying their imports; this is being done either through clearing arrangements or through diverting trade, wherever possible, to the sterling area. Although he did not question the soundness of the policy he made a statement to the effect that more than any other thing the British are afraid of being put in the same position, which they were in after the World War, in respect to the U.S.

We

In answer to our inquiry as to whether he had thought much yet about war aims and reconstruction after this war, he stated frankly that he has had hardly any time to think about anything other than his blockade problems, he has been so busy with them. However, that ^{Great} Britain and France agree completely as is possible on their war aims before this war ends is of the greatest importance. It is his opinion that political and economic questions should be separated as far as is possible. He is in favor of a very liberal treatment to a defeated German nation in regard to the economic side; of course, he assumed that the war aims of the Allies are of no consequence, in a practical way, if they are defeated. In his own thoughts he hasn't come to any conclusion regarding the answer to the political side. As do others, he believes that no solution to the German problem can be found in splitting up their country and separating them; nor does he believe that there will be a sufficient evolution in their character over a visible future era to change them into neighbors that can be trustworthy and friendly. He has not yet come to a conclusion as to whether or not he favors the French frontier to be set on the Rhine River. Many French circles appear to be forming a firm conviction that France should insist on a Rhine frontier for their future security. Professor Rist said events in recent years

years had shaken his former opposition to such a frontier. He does, however, fear that the Nazi ruse of calling on allies to help prevent Bolshevization of Germany and Europe may be successful eventually. Certain quarters, particularly in Great Britain, and even in France might rally in the future to an appeal of this nature, he believes.

We are passing on, for whatever consideration it may be worth, an interesting story which he told us about the last interview in Moscow of the Foreign Minister of Turkey: his patience being exhausted after his very long and inactive sojourn in Moscow, the Foreign Minister of Turkey requested Molotov for a farewell interview; Stalin entered the room during the Minister's interview with Molotov and gave a piece of paper to Sarajoglou; on the sheet of paper the following sentence was written: Turkey must close the Straits to warships of France and Great Britain. (Prof. Rist was told this story by one of his associates in the Ohoman Bank, who is a personal friend of the Turkish Foreign Minister; he had personally heard this account from Sarajoglou himself.) The Turkish Foreign Minister replied no to Stalin very firmly. Then Stalin handed him another paper stating that Turkey must be an ally to Russia and Germany, to which Sarajoglou replied no again. At that Stalin tore up both of the papers which he had handed to Sarajoglou; and, turning to leave the room, Stalin
smiled

smiled at Sarajoglou and said the following words: You are right; a long-standing friendship is of more worth than a few torn pieces of paper.

BULLITT

RECEIVED

NOV 11 1956

THE WHITE HOUSE
WASHINGTON
NOV 11 1956

EA:MSG

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris

DATE: November 13, 1939, 7 p.m.

NO.: 2742.

PERSONAL AND STRICTLY CONFIDENTIAL FOR THE
SECRETARY AND THE SECRETARY OF THE TREASURY.

Our no. 2736, November 13, 3 p.m.

Matthews was informed last evening by Rist that there was one vulnerable spot in the German armor--molybdenum. Rist said he understood molybdenum to be essential to the manufacture of armaments and shells. He also understood that although it is to be presumed that Germany has sufficient stock to meet present needs it cannot last forever. He said that the United States produces far more than any other country in the world (approximately 92.5 percent of world production for 1938; 85 percent of this was produced by (?) molybdenum company -- Minerals Year Book, 1939).

The French blockade authorities have had recent information that Russia is making preparations for near-future purchases from us of substantial amounts for transshipment to Germany (according to the Year Book we export from 50 to 75 percent of production annually, although there is no separate classification for this in our trade statistics). He wondered whether the United States needs of molybdenum for
national

-2-

national defense purposes were great enough to require embargoing exports of this metal; of course he greatly hoped that this would be the case.)

Rist added that France might also be in need of supplies of molybdenum which might possibly be purchased immediately from us. (The other major producers are Mexico, Morocco and Norway in the order of their appearance.) He stated that in any event it would be impossible for him to overestimate the importance from the standpoint of the allies of preventing arrival of molybdenum in Germany. He further stated (as in telegram 2571, October 24, 6 p.m.) that fats, oils and forage likewise are recognized weaknesses in the war economy of Germany and he hoped only small amounts of these materials would reach Germany. END MESSAGE

BULLITT

RECEIVED

OCT 25 1939

1-2-3-4-5-6-7-8-9-10-11-12-13-14-15-16-17-18-19-20-21-22-23-24-25-26-27-28-29-30-31-32-33-34-35-36-37-38-39-40-41-42-43-44-45-46-47-48-49-50-51-52-53-54-55-56-57-58-59-60-61-62-63-64-65-66-67-68-69-70-71-72-73-74-75-76-77-78-79-80-81-82-83-84-85-86-87-88-89-90-91-92-93-94-95-96-97-98-99-100-101-102-103-104-105-106-107-108-109-110-111-112-113-114-115-116-117-118-119-120-121-122-123-124-125-126-127-128-129-130-131-132-133-134-135-136-137-138-139-140-141-142-143-144-145-146-147-148-149-150-151-152-153-154-155-156-157-158-159-160-161-162-163-164-165-166-167-168-169-170-171-172-173-174-175-176-177-178-179-180-181-182-183-184-185-186-187-188-189-190-191-192-193-194-195-196-197-198-199-200-201-202-203-204-205-206-207-208-209-210-211-212-213-214-215-216-217-218-219-220-221-222-223-224-225-226-227-228-229-230-231-232-233-234-235-236-237-238-239-240-241-242-243-244-245-246-247-248-249-250-251-252-253-254-255-256-257-258-259-260-261-262-263-264-265-266-267-268-269-270-271-272-273-274-275-276-277-278-279-280-281-282-283-284-285-286-287-288-289-290-291-292-293-294-295-296-297-298-299-300-301-302-303-304-305-306-307-308-309-310-311-312-313-314-315-316-317-318-319-320-321-322-323-324-325-326-327-328-329-330-331-332-333-334-335-336-337-338-339-340-341-342-343-344-345-346-347-348-349-350-351-352-353-354-355-356-357-358-359-360-361-362-363-364-365-366-367-368-369-370-371-372-373-374-375-376-377-378-379-380-381-382-383-384-385-386-387-388-389-390-391-392-393-394-395-396-397-398-399-400-401-402-403-404-405-406-407-408-409-410-411-412-413-414-415-416-417-418-419-420-421-422-423-424-425-426-427-428-429-430-431-432-433-434-435-436-437-438-439-440-441-442-443-444-445-446-447-448-449-450-451-452-453-454-455-456-457-458-459-460-461-462-463-464-465-466-467-468-469-470-471-472-473-474-475-476-477-478-479-480-481-482-483-484-485-486-487-488-489-490-491-492-493-494-495-496-497-498-499-500-501-502-503-504-505-506-507-508-509-510-511-512-513-514-515-516-517-518-519-520-521-522-523-524-525-526-527-528-529-530-531-532-533-534-535-536-537-538-539-540-541-542-543-544-545-546-547-548-549-550-551-552-553-554-555-556-557-558-559-560-561-562-563-564-565-566-567-568-569-570-571-572-573-574-575-576-577-578-579-580-581-582-583-584-585-586-587-588-589-590-591-592-593-594-595-596-597-598-599-600-601-602-603-604-605-606-607-608-609-610-611-612-613-614-615-616-617-618-619-620-621-622-623-624-625-626-627-628-629-630-631-632-633-634-635-636-637-638-639-640-641-642-643-644-645-646-647-648-649-650-651-652-653-654-655-656-657-658-659-660-661-662-663-664-665-666-667-668-669-670-671-672-673-674-675-676-677-678-679-680-681-682-683-684-685-686-687-688-689-690-691-692-693-694-695-696-697-698-699-700-701-702-703-704-705-706-707-708-709-710-711-712-713-714-715-716-717-718-719-720-721-722-723-724-725-726-727-728-729-730-731-732-733-734-735-736-737-738-739-740-741-742-743-744-745-746-747-748-749-750-751-752-753-754-755-756-757-758-759-760-761-762-763-764-765-766-767-768-769-770-771-772-773-774-775-776-777-778-779-780-781-782-783-784-785-786-787-788-789-790-791-792-793-794-795-796-797-798-799-800-801-802-803-804-805-806-807-808-809-810-811-812-813-814-815-816-817-818-819-820-821-822-823-824-825-826-827-828-829-830-831-832-833-834-835-836-837-838-839-840-841-842-843-844-845-846-847-848-849-850-851-852-853-854-855-856-857-858-859-860-861-862-863-864-865-866-867-868-869-870-871-872-873-874-875-876-877-878-879-880-881-882-883-884-885-886-887-888-889-890-891-892-893-894-895-896-897-898-899-900-901-902-903-904-905-906-907-908-909-910-911-912-913-914-915-916-917-918-919-920-921-922-923-924-925-926-927-928-929-930-931-932-933-934-935-936-937-938-939-940-941-942-943-944-945-946-947-948-949-950-951-952-953-954-955-956-957-958-959-960-961-962-963-964-965-966-967-968-969-970-971-972-973-974-975-976-977-978-979-980-981-982-983-984-985-986-987-988-989-990-991-992-993-994-995-996-997-998-999-1000-1001-1002-1003-1004-1005-1006-1007-1008-1009-1010-1011-1012-1013-1014-1015-1016-1017-1018-1019-1020-1021-1022-1023-1024-1025-1026-1027-1028-1029-1030-1031-1032-1033-1034-1035-1036-1037-1038-1039-1040-1041-1042-1043-1044-1045-1046-1047-1048-1049-1050-1051-1052-1053-1054-1055-1056-1057-1058-1059-1060-1061-1062-1063-1064-1065-1066-1067-1068-1069-1070-1071-1072-1073-1074-1075-1076-1077-1078-1079-1080-1081-1082-1083-1084-1085-1086-1087-1088-1089-1090-1091-1092-1093-1094-1095-1096-1097-1098-1099-1100-1101-1102-1103-1104-1105-1106-1107-1108-1109-1110-1111-1112-1113-1114-1115-1116-1117-1118-1119-1120-1121-1122-1123-1124-1125-1126-1127-1128-1129-1130-1131-1132-1133-1134-1135-1136-1137-1138-1139-1140-1141-1142-1143-1144-1145-1146-1147-1148-1149-1150-1151-1152-1153-1154-1155-1156-1157-1158-1159-1160-1161-1162-1163-1164-1165-1166-1167-1168-1169-1170-1171-1172-1173-1174-1175-1176-1177-1178-1179-1180-1181-1182-1183-1184-1185-1186-1187-1188-1189-1190-1191-1192-1193-1194-1195-1196-1197-1198-1199-1200-1201-1202-1203-1204-1205-1206-1207-1208-1209-1210-1211-1212-1213-1214-1215-1216-1217-1218-1219-1220-1221-12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THOMAS G. CONNELL
 HARRY J. RUDICK

November 13, 1939.

The President,
 The White House,
 Washington, D. C.

My dear Mr. President:

In response to your recent request for information on the subject of possible tax changes which would assist in the production of increased revenue, I am enclosing herewith a memorandum, marked A, discussing a number of discriminations the elimination of which would result in substantial additional revenue. How much additional revenue would be forthcoming can be determined only by expert Treasury computations. With the thought that you may wish these computations, I am taking the liberty of enclosing a suggested memorandum from you to the Treasury with an attached list of questions marked A-1 keyed to Memorandum A.

In view of the time pressure upon you, I have prepared a shorter memorandum marked C summarizing Memorandum A point by point.

Memorandum A does not attempt any discussion of the obviously advisable expedient of raising (a) the income surtax

The President

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brackets on incomes between \$5,000 and \$50,000, and (b) the estate tax brackets on medium-sized estates. Nor does it deal with some other suggestions which have been made to me, as for instance, (1) the suggestion that the earned income credit be discontinued for incomes over \$10,000 (which might reasonably yield an additional 7.5 million of revenue) and (2) the suggestion that the tax on life insurance companies must be too low because in recent years such corporations have paid less than half a million dollars in Federal income taxes. Both these suggestions need further consideration.

While the matter of estimated yield can be finally estimated only by Treasury statisticians, I have been advised that an annual yield of 90 million dollars may be expected from suggestion 1 in Memorandum A and 40 million from suggestion 25. I have been told that suggestion 13 should yield over 30 million dollars. Many of the remaining suggestions would produce additional revenue sufficient, in combination with a reasonable excess profits tax and increase of lower surtax and medium estate tax brackets, to raise the additional revenue you have in mind without the necessity of imposing any so-called luxury or sales tax.

I am proceeding with the preparation of a memorandum on an excess profits tax which will incorporate the essential details of your general plan for such a tax. You will receive this memorandum in a day or so.

The President

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The existing revenue statutes involve a number of unsound provisions resulting in hardship upon taxpayers, and I think that any general modification should be a "two-way street" in that it should seek also to eliminate these defects. In line with this thought I also enclose a separate memorandum, marked B, itemizing some, but by no means all, of these points of taxpayer dissatisfaction which you may want to forward to the Treasury in order to secure an authoritative estimate of the loss of revenue which may be involved therein. A covering memorandum to the Treasury is enclosed as a matter of convenience if you should desire to secure this information; to this memorandum is attached a list of questions marked B-1 keyed to Memorandum B.

I am sorry that the enclosed memoranda could not have been confined to fewer pages. But taxes seem an inevitably complicated subject, and it seems inadvisable to attempt to deal with the points involved without covering the refinements reflected in the enclosed memoranda. It should also be added that all figures used for proposed rates and limitations are entirely tentative.

It may be that Treasury officials should be advised by you at an early date that you contemplate the possibility of changes in the tax laws so that they will not inadvertently embarrass your plans by premature statements on the Hill or to the public.

The President

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I shall be only too happy to serve you further in
any way you desire.

Respectfully yours,

Hubert H. H. Paul

REP:JK

MEMORANDUM OF TRANSMITTAL
OF A AND A-1

TO: Honorable Henry Morgenthau
Secretary of the Treasury

FROM: The White House

I transmit to you herewith a copy of a memorandum marked A prepared by Mr. Randolph E. Paul, whom I have consulted with respect to possibilities of securing additional revenue by the elimination of various discriminations contained in the statutes covering the taxation of income, estates and gifts as now enacted. I would like to have from you an estimate of the revenues which would reasonably be derived from Mr. Paul's suggestions. For your convenience I enclose a memorandum of specific questions keyed to Mr. Paul's memorandum, marked A-1.

I realize that some of these questions will be difficult to answer in categorical terms. Where the question deals with suggestions of a tentative nature, I will be obliged if you will make your answers as definite as may be possible under the circumstances.

MEMORANDUM A

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MEMORANDUM OF POSSIBLE CHANGES IN THE TAX
LAW WHICH WOULD INCREASE REVENUE BY THE
ELIMINATION OF DISCRIMINATIONS

INCOME TAX

1. Personal Exemptions
2. Stock Dividends
3. Trust Income
4. Unreasonable Accumulations of Surplus
5. Charitable Gifts in Form of Property
6. Non-Business Casualty Losses
7. Interest on Non-Business Loans
8. Deduction of Interest Paid or Accrued
9. Non-Business Bad Debts
10. Non-Business Taxes
11. Basis Where Optional Valuation Privilege Is Chosen
12. Taxation of Husband and Wife
13. Taxation of Interest from State Obligations
14. Taxation of Capital Gains
15. Corporate Distributions of March 1, 1913 Profits
16. Life Insurance Proceeds Paid in Installments
17. Double Loss Deductions
18. Property Transmitted at Death
19. Domestic Building and Loan Associations
20. Mutual Casualty and Fire Insurance Companies
21. Employers' Contributions to Pension Trusts
22. Discovery Value and Percentage Depletion
23. Development Expense
24. Taxation of Non-Resident Alien Individuals and Foreign Corporations

ESTATE TAX

25. Estate Tax Exemptions
26. Taxation of Life Insurance
27. Property Passing under Powers of Appointment
28. Reverter Interests
29. Gifts in Contemplation of Death
30. Elimination of Estate Tax Against Insurance Proceeds by Reason of Uncollectible Claims

GIFT TAX

31. Gift Tax Exemptions