DIARY

Book 230

December 16 - December 19, 1939

OFFICE OF THE DIRECTOR

TREASURY DEPARTMENT

PROCUREMENT DIVISION

WASHINGTON

1

December 16, 1939

MEMORANDUM FOR THE SECRETARY

The following statement indicates obligations that have been incurred to date covering purchases of strategic materials.

Material	Quantity under Contract	Amount of Contract	
Tungsten	425 S. Tons	$ 427,140.00	
Optical Glass Camera Lens	5,400 lbs.	39,200.00	
Optical Glass Fire Control	6,000 lbs.	36,000.00	
Chromium	20,000 L. Tons	530,000.00	
"	25,000 L. "	843,600.00	
Tin	840 S. "	825,944.00	
Manganese	5,000 L. "	180,000.00	
"	25,000 L. "	765,000.00	
Quinine	700,000 ozs.	404,600.00	
			$ 4,051,484.00
Preparation Storage Facilities			50,000.00*
Reserve for averages, inspection, freight, administrative and incidental expense			601,688.00
TOTAL CONTRACTS			$ 4,703,172.00
Estimated obligations covering proposals to be opened December 19, December 20 and December 28, covering Quartz Crystals, Manganese and Tin			1,800,000.00
			6,503,172.00
Balance unobligated			3,496,828.00
TOTAL APPROPRIATION			$ 10,000,000.00

*Estimated

Information was received from the Budget that there had been approved for submission to Congress for appropriation during the coming session $15,000,000 for strategic and critical materials.

Director of Procurement

-3

THE COMMANDANT OF THE UNITED STATES COAST GUARD

WASHINGTON

16 December 1939.

STRICTLY CONFIDENTIAL

MEMORANDUM FOR - The Secretary of the Treasury

In accordance with your verbal request, the following information is furnished regarding the informal talk that Ambassador Kennedy gave to a group of military officers on 15 December, in the office of the Chief of Naval Operations.

On Thursday, 14 December, Admiral Stark called, and invited me to be present at this confidential-informal gathering. There were present approximately twenty officers, including General Marshall, Chief of Staff of the Army, and seven or eight other Army officers; Admiral Stark, Chief of Naval Operations, and eight or nine Navy officers; one or two Marine Corps officers; and myself. (There may be some variations from these figures in the proportion of Army and Navy officers as I was not personally acquainted with all of them.)

Ambassador Kennedy stated that his remarks were strictly confidential, in many cases were a matter of opinion, and that he realized his opinion on military matters was that of a layman, and that the Army and Navy could take that for what they considered it worth. The substance of Ambassador Kennedy's remarks were as follows, as far as I can remember, and you will, of course, understand that, through misunderstanding on my part, some of them may not be in accordance with the facts or with the intent of Ambassador Kennedy's remarks.

Generally speaking, he painted a very pessimistic picture of the economic situation in England and France and intimated that, in his opinion, Germany could hold out as long, if not longer, economically, than England; that Germany was building submarines faster than Great Britain was sinking them; that the urgent cry of Great Britain was for more destroyers, and asked the Ambassador if there was any chance of getting, 50, 60, or more destroyers from the United States. That the lack of accomplishment on the part of the British Navy was being criticised severly, both in official circles and by the public; that the German air force was a menace to the British Navy, and that a competent air force was more than a match for a competent sea force. That German aviators captured by the British stated the last instructions they received before takingoff for bombing military objectives was that, under no conditions drop bombs where any damage might result to civilian population. That, in his opinion, air forces on both sides had refrained from active bombing operations on account of the fearful destruction that would ensue, and neither side wanted to start it. That the air raids made by Germany on Scapa Flow and other British objectives, were all made by members of the German air force volunteering for this duty, rather than sending an organized squadron for that purpose and, the British were at a loss to understand this procedure. That the British and French people, generally, were pessimistic about the whole war situation, and were hoping for some sort of an early peace. That British boys going to the front were freightened and had no enthusiasm. That British officials felt no matter what the results of this war were, that they would never be able to get the people behind another war and, consequently, the final peace from this war must settle the situation for many years to come.

The Ambassador stated that France could not use any more British troops at the front, as they were having difficulty now in supplying the troops already there, due to breakdown of transportation facilities - principally roads - that one of the main reasons why Great Britain had so many men in training in England was due to an effort to bolster French morale; and that British divisions at the front were broken up and scattered throughout French divisions for psychological reasons and, to prevent any mass feeling on the part of the French for a separate peace with Germany - which, the British felt, would be a possibility, if not carefully watched. That the production of planes in Great Britain was well below what was published in the papers, and that the training of aviators was a serious problem, due to climatic conditions. That the loss of aviators under training was very high, and that building up of the air force - both in materiel and personnel - was a matter of grave concern, and well below what was given to the press. That some consideration was given to training aviators in Egypt - despite the long haul back and forth; and that while some training was being carried on in Canada, and probably would be enhanced, that this was not satisfactory again, due to climatic considerations.

That General Ironsides (British Chief of Staff) felt that the Germans had the best military machine in the world, including an excellent General Staff; that General Gamelin (French Chief of Staff) felt the German Army was poor and greatly inferior to the French. That the consensus of opinion was that an offensive would start next spring; it being a drive through Belgium, and a second drive through the Maginot line. That England and France had been trying to draw up plans with Belgium, but that Belgium would not cooperate -

probably through fear of German reprisals; that all small neutral countries (Belgium, Holland, Scandinavian countries, and the Balkans) feared offending the Germans far more than offending the Allies, as they felt reprisals from Germany would be more ruthless.

He stated that it cost England a lot of money to buy-off Turkey, and that it was now costing them a lot of money to keep Italy and Rumania neutral. That Germany was getting about 1/4 - 1/5 of Rumania's oil, and Great Britain was taking the balance, just to keep it from going to Germany, and was making England pay a high price for it. That Italy was using similar tactics with her products. That Great Britain could not keep this strain up, and that she would be economically exhausted in a year - or shortly thereafter. That England had about a billion and a half of securities in this country, which she could not unload, except at a tremendous sacrifice; that the same was true of her investments in South America (approximately three billions of dollars); and that the same was true of her investments in the Far East. That by the end of this year, if not before, people in England and France, and all Europe, would be ready for communism or some other radical change in the social order.

He stated that the economic ruin of Europe would have tremendous repercussions in this country and, that he felt the United States should bend all its efforts toward improving the economical conditions of the United States - and to strengthen our position, so that we would be able to withstand the shock of economic ruin in Europe. He very forcefully stated that, under no possible condition, should this country let itself be drawn in the European war; that England and France were doing everything possible to get us involved and, for that reason, at the present time, we had greater access to inside information within the British Government than anyone except high British officials - but that, once Great Britain was assured that they could look to no help from this country, that all access to confidential information would be denied. He stated that this country would, for its own self-preservation, have to help out the economic conditions of the world after this war was over, if not before - and we should prepare ourselves for that role. That we should be prepared, if necessary, to give supplies and dollars, to help restore economic balance, rather than lend money, or expect any financial return.

He told the Navy Admirals frankly that he felt too much money was being spent and proposed for National defense. in view of the economic situation in this country.

He felt there was no chance of any revolution within Germany; that the German people were behind Hitler as strong now as ever.

He stated that neither England nor Germany were giving any help to Finland - that they had all they could do to take care of themselves. He spoke of conditions in Spain, and stated that another revolution might occur in that country at any time, and that conditions in Portugal were no better.

R R Waesche

R. R. WAESCHE
Rear Admiral, U.S. Coast Guard,
Commandant.

EXECUTIVE OFFICE OF THE PRESIDENT
BUREAU OF THE BUDGET
WASHINGTON, D. C.

STRICTLY CONFIDENTIAL

DEC 16 1939

My dear Mr. Secretary:

Reference is made to my letter of November 30, 1939, advising you of the amounts to be included in the 1941 Budget for the Treasury Department.

You are advised that, in addition to the amounts indicated therein, there is to be included in the 1941 Budget an item of $15,000,000 for the purchase of strategic and critical materials.

Very truly yours,

Harold D. Smith
Director.

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

STRICTLY CONFIDENTIAL DEC 16 1939

My dear Mr. Secretary:

Reference is made to my letter of November 30, 1939, advising you of the amounts to be included in the 1941 Budget for the Treasury Department.

You are advised that, in addition to the amounts indicated therein, there is to be included in the 1941 Budget an item of $15,000,000 for the purchase of strategic and critical materials.

Very truly yours,

(Signed) HAROLD D. SMITH

Director.

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

Subject: Conference at Secretary's home, December 16, 1939, at 4:00 P.M.

Present: Secretary Morgenthau, Admiral Stark and three assistants, Mr. White

The Secretary explained to Admiral Stark that the President had asked him (the Secretary) to see if he couldn't get the molybdenum exporters to voluntarily cease their exports of molybdenum to Russia and Germany. The Secretary described briefly the discussions he had had with the molybdenum people pursuant to the President's wishes. He asked Admiral Stark whether the action so far taken and contemplated with respect to the moral embargo on molybdenum and aluminum, and the possibility of getting the British to prohibit exports of nickel to Russia, Germany and Japan would in any way interfere with the program of our navy or army, or in any way harm our interests. Admiral Stark replied that such a program, in his opinion, would definitely not be harmful to us. His assistants acquiesced in that opinion. Admiral Stark further stated that even were Russia to retaliate by prohibiting the exports of manganese to the United States, the United States could get all the manganese needed from other sources.

Admiral Stark further stated, in response to a direct question from the Secretary, that he agreed with the conclusions as reported to the Secretary by the molybdenum people that unless Russia and Germany were deprived of tungsten and nickel as well as molybdenum they would not be adversely affected to any significant extent. He further stated that if it were possible to prevent exports of nickel, molybdenum and tungsten from reaching Germany, Russia and Japan it would definitely be harmful to those countries and would impair their military effectiveness to some extent. Admiral Stark expressed the view that he did not think China could be induced to stop her exports of tungsten to Russia because of her present great dependence upon Russian supplies.

The Secretary explained to Admiral Stark that the molybdenum people felt they were being called upon to risk a permanent loss of some of their molybdenum markets unless the supplies of tungsten, which could be substituted for molybdenum, to Japan and Russia were likewise curtailed. The Secretary said that with the President's approval he wished to request Admiral Stark to have the appropriate men in the Navy Department confer with metallurgists of the molybdenum concerns after Admiral Stark had talked to them, to explore the possibility of promoting a greater use of molybdenum by the United States Army and Navy. Admiral Stark replied that they did not use very much molybdenum but he thought it might well be worth trying and he would be glad to see the molybdenum people and investigate the possibilities.

HD White

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Berlin, Germany

DATE: December 16, 1939, 10 a.m.

NO.: 2370

10

Authoritative German sources say that within the next few days Germany expects to complete its protracted trade negotiations with Rumania. These sources said that Rumania had shown a willingness to furnish more oil to Germany, and to give a higher exchange value to the mark in terms of Rumanian lei; however, as to the exact exchange rate, these informants professed ignorance. From Bucharest had come a United Press report that there had been agreement on an exchange value of 46.47 lei; to this the informants commented that the rate mentioned would be a compromise between the rate of 55 lei asked by the German negotiators and the present seller's rate of 40.5. Rumania, it was alleged, had been giving the pound sterling a higher exchange rate than the mark, disregarding the depreciation which during recent months had been undergone by sterling.

KIRK.

EA:LWW

11

TELEGRAM SENT

JR GRAY

December 16, 1939

Noon

AMEMBASSY

BERLIN (GERMANY)

1108.

Your 2363, December 15, 4 p.m.

It is preferable to Treasury that Heath sail on REX January 2.

HULL
(FL)

EA:FL:LWW

Treasury Department
Division of Monetary Research

Date 12/20/39 19

To: Miss Chauncey

From: H. D. White

For your files.

I talked to the Secretary about this memorandum at his home 12/16/39.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE December 16, 1939

TO Secretary Morgenthau

FROM Captain Puleston and Mr. White

Subject: Possible Control of Certain Strategic Metals

Conclusions

1. We are in a position to restrict the supplies of molybdenum and through cooperation with Canada and New Caledonia to restrict the supplies of nickel, but we are not in a position to restrict the supply of tungsten unless we can control China's exports of tungsten.

2. Restriction upon the supplies of molybdenum would not interfere significantly with the ability of Russia, Germany or Japan to conduct a war as long as tungsten is not restricted.

3. Restriction upon the supplies of nickel would probably not seriously hamper either Russia or Germany for some time but might seriously affect Japan.

4. Russia is the only country of the three in a position to take retaliatory measures against the United States in the form of withholding materials we need. This she could do by restricting her exports of manganese. Such restriction, however, would not seriously hamper our steel industry because Cuba, Brazil, and the British Empire could take care of our needs if necessary.

I. Are we in a position to restrict the supplies of molybdenum, tungsten or nickel?

(a) Molybdenum

United States produces over 90 percent of the world's molybdenum. There are less than ten companies now operating mines in the United States and two of these produce over 90 percent of the domestic production. Under such circumstances it should not be difficult to control exports either by a "moral embargo" or by other means.

(b) Tungsten

China exports one-third to one-half of the world's consumption. The only other countries that produce tungsten on any large scale are Burma, 5,000 tons; United States, 3,000 tons; Bolivia, 2,000 tons; Japan, 2,000 tons; and Portugal, 3,000 tons. China has already committed herself to a barter arrangement with Russia to supply 5,500 tons a year. This is more than United States consumes in a year and is probably enough to take care of Germany and Russia.

(c) Nickel

Canada produces from 85 to 90 percent of the world's output. New Caledonia, Russia and Norway are the only other large producers, but Russia has been an importer of nickel. Reports indicate that Japan is now producing some nickel but she is still dependent upon imports for the bulk of her needs. Through cooperation with Canada and New Caledonia we could restrict the supplies available to Germany, Russia and Japan.

II. <u>Would such restriction be likely to hamper to any great degree Russia, Germany or Japan?</u>

(a) <u>Russia</u> is likely to be handicapped very little if at all by restrictions of the supply of molybdenum or nickel: (1) She has been importing large quantities of molybdenum from the United States in the last three years and should have ample stocks for some time to come, at least for her own uses. (2) Tungsten, which serves practically the same purpose as molybdenum as a steel alloy, is now being imported from China on a barter arrangement, amounting to 5,500 tons per year. (3) Russia produces about 2,500 tons of nickel and imported in 1937, 9,000 tons. The ultimate source for Russian imports is Canada. She may have large stocks at the present time and she has built or is building plants to increase her domestic production to 5,000 tons. Nickel is not an indispensable metal so that Russian production and use of substitutes would probably prevent an embargo from having any serious adverse effects upon her military effectiveness.

(b) <u>Germany</u> probably would not suffer materially from such restrictions for some time: (1) The War Department reports that she has large stocks of tungsten; (2) It would be surprising if in the past few years she has not accumulated some stock of nickel and molybdenum;

(3) she may be able to acquire some of Russia's stocks of these metals; (4) she will be able to acquire some of Norway's production of molybdenum and nickel; (5) she produces about 1,000 tons of nickel a year and imported 4,000 tons in 1938; (6) while it is possible to substitute other metals for nickel, Germany is dependent almost entirely upon her present stocks of other alloy metals with the exception of bauxite and manganese.

(c) Japan would not be affected severely by the restriction of the supply of molybdenum but might be handicapped by the restriction of nickel depending upon her stocks. (1) The Japanese Empire produces about 100 tons of molybdenum, 2,000 tons of tungsten and an unknown but insufficient quantity of nickel. (2) She has been importing large quantities of nickel and molybdenum and may have sufficient stocks of these metals for her own use.

III. Are Russia, Germany or Japan in a position to take retaliatory measures which would be harmful to the United States?

Russia is the only country of the three in a position to take retaliatory measures against the United States. This she could do by restricting her exports of manganese.

(1) While over 90 percent of the total American manganese requirements are imported, only around one-third is derived from Russia. The other important sources are Cuba, the Gold Coast, Brazil, and India.

(2) The United States had roughly a year's reserve on hand on October 30. This stock should be sufficient to carry the American industry until substitute sources of supply are developed.

(3) The loss of Russian supplies could be made up from our other sources. Brazilian exports could be increased by improving the railroad (which has been allowed to deteriorate) from the mines to the coast. Cuban production could also increase somewhat. This conclusion is borne out by the experience of 1914-1918. In the last war, with the loss of Russian sources and with a greatly increased demand, the United States satisfied nearly all of its requirements of foreign manganese

from Brazil and Cuba. At the same time, domestic production also increased, though with difficulty and with greatly increased costs, until in 1918 domestic production met 35 percent of total requirements.

(4) There is in addition the possibility of securing supplies from the British Empire: India, the Gold Coast, and the Union of South Africa. Practically all of the United Kingdom's requirements are met from these sources. In addition, almost two-thirds of French needs are supplied by the British and French Empires (most of the rest, or about 100,000 tons comes from Russia). Since the bulk of South African ore, around 300,000 tons a year, has been going to Germany, this will now be available as surplus to meet either increased Allied or American demands.

(5) This substitution of other ores for Russian, however, it must be pointed out, will be attended by somewhat higher costs and some inconvenience to the steel industry. This is because the ores which would probably be substituted for Russian ore are of a lower grade. Only around 10 percent of South African ore runs over 48 percent manganese content, whereas our imports of Russian ore average 48.7 percent. Brazilian production has also been running to lower grade ore in recent years. Cuban ore likewise averages somewhat lower than our Russian ore imports.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

CONFIDENTIAL

DATE December 16, 1939

TO Secretary Morgenthau

FROM Mr. Cochran

The foreign exchange market was very dull. In New York, sterling opened t 3.93-5/8, after closing in Amsterdam at 3.92-15/16. There was an inquiry or a small amount of sterling and the rate moved up to 3.94-1/4. It losed at 3.93-7/8.

Sales of spot sterling by the four reporting banks totaled £153,000, rom the following sources:

By commercial concerns................................£ 123,000
By foreign banks (Far East)...........................£ 30,000
Total.........£ 153,000

Purchases of spot sterling amounted to £201,000 as indicated below:

By commercial concerns................................£ 49,000
By foreign banks (Europe and Far East)................£ 152,000
Total.........£ 201,000

The Guaranty Trust Company reported that it had sold cotton bills otaling £6,000 to the Control at the official rate of 4.02 on the basis of mediate mailing. Such bills, when sold to the Control, are for delivery in ondon within 30 days.

The other important currencies closed as follows:

French francs	.0223-1/2
Guilders	.5320
Swiss francs	.2244
Belgas	.1660
Canadian dollars	12-5/8% discount

We sold the following amounts of gold to the banks indicated to be added to their earmarked accounts:

$3,500,000 to the Central Bank of Argentina
800,000 to the Central Bank of Uruguay
$4,300,000 Total

The Federal Reserve Bank informed us that it received a letter from the Bank of Poland, requesting the Federal to obtain a license to transfer approximately $2,240,000 in gold from its account to the account of the Bank of France. Permission to make this transfer was granted by the Treasury.

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

$21,000,000	from Japan, representing four shipments by the Yokohama Specie Bank, Kobe, to the Yokohama Specie Bank, San Francisco, for sale to the U. S. Mint in San Francisco.
2,083,000	from England, shipped by the Bank of England to the Federal Reserve Bank, New York for account of the Bank of Portugal. The disposition of this shipment is unknown at present, but it will probably be earmarked for account of the Bank of Portugal.
537,000	from England, shipped to the Guaranty Trust Company of New York for account of the Amsterdam Bank.
14,000	from Canada shipped to the Guaranty Trust Company of New York.
$23,634,000	Total

The last two shipments listed will be sold to the U. S. Assay Office at New York upon arrival.

Mr. Knoke telephoned me at 4 P.M. on December 13 that the cash balance of the Russian State Bank with the Chase had risen from $6,000,000 to $11,700,000, due to payment by the Assay Office on a shipment of Russian gold bars made on behalf of the Russian State Bank from Italy. This was the first Russian gold to arrive in New York via Italy. The SS Gripsholm brought Russian gold from Sweden on December 4. Confirmed credits of the State Bank with the Chase were $4,300,000.

Mr. Knoke telephoned me this forenoon that as of this morning the balance of the Russian State Bank with the Chase had declined to $10,200,000. Confirmed credits amounted to $4,400,000. The Amtorg balance as of last night was $1,200,000. There is nothing particularly significant in the above figures. A point of interest is, however, that the Chase Bank has now received a cablegram from the State Bank of Russia indicating the latter's intention to ship gold from Vladivostok, and inquiring whether the Chase would give an advance against such gold in transit. The Chase Bank is considering this proposition. If it accepts, it is quite probable that it would impound in the dollar account of the State Bank an amount of dollars corresponding to the advance to be made.

Mr. Knoke referred to the attachment of Reichsbank accounts in New York and to the decision this week by the Appellate Court. The Reichsbank has now cabled the Federal Reserve Bank to transfer its dollar balances to the B.I.S. and, furthermore, to transfer all Reichbank credit items as received to the B.I.S. The Federal Reserve Bank lawyers are now studying the questions raised by these instructions. For sometime past a procedure similar to that requested by the Reichsbank has been followed with respect to the accounts of the National Bank of Hungary. With this precedent, it might be difficult for the B.I.S. to refuse to accept transfers from the Reichsbank account.

CONFIDENTIAL

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE December 16, 1939

TO Secretary Morgenthau

FROM Mr. Cochran

At 12:10 today the Secretary told me by telephone that he thought the message which we gave Pinsent yesterday, for the basis of an inquiry, should also be transmitted directly to the French. I called Pinsent, to let him know that we would make the same inquiry through Leroy-Beaulieu, and asked him to send a short follow-up cable to London to let them know that we would do this. I then telephoned Leroy-Beaulieu and arranged to see him in New York on Monday to give him a message.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE December 16, 1939

TO Secretary Morgenthau

FROM Joseph P. Cotton, Jr.

Re Colombian Debt.

Attached is a copy of a memorandum of a conversation which Duggan had with Laylin who, you will recall, is counsel for the Colombian Ambassador, Turbay, which Duggan asked me to convey to you.

On the basis of talks with Mr. Rublee and Mr. Laylin, I feel

(1) There is some hope of getting the Council and the Colombians together on a permanent settlement if neither side is permitted at this stage to take a position publicly and matters are kept in the negotiating stage.

(2) Turbay is anxious for a settlement, but is entirely governed by political considerations. He must make a stand on the basis of the cable paraphrased in the Duggan memorandum so as to be able to tell the Colombian Congress that he tried on that basis. If he is to be persuaded to seek new instructions, it must be made apparent to him that this Government is backing the Council.

(3) On the other hand, the Council, although it probably would not modify its position substantially as regards a permanent settlement, would be willing to consider a temporary settlement on a reduced basis, or would raise no objection to an arrangement approved by this Government on a different basis, than that outlined by Mr. Traphagen.

I will show the Duggan memorandum to Dr. White and I am available over the week-end at Michigan 0017.

J.P.C.Jr.

DEPARTMENT OF STATE

Memorandum of Conversation

CONFIDENTIAL DATE: December 14, 1938

ECT:

ICIPANTS:
Mr. John Laylin

Mr. Duggan

ES TO:

Mr. Laylin came in to inform me that he was now in a position to give me a full background regarding recent developments in connection with the negotiations for a settlement of the Colombian debt default. Although it was he, himself, that had made the suggestion that he be permitted to go over the situation with me, the Ambassador was in full accord that he do so; moreover, the Ambassador desired that the information Mr. Laylin was about to give me be conveyed through proper channels to the Secretary of the Treasury for his confidential information.

Mr. Laylin said that he had found Dr. Jaramillo and the Colombian Ambassador two very distinct and

different

different personalities. Dr. Jaramillo was a financier and approached the debt problem from the standpoint of the need of restoring Colombia's credit. Dr. Turbay was a politician who, although he wanted a debt settlement because he believed United States Government credits were contingent upon it, nevertheless was gauging very carefully the effect upon Colombian public opinion of a settlement under various terms. Dr. Jaramillo was in favor of a generous settlement; his political career being behind him, he was not particularly concerned with its effect on the political situation. Señor Turbay, on the other hand, had his finger on the political pulse and would not recommend a settlement that would in any way injure his political future. In the beginning Mr. Laylin was not sure which of the two men would have the greater influence in determining the final result; now he is convinced that it is Señor Turbay because of his political influence in Colombia at the present time, whereas Dr. Jaramillo has practically no political influence even within the Conservative Party.

After both Dr. Jaramillo and the Colombian Ambassador had studied the debt situation they had a number

number of joint meetings with Mr. Laylin. In these meetings Dr. Jaramillo indicated that he was in favor of a debt settlement which would have a starting interest rate of 3 percent and a final interest rate of 4 percent. The Colombian Ambassador was in favor of a flat interest rate of 3 percent. In an endeavor to find some procedure for improving Señor Turbay's offer, Mr. Laylin worked out the following scheme: that the interest rate start at 3 percent and work up to 3-1/2 percent; that thereafter 5 percent of the excess of Colombian Government revenues over 80,000,000 pesos be devoted to interest payments provided that the principal amount of the debt has been decreased to $35,000,000. A number of statistical tables were worked out regarding this plan, on which various assumptions were made. These tables showed that it would probably be ten years before the principal amount of the debt would be reduced to $35,000,000.

Dr. Jaramillo was enthusiastic about the scheme. Señor Turbay was lukewarm to it, preferring his flat 3 percent scheme. Mr. Laylin had other tables made up by Schroeder which brought out the surprising fact that the total amount which Colombia would pay out in order to

liquidate

liquidate the debt would be less on the scheme that he proposed with the flexible provision than a flat interest rate of 3-1/2 percent (This assumes of course that the budget would exceed 80,000,000 pesos). Although this was a surprise to the Colombian Ambassador, he nevertheless has not budged from his preference for a flat 3 percent interest rate.

The meeting between the Ambassador and Dr. Jaramillo and Mr. Traphagen was cordial and friendly. Mr. Traphagen made an excellent impression on both Señor Turbay and Dr. Jaramillo. At this conference the Ambassador first set forth the position of the Colombian Government. According to Mr. Laylin, his presentation was very forceful in giving reasons for the political difficulties that faced Colombia in making a debt arrangement. After a survey of these difficulties, the Ambassador informed Mr. Traphagen that he was under instructions not to agree to any debt arrangement which would eventually provide for a final outlay of more than $2,000,000 a year, that he was prepared at this time to recommend strongly to his Government that it accept an agreement providing for a flat 3 percent interest rate and that he was also willing to consider and to forward to his Government as a suggestion of the

Council

Council any other proposal for a debt settlement provided that it would not exceed an eventual expenditure of more than $2,000,000 a year.

After a friendly discussion, Mr. Traphagen stated that he would like the members of the Executive Committee of the Council and such other directors as could be present to hear directly from the Colombian Ambassador his point of view.

A meeting was held therefore in India House on Tuesday, December 12, attended by the members of the Executive Committee of the Council and one or two other directors. Mr. Francis White was present but did not take part in the discussions. The Colombian Ambassador covered approximately the same ground that he had gone over with Mr. Traphagen. He did not, however, give the impression of being so flexible or disposed to compromise as he had with Mr. Traphagen. The reason for this will appear hereafter.

After the Ambassador's statement, Mr. Traphagen opened the discussion to questions or observations to the other members of the Council present. Mr. Chubb expressed disappointment that the guaranteed bank debt had not been included. The Ambassador gave two reasons for its

organization:

organization: (1) that it was not a regular federal debt and that although the Government had guaranteed it, the Government was responsible only for the defaulted coupons, and (2) that the bank was in a position financially where it should be able to take care in the future of its scheduled payments. Mr. Thatcher asked what percentage of the Colombian budget the debt service, both internal and external, would amount to. The Ambassador agreed to furnish the statistics.

At the end of the meeting Dr. Jaramillo inquired whether the Council would be good enough to give a brief statement of its views in writing. Mr. Traphagen said that it would. Dr. Jaramillo then inquired whether that statement could be prepared and delivered the same day; although Mr. Traphagen expressed preference for a longer period, he stated that he would endeavor to comply with the wishes of the Colombians. Thereupon the members of the Council withdrew to prepare the statement. Later on in the day Mr. Leylin was informed by Mr. Traphagen that the members of the Council had decided that the time had passed for bargaining and that the Council intended to present to the Colombians a proposed solution that the Council would be prepared to support. Mr. Leylin gathered the impression from Mr. Traphagen that in preparation of of this offer there would be consultation by him with this Government.

Mr. Laylin then explained the reason for the less flexible attitude assumed by the Ambassador at the second meeting. On Monday, December 11, the Ambassador received a cablegram directly from President Santos, which made the following points:

1) that the Ambassador should bear in mind that an agreement on the United States debt implied the necessity of an agreement on the British debt;

2) that the amount set aside for amortization was to be used to purchase bonds at their market value and not at their full value. This point was rather cryptic in the telegram and Mr. Laylin stated that Señor Turbay had assured him that it was not intended that the amount set aside for amortization be reduced to that necessary to purchase at the market value sufficient bonds which at par value would fill the amount set aside for amortization; rather that it was merely a reiteration of Colombia's intention to secure with the funds set aside for amortization as many bonds as it could;

3) that if the English debt of approximately 1,200,000 pounds sterling is added to the United States debt of $45,000,000 a total of approximately $51,000,000 of debt is arrived at;

4) that

4) that the total amount to be available for debt service during the first year is to be no more than $1,750,000. This amount, moreover, is to include the service on the English debt. Moreover, the Ambassador should make an endeavor to reduce the figure of $1,750,000 because of the strain on the Colombian economy arising out of the war.

Mr. Laylin informed me that he had very vigorously stated to the Ambassador that the attempt to include service on the British debt within the figure of $1,750,000 would open the Colombian Government to an accusation of bad faith since at no time since the start of the negotiations had it ever given the slightest indication that the figure for service mentioned in connection with the United States negotiations included the service on the English debt. Mr. Laylin feels quite certain that although the Ambassador may feel it necessary to bring up the point in accordance with his instructions he will recede upon learning of the Council's very vigorous objection.

Mr. Laylin also said that the Ambassador realized clearly that no debt settlement could be arrived at on a figure of less than $1,750,000, although again the Ambassador might endeavor to have this figure shaved in order to comply with his instructions;

5) that

5) that for the first years of the debt arrangement the interest rate should be 2 percent with a certain amount set aside to liquidate back interest;

6) that the interest rate should not pass 3 percent and that the Government's position on this should be insisted upon. Reference was then again made to amortization on the basis of market values;

7) that the starting interest rate of 2 percent might go up 1/4 of a percent a year, with an amortization of $600,000. Under no circumstances was the liquidation of the arrears to be more than 1 percent.

Mr. Laylin stated that he and the Ambassador had studied these new instructions very carefully and that he thought the Ambassador fully appreciated that no settlement could be arrived at on the basis stipulated. The Ambassador professed not to understand why his Government sent him this telegram since he thought that his Government fully understood that no settlement was possible on this basis which is practically the same basis as proposed by the Colombian Government last July.

Mr. Laylin also said that the Ambassador thought it wise that this Department and the Treasury Department be advised of developments since it seemed probable that Mr. Turnhagen would get in touch with the two departments

to

to check with them before presenting the Council's position to the Colombian Ambassador.

Mr. Laylin concluded that the Ambassador really was desirous of bringing about a settlement provided always that it was one that could be justified politically in Colombia. The Ambassador is even willing to fly back to Colombia, with or without Mr. Traphagen, if his presence there would be useful to putting a debt settlement through.

Mr. Laylin added that while the Ambassador desired this Government to know of the foregoing background he requested that he be fully protected in all particulars since it might be misunderstood in Colombia if it were to become known that he had disclosed to the Department, and through the Department to the Council, such information as the instructions contained in President Santos' telegram to him.

Laurence Duggan

RA:LD:MJC

JR

GRAY

30

Bogota

Dated December 16, 1939

Rec'd 2:40 p.m.

Secretary of State,

Washington.

140, December 16, 1 p.m.

Referring to my telegrams Nos. 133. and 135. bill became Law No. 54 yesterday.

Congress closing today and I will report important legislation as soon as details available including possible last minute riders.

BRADEN

NPL

December 16, 1939.

MEMORANDUM FOR THE SECRETARY:

The accompanying report prepared in the Division of Tax Research describes and analyzes the income certificate plan for agriculture as contained in bills presented at the 1939 regular session of Congress. The following are the principal findings of the report:

1. The certificate plan combines processing taxes and benefit payments for certain farm products and is additional to the present farm program. Taxes and benefits would be outside the Budget and would continue in effect until repealed. The plan would be administered by the Secretary of Agriculture.

2. The plan is sponsored by the Secretary of Agriculture and farm groups. At the 1939 regular session bills were introduced to cover cotton, rice and wheat. The rice plan has been approved by the Senate Committee.

3. Total public expenditures for agriculture would be greatly increased; expenditures from the general revenues of the Government might be reduced.

4. Growers would receive larger benefit payments, with greater regularity than otherwise. However, the plan could not be applied effectively to all major commodities.

5. Agricultural trades would be adversely affected through some reductions in their profit margins and volume of business. They would bear the bulk of the administrative burden of tax compliance.

6. The tax is levied on a quantity basis, regardless of price. The tax rate for rice is 1 cent per pound. For cotton and wheat the rate is set annually by formula. Probable current rates are: Cotton, 7 cents per pound, wheat, 45 cents per bushel.

7. The cost would fall in large part on consumers. The tax would be regressive, imposed irrespective of tax-paying ability or the price of the consumed commodity. It would be particularly burdensome on the unemployed and the under-employed.

8. The tax would be hidden from the public and exempt from the supervision of the regular tax-collecting and auditing agencies of the Government. A new tax-assessing and tax-collecting agency would be created, adding to the complexity of the tax system.

Roy Blough

(COPY:FE:JPS)

No. 27

AMERICAN CONSULATE GENERAL

American Foreign Service, Hanoi, Indochina
December 17, 1939.

Subject: French Road Construction along
Chinese Frontier.

The Honorable

The Secretary of State,

Washington.

Sir:

I have the honor to report, as of possible interest to the Department, that the construction of a road connecting Bac-Quang with Laokay is progressing rapidly. Bac-Quang is an important center on the road from Hanoi to Ha-Giang, close to the Chinese frontier to the east of Laokay. The construction is under the direction of the military and, so far as I have been able to ascertain, the road will be reserved in the main for military usage. A reliable source of information states that approximately 15 thousand workmen are engaged along this new road of about 120 kilometers. Some American road building equipment has recently been purchased for this construction.

There is some possibility that this road will be available for commercial traffic into Yunnan, depending upon the existence of means of transportation beyond Laokay. The possibility is, however, rather remote, as the reported construction of a road from Kunming to Laokay (Hokow) is a somewhat doubtful matter. I have received a memorandum regarding this Yunnan road which indicates that construction has been started on certain sections but that completion is some months away. The following excerpt is of some interest:

"When the Mengtze-Manhao road is completed and the Manhao-Hokow section under construction, junks will be used for conveying goods from Hokow to Manhao.

"The cost of construction will lay entirely with the Central Government, the Yunnan Government providing only labor. An executive of the Communication Bureau added that when the road from Kunming to Kaiyuan is completed, goods coming from Tonkin by rail will be landed at Kaiyuan and shipped on by truck to Kunming or even directly to Kweichow or Szechuan. In this way a lot of time will be saved and pressure on the railway relieved."

During a conversation with General Martin, the highest ranking military officer in Indochina, it was stated that a system of military roads along the frontier was considered highly advisable. The road from Hanoi to Ha-Giang (via Bac-Quang) is fairly good and can handle gross weights of 4 1/2 tons. The new road is being constructed to handle comparable traffic. The road is therefore not only a valuable addition from a military point of view but it is also of possible future commercial importance.

Respectfully yours,

For the Consul at Saigon,

CHARLES S. REED II,
American Consul.

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

815.4

CSR:csr

December 18, 1939

Watson called me and asked whether I would see him, General Arnold and Colonel Byrnes and I said sure; that they should come over for lunch, whereupon Watson said "We can tell the President about it afterwards," and I said, "No, sir; we will tell him before." And he said, "Would I tell him?" and I told him no, that I would not; that he should tell the President and find out whether he approves. They want to see me about the Munitions Board.

FE:SJR)

No. 405

Air Mail

EMBASSY OF THE
UNITED STATES OF AMERICA
Chungking, December 18, 1939.

35

Subject: Export of Tung Oil to the United States under the Export-Import Bank Credit Agreement:

Transportation Problems; Plans for Centralizing Purchase of Tung Oil in China; Export Trade Monopolies

The Honorable
The Secretary of State,
Washington.

Sir:

I have the honor to state that Mr. P. W. Tsou, Chairman of the Foreign Trade Commission, informed Secretary Weil at a luncheon at his residence on December 17, 1939 that 22,500 of the 25,000 tons of tung oil required to meet obligations for the first year under the Export-Import Bank credit agreement had been shipped from Chungking, and that he was confident the remaining 2,500 tons would be shipped in time to fulfill the requirements of the agreement. He admitted that the closing of the Nanning road created a problem, but said he felt sure that it would be possible to ship the 35,000 tons required during the second year by use of the Yunnan Railway, the Burma highway, and the Hochih-Caobang highway (west of Nanning), which Chinese officials (including Dr. Peng Hsueh-pei) assert will be ready for use within a month. Mr. Tsou indicated that he did not know how many trucks would be used on the Hochih-Caobang road, and therefore could not make an estimate as to how much tung oil would be shipped over this route, but he did admit that when this road was opened it would not be entirely satisfactory, since pay-loads would probably have to be limited to one ton per truck.

In this connection, reference is made to despatch No. 26 from the Consul at Hanoi to the Department, dated December 10, 1939, in which the opinion is expressed that "road transportation to China via Indochina is practically finished unless the Chinese retake Nanning and drive the Japanese out of Kwangsi". In the light of information received from Hanoi, and from Mr. M. E. Sheahan, American motor transport expert now in Chungking, the Embassy has reason to believe that Mr. Tsou is unduly optimistic so far as prospects for motor transport from China to Indo-china are concerned. It thus remains to be seen whether increased traffic on the Yunnan Railway and on the Burma Highway will compensate for the loss of the Nanning Highway as a route for the export of tung oil.

With reference to the formation of the China Transportation Company, (Embassy's telegram to the Department No. 623, December 2, 1939), Mr. Tsou remarked that "most of the motor transport" would be in the hands of Foo Shing Commercial Company. He added that details of coordinating the Foo

Shing transportation organization with other motor transport organizations under the China Transportation Company were not yet "completely settled".

Mr. Tsou went on to say that the aim of the Foreign Trade Commission was to export a total of approximately 60,000 tons of tung oil a year to begin with, and, eventually, to treble this quantity. In this connection he said the Government was extending considerable financial aid to tung oil growers in Hunan Province in an effort to increase production.

Mr. Tsou further stated that he hoped to centralize the purchase of tung oil in China in order to stabilize prices, and that he was working on a plan under which the Foo Shing Commercial Company would be the sole agency purchasing from producers. He added, almost hastily, that foreign purchasers would be able to obtain tung oil "at a fair price" from the Foo Shing Commercial Company.

The policy of Chinese Government monopolies in different lines of export trade threatens to create difficulties for American firms and a conflict with the policy consistently advocated by the American Government of freedom for private enterprise. When, as in the case of tung oil export, such a monopoly has a colorable pretext on the ground that it is necessary in the fulfilment of an undertaking having the sanction of the American Government itself, complications are increased.

Respectfully yours,

For the Ambassador:

WILLYS R. PECK
Counselor of Embassy

Original to the Department by airmail
Four copies to the Department by pouch
Copy to Embassy, Peiping
Copy to Consulate General, Shanghai

610/610.2/851/860.2

WRP/TEW:MCL

December 18, 1939

This material was given to Secy Morgenthau today by Secretary Wallace. He gave the "Summary of Political Advantages of the Farmers Income Certificate Plan" to Secy Morgenthau for his own confidential information.

Effect on Processors

ctly Confidential

December 16, 1939

39

SUMMARY OF THE POLITICAL ADVANTAGES OF THE
FARMERS' INCOME CERTIFICATE PROGRAM

A. The proposed Farmers' Income Certificate Program would assure a greater increase in farm income than could be expected under any other practical and permanent alternative. The farm vote may be the decisive factor in the 1940 election.

B. If the Democratic Party should adopt the Farmers' Income Certificate Program, the Republicans would find that they had lost their thunder in the form of various domestic allotment plans and would have only two major alternatives, namely: No farm program, or outright price fixing. Since farmers will demand a program of some kind, and since outright price fixing by governmental decree is so vulnerable, it would seem that the Democrats could hardly place themselves in a better position on the farm front.

C. The Farmers' Income Certificate Program is a simplified method of achieving the advantages of the processing tax principle without involving the appropriation of public funds. It would be consistent with the original New Deal farm program. In fact, its adoption would show that after having been forced by an adverse Supreme Court decision into increased direct government payments, commodity loans, and export subsidies, the farmers and the Congress had found that basic principle of the original Democratic farm program is still the best alternative available.

D. The Farmers' Income Certificate Program should have a substantial appeal to several large groups not only because of its budgetary balancing aspect but also because it would avoid the necessity for increased commodity loan rates and export subsidy payments.

E. Under the Farmers' Income Certificate Program, the farmers would cash their certificates from the revolving Government pool several months before manufacturers would be obliged to purchase the certificates from the pool for delivery to the Government upon the sale of their finished products. Consequently, the Program would inject a large increase of purchasing power into our economy beginning in the midsummer. This should have a stimulating effect upon general business conditions at a time when many economists are agreed that it may be most needed.

F. Adoption of the Farmers' Income Certificate Program should make possible the release of funds heretofore appropriated for parity payments, to be used in the future for an expansion of the Stamp Plan which is a benefit not only to farmers and persons on relief but also to the numerous and politically powerful wholesalers and retailers. This should avoid what otherwise might prove to be an unfortunate contest on the part of the retailers, who are such important customers of most local newspapers, to obtain funds for the Stamp Plan by raiding the regular WPA or Agricultural appropriations.

Preliminary and Confidential

December 16, 1939

39

SUMMARY DESCRIPTION OF THE
FARMERS' INCOME CERTIFICATE PROGRAM

I. OPERATION OF THE PROGRAM.

A. Each producer of certain eligible crops (including at least cotton, wheat, and rice) who cooperates in the AAA production and soil conservation programs would receive certificates representing his normal production.

B. The certificates would be assigned a face value equal to an amount estimated to be required to give producers the difference between market and parity prices on the domestically consumed portion of the crop.

C. Processors and importers would be required, upon the sale of their products, to surrender to the Government a certain ratio of certificates for each unit of the raw material consumed in manufacturing the products sold. This ratio would be so determined that all the certificates distributed to growers would be returned by manufacturers and importers with respect to products consumed domestically. Certificates would be refunded to manufacturers with respect to finished products exported.

D. A Government pool would be established to purchase certificates from farmers and sell certificates to manufacturers and importers. The pool would be financed by a revolving fund supplied by the Commodity Credit Corporation. Through the operation of the pool the market prices of the certificates would be maintained at their face values, and an adequate supply of certificates would always be available to manufacturers and importers.

II. NEED FOR INCREASED FARM INCOME.

A. Large gains have already been made in increasing the income of farmers and conserving the soil resources of the Nation. The gross farm income (including benefit payments) for the United States increased from $5,284,000,000 in 1932 to $8,811,000,000 in 1938.

Despite this gain of 67%, however, farmers still participate in only a seriously deficient share of the national income: Agriculture today has approximately 25% of the total population, and 31% of the Nation's children, but only 11% of the national income.

Even with the present benefit payments, the average annual income of farmers lacks approximately $1,250,000,000 of parity.

3. There are two fundamental needs for governmental aid with respect to agriculture: One is to offset the greater inherent tendency of agriculture, as compared with industry, to increase production; the other is to conserve the soil resources of the Nation.

(1) The production of both industry and agriculture is stimulated by increasing prices but, speaking generally, agriculture is basically unlike industry in that the pressure of low prices usually causes a large and prompt decrease in industrial production whereas it tends to drive agriculture into the increased production of soil mining cash crops and the abandonment of soil conserving practices. This greater inherent tendency of agriculture to increased production is one of the fundamental causes of farm distress and disequilibrium between industry and agriculture. Increased agricultural production could be beneficial to farmers as well as to consumers if it were accompanied by increased industrial production. In fact, greater industrial activity is a basic requirement not only for urban prosperity but also for the full recovery of agriculture. Regardless, however, of such highly desirable and essential improvements as may occur in industrial activity it will remain necessary, in order to preserve a healthful balance between agriculture and industry, to continue some means of offsetting the inherently greater tendency of agriculture to increase production. In other words, the real difficulty is not the total overproduction of industrial and farm products. That would hardly be possible so long as there were proper balance. The trouble is too little or too much production of one group of commodities in relation to the production of other commodities and services. Consequently, the term unbalanced production is more accurately descriptive of the condition that needs to be avoided than the more common but somewhat misleading term overproduction.

(2) The welfare of agriculture and other groups over a long period is fundamentally dependent on the conservation of our soil resources. Fortunately, it has been found possible to progress simultaneously toward

both these essential objectives by means of the agricultural conservation programs. They furnish an incentive to preserve our soil resources by substituting soil conserving crops for the soil depleting crops that tend to be produced in excessive quantities. The use of marketing quotas in the regulation of interstate commerce in agricultural commodities also tends to avert unbalanced production. With this necessary and sound basis for the stability and prosperity of agriculture already established, it is possible to add additional measures for increasing domestic consumption and for maintaining our normal share of the export markets. But if the measures to be adopted for these purposes are to result in the maximum advance toward the equitable participation of farmers in the national income, they must support rather than impair the incentives under the existing programs to avoid a condition of unbalanced production and soil destruction.

III. ALTERNATIVES FOR INCREASING FARM INCOME:

A. Increased direct governmental payments. Clearly, there is not more than a small possibility, in the face of the existing deficit and the needs for increased national defense, of being able to improve the income of agriculture through increased appropriations from the Treasury. Moreover, this would not be the most desirable alternative even though it were possible, because it would leave agricultural income dependent upon a temporary and highly uncertain basis.

B. Increased commodity loan rates and export subsidies. These alternatives would also oblige farmers to rely to an undesirable extent upon government appropriations. Moreover, the greater the commodity loan rates fixed by the Government, the greater the appropriations of funds required for export subsidies. Finally, if a price pegging loan program is to be successful, the production must be decreased and domestic prices advanced to a point that permits liquidation of the loans without loss. Yet high domestic prices, which would be brought about through higher price pegging loans, would tend to encourage increased production and withdrawals from the present AAA adjustment and soil conservation programs. This, in turn, would tend to defeat the loan program and convert it, by requiring appropriations to cover loan losses, into a system of increased direct government payments without having secured production adjustment and soil conservation. It is doubtful that a system of marketing quotas could fully offset these tendencies. A more desirable alternative for increasing farm income would be one that would not only avoid the necessity of increased loan rates and export subsidy payments but also strengthen the programs for production adjustment and soil conservation.

C. Fix prices at higher levels by governmental decree. This alternative would not encounter budgetary difficulties, at least until a possible lack of production adjustment had swamped the program with unmarketable surpluses after a period of two or three years. It is obvious, however, that a program of outright price fixing could not long endure in the absence of a strong incentive for production adjustment. Most price fixing proposals omit any arrangement for production adjustment or soil conservation, and it is also difficult to envision how an adequate production adjustment program could be made effective under a price fixing plan. So far as any one has yet been able to suggest it would also be necessary under a system of prices fixed by governmental decree, and especially in the case of export crops, for the Government either to take over much of the buying and selling functions from the established and normal channels of trade or to undertake the policing of literally millions of transactions. It also seems clear that neither of these alternatives for effectuating a fixed price program could be expected to command the widespread public support that would be necessary for its continued operation.

D. Apply the internal tax or certificate principle. This would, as explained below, avoid budgetary difficulties, provide a permanent method of financing, and strengthen the production and soil conservation programs without giving rise to any major administrative difficulties.

IV. ANALYSIS OF THE FARMERS' INCOME CERTIFICATE PROGRAM.

A. The Certificate Program, since it would not require appropriations from the Treasury, would promise a greater increase in farm income than any of the other three alternatives. The only possible exception is a fixed price program, but as has been mentioned, this would tend to defeat the soil conservation programs, give rise to either extremely difficult administrative problems or the taking over by the Government of certain large functions of the established trade, and probably in the end become swamped with excessive supplies and create a large budgetary problem.

(1) The degree of success of an effort to bring about a fair and equitable participation by farmers in the national income will depend in large part on the selection of the source from which additional income is to be sought. Except for the possibility of obtaining improved prices from export sales through the operation of an international agreement, there are only two possible sources from which the income of farmers may be increased, namely, appropriations of funds from the public treasury and increased prices to domestic consumers. We should most probably have a far more judicious and equitable allotment of public subsidies among the various groups in our population if instead of having some of our subsidies in indirect forms, such as tariffs, quotas, monopoly privileges, and publicly increased wages and bargaining power, all grants of public aid had, from the beginning, been only in the form of direct and outright appropriations of public funds. But since this was not done, and since the possibility of bringing about such an idealistic arrangement is exceedingly remote and impracticable under the existing circumstances, we shall be obliged, however reluctantly, to resort to an even wider use of indirect subsidies if we are going to attain a reasonable degree of equity in the distribution of public grants of aid.

Briefly, we find ourselves confronted with an unwelcome fact which must be taken into consideration in planning a course of action to achieve an equitable result. The history of most efforts by groups to improve their circumstances through governmental aid has emphatically demonstrated that for a variety of reasons the appropriation route, as compared with increased prices, is the hard way. Long ago the manufacturing industries as a whole were compelled to recognize and act on this phenomenon. When in search of government aid, they usually pass over the possibilities of obtaining appropriations of public funds, and confine their requests to various devices, such as tariffs and quotas, for increasing their selling prices. This practical situation determines the result to such a great extent that it is difficult to believe that farmers are going to have a fair and equitable share of the national income so long as they are handicapped, as compared to industry and labor, by being obliged to receive increases in their income primarily through appropriations rather than improved prices.

B. Wherever applicable the Certificate Program would give agriculture a permanent form of financing more nearly comparable to that now enjoyed by industry and labor through legislation providing for tariffs, quotas, wages and hours, and collective bargaining.

C. The Certificate Program would strengthen the AAA production and soil conservation plans by adding to the present cash payments the value of the certificates as an additional incentive to cooperate in the AAA programs.

D. The Certificate Program would avoid any necessity for increased commodity loans and export subsidies by making it possible to increase the income of farmers without requiring an increase in domestic farm prices.

E. The Certificate Program would reduce the need for the non-budgetary appropriation item, of more than $200,000,000 during each of the past two years, commonly known as the parity payment fund, and thus decrease the deficit that would otherwise be incurred.

F. The Certificate Program could be conveniently administered by the existing AAA facilities without appreciable increase in expenses.

G. The Certificate Program is unlike those forms of taxation usually regarded as regressive. The principal factor that sets the Certificate Program apart from ordinary sales taxes and similar regressive levies is that the proceeds are to be used exclusively for the benefit of one of the lowest income groups among the population. In view of the fact that all of the revenue derived under the Certificate Program would be used to benefit a group whose income is substantially less than the income of those on whom the cost would fall, it is evident that upon being considered in all its aspects, the net result of the Certificate Program would be somewhat similar to progressive taxation in that it would transfer purchasing power from a higher to a lower income group. In this connection it may be pointed out not only that the average per capita income is lower for the total farm group than for the total non-farm groups, but also that some of the lowest income farm groups (for instance, share-croppers) have incomes below those of some of the lowest non-farm groups (for instance, WPA workers).

Certain additional related factors may be noted:

(a) The Certificate Program could hardly be called regressive insofar as it serves only to bring farm income up to a reasonable historical level, such as parity.

(b) The relative disadvantage under which farmers are laboring is indicated by the fact that non-farm group incomes now have a purchasing power for food approximately 25% greater than in the 1920s.

(c) Very few consumers object to the payment of prices not in excess of those required to give farmers a parity or other reasonable return.

(d) A large majority of the total public revenue raised in the United States is derived from truly regressive forms of taxation.

(e) The public aid granted industry and labor in the form of tariffs, quotas, monopoly privileges, and labor legislation, usually have effects similar to regressive taxes.

(f) The Certificate Program, as it happens, is best adapted to those commodities, such as cotton and wheat, for which moderate changes in the price of the raw product have little effect on consumption. Moreover, the Food Stamp Plan is being used to benefit the lowest income non-farm groups and to protect the public, as well as the farmers, against a decrease in consumption.

H. Despite its obvious budgetary balancing aspect, the net effect of the Certificate Program probably would not be deflationary. There are two reasons for this:

(1) In the first place, the establishment of the revolving pool to purchase certificates from farmers and resell them to manufacturers would insert a substantial (perhaps at its peak as much as $300,000,000) of purchasing power into the economy. This would come about because, on the average, farmers would get paid for their certificates several months in advance of the date on which the manufacturer would be obliged to acquire the certificates and return them to the Government.

(2) In the second place, there will probably be a strong and effective demand upon Congress for a substantial appropriation to finance a general expansion of the Food Stamp Plan which has proved to be beneficial not only to farmers and persons on relief in urban centers, but also to the numerous retail merchants who are usually among the most important customers of local

newspapers. If the so-called parity payment fund were rendered unnecessary by an adoption of the Certificate Program, Congress might be expected to appropriate a similar sum for extension of the Food Stamp Plan with the consequence that there would be no net decrease in government spending. Further unbalancing of the budget would be avoided, but with the injection of the purchasing power to be derived from the establishment of the revolving pool for certificates, there would be a substantial net increase in the purchasing power of the population.

RE COLOMBIAN FINANCE

December 18, 1939.
4:30 p.m.

Present: Mr. Hanes
Mr. Cotton
Mr. White
Mr. Welles
Mr. Jones
Mr. Feis
Mr. Riefler

H.M.Jr: Jesse, this is the way the thing stands, and Cotton can correct me, because he has been following it. This fellow Jaramillo, or somebody, made an offer of two million dollars. The Bondholders Protective Committee comes back and says, "We want two million three, plus the interest on this mortgage bank," which is O. K.

Cotton: They don't say that. They say that to you and Mr. Jones. They don't say that to the Colombians yet.

H.M.Jr: Now, over the week-end, the President of Colombia sent the telegram which Jack Laylin tells Duggan who tells Cotton and I told Cotton to get it to you.

Jones: He did.

H.M.Jr: They announce a million and three-quarters less what they owe Great Britain, which is around two hundred thousand dollars and roughly it gets down to a million and a half, and I say, "Spinach."

Jones: I am with you on that.

H.M.Jr: As Cotton says, these fellows are politicians and not just like you and me, a couple of hardheaded business fellows. We don't say it to them so rough, we say we will keep on negotiating.

Riefler: I say, "Spinach," too.

Cotton: It is all a question of whether he will see if he can get anywhere on the basis of those instructions and then see if he can get somewhere on any others.

Jones: We have got politicians ourselves. I read that memorandum you sent. Who are you meeting with this afternoon?

H.M.Jr: Well, Welles and Feis will be here. Welles had been seeing the various people connected with Colombia. I haven't seen anybody. I did see Mr. Traphagen once. You were out of town. He came down here and made this report and said he wanted to hear from me and I think we had better get word to him that I won't be able to call him today. I will call him tomorrow.

Jones: Well, it is your view that we ought to stand behind the Committee as long as they are reasonable?

H.M.Jr: Yes. I thought this, that we could say the State Department - if that is what the President of Colombia wants, they can say in any kind of language they like that we are just not going to do anything on that kind of an offer. We don't think that kind of an offer is fair.

Jones: I subscribe to that a hundred percent.

H.M.Jr: And that until they can make up an offer which we think is fair, all bets are off.

Cotton: Do you want to talk this over and see what Mr. Jones thinks about it?

H.M.Jr: Does that change what I say?

Cotton: No, that just puts it in a different way.

Jones: More gentle, diplomatic.

H.M.Jr: Well, they are seeing Duggan frequently, and let Mr. Welles send for this Colombian Ambassador and put it to him politely that we say no.

(Mr. Feis and Mr. White enter the conference)

Over the week-end I got this memorandum of the conversation between Duggan and Jack Laylin which I asked Cotton to make sure that you saw, which, to sum up, as I understand it, where the Ambassador of Colombia and Mr. Jaramillo were offering two million net. They now offer us a million seven hundred fifty thousand dollars, out of which the

British have to be paid also. That brings it down roughly to about a million and a half.

Welles: Is that correct, Doctor?

Feis: Yes.

H.M.Jr: Isn't that about right, Herbert?

Feis: Yes, sir.

H.M.Jr: And it seemed to me - this is coming from the President of Colombia. I also understand from Cotton, who has got from Rubling and Jack Laylin, that they as counsel for Colombia feel that this is not fair and just sitting around chinning here while we are waiting, we thought that in some polite manner it should be conveyed....

Jones: How many years of past due interest on this Colombian debt, five or six? Do you know, Cotton?

Cotton: Five.

Jones: Do you know when that five is? The first thing you know it will be '40. I wonder whether we are dealing with five years or six years of accumulated interest. Do you know?

Cotton: I don't know.

Jones: Have you got that, Doctor?

Feis: I have got a figure given as one million six hundred twenty-four thousand dollars. I don't know what period of time that covers.

Jones: It is the 45 million - they have bought in some of this 45 million now outstanding in this country?

Feis: 45 outstanding, Mr. Jones. We don't know how much of it in the United States. The Department of Commerce's best guess - but they warn us that it may be way off - is 26 in this country.

Jones: Twenty-six?

Feis: There is 45 of the dollar issue out. Their best guess is that 26 of it is here.

Jones: Of course they have got to provide for all of it alike.

Feis: That is right, sir.

H.M.Jr: We are all doing our homework. Is the so-called Laylin formula the one where we do it on the basis of their income?

Cotton: No.

H.M.Jr: I don't like that one. Supposing I read out loud what Cotton has written. It may help us all. I think he is the only one who has done his homework, as far as I know.

Feis: I think there are five years of over-due now.

H.M.Jr: May I read this, which was handed to me just before you came in?

Welles: Please.

H.M.Jr: This is written by Cotton.

"The Colombian Ambassador be informed:

"(1) That the Committee regrets that, apparently, so little progress has been made toward a settlement; and must inform him, in all frankness, that it sees no hope, given the instructions recently received by him from President Santos, of a satisfactory permanent settlement which would rehabilitate the credit of the Colombian Government and provide an adequate basis for consideration by this Government of future credits to Colombia.

"(a) The Ambassador must realize the unfortunate effect produced upon the Council by his statement that the over-all sum for bond service, which he indicated his Government was prepared to make available, should include service of the sterling as well as of the direct dollar debt. This point has never been raised before.

"(b) It is even more unfortunate that, after offering two millions in annual service the Ambassador would now, on the basis of his recent instructions, have to indicate to the Council that this sum would be initially reduced."

May I interrupt that? The information is from Laylin to Duggan. You have never had it from the Ambassador to the State Department, is that right, Joe?

Cotton: The Ambassador knew of Laylin's talk to Duggan and approved of it.

H.M.Jr: But it is Laylin to Duggan, right?

Cotton: Yes.

H.M.Jr: I don't know whether that is....

Jones: In other words, you haven't got it direct yet.

H.M.Jr: I would call that not direct, wouldn't you?

Welles: I would not call it direct.

H.M.Jr: I mean, that is the point I wanted to make.

"(2) That the Committee feels, in so far as it has been informed of the conversation between the Ambassador and the Council, that the matter of the Government-guaranteed mortgage bank debt has been insufficiently explored. On the basis of the Committee information available to it, the Committee understands that the amount of these bonds which remains outstanding in the hands of the public is much reduced, and, accordingly, that a relatively insignificant amount of foreign exchange would be required to service the outstanding bonds if an adjustment of the interest rate could be arrived at. The Ambassador must realize the importance of reaching an adjustment in regard to these guaranteed bonds from the standpoint of rehabilitating the credit of his Government. It is hoped that he will seek instructions which will permit him to include these bonds within the scope of his conversations with the Council."

Was this written in the Treasury? It is wonderful. We are learning. Aren't you surprised?

Welles: I have never seen anything come out of the Treasury that has not been well done.

H.M.Jr: Thank you.

"(3) At this stage the Committee does not feel called upon to express an opinion as to what would constitute a reasonable basis for permanent settlement of the direct dollar debt of the Colombian Government. However, as stated above, the Committee sees no hope of settlement within the limits of the instructions recently received by the Ambassador from President Santos. The Ambassador must understand the difficulty in which the Council is placed in being asked to consider an offer which does not measure up to the proposal (which did not lead to agreement) communicated informally to the Department of State last summer, which the then Ambassador from Colombia decided he would recommend to his Government if assured of a favorable reception for the Council.

"In the hope that conversations between the Ambassador and Mr. Traphagen may continue with some prospect of reaching an agreement, the Committee has decided to use such influence as it possesses to restrain the Council from taking a position with the Ambassador which might lead to a breakdown in negotiations; and, on the other hand, the Committee trusts that the Colombian Ambassador feels that he is in a position to seek new and more satisfactory instructions from his Government in regard to these negotiations.

"(a) If it is desirable to go further, the Ambassador might be informed that a permanent settlement along the following lines would seem reasonable:

"As regards the direct dollar debt: An initial three percent interest rate; recognition in principal of the arrears as provided in the 'Laylin proposal';"

What the hell is the Laylin proposal?

Cotton: That is the one last summer, one-sixth of the arrears would be paid.

Welles: Do you want me to read it?

"Interest from three percent initially to four percent, provision to be made for liquidating arrears at one percent and six million of Treasury bonds to be ignored or cancelled. The initial payment, one million six hundred seventy-five thousand of the first year, be kept near the budget figure by limiting amortization to a small amount at first."

Cotton: The arrears here mean those which the Council would agree to.

H.M.Jr: Look, this paragraph, beginning, "As regards the direct dollar debt," how much would that total a year? Is that two million or two million three?

Cotton: Two million three.

H.M.Jr: Two million three?

Cotton: Yes.

H.M.Jr: Has Laylin agreed to two million three?

Cotton: No. I just said the arrears provided by the Laylin proposal, which is one-sixth proposed by the Council. The Council said it would just accept anything.

H.M.Jr: And the Laylin is one-sixth?

Cotton: That is right.

H.M.Jr: You are familiar with that?

Jones: That is one percent?

H.M.Jr: No, what the Council said was this: They take one-sixth of the total arrears and divide that so that that will be paid one-thirty sixth each year for thirty-six years.

Jones: Yes, but that is one percent per annum instead of six. The notes are at six percent and now they accept one percent payable over a period of - how many, six years?

Cotton: Yes. The Council is ready to accept that.

H.M.Jr: Is that one percent?

Jones: Yes.

H.M.Jr: I didn't know that.

"A four percent rate after the arrears are disposed of and a minimum annual amortization of five hundred thousand dollars;"

I again say that that totals two million three a year.

"As regards the guaranteed debt: A three-to-three and a half percent rate; amortization at one percent of the face amount of the presently outstanding bonds annually."

Again, is that what the Council wants?

Cotton: No. The State Department seems to have information that probably only four or five million of those bonds are outstanding instead of the ten we are figuring on, so they are rather small amounts. It depends on the basis for figuring.

Jones: Does the two million three include all these three items?

Cotton: No, the two million three is only on the direct.

Jones: It doesn't take care of the Land Banks?

Cotton: No.

H.M.Jr: If you don't mind, I would like to do this thing a little differently. All of this is all right with the exception of "(a)", and inasmuch as Mr. Welles says that he hasn't received an official notice from the President of Colombia, I would like to make this suggestion to Mr. Welles, if it is agreeable to Mr. Jones, that Mr. Welles send for the Ambassador or whoever he deals with and simply say, "We hear that the President, Santos, says so and so. If that is correct, of course we couldn't accept it." That would seem to give the President of Colombia a chance to back out again, wouldn't it, and not give them at this stage a formal plan that we would take, you see. If we give them a formal plan they will just back away from that again and try to begin to trade again. The President of Colombia says, "A million seven hundred fifty, less what we owe England." Mr. Welles could say, "I hear that. If that is correct, of course we couldn't go along, but now if you boys will come along with something like what you offered last summer maybe we can get behind that," but not give them a formal plan at this time.

Jones: I doubt if we should give a formal plan now. They are the people that are seeking something. They want a new loan. They owe this money. We are here to help settle with the holders of the old loan and if that can be done on the basis of that we can advise them we will consider lending them some new money.

Welles: How about doing this, doing exactly what Henry has suggested and then saying, "I suggest that you get new instructions and let those new instructions comprehend what is the best offer you are prepared to make." Otherwise, this will be interminable and we want to get it done.

H.M.Jr: But not at this time to make any formal offer.

Welles: No, I quite agree.

H.M.Jr: Is that all right with you, Jesse?

Jones: I am not certain that is good tactics, because when he gets out and says, "This is the best I can do," then we are put up to the point of having to say, "Well, I am sorry, we can't do it."

H.M.Jr: What I suggested was that Mr. Welles say, "If what we understand of the proposal is correct, it is impossible."

Jones: But if Sumner said in addition to that, "Tell us what is your..." I don't like ultimatums.

Welles: I don't have to use the word "best". I can simply say, "What is your offer?" Otherwise, they are going to sit back and wait for us to make some suggestion.

H.M.Jr: Couldn't you go a little bit further and say that if what we understand the President had in mind is their offer, we could tell them that it is useless?

Welles: Yes, I intended that.

Jones: Now, this conversation between Duggan and - who?

H.M.Jr: Laylin.

Jones: Is this formal, is it a part of the proceedings?

Welles: No. Laylin is acting as counsel for the Colombian Embassy in this matter.

White: Mr. Secretary, you called my attention to coffee prices. The decline makes a difference, at present rates, of about ten million dollars to them in a year, that is, the recent decline in their coffee prices which took place over the last two weeks means that they have ten million dollars a year less foreign exchange than they would have had had that not decreased in price. They may offer that as some kind of a justification for attempting to reexamine their offer of last summer. That is why I think it is better not to have any specific - Give them another chance to come back.

H.M.Jr: Do you think this approach with Colombia is all right, Johnny?

Hanes: Yes, I do. I like Sumner's suggestion and your suggestion.

H.M.Jr: Then if that....

Welles: What he is going to say if I say that we couldn't possibly expect this proposal to be considered, he is then going to say, "Well, tell me frankly what do you think will be considered." My reply then will be, "Well, what is your offer?"

Jones: Then I think we can very properly give them a proposition when he asks for it.

Welles: I think that is inevitable, he will.

Jones: I should think it would be. Then he has asked for us to give him one and we will give it to him.

Welles: All right, we all agree on the procedure that Henry suggests then. The question then is as to what proposal we would consider fair to put up to him.

Jones: That we would consider fair?

Welles: Yes.

Jones: Are we ready to discuss that?

H.M.Jr: I am ready.

Jones: I am.

H.M.Jr: Do you want to talk first?

Jones: I don't care.

Welles: We have as a basis for consideration this suggestion that is in Mr. Cotton's memorandum here.

Jones: As a basis?

Welles: Yes.

White: Is that a position this Committee wants to take, as to what it regards fair rather than to evaluate the arrangement they might make with the Council? They are injecting themselves right into it in place of the Council. Might it not be better to get a better offer from them and then see what the Council does?

H.M.Jr: The Council has been down here, Harry, and the Council has said to me, "We will do business on a basis of two million three, never mind how it is divided, plus a settlement - that the mortgage bank should take care of this indebtedness, which it can afford to do."

Welles: I have here....

H.M.Jr: Which it can afford to do.

Welles: I have this memorandum. It says that Mr. Traphagen informed the Secretary of the Treasury on December 14th that the Council had formulated an irreducible minimum which is presented in the attached schedule. It will be noted that this differs from the Laylin plan only in that the proposals are larger initial amortization and an increase in the arrears in five years instead of six, although Mr. Traphagen indicated a willingness to follow the Laylin plan in this and provide for initial payments of four hundred thousand on the guaranteed bonds of the agricultural mortgage bank. The latter, added to two million three, would result in total payments of two million seven a year.

Cotton: They have gone into the guaranteed debt situation, Mr. Welles. Mr. Traphagen was quite apparently - when he talked to the Secretary - that is, speaking on a ten million dollar basis. Now, if your information is correct, I take it that probably there are only four million of those bonds outstanding in the hands of the public, which changes that considerably.

White: Mr. Secretary, I would like to make another plea, that it is awfully important that this settlement be made and even at the sacrifice from my point of view of a little bit less favorable terms than we might like to see, if it can be made on no more favorable terms, and for that reason I should think that we should be most reluctant to say what we regard as reasonable if that be taken as an irreducible minimum and rather keep a free hand, because this may break down and I think it would be most unfortunate.

Welles: I heartily agree.

H.M.Jr: I used to sit in my father's office when he was Ambassador to Turkey and the way these fellows are acting, I don't think they are very much different from the Turks. Am I running the Turks down?

Welles: I get the impression you are running the Colombians down.

H.M.Jr: What I have in mind is this, that if we for the time being take the position of the Council and hold for the two million three plus the thing on the Colombian bank and stick to that, maybe we can get - go back to the agreement of last summer of two million dollars, but I gather these fellows are traders.

Jesse, if we stick to the position for the time being of the Council and then they say it is irreducible minimum - but I think if they could get two million dollars on the line they would take it and like it.

Welles: Do you think the Council would?

H.M.Jr: I am just guessing, but if we say two million now to Colombia, they go back to a million and three-quarters.

Cotton: The Council would take less than a temporary settlement.

Welles: The Colombians won't discuss it on that term.

H.M.Jr: I think these fellows are traders and if you stick to two million three plus the mortgage bank, we will have to do a little trading with them. What do you think, Jesse?

Welles: Doctor, is it your understanding that in the conversations last summer....

Jones: I don't know what the two million would pay. I like the idea of having a certain fixed service charge, whether it is two million or whether it is some other sum. Then I think that if we could have something to do with how that money was to be used, provided - having in mind that we have got to go to the Hill for money for the bank and that we have got to face a Committee which is going to ask some pertinent questions.

H.M.Jr: I think if we said to the Colombian Government right now two million dollars, they would back right away from it again.

Jones: Are you asking for two million?

H.M.Jr: If we do.

Jones: They don't need this money very badly, if that is the case.

H.M.Jr: Well, they offered two and they think we are so hot for a settlement now that they are offering about a million and a half.

Jones: Why are we so anxious for a settlement?

Welles: Well, I think there are a good many reasons, Jesse. I think that it is bad policy at this time to let this matter be unsettled. It is creating very bad opinion in the United States, as you know. You were just speaking about the reaction on the Hill and all over the country. If we start getting a series of press attacks, as we probably will soon, it would create resentment down there and make very bad feeling. It is purely from the political aspect. From the economic and financial aspects, I think that this thing being settled makes it possible for you to undertake some pretty effective work along the lines of credit, which I would think probably would be productive of pretty far reaching benefits in years to come.

Jones: Then aside from that what are the advantages as regards South America and this country, and so forth and so on?

Welles: I think what I have just said covers that pretty well.

Jones: I don't see how we can defend - excepting recommending to the bondholders or agreeing to a one percent settlement on the six percent interest obligation. I would a good deal rather take the net sum, and I would rather accumulate the - add to the 45, three percent interest for these five years and then give them a straight three percent bond from there on to maturity, take the same dollars that Colombia is going to pay ultimately and fix a formula that we can put in the sums on principal without charging them any more money. This thing is jumping from three and a quarter and three and a half and four. I would rather do it the other way and give them a three and a half percent bond.

White: There was something originally said about making it flexible so as to permit the bondholders to get a little more and permit them to pay a little more, which would give them the possibility of making something of their claim that in this war situation they are kind of hard put and yet be some protection to the bondholders. I thought there was going to be some kind of flexible scale beyond an irreducible and accepted minimum that might take care of that and certainly would look a lot better both from the point of view of Colombia and from our point of view, if some such arrangement could be worked out and we could get promise of increased payments later on if they could afford it. It might be in addition to some acceptable minimum and it might make it possible to come together on that minimum now, because they may come around and say, "Well, things look pretty bad to us. Coffee is dropping and will drop still more and it is 60 percent of our exports and we simply cannot commit ourselves to payments of this kind."

62

I don't think they are sound in that. I think they can afford to pay more, yet they could make much of that argument and if we can take away the strongest portion of that by saying, "All right, let's have this payment now and then let's make this flexible portion," I wonder whether that may be a basis for compromise that might work out satisfactorily.

Jones: I see no reason why we shouldn't - if we fixed a sum of $2,500,000, or whatever the sum is, there is no reason why we shouldn't, due to unnatural conditions now, take a less amount for a period of one or two or three years or until conditions have adjusted themselves. That wouldn't be - that wouldn't be so bad. You could let the payment in any event be enough to pay the interest of the entire debt.

Welles: There is just one point there, Jesse. I don't think the Colombian Government would agree to anything except a firm, final settlement, and anything in the nature of a settlement which envisages changes in the next few years will make them, I think, feel that this is on a temporary basis.

Jones: I am talking about a firm settlement, but instead of - if a million seven hundred fifty thousand would serve for the next year, there is no reason why we shouldn't - that is final. Two million the next year, maybe, two and a quarter the next year. Probably get up to your fixed sum. That could all be definite. It needn't be depending on anything.

White: I think there is much in that.

Jones: A lot of people - you start out with the thing on a smaller amount and when the conditions are a little better with you, you increase your payments.

White: I think that is a very good idea, give them a chance to pay less for a few years.

Jones: I think they would like that and I would like it if I was in their place and I would like it from our standpoint.

Now, if you calculate the past due interest at three percent, that amounts to something like seven and a half million dollars in addition to the 45. That would be some 52 or 53 million dollars. 53 million dollars takes a million six hundred thousand to pay the interest and you can fix the interest if you want to on your hieroglyphics.

H.M.Jr: I just wanted to see what you are using.

Jones: Three.

Cotton: You are going to fund the past due debt?

Jones: Yes. I would rather have it if I was a bondholder or if I was a debtor. Then when you finally provide for your sinking fund, when you reach that, allow that sinking fund to be used to buy a bond, so if I want to sell my bond at thirty cents or forty cents or fifty cents and they want the whole issue for seventy-five, go ahead. That encourages them to buy their bonds in because they can save money by doing it.

Welles: I think that is a good point.

Jones: I would be glad to sit down and work out a formula and submit it to you.

H.M.Jr: Why don't you do that, Jesse? After all, 24 hours in this thing - could you put that down on a piece of paper and then let's take a look at it?

Jones: Yes, sir. I can give it to you in the morning.

H.M.Jr: All right. I would like to take a look at it.

Riefler: I have got a suggestion I would like to put in.

H.M.Jr: Talk up.

Riefler: I have a suggestion I would like to put in the pot. I agree with you (Jones) that it seems to me this raising the interest rate always leaves the bond in an indeterminate status. It is much better to have a flat interest rate bond. I would suggest a three percent flat interest rate bond plus a sum that changes each year in accordance with their exports. For example, a certain percentage - the excess of their exports over its annual value from 1930 to date, if that is 160 million pesos, you would take 10 percent over that or 9 or whatever it is, that that contingent sum be used, half to pay off the interest arrears and half to amortization until the interest arrears are cleaned up and then all to amortization.

H.M.Jr: Sounds like a parity payment to me.

White: It has a desirable degree of flexibility.

Cotton: If you could give up the four percent rate you will never get it anywhere again.

White: Never get the four percent rate?

Cotton: No.

White: Three percent is high enough under the circumstances.

Jones: It seems to me it is more important to preserve the integrity of the principal of this and after all a government that is solvent and sound ought to be able to borrow money at three percent. We can take the same dollars and spread them around here so that it will make a better looking settlement for all of us.

H.M.Jr: For me it has been a tough day and Jesse just begins to really click at this hour and I don't.

Jones: Having made two speeches today and seen forty delegations, I am about frazzled out, but I can raise to a fly still.

H.M.Jr: How about giving us something tomorrow?

Jones: I will be glad to do it.

H.M.Jr: Any of our people are available. Cotton, Riefler and White are available.

Jones: All right.

H.M.Jr: Then as soon as the memorandum comes, we can have a three-way conversation so that you (Welles) can see the Ambassador right away.

Welles: I don't need to wait to see the Ambassador for this. I will be away tomorrow, anyway.

Jones: You wouldn't see him tomorrow anyway?

Welles: No. I should think really the wisest thing for me to do in accordance with the suggestion you made was to see the Ambassador sometime on Wednesday to tell him that we have heard that some instructions of this kind have been received from the President of Colombia and that in all friendship and candor I want him to know before it goes further that we are perfectly convinced that this is not a fair agreement which could be acceptable, that we constantly hope he will get some new offer from the Colombian Government and that when that new offer comes, he drop in to see Mr. Jesse Jones and discuss the basic points contained in that new offer with Mr. Jones. By that time, Mr. Jones will have sent you and myself and the rest of us the ideas that he has got in mind. Is that agreeable?

H.M.Jr: Fine. And I will call up Mr. Traphagen tomorrow and tell him we are working on this thing and for him to sit tight.

Jones: When is all this - that is all right.

H.M.Jr: I will just tell Traphagen to keep his shirt on and sit tight.

Jones: I am thinking now about me and my wife and Christmas and Houston.

H.M.Jr: When would you be leaving?

Jones: Wednesday night was my plan.

Welles: He couldn't cable his government and get a reply by Wednesday night anyhow.

Jones: I don't think you are going to get anywhere during the Christmas week-end anyhow, you are so far apart. I am perfectly willing to give you the formula.

H.M.Jr: And then Mr. Welles can see him Wednesday and if he gets instructions while you are away and we agree on the formula, Mr. Welles can give him the formula.

White: The Government is then taking over the negotiations, is that clear, Mr. Secretary?

H.M.Jr: No.

White: That seems like it to me. It seems they are taking over the negotiations for the Council.

Riefler: We would have to give the formula to the Council, I think.

Jones: In the last analysis, they have got to get the money from the Government and we are not going to give them the money until we can arrive at something like this.

White: I thought the Council was going to do the negotiating and going to refer to us when they come to an impasse and I take it the intent originally was to operate through the Council and now here the Government is stepping right in and taking over the negotiations.

H.M.Jr: Not yet. I think this is all right as far as we have gone.

Jones: I don't see anything wrong with it. What do you think, Sumner?

Welles: I think Dr. White's point is one that we naturally all have to bear in mind. I think he is absolutely right. I think we have to avoid doing anything which implies taking over the negotiating from the hands of the Council, but my understanding had been that after I gave this message to the Ambassador and his government and they reconsidered and had some other ideas which were more generous in their character, it would be helpful for him to drop in and see you (Jones) in order to talk out ways and means by which this amount might be divided up between interest, amortization, and so on.

Jones: Is this gentleman in town now?

Welles: Oh, yes. You have seen him once already, you know.

Jones: Well, I can see him again. I can see him tomorrow.

H.M.Jr: To go back on the thing, the way we did it was, the Council saw him. We don't know officially that they have dropped the thing to a million and three-quarters and if they do get another offer, maybe it would be better to send them back to the Council and keep that channel.

Welles: I think that ought to be kept. I don't think it would do any harm....

Jones: Back to the Committee? That is readily preferable.

H.M.Jr: I think Harry is right.

Welles: I don't think it would do any harm for him to talk informally to Jesse as to the ways in which any offer might be worked out.

H.M.Jr: If I was Jesse and he doesn't mind my volunteering, he is going to be the lender. I would be reluctant in his place to talk to them.

Jones: I prefer not to.

H.M.Jr: I think the original position that we have taken was that you, as the ultimate lender of money ought not to talk to them on this and let the Council do it.

Jones: We're not going to be in position to lend them this money until we see Congress anyway, so

I see no reason why you should try to bring the negotiations to a conclusion in a hurry.

H.M.Jr: Well, I think we ought to push as hard as we can and if you will send us a formula we can all take a look and talk about it before you leave Wednesday night, see if we can come to an agreement on that. Mr. Welles will see this fellow Wednesday and tell him to go back for new instructions. I will call up Trap-hagen tomorrow and tell him to sit tight.

Jones: All right.

H.M.Jr: And give him a little background. All right?

Welles: So far as the background is concerned, I rather question the desirability of giving him very much at this stage. This Laylin report, I have no doubt is perfectly accurate, but it may be due to misunderstanding and misconception or something of that kind, but see if we can get the Colombian Government to modify this before giving him any background.

H.M.Jr: I think with all due respect to the Colombian Government, that they made the mistake of letting Jack Laylin - he is just another person training on this thing. You have got the Council and the Colombian Government and the three of us are supposed to be kind of umpires.

Welles: He is acting as counsel for the Colombian Embassy, lawyer for the Embassy.

H.M.Jr: Why doesn't the Ambassador as well as Jaramillo speak for themselves?

Welles: If they wanted to do it, I think they would.

Jones: All right, sir, what else?

H.M.Jr: That is all.

December 18, 1939.

RECOMMENDATIONS
RE: Colombian Debt Negotiations.

I.

89

The Colombian Ambassador be informed:

(1) That the Committee regrets that, apparently, so little progress has been made towards a settlement; and must inform him, in all frankness, that it sees no hope, given the instructions recently received by him from President Santos, of a satisfactory permanent settlement which would rehabilitate the credit of the Colombian Government and provide an adequate basis for consideration by this Government of future credits to Colombia.

(a) The Ambassador must realize the unfortunate effect produced upon the Council by his statement that the over-all sum for bond service, which he indicated his Government was prepared to make available, should include service of the sterling as well as of the direct dollar debt. This point had never been raised before.

(b) It is even more unfortunate that, after offering $2 millions in annual service, the Ambassador would now, on the basis of his recent instructions, have to indicate to the Council that this sum would be initially reduced.

(2) That the Committee feels, in so far as it has been informed of the conversations between the Ambassador and the Council, that the matter of the government-guaranteed mortgage bank debt has been insufficiently explored. On the basis of the information available to it the Committee understands that the amount of these bonds which remains outstanding in the hands of the public is much reduced, and, accordingly, that a relatively insignificant amount of foreign exchange would be required to service the outstanding bonds if an adjustment of the interest rate could be arrived at. The Ambassador must realize the importance of reaching an adjustment in regard to these guaranteed bonds from the standpoint of rehabilitating the credit of his Government. It is hoped that he will seek instructions which will permit him to include these bonds within the scope of his conversations with the Council.

(3) At this stage the Committee does not feel called upon to express an opinion as to what would constitute a reasonable basis for permanent settlement of the direct dollar debt of the Colombian Government. However, as stated above, the Committee sees no hope of settlement within the limits of the instructions recently received by the Ambassador from President Santos. The Ambassador must understand the difficulty in which the Council is placed in being asked to consider an offer which does not measure up to the proposal (which did not lead to agreement) communicated informally to the Department of State last summer, which the then Ambassador from Colombia decided he would recommend to his Government if assured of a favorable reception by the Council.

In the hope that conversations between the Ambassador and Mr. Traphagen may continue with some prospect of reaching an agreement, the Committee has decided to use such influence as it possesses to restrain the Council from taking a position with the Ambassador which might lead to a breakdown in negotiations; and, on the other hand, the Committee trusts that the Colombian Ambassador feels that he is in a position to seek new and more satisfactory instructions from his Government in regard to these negotiations.

(a) If it is desirable to go further, the Ambassador might be informed that a permanent settlement along the following lines would seem reasonable:

As regards the direct dollar debt: An initial 3% interest rate; recognition in principle of the arrears as provided in the "Laylin proposal"; a 4% rate after the arrears are disposed of and a minimum annual amortization of $500,000;

As regards the guaranteed debt: A 3-to-3½% rate; amortization at 1% of the face amount of the presently outstanding bonds annually.

II.

Mr. Traphagen be informed: Of the situation generally; that the Colombians are chiseling in the whole matter; that the Committee hopes, nevertheless that negotiations may continue if steps taken by the Committee lead to the Colombian Ambassador seeking new instructions from his Government, and accordingly that the time has not arrived for communicating to the Ambassador the Council's "irreducible minimum", which, broadly speaking, the Committee considers reasonable by way of a permanent settlement; that the Committee, if it fails in its attempt to get the Colombian Ambassador to seek more satisfactory instructions, reserves decision as to whether it will ask the Council to seek a temporary settlement on a basis below the "irreducible minimum".

HSM

PLAIN

Bogota

Dated December 18, 1939

Rec'd 1:25 a. m., 19th

Secretary of State,

Washington.

146, December 18th.

This afternoon Exchange Control Board issued resolution with stated intention to avoid sharp oscillations in international exchange and to regulate imports, resume follows:

Article 1, all applications for exchange covering imports approved heretofore or in future can only be used in an amount equivalent to foreign exchange acquisitions by Bank of the Republic in immediately preceding week. all applications issued and those to be granted in future will be handled chronologically giving preference to indispensable raw materials, machinery, drugs, and items considered worthy of preference first granting of exchange will be in second week of January based on exchange receipts during preceding week.

Article 2, approved exchange permits will be valid only for 30 days.

Article 3, exchange deposit certificates issued by Bank of the Republic henceforth must be utilized by depositors within 30 days, otherwise bank will acquire them at exchange rate on day of acquisition.

Article 4, issuance will be continued of applications for payment of imports, the value of which is to be deposited in Bank of the Republic but which do not involve transfer foreign exchange. Full text and comment follows direct air mail.

BRADEN

MCL

TELEGRAM SENT

DECEMBER 18, 1939

7 p.m.

73

AMEMBASSY

BOGOTA (COLOMBIA)

123

A special cable to the New York Times dated Bogota, December 16, indicates that the Congress before adjourning conferred extraordinary powers on the President with regard to "renewal of service on Colombia's foreign debt". Please telegraph the nature and scope of these powers if press report is accurate.

HULL
(LD)

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION CONFIDENTIAL

DATE December 18, 1939

TO Secretary Morgenthau

FROM Mr. Haas

Subject: The Business Situation,
Week ending December 16, 1939.

Summary

(1) New industrial orders last week continued to decline, partly because of seasonal influences, although buying of cotton textiles increased with the rise in cotton prices. A decline in steel orders to slightly above 60 per cent of capacity has caused a further reduction in steel output, though heavy unfilled orders continue to sustain the operating rate above 90 per cent.

(2) The continued rise in prices of many commodities, chiefly agricultural and food products, constitutes a strengthening business factor in the longer-term outlook. It appears to be based on a more substantial foundation than was the war-inspired price upturn of last September, and evidently represents a second phase in a general upward price movement.

(3) Prices of industrial materials have so far shown less response than agricultural prices to strengthening price influences, partly because of the less optimistic near-term business outlook. Our "index of confidence" has again declined, and the price upturn has had little effect as yet on the trend of new industrial orders.

- - - - -

The general situation

While the near-term business outlook continues to point to some setback in industrial production, largely in the heavy goods industries, the longer-term outlook has been strengthened by indications that the recent upturn in prices of various commodities represents a second phase in a general rise in commodity prices.

The price rise has not, as yet, brought an improvement in our composite index of new orders, which declined last week to a new low for the current movement. (See Chart 1) While new orders for textiles and for products other than steel and textiles were slightly higher, this was more than offset by a further decline in steel orders, partly due to seasonal influences.

Neither has the price upturn been reflected in our "index of confidence", which last week declined to a new low, after improving slightly during the previous week. One reason new industrial orders have been only slightly affected is that the price rise so far has been confined largely to agricultural and food products. While the Dow-Jones futures index, heavily weighted with agricultural products, has risen 8.3 per cent in two weeks (based on weekly average prices), our index of prices of 9 sensitive industrial materials has declined 0.9 per cent in the same period.

Nevertheless, an improving underlying trend for certain industrial materials quoted on the futures markets has been reflected in a strengthening of near-month futures prices as compared with the quotations for more distant deliveries, indicating an improvement in actual demand. This is particularly noticeable for copper, rubber, hides, and wool. In the case of silk, on the other hand, the recent sharp price increase has been accompanied by a weakening of near-term futures quotations in comparison with more distant months, which casts some doubt on the permanence of the recent upturn in silk prices.

Dow-Jones index at new high

The concentration of the price rise among agricultural products has especially affected the Dow-Jones futures index, which is most heavily weighted with cotton, wheat, sugar, silk, and corn. (See Chart 2) This index last week was carried above its September high, to a new peak since September 1937.

Individual price trends in the futures markets for domestic and import products are shown in Charts 3 and 4, respectively. The strong improvement in cotton prices, which has carried May futures nearly to the 11-cent level, has been influenced by huge export sales in recent weeks. A heavy export movement has been stimulated in part by sharply increased prices for Indian and Egyptian cotton and in part by a gradual reduction in the United States export subsidy, which has encouraged exporters to hasten export sales in fear of a complete removal of the subsidy.

Domestic consumption of cotton in November established a new record for the month, and current estimates indicate that about 1,750,000 bales may need to be drawn from the Government loan stocks this season to meet consumption requirements.

The steep rise in wheat prices which has carried May futures to a level of $1.05, has been stimulated in part by recent damage to the Argentine crop, which was confirmed last week by an official estimate indicating a crop this season of 147,000,000 bushels, 56 per cent less than last year.

Silk prices have risen steeply on a wave of speculative buying in both this country and Japan, encouraged on this side by fear of reduced imports after termination of the Japanese treaty, and in Japan by an unusually heavy consumption of silk.

Price rise likely to continue

The recent upturn in prices of many commodities, coming as it does after a three months' period of adjustment following the war-inspired buying movement of last September, and accompanied by improved statistical situations for various commodities, appears to rest on a substantial basis and to initiate a second stage in a general upward price movement.

The substantial nature of the price rise is indicated by the fact that it has occurred in spite of declining confidence in the business outlook, without the background of widespread optimism that accompanied the upturn last September. Prices have been forced upward by a combination of concrete factors, the following being among the more important:

(1) A prospective decline in production of various farm products due to the mid-western drought, which in many sections has been intensified during the past few weeks.

(2) A reduction in world supplies of various commodities due to active consumption in industrial and armament activity, and to losses in ocean transportation.

(3) Increased commodity demand, particularly in this country, resulting from the marked improvement in industrial activity.

(4) The allied campaign to buy up stocks of essential materials in neutral countries to prevent their falling into Germany's hands, and to contract for the entire production of various Empire crops.

Steel orders and output declining

Some further falling off in steel orders was reported last week, in part a normal seasonal development, accompanied by a further slackening in the rate of steel output. Orders reported by the United States Steel Corporation for the week ended December 7 dropped to the equivalent of about 61 per cent of capacity, the lowest since the first week of September. (See Chart 5) The Iron Age reports that the present volume of new orders is estimated by some steel companies as equal to 65 or 70 per cent of capacity, but that a further recession may be seen in the next few weeks owing to year-end inventory considerations.

Current business news

The New York Times index for the week ended December 9, by virtue of a pronounced increase in automobile production at the Chrysler plants, showed an increase of 0.3 point over the figure for the previous week, rising to 106.3. An upturn of 18.5 points in the index of automobile production, and moderate increases in the indices of electric power, lumber, and cotton mill production, were partly offset by declines in the steel and carloadings indices.

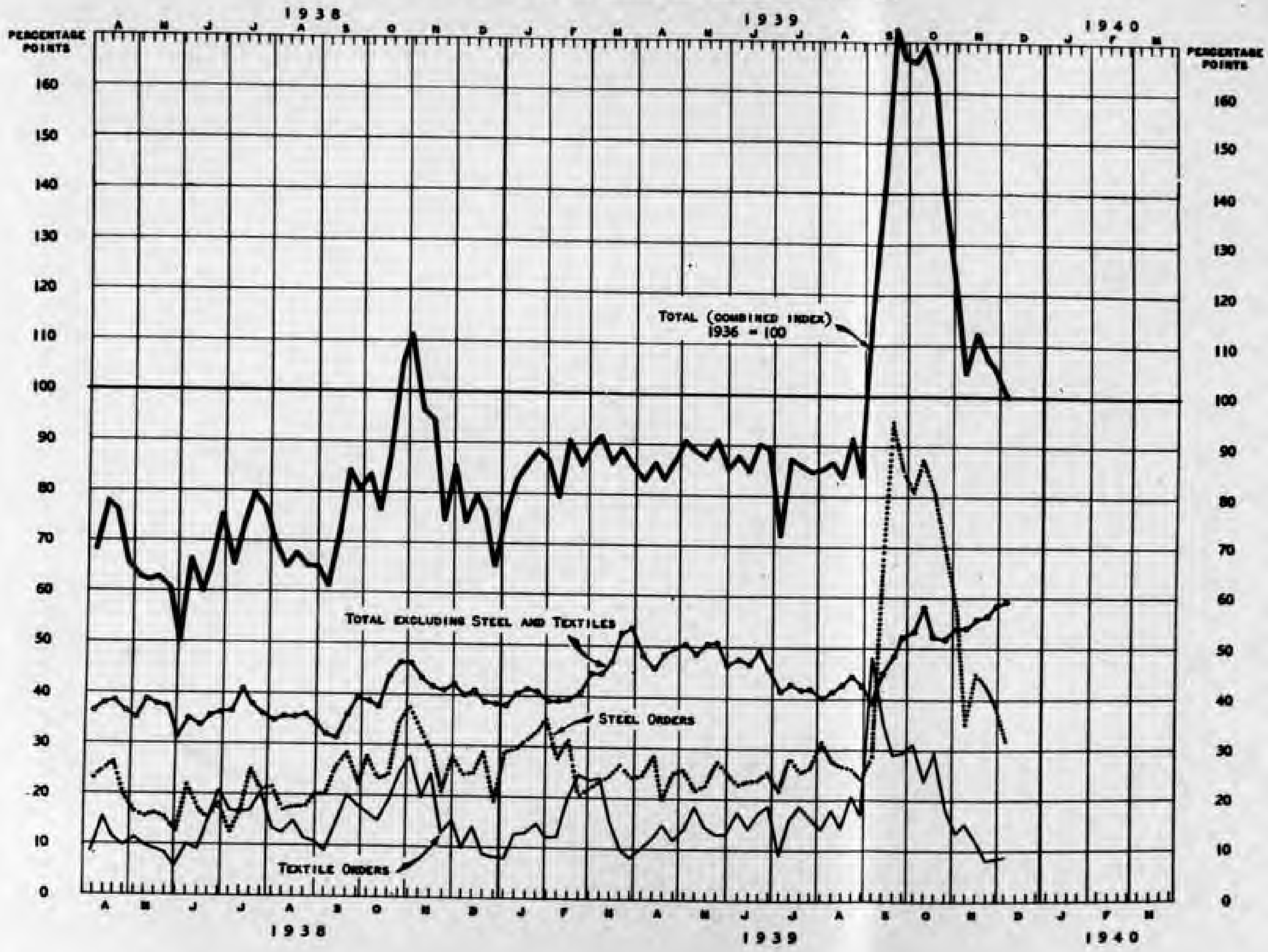
For the week ended December 16, the New York Times index will be favored by a moderate further rise in automobile production at the plants of all three major producers, contrary to the usual seasonal trend. The index of steel production, on the other hand, will be lower.

78

Chart 1
CONFIDENTIAL

INDICES OF NEW ORDERS

Combined Index of New Orders and Selected Components

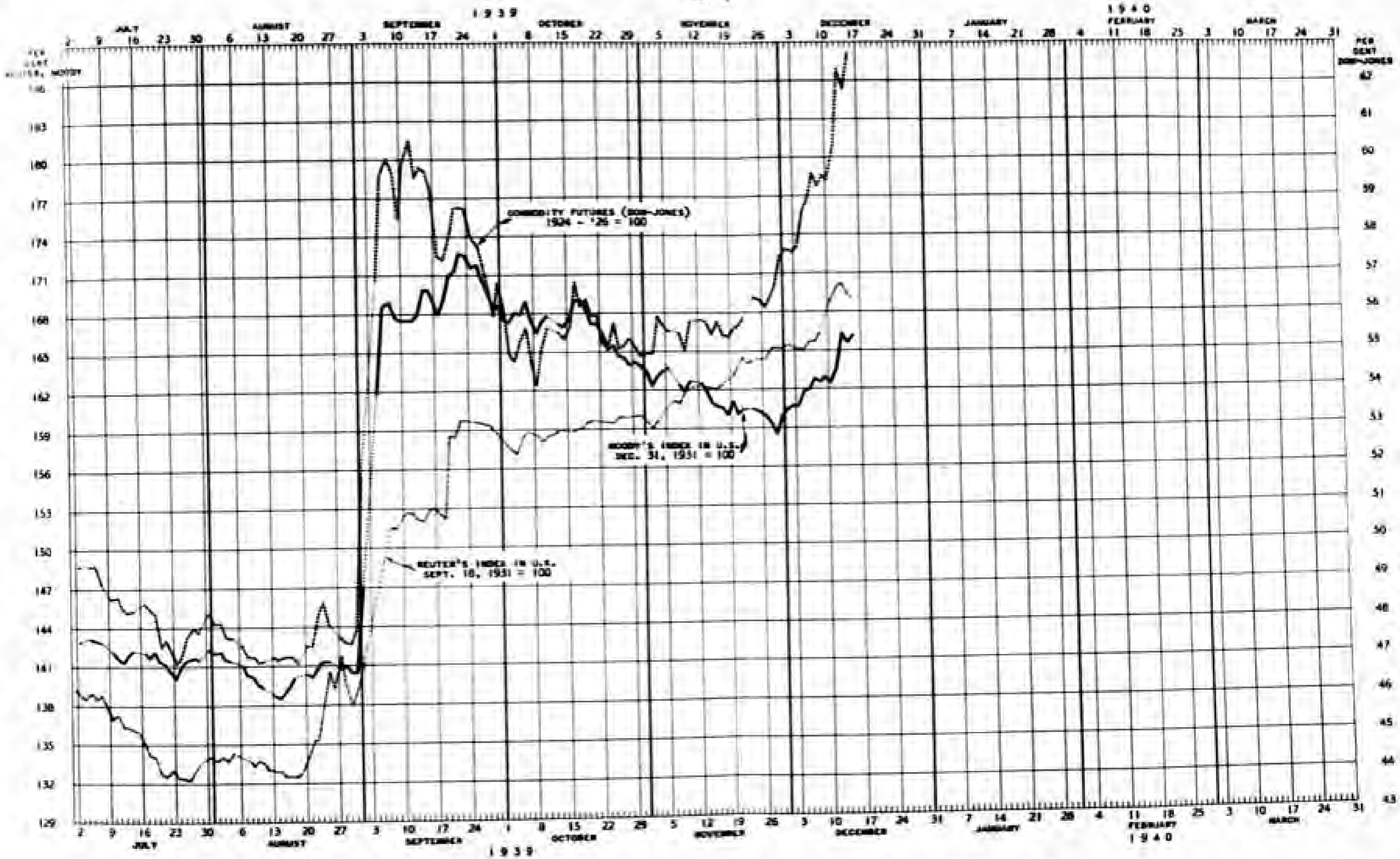


Office of the Secretary of the Treasury
Division of Research and Statistics

1 - 85 - B

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

Daily

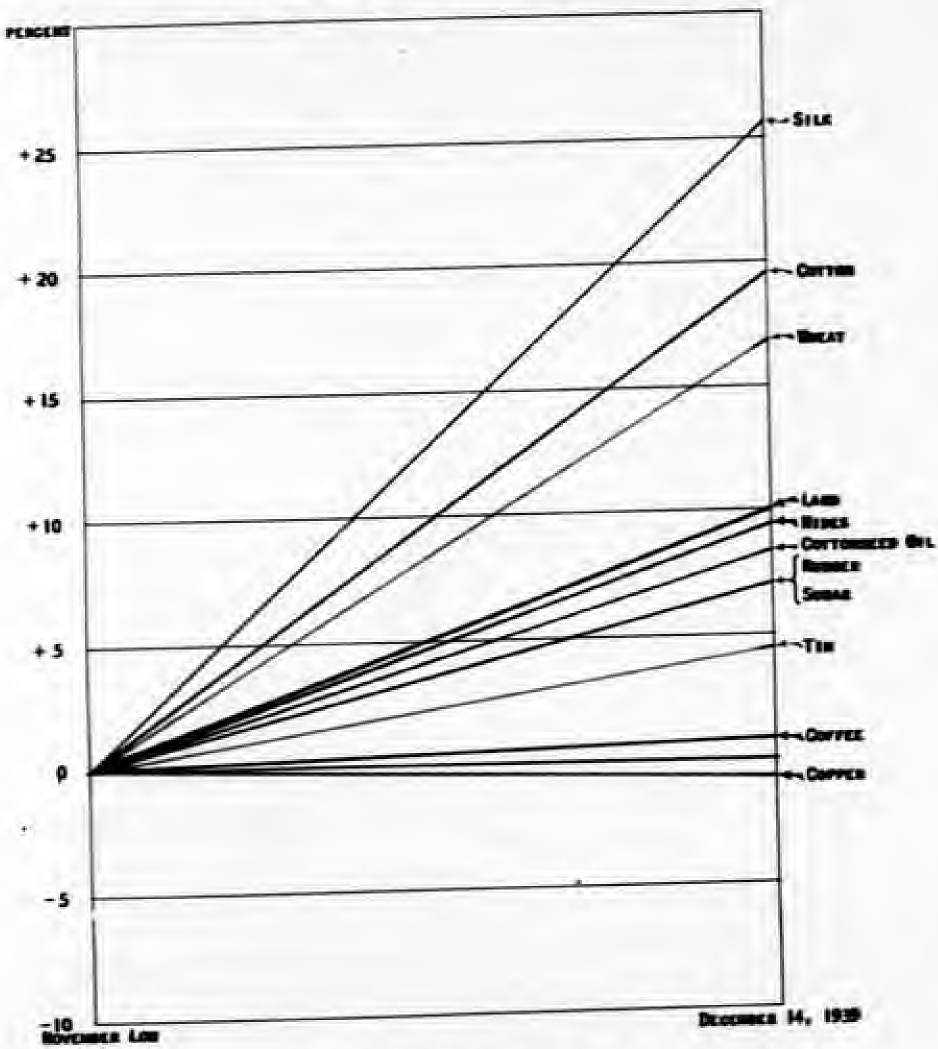


Office of the Secretary of the Treasury
Division of Research and Statistics

P - 101 - 1

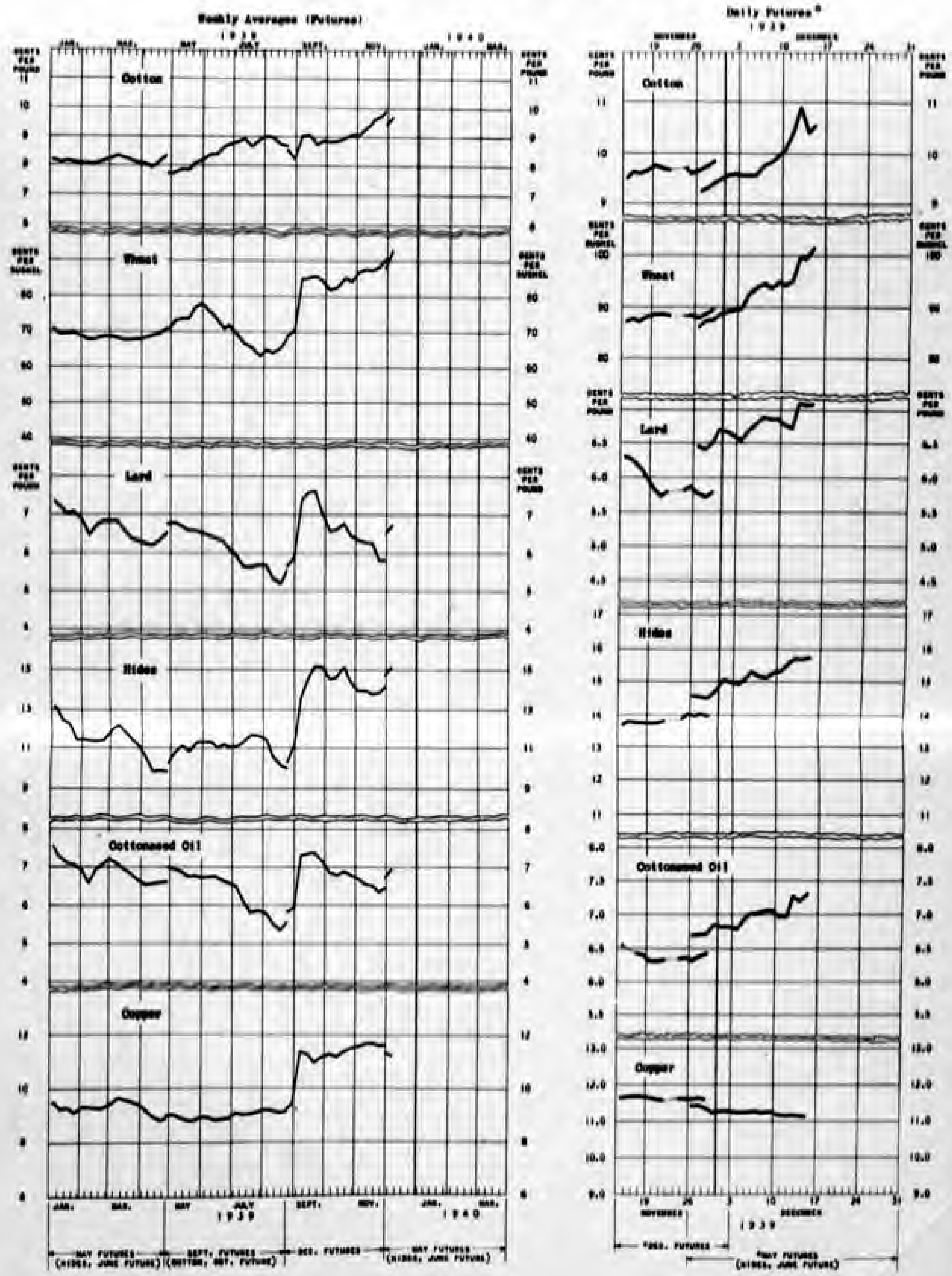
PERCENT CHANGE IN SELECTED COMMODITY FUTURES*

November Low to December 14, 1939



* May Futures Except Hides Which are June

PRICES OF SELECTED DOMESTIC COMMODITIES

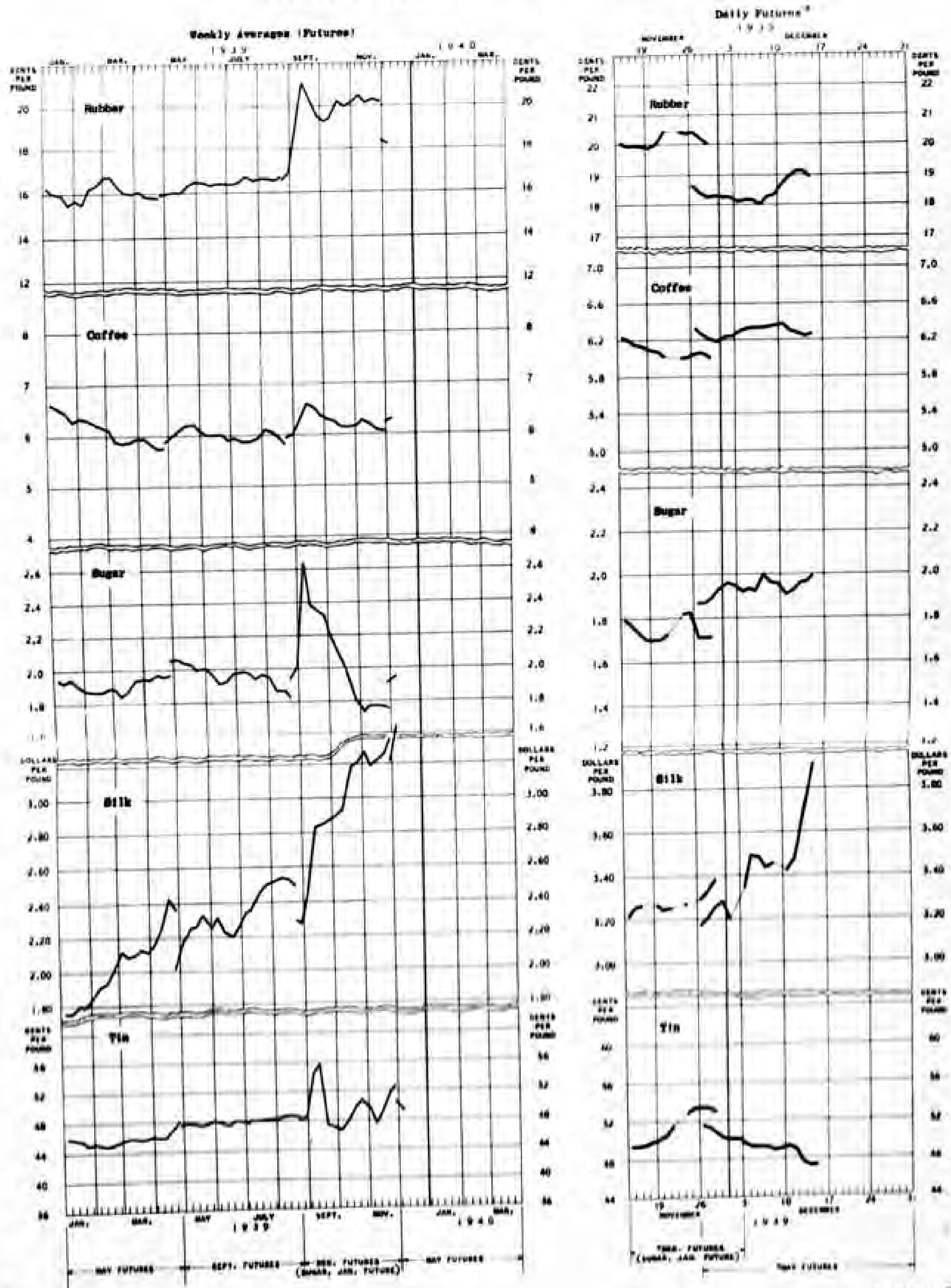


81

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

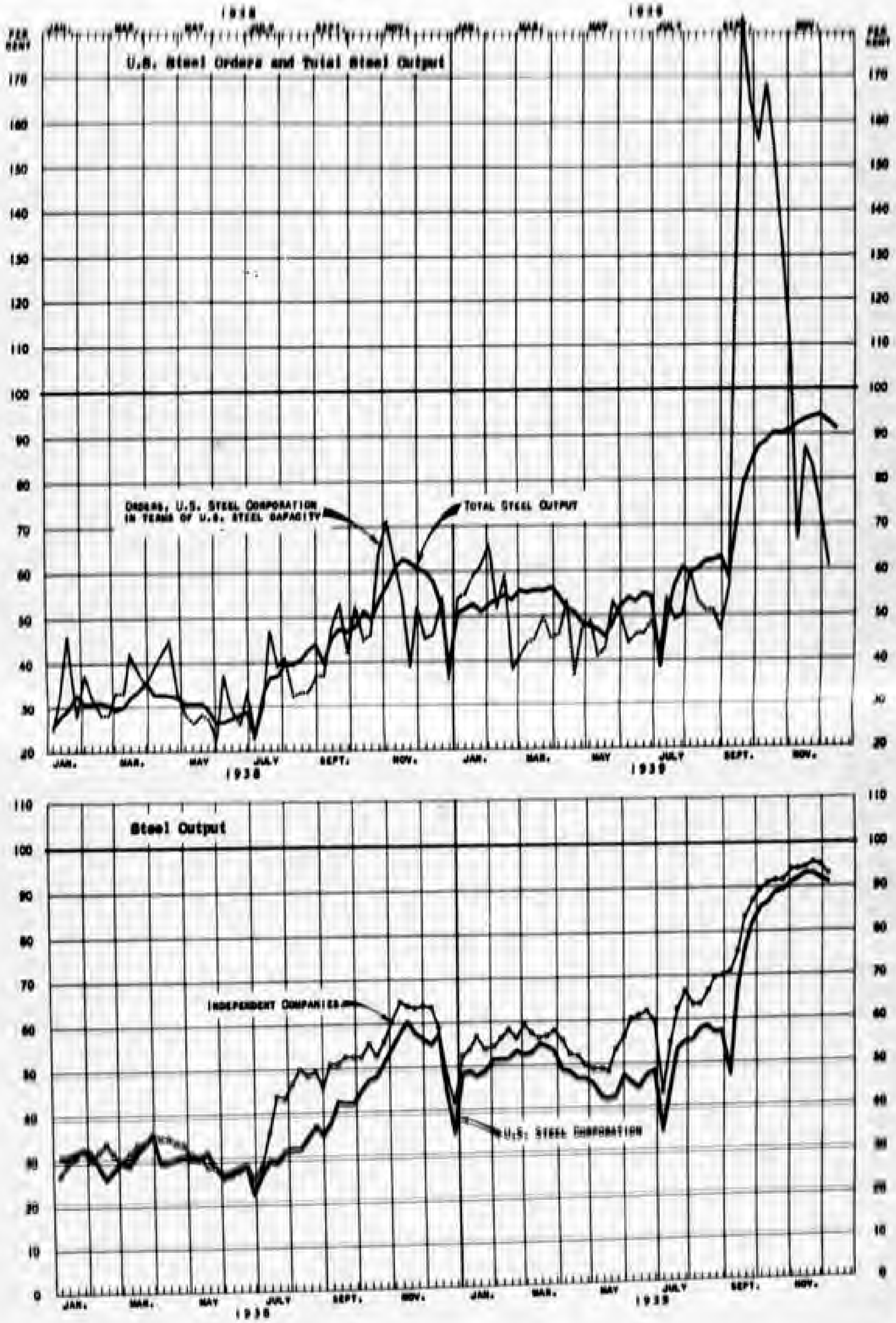
F-143-A-25
Chart 3

PRICES OF SELECTED IMPORT COMMODITIES



STEEL INGOT PRODUCTION AND U.S. STEEL CORPORATION ORDERS

Expressed in Percent of Capacity



TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE December 18, 1939

TO Secretary Morgenthau

FROM Mr. Dietrich

CONFIDENTIAL

The foreign exchange market was quiet with the sterling rate strong. In New York, the opening quotation was 3.93-1/2 bid and, on buying by commercial concerns, the rate improved by successive stages to 3.95-1/4 by the late afternoon. It closed at 3.95.

Sales of spot sterling by the four reporting banks totaled £391,000, from the following sources:

By commercial concerns	£ 152,000
By foreign banks (South America and Europe)	£ 239,000
Total	£ 391,000

Purchases of spot sterling amounted to £447,000, as indicated below:

By commercial concerns	£ 311,000
By foreign banks (Europe, South America and Far East)	£ 136,000
Total	£ 447,000

Sterling for one month delivery was quoted at 2¢ per pound discount and, for three months, 6¢ per pound discount.

The Guaranty Trust Company reported that it had sold cotton bills totaling £3,000 to the British Control at the official rate of 4.02.

The rate for the guilder closed Saturday at .5320 and, this morning in Amsterdam, it was quoted as high as .5333-1/4. It was unable to maintain the improved rate in this market and receded to close at .5318.

The other important currencies closed as follows:

French francs	.0224
Swiss francs	.2244
Belgas	.1663
Canadian dollars	11-3/4¢ discount

The Federal Reserve Bank purchased 50,000 Swiss francs for the account of the Bank of Latvia.

There were no gold transactions consummated by us today.

The Federal Reserve Bank reported the following shipments of gold, consigned to it to be earmarked for account of the respective banks that made the shipments:

$ 4,991,000	from the Netherlands, representing two shipments by the Netherlands Bank.
3,829,000	from Sweden, shipped by the Bank of Sweden.
2,201,000	from Mexico, shipped by the Bank of Mexico.
$ 11,021,000	Total

The statement received from the Federal Reserve Bank entitled "Incoming Gold Shipments" today totaled $115,267,000. Upon arrival of this gold, it will be disposed of as follows:

$ 60,606,000	for sale to the U. S. Mint at San Francisco.
9,305,000	for sale to the U. S. Assay Office at New York.
45,356,000	to be earmarked at the Federal Reserve Bank of New York.
$115,267,000	Total

Of the amount to be sold to the Mint at San Francisco, $45,906,000 is gold shipped from Japan.

The U. S. equivalents of the London prices for spot and forward silver were 41.50¢ and 41.30¢, respectively. Handy and Harman's price and the Treasury's price for foreign silver were unchanged at 34-3/4¢ and 35¢ respectively.

We purchased 425,000 ounces of silver, under the Silver Purchase Act. All of this silver was new production from foreign countries and it was for forward delivery.

A Reuters despatch from Bombay stated that it was reported that the Reserve Bank of India had intimated its preparedness to entertain applications for licenses for importing silver under certain conditions which would shortly be made public. The despatch further stated that it was understood that minimum and maximum prices for the sale of imported fine silver covered by license would be 62 rupees and 64 rupees per 100 tolas, respectively. Today's U. S. equivalent of these prices, less the import tax, is 43.21¢ and 44.79¢.

There was no quotation for spot silver in Bombay today. The only price was for delivery January 7, the first settlement day. The U. S. equivalent of the January 7 price was 43.52¢, off about 7/8¢ from Saturday's spot price. For the past few weeks, forward silver has been at a premium over spot and, in view of the fact that the forward rate is lower, it would indicate that this recession of price is attributed to the reported silver importations into India under license.

Mr. Cameron of the Federal Reserve Bank of New York informed me that they had received instructions from Finlands Bank to place at the disposal of the Finnish Legation $2,640,000. The Legation wanted this amount paid to the National City Bank today and in order to save the loss of one day by mailing the instructions to New York, I arranged that the letter addressed by the Finnish Minister to the

CONFIDENTIAL

Federal Reserve Bank instructing it to make the payment to the National City Bank be delivered to me. The Finnish Minister called with the letter which I telephoned to New York and the payment was made to the National City Bank today. The letter was subsequently forwarded to the Federal Reserve Bank of New York.

HMJr.

CONFIDENTIAL

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

57

DATE DEC 18 1939

TO Secretary Morgenthau

FROM Mr. Foley

Re: Use of Stabilization Fund to increase the working balance of the Treasury.

The Stabilization Fund holds $1.8 billion in gold outside of the operating portion of the Fund. Under the authority granted to the Secretary of the Treasury by section 10 of the Gold Reserve Act of 1934, as amended, pursuant to which the Fund was set up, this gold or any part thereof may be converted into dollar credits by "selling" the gold to the Treasury. The gold received by the Treasury from the Fund could, of course, be used as the basis for the issuance to the Federal Reserve banks of gold certificates or gold certificate credits. The Stabilization Fund would then have dollar credits on the books of the Treasury against which it could draw to meet its needs. However, to the extent that the Fund did not draw on such dollar credits the Treasury could use the balances made available by the issuance of gold certificates for current expenditures or to retire outstanding public debt obligations.

Furthermore, although under existing law the Stabilization Fund continues until June 30, 1941, the Fund may be terminated at any time prior to that date by the President declaring the existing emergency ended. Should the Fund thus be terminated, its assets could be covered into the Treasury and the working balance increased to that extent. I am not at this time deciding whether the Stabilization Fund could legally be terminated <u>in part</u>.

There are, of course, important policy considerations involved in either of the courses of action outlined above. For example, on a number of occasions you and the President have said that it was essential to keep $2,000,000,000 intact in the Stabilization Fund as a weapon of defense comparable to the Navy. On other occasions you have said that the Fund ultimately will be used for the purpose of "retiring part of the outstanding debt".

E.H.F.

PARAPHRASE OF TELEGRAM SENT

TO: American Legation, Tehran

NO.: 67

DATE: December 18, 1939

Reference is made to your no. 155 dated December 6, 3 p.m.

After giving careful consideration to the inquiries made last September by the Iranian Chargé d'Affaires as to whether it would be possible to obtain a loan of $15,000,000, the competent agencies of the United States Government did not find that it was in their competence to make the requested loan, nor do these agencies have the funds available. This information was contained in the Department's instructions no. 467, 468 and 470. Of course unofficial sources of credit in the United States are open to access by the Iranian Government, but these sources of credit will make their own judgment of financial conditions and this will determine their attitude. For their further consideration, the appropriate agencies of this Government are being informed by the Department of the contents of your no. 155.

HULL

EA:EB

ADDRESS OFFICIAL COMMUNICATIONS TO
THE SECRETARY OF STATE
WASHINGTON, D. C.

DEPARTMENT OF STATE
WASHINGTON

89

December 19, 1939.

The Secretary of State presents his compliments to the Honorable the Secretary of the Treasury and encloses a copy of a paraphrase of telegram no. 67, dated December 18, 1939, to the American Legation at Tehran with reference to a loan requested by the Iranian Government.

Enclosure:

Paraphrase of no. 67,
December 18, 1939, to
Tehran.

RECEIVED
11:00
DEC 20 1939
TREASURY DEPARTMENT
Office of the Secretary
Technical Assistant to the Secretary

I called Pinsent and told him that the Secretary did not want to see Lord Riverdale because he wanted to confine his dealings on these matters with Mr. Purvis.

H. S. K.

Bx 230

Jules Ann

90

December 18, 1939

Memorandum for Mrs. Klotz

From Mr. Stewart

At noon today Mr. Pinsent phoned me saying that he would like to talk to me over the phone since Cochran was away. He stated that Lord Riverdale would be in Washington on Wednesday afternoon and while he had no authority from the British Government to deal with questions concerning the alloy metals, he was an expert in alloys. Mr. Pinsent thought that perhaps the Secretary would like to have someone in the Treasury talk with Lord Riverdale. Mr. Pinsent also asked who there was in the Treasury that Mr. Chalkley, of the British Embassy, could talk to on the general subject of the control of the strategic metals.

All that I agreed to do was to call these questions to the attention of the Secretary.

For my own part, I see no reason why anyone in the Treasury should talk with Lord Riverdale, no matter how much of an expert he may be, if he has no authority from the British Government to deal with the matter. I do not know the answer to the question of how the British Embassy may best inform itself concerning the recent movements made by this Government in connection with strategic metals, and therefore have no recommendation.

HSM

PLAIN

London

Dated December 18, 1939

Rec'd 1:20 p. m.

Secretary of State,

Washington.

2657, December 18.

FOR THE SECRETARY OF THE TREASURY FROM BUTTERWORTH.

I arrived in London Saturday December 16, 6 p. m. I passed on to the Embassy in Paris the available information on molybdenum and left with them for their strictly confidential information a copy of the Climax Company's report of December 5 and a copy of Merica's letter to Purvis of December 9 which the latter sent me to the clipper. I also passed on your message regarding the non-appearance of the French representatives in the matter of aluminum purchases.

JOHNSON

HPD

JR GRAY

Paris

Dated December 18, 1939

Rec'd 9:50 a.m., 19th.

Secretary of State,

Washington.

2994, December 18, 9 p.m.

FOR THE TREASURY.

While selling orders weighed on the securities market today they were offset to some extent by buying orders and the undertone remained steady. At the end of the day most French variable revenue securities finished around Friday's closing prices. International securities were active and firm in most instances. Young bonds moved up from 94 to 120. Suez advanced 270 francs. Rentes were steady. The exchange guarantees issues of 1925 and 1937 gained 2.45 francs and 5.80 francs respectively.

Deposits in national (postal) saving banks during the period November 16 to 30 totalled 347 million francs and withdrawals 147 millions.

Under the authority embodied in the decree of October 13, 1939 (see the Embassy's despatch No. 5304 of November 17, 1939) an arrete published in the Journal Official of today provides for the creation of another fund under the Ministry of Armament for the purpose of

equalizing

-2- #2994, December 18, 9 p.m., from Paris.

equalizing the import and domestic prices of pure or refined nickel or nickel in ingots or unprocessed.

The Swiss National Bank statement for December 15 shows gold holdings down 4.6 millions to 2302.8 millions. Foreign exchange holdings were down 12.8 millions to 321.7 millions. Note circulation was down 11.5 millions to 1979 millions. Gold cover of note circulation and sight liabilities is 81.87 per cent as against 81.70 per cent.

BULLITT

PEG

CK GRAY

Berlin

Dated December 18, 1939

Rec'd 8:23 p.m.

Secretary of State

Washington

2396, December 18, 6 p.m.

My 2370, December 16, 10 a.m.

The December 16 issue of the SUDOST ECHO of Vienna, a periodical chiefly devoted to German economic relations with eastern and southeastern Europe, publishes the following with regard to the German-Rumanian conflict over the mark -- lei exchange rate:

"Because of the overprice for exports made in western currencies there has occurred a general price increase in Rumania and also a deterioration of the lei. In the first week of December, there was the extraordinary circumstance that the dollar -- reckoned according to the parity of the lei -- (was?) we worth about 6 Reichsmarks whereas the dollar parity in Berlin was only 2.49 marks. Since that time the depreciation of Rumanian currency has further developed. On the basis of recent quotations on the free exchange market the price of the dollar is around 8 marks.

"Despite this circumstance the German-Rumanian

clearing

-2-#2398, December 18, 6 p.m. from Berlin.

clearing rate continues to be 41 lei for 1 mark. This is an absolutely untenable situation."

INFORM TREASURY

KIRK

NK
EMB

December 16, 1939.
2:39 p.m.

H.M.Jr: Hello.

Operator: Admiral Stark.

H.M.Jr: Thank you.

O: Go ahead.

Admiral Stark: Good afternoon, sir.

H.M.Jr: Good afternoon admiral. This is Morgenthau.

S: Yes, sir.

H.M.Jr: Admiral, would it be convenient for you on Friday, to see one or two representatives of the molybdenum industry?

S: When, Friday?

H.M.Jr: Wednesday.

S: Yes, any time.

H.M.Jr: Would you set a time.

S: Well I can make it morning or afternoon. Wednesday afternoon, say two-thirty. If they want it in the morning, quarter of eleven or so long in there most any time.

H.M.Jr: Well I'll tell them quarter of eleven.

S: All right sir.

H.M.Jr: And I'll find out who's coming down and send you over a little memo.

S: All right sir.

H.M.Jr: Quarter of eleven on Wednesday.

S: Yes, sir.

H.M.Jr: Thank you very much.

S: Entirely welcome.

December 18, 1939.
2:40 p.m.

Operator: Go ahead.

H.M.Jr: Hello.

Adolf Berle: Oh, Mr. Secretary?

H.M.Jr: Talking.

B: I merely called up to thank you very much for that letter regarding this Pan-American Bank Institution business.

H.M.Jr: You liked it.

B: I was infinitely obliged and I think it put it exactly in the proper way which is the subject for exploration and work going on on that basis. I don't think any of us can tell whether we'd be able to turn up something.

H.M.Jr: Well -

B: To commit to but that gives us exactly what we need which is liberty to discuss it without being embarrassed later.

H.M.Jr: Well I'm glad you're pleased and I wrote the letter whole heartedly, I mean there was no -

B: Well I -

H.M.Jr: It wasn't something I put my name to reluctantly.

B: Well I know that and I was very glad. I know there's a good deal of division of opinion about it and rightly so because it's very easy to go off the deep end and I merely meant to say I appreciated very much you're being able to convince yourself because I know that was done after careful consideration with the people who had studied it. I meanwhile have attacked the Federal Reserve with somewhat more confidence but I entertain the hope that we may be able to work out a similar attitude with them likewise.

H.M.Jr: You're more lucky than I am. Did you see all that stuff in the papers today?

B: Oh, the Crowder stuff?

H.M.Jr: Yes.

B: Sure.

H.M.Jr: You know how that came about.

B: Well I know that they asked - instructed me and after talking with Steve Early I tried to make up rather an inocuous story of the picture and later we exchanged notes with Johnny Hanes so that he would know what I was doing.

H.M.Jr: Yes.

B: What happened to that?

H.M.Jr: Well you see the men saw Alsop working here and they said, well if he's getting access to the Treasury files we're entitled to it, so I asked Steve Early and the only suggestion you've got to give it to the working press.

B: Well I should take exactly the same position if anybody asked me for mine.

H.M.Jr: So he called up Alsop and told him that he had told the Treasury to give exactly the same stuff to the working press that he'd received.

B: Well there's no reason that I know of why not. I think you have it exactly right.

H.M.Jr: And there it is on the front page of the Times.

B: Well it doesn't do any damage does it?

H.M.Jr: I don't think so.

B: It's merely a story that everybody had a good working guess what was coming and was working hard to prepare for it. I don't see anything wrong about it. It may spoil Alsop's style but that's too bad, we can't run the press merely for the benefit of one pair.

H.M.Jr: But I thought - I knew that you'd handled it for the President with Alsop and I thought you might be curious to know how mine got out. That's the way it got out.

B: Well as a matter of fact I had some guess that that was going to happen because Frank came in here to ask me questions and he said that their man was going to ask for it. Well I made out some work out here so everybody could know it so that there's no secret about it and they might have asked the same thing from me, and we tried to fix it so that anything they got we didn't care.

H.M.Jr: Yes.

B: You didn't I take it, I mean the story -

H.M.Jr: No it's out and I hope that the White House won't ask me to give any more files out.

B: Well I hope so too. I don't like the idea. Oh, by the way, Mr. Secretary, since I have you on the wire, I'd merely like to clear up one thing. I've heard myself surprisingly enough quoted. I think in connection with this French trawler business -

H.M.Jr: Yes.

B: Having been in favor of the war.

H.M.Jr: Yes.

B: Well of course I wasn't and I am not and I would like to make that perfectly clear. I've been in one war and I know what it's about. I don't want any more of the trawlers in that business. I think it was one of the cases where the skipper had gone out a bit on the end of a limb

H.M.Jr: Sometime, not too distant in the future, let's talk about it, because I was terrifically upset.

B: Well I'm sorry about that, I didn't know. I know on the trawlers, I thought they were entitled to their trawlers particularly in view of the commitments that had been made and assuming that they would tell us, that they are not to be used in connection with the naval forces. They did tell us that, that's all. Our people here take a different view of that old Alabama Statute that your people invoke but that isn't serious because everybody takes a different view of every Statute. But on the theory that as a member of the war party - I laughed a little bit because - if it was anybody but you - I ought to say I'm not philosophical about how it comes out. I think we have a distinct interest in that, but that's one thing, I can't claim to be impartial about this, I don't like the idea of an imperialist power in the Atlantic, but that's one thing. On the other side the idea that we ought to get in, I should say emphatically we ought not.

H.M.Jr: Well that's refreshing but that's what shocked me.

Well anybody that - of course I - Washington is a great place for telling what somebody else thinks about something, and on that end of it it was true that the trawlers, I wanted the French to get their trawlers in view of the commitments that were made. You see -

H.M.Jr: Well I was told that this was going to come up in Cabinet that Mr. Hull was going to bring it up, and when he didn't, having been primed with it and really having been shocked, I brought it up you see.

I see.

H.M.Jr: Because I figured if there is this school of thought why it's the kind of thing that ought to be discussed in Cabinet.

Oh I certainly think so far as I know, confidentially Mr. Secretary, there's only one man who really may feel that way and that's Bill Bullitt. I'm not sure how he feels but I think it's possible that he's got pretty steep in the French end of it.

H.M.Jr: I see.

There's one other man over here who just may have that idea for quite other reasons.

H.M.Jr: I see.

Whose name I won't mention because I might do him an injustice.

H.M.Jr: I see.

Beyond that I don't think you could recruit a corporal's guard who are in favor of getting into the war.

H.M.Jr: Well -

At least if there is I don't know where you'd find them.

H.M.Jr: Well that's cheerful.

B: Certainly not in this office.

H.M.Jr: As I say I not only was shocked but depressed.

B: of the depressioh.

H.M.Jr: Yes it helped me a lot.

B: The shock may be cushioned -

H.M.Jr: Well the shock is over but -

B: Because it simply would be plain damned foolishness now if - I may say frankly, that if it were a case of having a German-Russian combination with a fleet loose in the Atlantic and no checks on it we then probably I think would be presented with the alternative whether we wanted to stand on the Atlantic line with a very much enlarged Navy and so forth or whether we'd have to take a hand first, I don't know.

H.M.Jr: Well that -

B: That isn't imminent now.

H.M.Jr: No but it should be carefully thought out and we oughtn't to slip into it.

B: Absolutely and as a matter of fact one of the reasons why I've had all the neutrality work go over my own desk so that every document here that's gone through has been with a view to taking out as much as I can these various things that slide you chunk by chunk forward.

H.M.Jr: Now I held with what I understood was your position by succession of legal opinions, we shouldn't make up a neutrality policy.

B: I think that's perfectly proper. That's exactly true. What I was afraid was that a lot of these things were doing, that they go both ways you see.

H.M.Jr: You can't have any argument with me on that. I think that there should be a policy but frankly I don't know what it is and so when these ships get on the high seas and we are backed up by an opinion of the Comptroller - of the Attorney General, I think we've got to stick to the law.

B: Well I agree with that. I did think this that I think that first of all we've gone somewhat out of our way in the situation. In the second place I think they had stated the case both to the President and the Maritime Commission. I think the French Government thought it had a commitment and as you know in the World War we sold these ships right along.

H.M.Jr: Yes.

B: So that I think the immediate repercussion would have been a charge of breach of faith. Well the obvious thing to do was to ask them to tell us they wouldn't.

H.M.Jr: Yes.

B: And they did and that was that. And that was all, but that's all it had to do with it and I did say in connection with that, that we were having legal opinions all over the lot on all kinds of things, good,bad and indifferent and it seemed to me that it might be well to hold off, take account of the whole wash, we've been now ninety days in this thing and see where they were all taking us to so that we didn't have the Wilsonian experience of sliding from position to position and suddenly finding ourselves in a hell of a mess.

H.M.Jr: I agree with you entirely.

B: But my own plunk if you ask me for policy would be on the other side.

H.M.Jr: Well -

B: On the withdrawal side. I mean on the -

H.M.Jr: Peace side.

B: On the - on the non-war side, oh absolutely.

H.M.Jr: Well in the not too distant I'm going to call you up and let's have lunch together and talk about it more.

B:	I shall be entirely at your service.
H.M.Jr:	Of course from this conversation I don't think there's any difference between us.
B:	I don't think so. I've always understood that, what I've heard of your opinion, exactly agreed with my own.
H.M.Jr:	Well it seems to.
B:	And I have a whole lot of reasons other than straight foreign policy for it domestically as well.
H.M.Jr:	O.K.
B:	Well please do and let me know.
H.M.Jr:	I'll do that. I'll take the initiative.
B:	Goodbye.
H.M.Jr:	Thank you.

December 18, 1939.
2:50 p.m.

H.M.Jr: Hello.

Harold Hochschild: Hello Henry.

H.M.Jr: Hello Harold. Harold?

H: Yes.

H.M.Jr: I have made an appointment for the molybdenum industry to see Admiral Stark, Chief of the United States Navy, former Chief of Ordinance at ten-forty-five on Wednesday. Hello -

H: Yes.

H.M.Jr: I've seen him and he is prepared, he knows what the President and I want him to do.

H: Yes.

H.M.Jr: Namely to get the use of molybdenum increased in United States.

H: Yes.

H.M.Jr: And he's heartily in sympathy with that and can do it and knows how to do it and is ready to contact the industry.

H: Oh that's fine.

H.M.Jr: Now the question is who you send down and I've just got this suggestion. I think that there ought to be somebody from Kennecut, there ought to be somebody from Molybdenum of America, that's what it's called.

H: Yes.

H.M.Jr: Even that small, and if you don't mind I don't think it ought to be Schott, the President of Climax.

H: O.K. Henry. Do you think I should come?

H.M.Jr: I think if you could come it would be very helpful.

H: All right Henry.

H.M.Jr: I'd try to confine it to three people.

H: Well I would have to bring somebody else from Climax because as you know I'm not a technician.

H.M.Jr: Well bring Carl Loeb Jr.

H: Carl Loeb. All right and you mean I could come besides?

H.M.Jr: Yes.

H: All right Henry.

H.M.Jr: Yes, I'd like very much if you'd come. Now he knows all about - I've had him there and I've had all - I don't know how many Admirals with him. They're all ready to go and as he put it Molybdenum is being patriotic and it's up to them to help them.

H: Yes.

H.M.Jr: And they've got all the connections with the industry.

H: Yes.

H.M.Jr: And they're ready to go right down the line on the orders of the President.

H: All right Henry that's fine. Henry, may I ask you something?

H.M.Jr: Please.

H: Have you seen - you've seen I take it, the letter from the State Department?

H.M.Jr: Well I - I think I have -

H: Well you know the basis of it is that - I mean we've gotten it you see.

H.M.Jr: Yes.

H: And they simply - it refers to the President's press - statement at the press conference about country's unprovoked bombardment and machine gunning, etc.

H.M.Jr: Yes.

H: Now it does not mention Germany, Russia or Japan.

H.M.Jr: No, no.

H: Now of course you can imagine we have scores of inquiries from our stockholders about this and we feel that we have to issue some kind of a statement. You see they want to know how much business we've been doing with Russia and Japan which we've never told them and which we think we ought to tell them now.

H.M.Jr: Yes.

H: Can we say that we have been unofficially,been given to understand without mentioning any name that Russia, Germany and Japan are in mind.

H.M.Jr: You'd better let me check that. I tell you what you do Harold, when you come down Wednesday, bring down a draft of a letter to your stockholders.

H: All right Henry.

H.M.Jr: And I will - bring that in to me and I'll try to get a clearance on it from the State Department.

H: All right Henry, that will be swell.

H.M.Jr: And I think you people ought to meet anyway, the people over at the State Department that are handling this.

H: Yes, I'd like to.

H.M.Jr: See?

H: Yes.

H.M.Jr: But I think you're going to be pleased with the reception you get over at the Navy.

H: Well that's fine Henry.

H.M.Jr: All right.

H: Thank you very much.

H.M.Jr: You're welcome.

H: Shall I come to see you first?

H.M.Jr: Just a minute let me look please. Just a second - See your appointment is ten forty-five. I'd rather see you afterwards.

H: All right -

H.M.Jr: Because then I'll know -

H: You want me to call you up then after I get through.

H.M.Jr: Yes, call up Mrs. Klotz and she'll tell you - fix you up with an appointment.

H: All right Henry.

H.M.Jr: Cheero.

H: Thanks very much.

H.M.Jr: Goodbye.

December 18, 1939.
5:36 p.m.

H.M.Jr: Hello.

H. Merle Cochran: Hello Mr. Secretary.

H.M.Jr: Hello, Merle?

C: Yes, sir.

H.M.Jr: I'm sorry to hold you up but I've had a succession of meetings. Where are you?

C: I'm at the McAlpin Hotel, but I'm speaking over a Federal line.

H.M.Jr: Merle, that second telegram they sent about Whigham, you know, when he was there - hello.

C: Yes.

H.M.Jr: You know you sent me a memo, there were two cables -

C: Yes.

H.M.Jr: That Pinsent sent and one of them was about Whigham.

C: Yes.

H.M.Jr: And having a representative come back.

C: Yes.

H.M.Jr: How did he happen to do that?

C: Well he had had that in his mind all the time.

H.M.Jr: Oh!

C: And I said, "Well we didn't bring that up".

H.M.Jr: Yes.

C: And he wanted to make it stronger and I said, "Remember what the Secretary said, you might not even see some one".

H:M.Jr: Yes.

C: Remember?

H:M.Jr: Yes.

C: And he said, "Well I feel that we had to do this because of our own situation". He said his Ambassador and he both felt very strongly on that.

H.M.Jr: Yes.

C: And there he was and they should send someone back.

H.M.Jr: Uh-huh.

C: And I said, "Well don't put it in the same category".

H.M.Jr: Yes.

C: "This is one is based definitely upon your interview with the Secretary".

H.M.Jr: Yes.

C: I said, "The other you're putting up from your own standpoint".

H.M.Jr: Yes. well it - I think it's unfortunate they went the same day isn't it?

C: I raised that point as strongly as I could, I said "Why don't you wait a while". He said "No, I want to get it there before Whigham arrives", he said, "He'll be there in a day or two".

H.M.Jr: Yes, well, O.K. Now this fellow - well that's something else again. I understand this Lord Riverdale will be down here Wednesday.

C: Yes.

H.M.Jr: That's another story.

C: Yes.

H.M.Jr: All right. How's your wife?

C: We've had nothing done today except X-rays. We had them taken this morning and we're just up getting the reading at five o'clock.

H.M.Jr: Right.

C: So tomorrow morning we see a regular science doctor for consultation.

H.M.Jr: Oh -

C: I hope we shall get through tomorrow.

H.M.Jr: Well everything's been very - your end has been quiet today.

C: Everything is quiet.

H.M.Jr: I've had a hell of a day but nothing on the foreign matters.

C: Well I -

H.M.Jr: Incidentally - incidentally, this fellow from Canada will not be here Wednesday.

C: Oh he will not be.

H.M.Jr: No, he doesn't get here now until Thursday - Friday.

C: Friday.

H.M.Jr: Yes. Friday.

C: Well, if you keep that invitation open I'll certainly be with you then.

H.M.Jr: All right, it's open.

C: Fine.

H.M.Jr: Goodnight.

C: I saw the Frenchman today.

H.M.Jr: Yes.

C: And he understood that there was something about that account and he said, "I don't want to make the same mistake the other fellows did, won't you let me know just what you want".

H.M.Jr: Yes.

C: And so I gave him the same expression the others had used.

H.M.Jr: Good.

C: And he said he'd get it straightened out to begin with.

H.M.Jr: Now another thing, they sent us, there's another shipment coming from those people, the same size.

C: Is that so?

H.M.Jr: Yes. So my cable at this time is very important.

C: Yes.

H.M.Jr: Yes.

C: Well I explained the whole thing to him. I gave him all the background and he said he would wire us. He said incidentally that he'd just received a wire from his people yesterday.

H.M.Jr: Yes.

C: Wanting an estimate from him as to how many dollars they would need over here on the contracts that he had in mind.

H.M.Jr: Well that's interesting.

C: So it fits in and he's going to fly back to his home town, the second of January.

H.M.Jr: Well I want to see him before he goes.

C: Yes, he said he wanted to come down and have a good visit, take back any ideas we had.

H.M.Jr: Right.

C: And he hopes to have at least a preliminary answer for us before us before he goes.

H.M.Jr: Good. Thank you.

C: All right, then.

H.M.Jr: Goodnight.

C: Goodbye.

December 16, 1939.
4:22 p.m.

H.M.Jr: Hello

Operator: Mr. Sullivan, Chief of Mr. Helvering's office.

H.M.Jr: O.K.

O: Go ahead.

H.M.Jr: Hello

John Sullivan: Hello.

H.M.Jr: Are you with Mr. Helvering?

S: Yes sir, I am.

H.M.Jr: Well I spoke to him, then he's told you.

S: Yes, sir.

H.M.Jr: All right. Well he took it extremely well and so that's that, you're it.

S: I see.

H.M.Jr: And he certainly gave you a good send off.

S: Oh thank you.

H.M.Jr: So what I told him was we'd make it the 15th of January.

S: Yes, sir.

H.M.Jr: That doesn't keep me from sending over to the President the recommendation and let it go up in the first batch you see.

S: Yes.

H.M.Jr: All right?

S: All right, sir. Now I'll - I'll be back here Tuesday morning.

H.M.Jr: Yes.

S: And I think I ought to have a complete report on that other business in Boston by that time.

H.M.Jr: Righto.

S: And I think you'd want that before you did anything wouldn't you?

H.M.Jr: Oh -

S: I don't think there's any likelihood of -

H.M.Jr: You look healthy to me.

S: Well - that's the weight I've put on.

H.M.Jr: I'll be back next Thursday.

S: I see.

H.M.Jr: So give me a ring Thursday or come over and see me.

S: I will sir. By the way, did you sign the Consolidated Agreement?

H.M.Jr: It's coming in to me at four-thirty.

S: I see, because Navy wanted me to call. I wonder if you'd ask one of your girls to call me as soon as you've signed it.

H.M.Jr: Surely.

S: Because Navy is anxious to get the word.

H.M.Jr: Sure, I'll have somebody call.

S: Thank you very much. I wish you a Merry Christmas.

H.M.Jr: Same to you.

S: Thank you.

H.M.Jr: Goodbye.

S: Goodbye.

December 19, 1939.
12:41 p.m.

H.M.Jr: Hello.

Operator: I have Mr. Hochschild.

H.M.Jr: All right.

O: Go ahead.

H.M.Jr: Hello, Harold?

Harold Hochschild: Yes, Henry.

H.M.Jr: How are you?

H: Fine thanks.

H.M.Jr: We arranged for you and your associates to see Mr. Hull at three o'clock tomorrow.

H: I see.

H.M.Jr: Now then at that time you can bring up anything about your letters, so forth and so on.

H: I see, that is the whole delegation, - the four people.

H.M.Jr: The whole delegation. Yes, we're sending him over the names.

H: I see.

H.M.Jr: That gives you a chance.

H: I see Henry, then do you want to see me?

H.M.Jr: Well when you get through with Mr. Hull I would like to see you.

H: After that?

H.M.Jr: Yes.

H: All right Henry.

H.M.Jr: Just come over here.

H: Yes.

H.M.Jr: But I'm giving you service boy.

H:	You certainly are. I'll hand it to you for that.
H.M.Jr:	All right.
H:	Thanks a lot Henry.
H.M.Jr:	All right.
H:	Thank you.
H.M.Jr:	Goodbye.
H:	Goodbye.

EMBASSY OF THE

UNITED STATES OF AMERICA

216

Chungking, December 18, 1939.

AIR MAIL

No. 407

Subject: China Transport Corporation:

Articles of Incorporation; Official Announcement of Aims and Objectives

CONFIDENTIAL

The Honorable

The Secretary of State,

Washington.

Sir:

With reference to the Embassy's telegram to the Department, No. 623 of December 2, 1939, 10:00 a.m., regarding plans to coordinate motor transport throughout China under the control of the Ministry of Communications, I have the honor to enclose, for the information of the Department, a copy of a translation of
1/ the articles of incorporation of the China Transport
2/ Corporation; and a copy of the Central News release of December 16 announcing formation of the corporation.

Summary: Fundamental difficulties standing in the way of coordinating motor transport in China, including the problem of bringing the motor transport service of the Foo Shing Trading Corporation under a central organization, have been overcome. The articles of incorporation of the China Transport Corporation, approved by the Executive Yuan on November 28, 1939, authorize the Corporation to operate rail, water, and air transportation services throughout China; authorized capital is to be $50,000,000 Chinese National currency, half of which is to be subscribed by the Ministry of Communications; first objective is to coordinate motor transport, a problem on which three American experts have been working for three months. The Corporation is authorized to contract foreign loans; Chinese hope for improvement in transport system sufficient to encourage further credits from the United States.

The formation of the China Transport Corporation is largely due to the efforts of three American highway transportation experts headed by Mr. Maurice E.

Sheahan,

117

Sheehan, who arrived in Chungking in September 17, 1939, to advise the Ministry of Communications in carrying out plans to coordinate motor transport throughout unoccupied China. Although they were warned before leaving the United States (by an American in the Chinese Maritime Customs, and in the presence of a prominent Chinese who represents certain Chinese Government agencies in New York City) that the problem would probably be more difficult than they could possibly anticipate, they have been frankly amazed at the lack of efficiency, the wastefulness, and the apparently groundless objections to recommendations, which they have, from time to time, encountered. They have, nevertheless, succeeded in working out plans for a coordinated system of transport which, if it succeeds, may spell the difference between defeat and survival for the National Government.

The task of coordinating existing motor transport organizations involved negotiating not only with organizations comprising purely Chinese personnel, but also with the Foo Shing Trading Corporation, whose motor transport system is the largest, and probably the best organized of those to be absorbed by the China Transport Corporation. The Foo Shing motor transport service was organized, as the Department is aware, under the direction of two Americans—Messrs. Lawrence R. Groff and Eugene B. Read, who, like Mr. Sheehan, and his assistants, appear to have been sent to China with the unofficial approval of the United States Treasury Department. When the question of bringing the Foo Shing organization under the Ministry of Communications arose, the Foo Shing Corporation raised various objections (discussed in Rangoon's despatch No. 232, October 26, 1939), the chief of which was that bringing its trucks under control of the Ministry of Communication might interfere with carrying out its obligations under its contract with the Universal Trading Corporation (to maintain a fleet of not less than 1,000 trucks for use "continuously and exclusively" in the transportation of tung oil for export under the Export-Import Bank credit). Mr. Groff informed a member of the Embassy staff confidentially on October 15 that he disliked the idea of turning the organization he had built up over to the Ministry of Communication; that some of his Chinese assistants had said they would resign rather than work for the Ministry; but that rather than make it appear to the Treasury Department that opposition from the Foo Shing Corporation was responsible for failure of the coordination plan, he would turn his organization over without further argument. Mr. Groff

remarked

remarked on this occasion that if the Southwest Transportation Company was to be exempted from the consolidation, he saw no good reason why his organization should not be exempted too. The reason given for exempting the former, however, is that it is a semi-military organization, and that the China Transport Corporation is to concern itself exclusively with civil transport.

The fundamental difficulties have, however, now been overcome, and the Foo Shing motor transport service is to become part of the China Transport Corporation.

It will be noted that the new corporation is a "special charter company" authorized by the Executive Yuan "upon application of the Ministry of Communications and with the approval of the National Government"; its functions include operation of freight, passenger, and express services via highway, rail, water, or air; manufacture or assembly of equipment and supplies; ownership of buildings; operation of hostels; transportation of postal matter; purchase of securities of other transportation companies; and engaging in "other enterprises and activities pertaining to the conduct of transportation service".

The Embassy understands that the Corporation has no intention of taking over existing airlines, but that the charter authorizes operation of airlines in order that air freight lines may be established, if feasible, without being challenged by airlines already in operation. The Embassy also understands that authorization to carry mails is included in the charter merely to facilitate the operation of such services if and when necessary arrangements are made with the postal authorities.

It will be further noted that the charter is to run for thirty years; that half of the capital of $50,000,000 Chinese National currency is to be subscribed by the Ministry of Communications and the other half by other Government agencies or by commercial institutions; that three to five members of a Board of Directors of seven to eleven members are to be appointed by the Ministry of Communications, and the remaining members elected by the shareholders; and that the Corporation, with the approval of the Executive Yuan and the National Government, may contract foreign loans.

The last mentioned provision is, of course, significant, in view of Chinese Government officials' belief that if they can convince the Treasury Department that they are making progress in developing a transportation system the Export-Import Bank may be disposed to grant further credits.

The

The official release announcing formation of the new corporation (written at the request of an official of the Ministry of Communications by the local ASSOCIATED PRESS correspondent, who furnished the Embassy with the enclosed translation of the Articles of Incorporation) emphasizes the importance of an efficient transportation system in strengthening China's credits abroad; mentions the prominent part played by the American advisers in organizing the corporation; discusses proposed methods of operating and servicing trucks designed to increase efficiency; and refers to the possible purchase of road machinery for highway maintenance. Should it appear that there is any definite prospect of purchase of road machinery by the Ministry of Communications, the Embassy will undertake to inform the Department.

Respectfully yours,

For the Ambassador:

WILLYS R. PECK

Counselor of Embassy

Enclosures:

1/ Translation of Articles of Incorporation, China Transport Corporation.

2/ Copy of Central News release, December 18, 1939.

Original to Department by air mail
Four copies to Department by pouch
Copy to Embassy, Peiping
Copy to Consulate General, Shanghai
Copy to Consulate, Yunnanfu
Copy to Consulate, Rangoon
Copy to Consul, Hanoi

800
TEM:MCL

Owing to press of routine, completion of this despatch has been unavoidably delayed.

January 6, 1940.
2
2

Enclosure No. 1
to Despatch No. 407
Dated December 18, 1939

(C O P Y)

CHINA TRANSPORT CORPORATION
ARTICLES OF INCORPORATION

(Amended and passed by the 441st meeting of the Executive Yuan, November 28, 1939)

1. The China Transport Corporation shall be a special charter company to be organized by special action of the Executive Yuan upon application of the Ministry of Communications and with the approval of the National Government.

2. The functions of the Corporation shall be:

a. To operate freight, passenger and express service via highway, railroad, water or air.

b. To manufacture or assemble all necessary equipment pertaining to transportation service.

c. To manufacture or assemble, store and disburse necessary materials and supplies.

d. To own, lease or hire land and/or buildings and appurtenances thereto belonging.

e. To transport postal matters.

f. To construct and operate comfort and rest stations for the convenience of the travelling public and operating personnel.

g. To invest and hold in its name securities of other companies engaged in transportation.

h. To undertake other enterprises and activities pertaining to the conduct of transportation service.

3. The charter of the Corporation shall be for a period of 30 years subject to renewal by approval of the Executive Yuan and the National Government upon the application of the Ministry of Communications.

4.

4. The total authorized capital of the Corporation shall be $50,000,000 Chinese National Currency divided into 5,000 shares of $10,000 each, half of which is to be subscribed by the Ministry of Communications and the balance may be subscribed by other Chinese government or commercial institutions. The said capital shares shall be subscribed and paid for in cash or equivalent values.

5. The shares of the Corporation subscribed by Chinese government institutions shall not be transferable unless with the special permission of the National Government.

6. The Corporation with the approval of the Executive Yuan and the National Government may contract foreign loans.

7. The Corporation shall have a Board of Directors composed of from seven to eleven directors; of which three to five directors shall be elected by the Ministry of Communications; the remaining from among the other shareholders. The Managing Director of the Corporation shall be the ex-officio member of the Board.

8. The Board of Directors shall have three auditors, of which one shall be elected by the Ministry of Communications, and the remaining from among the other shareholders.

9. The Board of Directors shall elect among themselves a Chairman and, when necessary an Executive Committee composed of from two to three members.

10. The Corporation shall have a Managing Director and when necessary an Assistant Managing Director to be appointed by the Board of Directors.

11. The Corporation shall be registered at the Ministry of Communications and the Ministry of Economic Affairs.

12. The by-laws and regulations of the Corporation shall be passed by the Board of Directors subject to the approval of the Ministry of Communications.

13. The present articles of incorporation shall become effective from the day of their promulgation.

(True copy: HHL)

(Compared: TSW)

(COPY) Enclosure No. 2 to Despatch No. 407 Dated December 18, 1939 122

CENTRAL NEWS AGENCY, English Service, December 16, 1939

CHINA TRANSPORT COOPERATION ORGANIZED

Chungking, Dec. 16 (Central): Out of wartime China has emerged a comprehensive plan whereby existing means of communication in Asia's largest nation may be coordinated and developed. The Chinese Transport Corporation, whose articles of incorporation were approved by the 441st meeting of the Executive Yuan, has come into being.

China at war faces the need of maintaining and accelerating the pace of her exports, thereby strengthening her credits abroad which in turn will ensure a sound financial structure at home. But the formation of the new corporation is not to be regarded as simply a wartime, temporary development. It is a basic project that in time may be expected to place China's transportation and communication systems on a par with those of the most advanced countries of the world.

From the Chinese viewpoint, the United States affords the best example of highway service. Accordingly, much of the setup of the China Transport Corporation owes its inception to the advice given by the three American transportation experts now in China at the invitation of the National Government. Mr. M. E. Sheahan, vice-president of the Keeshin Freight Lines, Inc. of Chicago, as head of the visiting group, has brought to the local situation broad insight and lengthy experience.

Plans for the new corporation include full utilisation of the highways of Free China. Operations heretofore have been limited to daylight hours or the wakeful hours of drivers operating continuously on long trips consuming as much as ten days. The drive-relay plan will be inaugurated, whereby a driver's scope of operation will be confined to relatively short operating divisions. The cargo and truck will go through to destination with succeeding drivers.

Inauguration of this plan will halve the time now required for the same trips.

Merger

Merger of the major existing civil Government transport agencies will mean commencement of extensive equipment rehabilitation. Trucks now laid up awaiting repairs and spare parts will be placed in active service. Centralized control of spare parts will permit more economical usage.

The new corporation will follow the functional division of authority plan in contrast to the present plan of centering all functions in a given territory. This will permit of definite allocation of authority and responsibility to the person most qualified.

The China Transport Corporation will take its place among the largest enterprises in China, having an initial capitalization of 50,000,000 national dollars.

An official of the Ministry of Communications has given the additional information that road machinery for highway maintenance, particularly in sparsely settled districts where labor is scarce, and in regions constantly exposed to aerial attack by the enemy is also proposed. Full utilization of mechanical road aids, it is hoped, will afford speedy completion of cut-off roads, materially lessening distances between important cities. These more carefully engineered cut-off highways will lessen present road damage to equipment and speed up operations.

The official has pointed out that with the increased movement of export goods resulting from these many phases of highway transport improvement, the corporation will begin to augment its highway program by making use of railroads, waterways and airways.

In wartime, particularly, flexibility of operations is of paramount importance. This, the China Transport Corporation will bring to the nation's transportation system. In addition, simplification and coordination of routes and operations, efficiency in management and improved personnel will be provided.

The present time is considered an excellent one for the formation of a unified transportation corporation. Normal operations will be maintained; new ones will be begun, so that when the final peace is gained, the basis for quick, yet sound, expansion of all modern systems of communications in China will have been established.

(True copy: H. H. Kung)

(Compared: TSW)

RE: FINANCE OF DEFICIT

December 18, 1939.
9:00 a.m.

Present: Mr. Stewart
Mr. Haas
Mr. White
Mr. Viner
Mr. Reifler
Mr. Bell
Mrs. Klotz

White: Bernstein dropped in late last night and wanted to know why I wasn't there. He dropped in and left a copy, a rough draft of what they had, and I wasn't satisfied with it so I wrote a redraft, which is being typed now. I don't think it is their fault.

H.M.Jr: "At our luncheon conference on December 12th you requested a statement showing what might be done to make funds available to finance a deficit over the next eighteen months of as much as $4,600,000,000 without increasing the public debt."

He didn't say four billion six.

Bell: No, you made a statement to the group that day and Miss Chauncey wrote it.

H.M.Jr: Did I say four billion six?

Bell: Yes

Klotz: That is the figure that you had used.

H.M.Jr: "You indicated that you might even want to show in the forthcoming budget a smaller public debt at the end of this period than now exists, in which case it would, of course, be necessary to obtain funds in excess of the $4,600,000,000 by means other than direct borrowing or taxation.

"One obvious course of action open to us is the possibility of decreasing the working balance in the General Fund. I now estimate that the working balance on January 1, 1940, will amount to about $1,750,000,000. It might be possible to reduce this balance to $500,000,000 in which case about $1,250,000,000 would be made available for current expenditure. It should be recognized, however, that such a reduction would constitute a change of the policy which this Administration has hitherto maintained.

"The Treasury has carried, as a matter of policy, a substantial working balance and it has also refrained from utilizing to the full the short-term borrowing possibilities available through Treasury bills. This has assured the immediate availability of sufficient funds to meet whatever emergency might arise. The Treasury has thus been in a position to relieve the money market of major financing operations during critical situations, such as, for instance, the one which occurred last September. I believe that there are definite advantages in this policy, not only with respect to the Government security market, but also because of the record volume of demand obligations now outstanding - "

Bell: There is an advantage in carrying this large balance, because you may be called upon to meet these demand obligations.

H.M.Jr: "such as United States Savings Bonds, Postal Savings deposits, Unemployment Trust Fund, and commitments of the many credit agencies of the Government.

"The proceeds of the sale of obligations of credit agencies of the Government constitute another possible source of funds. During the calendar year 1939 we have sold guaranteed securities in the amount of about $800,000,000, the proceeds of which have been used largely to repay advances previously made by the Treasury. Thus the amount to be obtained from repayment of advances has now been reduced to approximately $100,000,000."

You mean they still —

Bell: Still owe us around a hundred million dollars.

H.M.Jr: Is that mostly T.V.A.?

Bell: T.V.A. is about fifty.

H.M.Jr: "The credit agencies of the Government, which already have on deposit in the Treasury working balances to the extent of approximately $400,000,000 might conceivably use their borrowing powers to obtain additional funds from the market, in excess of their own actual needs."

What is that agency?

Bell: Those that are checking accounts.

H.M.Jr: "These funds could then be deposited in the Treasury where they would be available to meet current Government expenditures."

Just how does that work?

Bell: If the R.F.C. sold five hundred millions of its obligations, they could deposit that five hundred million in Treasury and it would become part of our working balance but it would be in excess of its needs, so we would be using R.F.C. funds for finance purposes.

H.M.Jr: "However, adoption of such a course might subject the Administration to sharp criticism on the ground that it constituted an evasion of the congressional intent with respect both to the activities of these agencies and to the limitation on the public debt.

"The amount under the first two items would provide less than $1,400,000,000, which is far short of the $4,600,000,000. To obtain this sum it would, therefore, be necessary to employ additional measures which conflict with previous commitments to Congress and involve basic questions of currency and monetary policy. Measures which are legally possible include - " I just want to say this, certainly. So far as there is no pounding - I think the way it is put here, the President would say, "Well, I will take both of those." I haven't discussed this with anybody. If he wants to do it, it is there. I say that it is puting it in a very fair way. Certainly he can't object to that so far, do you think so?

White: I think so.

H.M.Jr: I am going to have to go through this whole business again, you know.

White: I don't see how this would be any other alternative. I presented my views - there were a good many concessions. I don't think if I had been there I would have won them around to my position. I can only present mine and theirs and let you choose. I think that the economics in this is weak. I think that the politics is bad and the tactics are bad.

Bell: We have ignored the politics.

White: I mean the politics of this statement. It is impolitic, and therefore I could only write another one which you would be in a position to decide very quickly which you prefer.

H.M.Jr: Well, I will go on.

White: It is being typed now. I just need another half hour.

H.M.Jr: "Use of Stabilization Fund Gold. We have the authority to transfer to the Treasury the $1,800,000,000 of gold now held for the account of the Stabilization Fund. If exercised this would provide $1,800,000,000 for the Treasury working balance to meet prospective expenditures. It would, on the other hand, leave the Fund with only a book credit against which it could draw at any time. If the current operations of the Fund should require more than the present $200,000,000 working balance, it would be necessary for it to draw against this book credit, and the Treasury in that event would have to find new money to meet such withdrawal.

"It was clearly not contemplated at the time when the powers in the Gold Reserve Act with respect to the Stabilization Fund were extended that its gold assets would be used to meet current expenditures. As Secretary of the Treasury, I have repeatedly advised the Congress that $1,800,000,000 of this Fund is still held in the form of gold and that there is no intention of using that gold for any purpose other than to meet Stabilization Fund requirements. Only when these requirements no longer existed, would it be appropriate to allocate the assets for the retirement of the public debt, and even then the proper timing of this use of the Fund would involve fundamental questions of monetary and currency policy."

Bell: Bernstein argued there was a question of legality in that second paragraph. He didn't clearly state the legal question to our satisfaction. He maintains that you never stated before any committees that you would not turn this billion eight gold into dollar credits and I don't think that we have necessarily said that. We have said that you would keep that gold there, that is what we have said, that you had no intention of using it for other purposes than the stabilization fund.

H.M.Jr: What I have said repeatedly, certainly it is uppermost in my mind on this stabilization fund, is that when there is no crisis that money should be used to retire the public debt and it should not be used for spending.

Bell: If you turn that gold into a dollar credit and use that gold, you see the credit would not mean anything so far as your debt was concerned. You could not use your credit.

H.M.Jr: There is no question in my mind how I feel about it, that the use of the money for part of the deficit —

Bell: There is another argument, Mr. Secretary, and that is that if you used the billion eight to meet current expenditures you have reduced the public debt. I think that is all right and you have got plenty of limitation on the debt, but when you reach forty-five billion dollars, which is the limit Congress has put on it, and then resort to this method I don't think you can say you are reducing debt by using gold dollars for current credit.

H.M.Jr: I think you could argue on that. I should think Mr. Roosevelt would want to be able to say two billion eight was not used for the purpose of assisting the financing of this deficit and that there is - that as to the approach to a balanced budget, we can use it to pay the people back the money we borrowed.

Bell: And at the proper time.

H.M.Jr: Or in the case of a great national emergency. I mean - you know, there might be a great national emergency which might come up. Well, I certainly wouldn't go on the Hill if they introduced legislation - if the President made a statement he was going to use this money and they introduced legislation to take that power away from him, I wouldn't go on the Hill to stop it and nobody from the Treasury in my position would go up there to stop that legislation. I appreciate the tempered tone of all this. I feel very much deeper on this, much deeper.

"Use silver seigniorage for issuance of silver certificates."

Didn't you say anywhere in here anything about excess reserves? Are you in this, Herbert?

Gaston: Oh yes.

Bell: Herbert was in.

H.M.Jr: Did you work 10 to 10, too?

Gaston: No, I didn't work as long as they did.

Viner: He was there.

Bell: It was rewritten after you left and we didn't do much on it.

H.M.Jr: "We have authority to issue silver certificates up to the monetary value ($1.29 an ounce) of the free silver now in the Treasury. If exercised, this would increase the amount of funds available to meet expenditures by about $1,500,000,000. When the Silver Purchase Act was approved, we decided to issue silver certificates only up to the cost of the silver, and to set aside any seigniorage in a special fund, and not to treat it as an ordinary Government receipt. I have stated publicly that this fund would eventually be used to retire the public debt."

Now, that I don't remember.

Bell: I have a quotation from a press conference.

H.M.Jr: Let me read it.

"As in the case of similar ultimate use of the Stabilization Fund gold, the appropriate time for the use of this seigniorage to retire the public debt would turn on questions of monetary policy."

White: If you did use silver for us, it would retire the public debt so the fact that he did make that statement merely might mean, aside from the last sentence, he might not think this was the appropriate time but he could say that this fund would eventually be used to retire the public debt, and I think it is a good time to do so.

Bell: That also applies to the two billion eight million.

White: Well, it is a little clearer, because here - there is a little more doubt about the other. You could retire some of the public debt.

H.M.Jr: Well now, let's just skip - I am not going to be part or parcel of anything which says the retiring of the public debt by spending some of this non-interest bearing money and in this way evade the issuing of additional interest bearing money which comes within the --

White: Mr. Secretary, that is the only way in which you can retire the public debt.

Viner: I think, Mr. Secretary, if you claimed you were retiring the public debt while the debt was day to day still growing, the public would think you were a trickster and a Shylock and they would be right.

White: That is a separate matter. Public reaction might be different, but the full facts --

H.M.Jr: No, I agree entirely with Viner. I am not going to be any part or parcel of it. I mean, I don't say that if the Administration wants to go ahead - that this is something that I am going to say, "Well, if you go ahead -" I mean - "I am going to resign."

Viner: That is not the issue at all.

H.M.Jr: But personally I am not up to the time the President's mind is open. I am going to present the figures. You don't any of you feel that this is sufficient that if he goes ahead this way that I should resign on that, do you?

Stewart: I think that your position is on perfectly sound ground.

H.M.Jr: I feel that the thing - I can't think of a good example, but I feel just the way Viner feels about it. I think - talking about politics, I don't know any time that would be worse to do it - and it is unnecessary.

Gaston: I am not fully satisfied with this paragraph on silver certificates. I would prefer to leave the question of retirement of the public debt entirely out of the matter of silver certificates, because I think it is purely a monetary question and I wouldn't be satisfied that you would want to use them ever to retire the public debt.

H.M.Jr: Even if I said that, I don't feel that way. On the Stabilization Fund - I have got to present this. I feel that very strongly. On the question of using the silver certificates —

Gaston: I would let that rest on monetary grounds.

H.M.Jr: I would like to do that.

Bell: That is all right.

H.M.Jr: I would like to do that.

Viner: Just eliminate all after "debt".

Gaston: And then say, "This issuance of silver certificates involves monetary policy which I will discuss later."

H.M.Jr: But I don't - not on the debt thing. I would like to leave that out. We are having a rebuttal this afternoon.

"Use the Balance of the Increment Resulting from the Reduction in the Weight of the Gold Dollar. This balance, in the amount of approximately $142,000,000, could be transferred to the working balance. This increment balance was appropriated or authorized to be used for specific purposes, namely, loans to industry through the Federal Reserve Banks and payment to the Philippines in connection with the reduction in the weight of the gold dollar. As in the case of the use of the Stabilization Fund gold and the silver seigniorage, the transfer of this increment to the working balance would raise a question of monetary policy. The sum involved, however, is not large and its transfer would have little practical importance. Other Legally Possible Measures. There are other executive powers which, if invoked, would make funds available in addition to those enumerated above; namely, further devaluation of the gold dollar, which would provide about $3,100,000,000, if it were reduced in weight to the full statutory limit; equal devaluation of the silver dollar, which would provide about $3,300,000,000; and the use of Thomas currency, issuable, however, only under certain important restrictions, which would provide $3,000,000,000."

Would it?

Gaston: You see it is much more than 9%.

White: It is 9 and 16.

Bell: It is only seventeen billion now.

Viner: It is about 16%.

White: That would be about a sixth —

H.M.Jr: "I am not discussing these measures in detail for the reason that I do not think you have their use in mind.

"There are two important phases of this whole problem upon which I should like to make further comment:

1. The budget and debt aspect, and

2. The general monetary and financial aspect.

"We are faced with a substantial deficit for the fiscal year ending June 30, 1941, as well as for the current fiscal year. For the past ten years the Government has financed its deficits by selling public debt obligations based on the public credit. The fact that the Treasury has been able to sell these obligations in the aggregate amount of approximately $25,000,000,000 during this period, and at the same time to reduce the average rate on the interest-bearing debt from 3.57% to 2.59% indicates to me that recourse to borrowing in the market in the normal way is still open to us without undue strain on the money market or unreasonable interest costs to the Treasury. I believe that if we depart from this established practice for meeting budget deficits we run the risk of impairing confidence in the financial operations of the Government."

Incidentally, Curry sent me over a very interesting memorandum. The increase of public debt is eighteen billion. That is the exact amount that we have contributed to State and Local Governments through relief, and W.P.A. I think that is a perfectly legitimate thing for the President to say. The State and Municipal debt limit has stayed still and ours has increased the exact amount of the contributions we have made to the State and Local Governments. It is a truthful statement.

"From the beginning of this Government Congress has kept a substantial measure of control over public debt issues. During the World War it was necessary for the Treasury to go to Congress each time it was required to issue additional Liberty Bonds. It has also been necessary for us to go to Congress on several occasions since 1933 to get additional authority in connection with the management of our public debt. In view of the past record I believe that we should follow the procedure of asking for an increase in the debt limit.

"Now as to the monetary and financial aspects. The use of the Stabilization Fund gold, the silver seigniorage, the gold increment balance, and the reduction of that part of the Treasury working balance not kept in commercial banks, would increase bank reserves by about $4,000,000,000. I do not believe that it would be advisable at this time to make recommendations to Congress which, if adopted, would commit this country to a policy of adding during the next eighteen months approximately $4,000,000,000 to the reserves of the banking system. The money markets of the country are more liquid today than ever before." I think you ought to put in a sentence reading as follows: "If, however, you decide to do it concurrently, there should be a recommendation to Congress that the Federal Reserve Bank increased its control over excess reserves."

White: You could even say that that is necessary without this.

H.M.Jr: You must concurrently ask Congress to —

Reifler: That hasn't —

Gaston: Add to that sentence there.

Stewart: I think you have got a lot more to say.

Reifler: Like to look at the mechanism of increase.

H.J.Jr: Will you think about that during the day, because that is, as I understand it - well, use the silver certificates, but at the same time slap —

Viner: What is the purpose there? We would have to know to write this letter. We would have to know what the purpose of that is.

White: Of increasing the reserves?

Viner: Yes

White: No, you make the point here that this would increase excess reserves.

Viner: What would Eccles' position be? What is the object? Is his object to increase the reserve requirements or is it to finance the Government?

H.M.Jr: I would go on the theory that the thing which lets - in talking to the President and advocating the silver thing, you see, all his speeches are framed along the one thing. He can't handle the credit situation, because the excess reserve has gotten out of control. In order to be consistent, if he recommends increasing it through use of silver certificates as a way to finance it, he has got to say, "Well, if you are going to do this, of course you have got to pump the Federal Reserve control."

Stewart: I think we ought to have a definite plan in mind.

Gaston: That indicates that the third object is definitely in his mind, that he wants us to exhaust our powers to effect the reserve situation.

We use up all our powers to effect the monetary situation so that the control is entirely in his hands.

White: I think it is much simpler than that. He may like that, but the problem is much simpler. He has prior to this gone on record as being opposed to the issue of silver certificates on the grounds that the excess reserves was already more than they could handle with the powers they have and that the silver certificates, if added, would intensify their problem and he has said that "If you are going to issue silver certificates, at least give us power," but he also believes that he should have more power to mop up the excess reserves anyhow, because the more gold coming in they will be higher so I think that what the Secretary wanted will be quite in order here.

Gaston: My understanding of the logic is that that will be a net gain for us.

Viner: Eccles is opposed to using the silver certificates - if he is opposed, you ought to quote it in this letter.

White: Only because it would increase his excess reserves. He ought to be glad to.

H.M.Jr: Bell? Wait a minute, I want to hear what Bell says.

Bell: I think Herbert Gaston is right.

H.M.Jr: What is that?

Bell: To put all of this money that the Treasury has got into the excess reserves and then that makes them so huge that Congress has got to do something about it and that means that the only authority that they can invest in anybody is in the Federal Reserve Board and he has complete control over the whole situation. Get the Treasury out of the picture, in other words.

H.M.Jr: "Interest rates are at the lowest levels in the history of this country. The volume of individual deposits, of currency in circulation, and of excess reserves of member banks are all at or close to record levels. It is clear, therefore, that none of the monetary conditions that might furnish an appropriate occasion to increase bank reserves through measures such as previously discussed is present at the moment. Our present monetary position already makes the effective use of credit controls sufficiently difficult. Additions to banking reserves by such Treasury operations will add to the difficulty.

"What changes in conditions may occur within the next eighteen months no one knows. It is important, therefore, to retain freedom of action in the monetary field. Commitment now to execute the monetary measures enumerated above would restrict such freedom of action and might result in unfortunate consequences."

I don't like "might result in unfortunate consequences." We don't know what they are.

White: I would like to see you try to be more specific about this.

H.M.Jr: I would either want to be more specific or leave that out.

White: That is so vague that you will find it very difficult —

Gaston: I think you are right, we ought to be more specific.

H.M.Jr: Either that or leave those five words out.

Stewart: That is all right with me.

Bell: I think we had it in one draft.

H.M.Jr: It would fall in line with the President's constant policy that he doesn't want his hands tied.

"Commitment now to execute the monetary measures enumerated above would restrict such freedom of action and might result in unfortunate consequences."

If you want to go into the unfortunate things, you will have to write a couple pages.

Gaston: Yes, that is weak.

H.M.Jr: "In the light of these considerations I recommend you propose in your budget message that the deficit be financed by the sale of public debt obligations, and that for this purpose you ask Congress to raise the limitation on outstanding public debt obligations from $45,000,000,000 to $50,000,000,000."

You don't want to say, "In the light of these considerations, inasmuch as under the law --"

Bell: We had that in there and had to take it out.

H.M.Jr: I want to say this: I think it is an extremely tempered document. I will give White a chance this afternoon to prepare his, but I am going to ask you gentlemen to get together with White during the day and see whether you can refine him down or he you. I have fifteen or twenty minutes and I don't see why White can't tell us now what he has in mind and I can tell him how much sympathy I have for what he has in mind. I just want to say one thing. You don't want to point out to the President that, "It is my honest belief that if you use the procedure, tell Congress that you are going to finance your deficit by using four billion dollars of this kind of money," that I think he runs a grave risk of Congress immediately taking that authority away from him.

Viner: You might want to say that in the letter. I don't think it is our role as experts to advise them about that. If you have them, it is your letter.

H.M.Jr: Up to this point, this letter could go to the President and I would be perfectly willing to have my name on it. If I put that other thing in --

Bell: We had that in the first draft.

Viner: You might tell him that personally, if you believe it.

H.M.Jr: I have decided the thing to do is to hand the letter to him personally.

Bell: You might want to discuss the political side of it, but not put it in a letter.

H.M.Jr: I think the thing to do is to walk it over. The only trouble with walking it over is that when I walk it over he always hands the letters back to me. It doesn't become a part of his file. If I send it over, he keeps it.

Now, Harry?

White: Well, I felt much as in the matter of presentation on that other point of view and I think that the economics of the positions taken here are woefully weak, myself. I don't feel that a strong case can be made or is made here or can be made, as far as I know, for the maintenance of this size balance through this period. I don't feel that there is any emergency and I would like to hear one named in which this Government cannot borrow all that it is likely to need during the next year on short term market. The only difference is that you might have an emergency in which you might have to pay more, but with excess reserves what they are --

H.M.Jr: I will answer you. You are taking the question of balances. I have told the President that it is my feeling that if the thing next summer stays no worse than it is now, I would be apt to let the balances run down to below a billion dollars. I am perfectly willing - I don't think they ought to go below seven fifty.

Bell: We put in here five hundred million.

H.M.Jr: I am going to say a working balance of seven fifty. That would give him a billion dollars that he could draw on. I am willing to just say —

Stewart: Let's make it seven fifty. We were pausing. We were considering the two figures.

H.M.Jr: I personally would say the seven fifty.

Gaston: We were trying to find the four billion six.

H.M.Jr: Say let the thing run down to seven fifty. I think certainly the U. S. Government ought to have seven hundred fifty million dollars in the Treasury.

White: Obviously your decision in that matter would be final. I still would like to hear the kind of emergency in which you couldn't raise more money if you needed it. I believe that I would be inclined to reduce that to three hundred million, but again I say, "That is my personal view," but I think a weak case is made here. It says it should be recognized, however, that such a reduction would constitute a change of policy which this Administration has hitherto maintained. I would be inclined to say that —

H.M.Jr: I am willing to say definitely that the balances will run down to seven fifty.

White: That finishes - then I merely would make —

H.M.Jr: No, I am willing to let the balances run down to seven fifty as of June 30, '41. Is that what you were talking about?

White: Yes

Viner: You are willing to make a definite recommendation there, not merely say —

White: The last six months would not be your —

Stewart: It is a statement of a tension.

H.M.Jr: In figuring the budget, I am going to say that on June 30, '41, there should be seven hundred fifty million in balance on hand, but that doesn't mean that in between time I can't carry a billion and three quarters or a billion and a half or a quarter, but figuring the budget as of June 30, '41, he ought to say seven fifty in the cash drawer and I say that is the minimum that the United States Treasury ought to have in the Treasury. I don't think anybody can argue with me on that, do you, gentlemen?

Viner: I don't feel on this little balance - I would like to have some sort of a careful calculation of what is a safe minimum balance in terms of the quick obligations, but beyond that I don't think I would go.

H.M.Jr: You haven't mentioned the thing at all. What I have done for the President, I have kept it so that I could always skip a quarterly finance. Now, if --

Viner: That takes a good deal of money. You won't be able to continue to do that.

White: Moreover, I question why - I mean I am going to fundamentally question why, because I think somebody else will fundamentally question why and I think the answer is difficult.

H.M.Jr: Don't let's argue, because this is - I am willing to say to the President, "I am willing to make this one concession, that on June 30, '41, the Bureau of the Budget can figure the balance at seven hundred fifty million dollars."

Bell: I think --

Gaston: I still think you ought to insist on his making provision in the budget message for borrowing all he will need to meet the deficit that he might mention in the budget message that we hope to make a better picture with respect to the public debt by being able to increase the general fund balance, but we need a reserve for contingencies. I am not - I may not use and probably will not use all of this debt authority or probably will not raise all of this by public debt borrowing, but nevertheless we have got to be safeguarded against emergencies. Therefore, I am puting it this way.

White: Don't you think that would be more appropriate at the end and not at this point?

Gaston: I mean his budget message.

White: Yes, but speaking of this letter. At this point, it is merely a question of whether the general funds can be reduced.

H.M.Jr: I am willing to say seven fifty.

White: My only passing comment is that I would like the three hundred and let's not go beyond that. The second point is with regard to the —

H.M.Jr: Harry, you don't want to see me today or six months from now have three hundred million dollars in there?

White: I said by the end of 1941.

Viner: What did you advocate to be fair by November, 1940, or October, 1940?

White: I believe - you asked me the question of fairness. I believe three hundred is enough, but in the light of the Secretary's belief and practice, I think it would be unwise to go suddenly down. There ought to be very gradually - to go down —

H.M.Jr: You want me by June, '40, to have three hundred million dollars?

White: By June, 1941.

H.M.Jr: Say June '40. Do you want to write a memorandum and put your name to it to the effect that by June '40 you would let it run down to three hundred million?

White: Oh no, I wouldn't want it. I would be glad to do it for you. The question is not by June '40 but by June '41.

H.M.Jr: I am willing to say June '41,seven fifty. So would you, wouldn't you? Would that bother you? You would be here and I am not apt to be here.

Bell: It doesn't bother me. We have got eighteen months to change it.

White: With the Republicans in, they should get along with twenty-five million.

H.M.Jr: We have given them a billion. Any of you fellows worried about that?

White: Shall I go ahead?

H.M.Jr: Yes

White: The next point is the Stabilization Fund. I should be inclined to handle that in the presentation a little differently. I feel - point out that it could be used and that it might be construed as being a reduction of the debt and then the way I had in mind was, what I would do in the letter, in pointing out the pros and cons, I would show what the public reaction might be and let him make his choice. In other words, in the first part of the letter I would have as little as possible of arguing as to what he should or should not do, but rather have the economic pros and cons discussed by what can be done, this is the effect of it, and then after I got through with that, I would say the economic advantages and disadvantages of each measure are so and so, and then I should be inclined to add that the political repercussions pro and con are so and so, and then I should be inclined to make a recommendation.

H.M.Jr: Why don't you people - when you have got your memorandum ready, ask these people to meet you.

White: I will be glad to.

H.M.Jr: You won't have another chance before four thirty.

White: That would be plenty of time. They are going to be here?

H.M.Jr: Oh yes

White: Why don't they make a meeting now?

H.M.Jr: You will stay until four thirty, won't you?

Stewart: I would like to stay through the discussion with Harry.

White: Why don't we make it earlier?

Stewart: I am free.

White: How about twelve o'clock?

H.M.Jr: The only person I need here at ten is you (Bell).

White: I will be ready to meet them at noon. I would like to take as much of this letter in --

H.M.Jr: I want to switch the subject a minute. Last night I read - this is for Harry - the Laylin memorandum on South America and the way I feel now, I told Mr. Cotton that with the President of Columbia saying one million seven fifty out of which you have also got to pay the English, the way I feel is to tell the Bondholders Protective Committee to forget it. I can't recommend that to them. What they have done is - Bondholders Protective Committee has asked two or three of these fellows to come back. I shouldn't think that the public would want to get into that. Certainly I want no part of it. The other thing, how sure are you people as to the statement of Mr. Cochran that this mortgage bank can out of its own income pay its obligations?

White: I know nothing about that.

H.M.Jr: Is there some way of finding out?

White: Yes, I should think so.

H.M.Jr: I can see you people at three fifteen on this - they are not coming before - for heaven's sake! Jones and Welles are coming at four thirty.

White: On that fall in the price of coffee, we were trying to estimate what it would mean to them. It might be a factor that --

H.M.Jr: I will have to see you men at three o'clock, this same group.

Viner: Couldn't you make Mr. Helvering at three and this group at a quarter to three, because then Stewart could make his train.

H.M.Jr: I can't do it. What time does your train go?

Stewart: Four forty five. It gives me half an hour.

H.M.Jr: I will be on time. I will be ready at three.

Stewart: Fine

White: I have a suggestion to make about the other in view of the fact that you have got this important document. Do you think you might postpone the meeting with Mr. Welles for another day to give you a little more time? It won't crowd you this afternoon so much.

H.M.Jr: Except this Cabinet meeting.

White: Do you want to do this before Cabinet?

H.M.Jr: No

White: You could get him tomorrow morning.

H.M.Jr: I am all right tomorrow morning.

White: Particularly since you have in mind turning down their offer, I think you might want to give it a little more thought.

H.M.Jr: After the President, we will talk about South America.

Would you (Mrs. Klotz) tell Mr. Welles and Mr. Jones that in view of the memorandum I have received from Mr. Duggan I need more time and therefore I would like to make it ten thirty tomorrow morning.

White: I presume Mr. Jones has received a copy of that?

H.M.Jr: I told Cotton last night to make sure. Then you people, we could make - we could talk about South America ourselves at four thirty this afternoon, but at three o'clock - I have from three to four to discuss this memorandum to the President. How is that?

Stewart: Fine

H.M.Jr: Then you gentlemen are going to meet together at twelve?

White: That is right.

H.M.Jr: Harry is a tough guy, a courageous fellow.

White: They have listened to everything I have had to say. I don't think I will change their minds much. I will have another try.

H.M.Jr: We will meet at three.

At our luncheon conference on December 12th you requested a statement showing what might be done to make funds available to finance a deficit over the next eighteen months of as much as $4,600,000,000 without increasing the public debt.

You indicated that you might even want to show in the forthcoming budget a smaller public debt at the end of this period than now exists, in which case it would, of course, be necessary to obtain funds in excess of the $4,600,000,000 by means other than direct borrowing or taxation.

One obvious course of action open to us is the possibility of decreasing the working balance in the General Fund. I now estimate that the working balance on January 1, 1940, will amount to about $1,750,000,000. It might be possible to reduce this balance to $500,000,000 in which case about $1,250,000,000 would be made available for current expenditure. It should be recognized, however, that such a reduction would constitute a change of the policy which this Administration has hitherto maintained.

The Treasury has carried, as a matter of policy, a substantial working balance and it has also refrained from utilizing to the full the short-term borrowing possibilities available through Treasury bills. This has assured the immediate availability of sufficient funds to meet whatever emergency might arise. The Treasury has thus been in a position to relieve the money market of major financing operations during critical situations, such as, for instance, the one which occurred last September. I believe that there are definite advantages in this policy, not only with respect to the Government security market, but also because of the record volume of demand obligations now outstanding such as United States Savings Bonds, Postal Savings deposits, Unemployment Trust Fund, and commitments of the many credit agencies of the Government.

The proceeds of the sale of obligations of credit agencies of the Government constitute another possible source of funds. During the calendar year 1939 we have sold guaranteed securities in the amount of about $800,000,000, the proceeds of which have been used largely to repay advances previously made by the Treasury. Thus the amount to be obtained from repayment of advances has now been reduced to approximately $100,000,000.

The credit agencies of the Government, which already have on deposit in the Treasury working balances to the extent of approximately $400,000,000 might conceivably use their borrowing powers to obtain additional funds from the market, in excess of their own actual needs.

These funds could then be deposited in the Treasury where they would be available to meet current Government expenditures.

However, adoption of such a course might subject the Administration to sharp criticism on the ground that it constituted an evasion of the congressional intent with respect both to the activities of these agencies and to the limitation on the public debt.

The amount under the first two items would provide less than $1,400,000,000, which is far short of the $4,600,000,000. To obtain this sum it would, therefore, be necessary to employ additional measures which conflict with previous commitments to Congress and involve basic questions of currency and monetary policy. Measures which are legally possible include:

Use of Stabilization Fund Gold. We have the authority to transfer to the Treasury the $1,800,000,000 of gold now held for the account of the Stabilization Fund. If exercised this would provide $1,800,000,000 for the Treasury working balance to meet prospective expenditures. It would, on the other hand, leave the Fund with only a book credit against which it could draw at any time. If the current operations of the Fund should require more than the present $200,000,000 working balance, it would be necessary for it to draw against this book credit, and the Treasury in that event would have to find new money to meet such withdrawal.

It was clearly not contemplated at the time when the powers in the Gold Reserve Act with respect to the Stabilization Fund were extended that its gold assets would be used to meet current expenditures. As Secretary of the Treasury, I have repeatedly advised the Congress that $1,800,000,000 of this Fund is still held in the form of gold and that there is no intention of using that gold for any purpose other than to meet Stabilization Fund requirements. Only when these requirements no longer existed, would it be appropriate to allocate the assets for the retirement of the public debt, and even then the proper timing of this use of the Fund would involve fundamental questions of monetary and currency policy.

Use silver seigniorage for issuance of silver certificates.

We have authority to issue silver certificates up to the monetary value ($1.29 an ounce) of the free silver now in the Treasury. If exercised, this would increase the amount of funds available to meet expenditures by about $1,500,000,000.

When the Silver Purchase Act was approved, we decided to issue silver certificates only up to the cost of the silver, and to set aside any seigniorage in a special fund, and not to treat it as an ordinary Government receipt. I have stated publicly that this fund would eventually be used to retire the public debt.

Use the Balance of the Increment Resulting from the Reduction in the Weight of the Gold Dollar. This balance, in the amount of approximately $142,000,000, could be transferred to the working balance. This increment balance was appropriated or authorized to be used for specific purposes, namely, loans to industry through the Federal Reserve Banks and payment to the Philippines in connection with the reduction in the weight of the gold dollar. As in the case of the use of the Stabilization Fund gold and the silver seigniorage, the transfer of this increment to the working balance would raise a question of monetary policy. The sum involved, however, is not large and its transfer would have little practical importance. Other Legally Possible Measures. There are other executive powers which, if invoked, would make funds available in addition to those enumerated above; namely, further devaluation of the gold dollar, which would provide about $3,100,000,000, if it were reduced in weight to the full statutory limit; equal devaluation of the silver dollar, which would provide about $3,300,000,000; and the use of Thomas currency, issuable, however, only under certain important restrictions, which would provide $3,000,000,000.

I am not discussing these measures in detail for the reason that I do not think you have their use in mind.

There are two important phases of this whole problem upon which I should like to make further comment:

1. The budget and debt aspect, and

2. The general monetary and financial aspect.

We are faced with a substantial deficit for the fiscal year ending June 30, 1941, as well as for the current fiscal year. For the past ten years the Government has financed its deficits by selling public debt obligations based on the public credit. The fact that the Treasury has been able to sell these obligations in the aggregate amount of approximately $25,000,000,000 during this period, and at the same time to reduce the average rate on the interest-bearing debt from 3.57% to 2.59% indicates to me that recourse to borrowing in the market in the normal way is still open to us without undue strain on the money market or unreasonable interest costs to the Treasury. I believe that if we depart from this established practice for meeting budget deficits we run the risk of impairing confidence in the financial operations of the Government.

From the beginning of this Government Congress has kept a substantial measure of control over public debt issues. During the World War it was necessary for the Treasury to go to Congress each time it was required to issue additional Liberty Bonds. It has also been necessary for us to go to Congress on several occasions since 1933 to get additional authority in connection with the management of our public debt. In view of the past record I believe that we should follow the procedure of asking for an increase in the debt limit.

Now as to the monetary and financial aspects. The use of the Stabilization Fund gold, the silver seigniorage, the gold increment balance, and the reduction of that part of the Treasury working balance not kept in commercial banks, would increase bank reserves by about $4,000,000,000. I do not believe that it would be advisable at this time to make recommendations to Congress which, if adopted, would commit this country to a policy of adding during the next eighteen months approximately $4,000,000,000 to the reserves of the banking system. The money markets of the country are more liquid today than ever before.

Interest rates are at the lowest levels in the history of this country. The volume of individual deposits, of currency in circulation, and of excess reserves of member banks are all at or close to record levels. It is clear, therefore, that none of the monetary conditions that might furnish an appropriate occasion to increase bank reserves through measures such as previously discussed is present at the moment. Our present monetary position already makes the effective use of credit controls sufficiently difficult. Additions to banking reserves by such Treasury operations will add to the difficulty.

What changes in conditions may occur within the next eighteen months no one knows. It is important, therefore, to retain freedom of action in the monetary field. Commitment now to execute the monetary measures enumerated above would restrict such freedom of action and might result in unfortunate consequences.

Commitment now to execute the monetary measures enumerated above would restrict such freedom of action and might result in unfortunate consequences.

In the light of these considerations I recommend you propose in your budget message that the deficit be financed by the sale of public debt obligations, and that for this purpose you ask Congress to raise the limitation on outstanding public debt obligations from $45,000,000,000 to $50,000,000,000.

RE FINANCE OF DEFICIT

December 18, 1939.
3:00 p.m.

Present: Mr. Hanes
Mr. Viner
Mr. Stewart
Mr. Riefler
Mr. Bell
Mr. Haas
Mr. Foley
Mr. White
Mr. Bernstein

H.M.Jr: Harry, read your draft of this out loud. Is that all right?

Stewart: Yes.

H.M.Jr: What is the monetary expert Foley doing here?

White: Why, I couldn't get any support from the monetary experts, so I went to the legal department. There are some legal points here that there is some question about, I think.

H.M.Jr: Well, read yours.

White: "This is in reply to your request for a statement showing how a deficit...."

H.M.Jr: This is to the President?

White: Yes.

"My dear Mr. President:

"This is in reply to your request for a statement showing how a deficit of $4,600,000,000 might be financed during the next 18 months without adding to the public debt.

"It will be possible to finance a deficit of this size without adding to the public debt in the following manner:

"(1) Reduction of the cash balance now in the General Fund, including $250,000,000 of free gold, to about $500,000,000 — $1,250,000,000

	(Brought forward)	$1,250,000,000
"(2)	Issuance of silver certificates against free silver in the Treasury including current acquisitions	1,700,000,000
"(3)	Replacement of gold in Stabilization Fund with dollar credit	1,800,000,000
"(4)	Release of the balance of the increment from the 1934 revaluation of gold, hitherto held for the Federal Reserve Banks and Philippine Islands	142,000,000
"(5)	Repayment of Treasury advances to government corporations	100,000,000
		$4,992,000,000

"(There are other executive powers which, if invoked would make funds available in addition to those enumerated above; namely, further devaluation of the gold dollar, which would provide about $3,100,000,000 if it were reduced in weight to the full statutory limit; equal devaluation of the silver dollar, which would provide about $3,300,000,000; and the use of Thomas currency, issuable, however, only under certain important restrictions, which would provide $3,000,000,000. I am not discussing these measures in detail for the reason that I do not think you have their use in mind.)

"1. Reduction of the General Fund. I now estimate that the working balance in the General Fund on January 1, 1940 will amount to $1,750,000,000. It would be possible by June 30, 1941 to reduce this balance to $500,000,000, in which case about $1,250,000,000 would be made available for current expenditure. A large balance has been carried hitherto as insurance against any possible difficulty in our quarterly financing of maturities and new money. In disturbed times, such as at present, there is something to be said for maintaining a large balance and I do not think it should be permitted to fall below $500,000,000. With excess reserves as high as they are now and with the additional gold that is certain to come in during the next year, taken together with the powers which the Federal Reserve System has, if necessary, to expand the credit base, there can be no question as to the ability of the Treasury to raise any amount of cash that it may possibly need through the sale of bills or notes, though possibly at higher rates. Furthermore, until the present $3,642,000,000 of unused gold and silver are fully utilized, they provide a ready source of funds to meet any emergency.

"2. The issuance of silver certificates. We have authority to issue silver certificates up to the monetary value ($1.29 an ounce) of the free silver in the Treasury. Under this authority we could during the course of the next year issue approximately $1.7 billion of silver certificates which would include the silver currently acquired.

"Silver certificates have always been issued against silver at the rate of $1.29 per ounce even though the market value has been below that almost continuously since the 1870's. Additional issue of silver certificates is about the only likely way we can "use" the free silver in the Treasury. With $17.5 billion worth of gold and the expectation that we will get at least several billion dollars more in the next few years there can be no question as to the "soundness" of our monetary system from the point of view of metallic reserves.

"3. Use of the Stabilization Fund gold. We have the authority to transfer to the Treasury the $1,800,000,000 of gold now held for the account of the Stabilization Fund and establish dollar credits with the Treasury for that amount. To the extent that the Fund did not draw on such dollar credits the Treasury could use the balances for current expenditures or to retire outstanding public debt obligations. (There are about $5 billion of bills, notes and callable bonds which can be retired in 1940. It would be possible to select from that group such sums as it was desired to retire.)

"To employ the Fund in this manner might be criticized as a violation of the Congressional intent with regard to the Fund. It was clearly not contemplated by Congress that the gold assets would be used to meet current expenditures. However, Congress did provide for the investment in government obligations of the assets of the Fund not currently needed for foreign exchange operations. Whether the use of these funds to retire outstanding obligations in the manner suggested above would be regarded as different from the investment of those funds in government obligations is a debatable point. It might appear to the public as a device to use the Fund for current expenditures rather than as a means of investment in government obligations. This interpretation will find support in the fact that only six months ago the Administration made a last ditch fight to have the Stabilization Fund maintained for the purpose of stabilising the exchange value of the dollar. Though use of the Fund in the manner described above would not destroy the usefulness of the Fund, it is susceptible to that interpretation.

"(As an alternative the Fund, which continues until June 30, 1941, could be terminated at any time prior to that date by the President declaring the end of the emergency referred to in the Gold Reserve Act. Should the Fund thus be terminated its assets of $2 billion could be covered into the Treasury and the working balance increased to that extent.)

"4. Use the balance of the increment resulting from the reduction in the weight of the gold dollar. This balance, in the amount of approximately $142,000,000, could be transferred to the working balance. This increment balance was appropriated or authorized to be used for specific purposes, namely, loans to industry through the Federal Reserve Banks and payment to the Philippines in connection with the reduction in the weight of the gold dollar. The sum involved, however, is not large and its transfer would have little practical importance.

"5. Borrowing by government corporations to repay debt to the Treasury. Government corporations can borrow in their own name and repay amounts they owe the Treasury. There is about $100 million still due the Treasury which can be repaid in this manner.

"It may be appropriate to point out various considerations involved in the use of the above sources of funds to finance the deficit.

"1. At present there are excess reserves of $5 billion. This financing program would add almost $4 billion, and inflowing gold during the next 18 months will doubtless add several billion more. The existing powers to deal with excess reserves are inadequate to absorb the present high level of excess reserves let alone an additional $5 billion. If the excess reserves were increased through the adoption of these measures it would seem all the more necessary that additional powers should be granted to the Federal Reserve Board to absorb larger amounts of the excess reserves.

"2. The adoption of the program suggested may arouse fears among some of the business and financial community of impending "inflation". They will also contend that the impending "inflation" will lead to a speculative inventory boom. Finally they may contend that there will be an undesirable degree of instability in the bond market because bond prices would rise now and fall later or they might claim that fixed income yielding investments, both government and non-government, will decline in price despite the greater abundance of investment capital. My own view is that any harmful results that may ensue from the use of funds as described above would flow from the widespread discussion that the announcement of such a policy would create rather than from any direct economic consequences.

"3. The criticism of these measures will be exploited to the full for political purposes during the coming months. All the critics of the Administration will join in the cry that we are beginning to resort to "crack-pot" monetary panaceas. They will say that Thomas currency is next, then further gold and silver devaluation, etc. Much political capital may be made of the bogie of "inflation", "monetary unsoundness", and "wild experimentation".

"4. On the other hand, I need not point out to you the favorable political consequences of not having to ask Congress to increase the permissible public debt this year.

"In the light of these considerations I would like to make a recommendation as to the procedure to be followed in financing the deficit of $4.6 billion. In your Budget speech you may wish to include a statement which would indicate that the deficit will be financed through the sale of public debt obligations and the utilization of the cash resources of the Treasury."

I understand from Mr. Foley that you don't have to specify the exact amounts which you would do, either, so this might be a way of handling it.

"During the coming months the Treasury will then proceed to decrease its cash balance by $1,250 million, utilize the balance of the gold increment of $142 million and raise $100 million through the repayment to the Treasury by government corporations. Thus $1.5 billion of the deficit will be financed with existing cash resources, leaving only $4.1 billion to be financed through public debt obligations. The bulk of this amount will be raised through the sale of United States Savings Bonds and Social Security obligations.

"At the present time the debt of the Federal Government subject to the limitation of $45 billion in the Second Liberty Loan Act, is $40.5 billion. An addition of $3.1 billion in public debt obligations during the next eighteen months will still leave the public debt below the legal limitation. Thus, it will not be necessary to ask this Congress for an increase in the debt limitation."

H.M.Jr: The whole first part of the approach isn't the way I want to approach him. It doesn't express me, because I am unalterably opposed to the President doing it this way. Therefore, I very much prefer the very tempered way these other gentlemen presented it, leaving an aftertaste that I don't want it. With you I get the aftertaste - well, I do want it, and then to give that one paragraph - you call it "crackpot" and everything else....

White: I say that is what will be said.

H.M.Jr: He is very shrewd. He would think that I am telling him that is what I think it is. I don't want to do that. The first part doesn't satisfy me because I want the aftertaste to be that I don't want it. This leaves the taste - you say of ~~between~~ it a "crackpot" and everything else and going to Congress and asking for it, you think he had better do it rather than ask Congress - I feel very deeply that he ought to ask Congress for it on the theory that 6 from 10 makes 4 and doesn't make zero. This is one of the times - if I may have that....

White: Yes. I was going to say irrespective of the manner of presentation I should like to make a strong suggestion that he shouldn't throw this whole subject into Congress for discussion, because I think if he does that there will be a terrific amount of objectionable discussion on both sides.

H.M.Jr: Well, I appreciate your sincerity and you will have to take my sincerity for granted. My conviction is so deep on this that I just don't want to argue about it.

White: That is all right.

H.M.Jr: This is one of these things that I feel very deeply and nobody can argue with me to change me. Well now, we have sown this thing for seven years and if we have to reap it in the eighth it is just too damn bad, but there it is. You would have the discussion anyway except it would center instead of on raising the debt limit from 45 to 50 million dollars on the fight to take all these emergency powers away from him. Your fight would be centered on each one of the things and I don't mind saying - I would tell him that I would not go up and make the fight against the Stabilization Fund to be spent. I just won't do it.

It is a choice. There is going to be a fight. Either the fight will be against the President to keep him from using these rights or the fight will be amongst Congress - not necessarily against the President - but shall they raise the debt limit, and I personally think we ought to face it honestly. We have sown this field for seven years; it is up to us to face it.

White: I am not sure that I have made myself clear. I didn't know either would be the issue. They weren't going to use either - going to reduce your cash balance, as I took it you agreed, and then raise the remainder through borrowing. There is no recommendation there that he use the other.

H.M.Jr: You said - now wait a minute.

White: O. K. As long as you understand my recommendation.

H.M.Jr: Well, I don't think you can straddle this thing. I haven't seen the new letter, but I am perfectly willing to say that the balance on June 30, 1941 should be 750 million. He doesn't need me on that. He can have it anything that he wants. That is a perfectly safe balance to shoot for, but outside of that I can't meet him - that gives him a billion dollars but outside of that I can't go any further.

Before Mr. Stewart goes, do you (Mr. Stewart) want to say anything?

Stewart: No. I agree entirely with your statement that you have just made on this. I think it is the right decision. When you get into the other letter, you will see there have been some modifications made.

There is one item on which I would like to comment. You suggested at the morning meeting that something should be said about the excess reserves. Nothing is said about it in this. I feel that if there is any proposal for modification of excess reserves, a separate inquiry should be proposed to us to consider what is the right thing to do and I would not be inclined to throw this in this letter, that of course "if you do this you will have to reconsider the excess reserves."

H.M.Jr: I think you are right.

White: Then why do you give that as an argument against it, that you are going to increase the excess reserves?

Stewart: This procedure will increase the excess reserves if there is a proposal anywhere in Washington for getting control of the excess reserves. If there is, I would like to see it, but I wouldn't want to make any commitment in advance about what it was.

White: I think that is being a little bit clever. It seems to me - I am questioning now - assuming that your letter is going forth, as I take it is, and that you want to make it as effective a letter as is possible. I take it that you are saying that one of the reasons, one of the objections, to the use of these various monetary devices would be that it would increase the excess reserves. Now, it would seem a reasonable answer to say that of course these excess reserves - additional powers might be given to take care of it.

Viner: I don't think so. The point is that we don't want to give a horseback opinion on just what problems that would give rise to and what would be the proper way to deal with that. I suppose if we were asked, we should be happy to study the problem and reach some conclusion.

Riefler: A lot of the advices are suggested to handle the problem of excess reserves.

White: But you can't think of any that wouldn't?

Riefler: No, but it is extremely important to see the one first. I should think there ought to be an Act by Congress. You can't dispose of that with a clause. Something would have to be done about excess reserves.

White: May I say a word about the strength of the other approach?

H.M.Jr: Which approach?

White: Their approach. Merely a question of making it stronger.

H.M.Jr: (To Mr. Stewart) When am I going to see you again?

Stewart: I should hope not in the near future, but I will come if you want me.

(Mr. Stewart leaves the conference)

White: Incidentally, Mr. Foley and Mr. Bernstein were reluctant to come in. I felt I needed some moral support, so I insisted on them being here.

H.M.Jr: It is all right. Foley needs - what is it they say at the Gridiron? Ladies always present but reporters never. So Foley is always present, lawyers never.

I want Hanes to get the benefit of the other letter. Who has got that? Will you (Bell) read that?

You (Hanes) may totally disagree with me. When you hear their letter you may or may not have had time to make an opinion.

Bell: May I ask first if you would like to change this figure back to four?

H.M.Jr: My recollection is that the President said four and I think....

Bell: I don't think it is important.

H.M.Jr: Then I would rather say four. The deficit is going to be around four, isn't it?

Bell: Well, I should think the deficit for eighteen months would be a good deal more than four.

H.M.Jr: Well, the next budget would be four.

Bell: I should think in the next budget it ought to be somewhere between two and three-quarters and three.

H.M.Jr: I would rather make it four.

Bell: O. K.

"At our luncheon conference on December 12th you requested a statement showing what might be done to make funds available to finance a deficit over the next eighteen months of as much as $4,600,000,000 without increasing the public debt. You indicated that you might even want to show in the forthcoming budget a smaller public debt at the end of this period than now exists, in which case it would, of course, be necessary to obtain funds in excess of the $4,600,000,000 by means other than direct borrowing or taxation.

"One obvious course of action open to us is the possibility of decreasing the working balance in the General Fund. I now estimate that the working balance on January 1, 1940, will amount to about $1,750,000,000. It would be possible, I think, if no new unfavorable developments occur, to reduce this balance to $750,000,000, by the end of the fiscal year 1941, in which case about $1,000,000,000 would be made available for current expenditure. Whether it would be wise, however, to commit ourselves in advance to so large a reduction is, I think, a matter for very careful consideration."

That, I think, has been changed.

"The Treasury has carried, as a matter of policy, a substantial working balance and it has also refrained from utilizing to the full the short-term borrowing possibilities available through Treasury bills. This has assured the immediate availability of sufficient funds to meet whatever emergency might arise. The Treasury has thus been in a position to relieve the money market of major financing operations during critical situations, such as, for instance, the one which occurred last September. I believe that there are definite advantages in this policy, not only with respect to the Government security market, but also because of the record volume of demand obligations now outstanding, such as United States Savings Bonds, Postal Savings deposits, Unemployment Trust Fund, and commitments of the many credit agencies of the Government.

"The proceeds of the sale of obligations of credit agencies of the Government constitute another possible source of funds. During the calendar year 1939 we have sold guaranteed securities in the amount of about $800,000,000, the proceeds of which have been used largely to repay advances previously made by the Treasury. Thus the amount to be obtained from repayment of advances has now been reduced to approximately $100,000,000.

"The credit agencies of the Government, which already have on deposit in the Treasury working balances to the extent of approximately $400,000,000, might conceivably use their borrowing powers to obtain additional funds from the market, in excess of their own actual needs. These funds could then be deposited in the Treasury where they would be available to meet current Government expenditures. However, adoption of such a course might subject the Administration to sharp criticism on the ground that it constituted an evasion of the congressional intent with respect both to the activities of these agencies and to the limitation on the public debt.

"The amount under the first two items would provide not more than $1,100,000,000, which is far short of the $4,000,000,000 desired. To obtain this sum it would, therefore, be necessary to employ additional measures which conflict with previous commitments to Congress and involve basic questions of currency and monetary policy. Measures which are legally possible include:

"I. Use of Stabilization Fund Gold. We have the authority to transfer to the Treasury the $1,800,000,000 of gold now held for the account of the Stabilization Fund. If exercised this would provide $1,800,000,000 for the Treasury working balance to meet prospective expenditures. It would, on the other hand, leave the Fund with only a book credit against which it could draw at any time. If the current operations of the Fund should require more than the present $200,000,000 working balance, it would be necessary for it to draw against this book credit, and the Treasury in that event would have to find new money to meet such withdrawal.

"It was clearly not contemplated at the time when the powers in the Gold Reserve Act with respect to the Stabilization Fund were extended that its gold assets would be used to meet current expenditures. As Secretary of the Treasury, I have repeatedly advised the Congress that $1,800,000,000 of this Fund is still held in the form of gold and that there is no intention of using that gold for any purpose other than to meet Stabilization Fund requirements. Only when these requirements no longer exist would it be appropriate to allocate the assets for the retirement of the public debt, and even then the proper timing of this use of the Fund would involve fundamental questions of monetary and currency policy.

"II. Use Silver Seigniorage for Issuance of Silver Certificates. We have authority to issue silver certificates up to the monetary value ($1.29 an ounce) of the free silver now in the Treasury. If exercised, this would increase the amount of funds available to meet expenditures by about $1,500,000,000. When the Silver Purchase Act was approved, we decided to issue silver certificates only up to the cost of the silver, and to set aside any seigniorage in a special fund, and not to treat it as an ordinary Government receipt. This was a decision not to use a monetary device for the purpose of lessening the amount of public debt borrowing. I still believe that decision was wise.

"III. Use the Balance of the Increment Resulting from the Reduction in the Weight of the Gold Dollar. This balance, in the amount of approximately $142,000,000, could be transferred to the working balance. This increment balance was appropriated or authorized to be used for specific purposes, namely, loans to industry through the Federal Reserve Banks and payment to the Philippines in connection with the reduction in the weight of the gold dollar. As in the case of the use of the Stabilization Fund gold and the silver seigniorage, the transfer of this increment to the working balance would raise a question of monetary policy. The sum involved, however, is not large and its transfer would have little practical importance.

"IV. Other Legally Possible Measures. There are other executive powers which, if invoked, would make funds available in addition to those enumerated above; namely, further devaluation of the gold dollar, which would provide about $3,100,000,000 $3,100,000,000 if it were reduced in weight to the full statutory limit; equal devaluation of the silver dollar, which would provide about $3,300,000,000; and the use of Thomas currency, issuable, however, only under certain important restrictions, which would provide $3,000,000,000. I am not discussing these measures in detail for the reason that I do not think you have their use in mind.

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"There are two important phases of this whole problem upon which I should like to make further comment:

1. The budget and debt aspect, and

2. The general monetary and financial aspect.

"We are faced with a substantial deficit for the fiscal year ending June 30, 1941, as well as for the current fiscal year. For the past ten years the Government has financed its deficits by selling public debt obligations based on the public credit. The fact that the Treasury has been able to sell these obligations in the aggregate amount of approximately $25,000,000,000 during this period, and at the same time to reduce the average rate on the interest-bearing debt from 3.57% to 2.59% indicates to me that recourse to borrowing in the market in the normal way is still open to us without undue strain on the money market or unreasonable interest costs to the Treasury.

"Now as to the monetary and financial aspects. The use of the Stabilization Fund gold, the silver seigniorage, the gold increment balance, and the reduction of that part of the Treasury working balance not kept in commercial banks, would increase bank reserves by about $4,000,000,000. I do not believe that it would be advisable at this time to make recommendations to Congress which, if adopted, would commit this country to a policy of adding during the next eighteen months approximately $4,000,000,000 to the reserves of the banking system. The money markets of the country are more liquid today than ever before. Interest rates are at the lowest levels in the history of this country. The volume of individual deposits, of currency in circulation, and of excess reserves of member banks are all at or close to record levels. It is clear, therefore, that none of the monetary conditions that might furnish an appropriate occasion to increase bank reserves through measures such as previously discussed is present at the moment. Our present monetary position already makes the effective use of credit controls sufficiently difficult. Additions to banking reserves by such Treasury operations will add to the difficulty."

H.M.Jr: This is the new one?

Bell: Yes.

"What changes in conditions may occur within the next eighteen months no one knows. It is important, therefore, to retain freedom of action in the monetary field. Commitment now to execute the monetary measures enumerated above would restrict such freedom of action and might have other grave consequences.

"To sum up: I think it would be inconsistent with sound fiscal and monetary policy for you to announce in your budget message for the fiscal year 1941 that you propose to use the methods indicated above to prevent an increase in the public debt over the present statutory limit; much less that you propose thus to accomplish over the fiscal year 1941 an actual reduction of the nominal amount of the debt.

"A reduction in the general fund balance in an amount not to exceed one billion dollars between January 1940 and June 1941 will probably be entirely feasible, but I think that an announcement that this is to be done should be qualified to admit another decision if developments demand it.

"I do not believe additional silver certificates should be issued (beyond the cost of the silver acquired) for merely budgetary reasons, but that any enlarged issue of this form of currency should have a strictly monetary justification.

"The gold earmarked for the Stabilization Fund is a cash resource that can be and should be ultimately used to reduce the public debt, but both the commitments we have made to Congress and monetary considerations argue against its use at this time for the purpose of avoiding public debt borrowing. The same considerations apply to the remainder of the gold increment in the General Fund.

"My recommendation therefore is that in that part of your budget message which deals with the means of financing the contemplated deficit for the fiscal year 1941 you indicate that the greater part of the deficit should be financed by an increase in the public debt and that you ask for amendment of the Second Liberty Bond Act so as to increase the debt authorization from $45,000,000,000 to $50,000,000,000.

"It may be conceivable that conditions might arise in the next year and a half which would justify the use of any or all of the resources listed above, but to announce in advance that they are to be used whether or not the justifying conditions are present would seem to me to be a mistake, because it would hamper your freedom of action and might raise apprehensions with respect to our fiscal policy which would seriously damage the public credit and faith in the wisdom of the acts of this Administration."

H.M.Jr: That is swell. There is just one thing. They say it would be a mistake, and I want to say, "grave mistake." It suits me.

Bell: That is what this group tried to do, was to draft something that you liked.

H.M.Jr: You (Hanes) can comment or not, as you like.

Hanes: I am so far from being an expert on this sort of thing that my comment wouldn't be worth anything, but I can just say that I have listened to the talk about this thing and you and I have discussed it before and recommended back there two or three months ago and at that time I know that my feeling was that I was opposed to it, but this thing here - I would say that would be - I would like to indicate my preference for that one.

H.M.Jr: Is that about the way you feel?

Hanes: Yes, that makes good sense to me.

I might say that I am not wholly in agreement with the statement you made a while ago that you would just as soon see your balances go down to 750 million dollars. I would hate to see you do that because you have, I think, saved a good deal of money for the Government by being in the comfortable position you were in the other way and you haven't felt that you had to go to market when you didn't want to. I would like to see you stay in that position, but I don't think that is so serious as the objections to doing the other things. I think the other things would be quite bad.

H.M.Jr: George, you have been very quiet. Do you want to say something?

Haas: No, I put a good many hours working on that last draft.

H.M.Jr: That suits you?

Haas: Yes.

H.M.Jr: Foley?

Foley: The only question I have, Mr. Secretary, is whether or not it is absolutely necessary to increase the borrowing margin. If there is to be only a deficit of four billion dollars between now and the 30th of June, 1941, and if by dropping your working balance you can pick up a billion dollars and you still have somewhere around four billion dollars additional borrowing margin, that gives you five billion dollars to take care of an estimated deficit of four billion dollars over an eighteen months period. Certainly with a margin of a billion dollars and an opportunity to go to Congress six months before the end of that period if additional borrowing margin is necessary because of unforeseen developments, it may be unnecessary to recommend an increase in the borrowing margin now.

H.M.Jr: I don't think they gave you the figures right. June 30, 1940, keeping the balances approximately where they are, I told Congress when I testified last week that the debt limit would be 44 billion plus, is that right?

Bell: Yes.

H.M.Jr: What did you figure the balances are?

Bell: A billion and a half.

H.M.Jr: See? Well, we will say it is 44 plus. All right, let's subtract three-quarters of a billion dollars, which would bring it down to 43,7. Now, we are running at a deficit - do you (Bell) think the deficit is going to be....

Bell: I think it will be four billion dollars in 1940. We are half through it now.

H.M.Jr: I mean the next fiscal year, the deficit.

Bell: On the basis of the figures I gave you, I think the deficit will be somewhere around 2,8.

Viner: Eighteen months?

H.M.Jr: No, fiscal year. I am going now from the first of July, '40, to the first of July, '41, which is twelve months.

Bell: The figures that I gave you, as I recall, showed a deficit of around 2,8. We got three billion dollars in the estimated receipts, so it brings it down to 3,6. I think there are many items eliminated, which will be put back in Congress, that that deficit will be nearer $3\frac{1}{2}$.

H.M.Jr: Let's call it three. You have got 43,7 to run another six months, and you have got to add a billion and a half to that for another six months, which brings it above the 45 debt limit to the end of Mr. Roosevelt's present term. See what I mean?

Foley: Yes, I see what you mean, Mr. Secretary, and I am saying....

H.M.Jr: I can't see....

Foley: I haven't checked the figures. I don't know whether there has ever been a legal check as to what the debt incurring power is within the 45 billion, I mean recently, the things that can be eliminated, that aren't under the second Liberty Bond Act, and just exactly what the net legal debt is at the present time.

H.M.Jr: Well, let me restate my position once more without getting down - I don't want to quibble. The issue isn't can we pick up a hundred here or two hundred here or three hundred here, that isn't the issue. That is why I am not wasting my time trying to find out whether I can pick that up. The issue is, shall the President of the United States say to the public that at the end of eighteen months from January 1, 1940, the public debt will be less than it is on January 1, 1940, see, through using the various emergency devices which have been given here.

Foley: There is no difference between us on that.

H.M.Jr: I say that I consider it to be the gravest mistake he can make. Is there any difference? I mean, that he should come out - and that is what he has got in mind - and paint a picture and say that the public debt on July 1, 1941, will be less than the public debt is on January 1, 1940.

Foley: I agree with you. I think that would be a mistake. The next point I thought was whether we ask Congress now to increase the debt limit and I am just asking whether that is necessary.

H.M.Jr: All right. I believe the alternative - I don't want him to say what I have just said, because I think in the first place it would be doing the thing that they have been accusing him of doing each year and which he never did do and which he said he wouldn't do, but he said, "I want those clubs in my closet for emergency when it arises." The emergency isn't here. I personally think that he could put the burden just the way I have said publicly two or three times, right square on the shoulders of Congress where it belongs.

Viner: Mr. Secretary, I think Foley's point is somewhat different. I don't recall that we really discussed it. I just took it for granted that it had been calculated that if he did none of these things that had been suggested, it would be necessary to increase the debt limit. I have no opinion on that.

Foley: That is the question I am raising.

Viner: I am just saying, I just take it for granted that somebody would work it out and it would be necessary.

Foley: This is a Presidential year. We are faced with an election. If it is possible to get over safely into the next Congressional year without throwing the question of increasing the debt limit in the hopper now, so that the country will become very debt conscious through a rehash of all the spending that this Administration has gone through, I think that we ought to try to avoid it if that is possible, and I am raising the question. Do we have to ask for an increase in the debt limit at this session of Congress, or by perfectly sound and perfectly conservative means continue as we have in the past and get over into next year?

H.M.Jr: We will let Dan answer that.

Bell: Of course, we haven't seen the final budget figures, but I think it might be possible for us to run into January or February, 1941, unless we are hit with some kind of a spending program, but I say that when the Secretary of the Treasury goes out on July 1 with a very small limitation on his borrowing and faced with all these demand obligations, it is a damned dangerous position to be in. I am just scared to death of it. If the President thinks with this budget document finally completed that he can get by into February, '41, then he might say that, but I think he ought to point out at the same time the danger of the limitation.

White: What danger, Danny?

H.M.Jr: Excuse me a minute. You indicate the greater part of that issue should be financed by increasing the public debt. You leave out that you ask for an amendment of the second Liberty loan.

Foley: You could say you are expressing no opinion at this time as to the necessity for increasing the debt limit at this session of Congress.

H.M.Jr: He could say to me, "You haven't seen my figures and maybe we are only going to have a two billion dollar deficit."

Bell: That is what we did say in this first draft that we didn't see them and therefore we were working in the dark.

Foley: That you are expressing no opinion at this time.

H.M.Jr: Leave out this, Dan, about increase in the public debt.

Bell: All right.

Viner: I didn't know that there was any issue there.

H.M.Jr: Leave out that.

Riefler: No question about it.

Viner: You didn't know either, did you?

Riefler: No.

Bell: We had been thinking of the eighteen months period and I just don't think that....

H.M.Jr: Does that satisfy you?

Bell: That you are going up to June 30, 1941?

Foley: Yes, that takes care of my point, because I think he has two things in mind and I think that you are saying no to both things, in this letter, and I don't think you have to.

H.M.Jr: I only want to say no to one thing.

Foley: Yes, and I think he would feel a great deal happier about this letter if you indicated either that it wasn't necessary to increase the debt limit or you weren't passing judgement on that at this time.

H.M.Jr: "That you indicate the greater part of the deficit should be financed by increase in the public debt."

Viner: I would say now that if anything is to be said about asking Congress for an increase in the debt limit it ought to be supported by the figures which justify that advice. But we can't do it. Then I would say that is not our problem anyway.

H.M.Jr: I am willing to stick to just the one point, that he doesn't do the silver certificate route.

Viner: I assumed there was no other way out.

Bell: I think it is all right from the Secretary's standpoint, but I think the President is going to have difficulty getting around showing on June 30, 1941, a 46 billion dollar debt and saying nothing about the billion dollar increase.

Viner: I am not questioning that. All I am saying now is that if there is any room for argument there I would want to see the argument before I make a recommendation.

Bell: I agree with this change.

H.M.Jr: Does this make you any happier, Harry?

White: That is what I was for, except that Ed put it much better. Now, having read it before, I was dissatisfied with the presentation. After hearing it again, I am even more dissatisfied, but I do like the way you come out, of not recommending any increase in the public debt. That is what I....

Viner: Not recommending an increase....

White: Any demand that the debt limit be raised, in the use of some of your cash balance. Those are the two things.

H.M.Jr: Well, of course when I was asked on the Hill about my own position, it is that if the debt limit goes above 45, "What would you do, Mr. Morgenthau," and I told them pointblank I would raise it. I told them last week and I am going to stick to it. It is all in the papers. I haven't got any other answer. If the President said to me, "What would you do if it goes above 45," and wants it in writing from me, I would give it to him in writing.

Foley: Yes, but I think we are talking about an eighteen months period here.

H.M.Jr: Let me just ask you this, Ed. I am not trying to put you on the spot, but I want to see whether you and I are together or not. It may be over-simplified, but in this thing that somebody has tried to sell the President he should say that six from ten makes zero, that I am arguing in this whole letter that I don't want him to say that. I want him to say that six from ten is four.

Foley: Well, I don't know what anybody has said to the President, Mr. Secretary. In so far as arguments against the use of some of these measures that have been put forward in this letter, I don't think I have any disagreement with you at all. I think we are in absolute accord. The only thing that I think you don't have to say in this letter is that it is absolutely necessary now to ask Congress at the forthcoming session to increase the public debt limit from 45 to 50 billion dollars.

H.M.Jr: You and I are in agreement and you two men aren't in any disagreement.

Viner: I say I don't know. I am withdrawing the recommendation as far as I am concerned, because I did it with inadequate information.

Bell: As a matter of fact, in discussing that letter last night we took out that and put it back after dinner.

H.M.Jr: You shouldn't have eaten.

Bell: One fellow said he liked it and it was a definite recommendation and we put it back.

Foley: I agree with you, Mr. Secretary, it would be a mistake to try to say that in June 30, 1941 the public debt would be less than it is on the first of January, 1940, or the 30th of December, 1940.

Viner: When is it possible to raise the debt limitation? It is possible to raise it at any time, isn't it, at any session of Congress?

H.M.Jr: Yes.

Viner: So that he doesn't have to do it in the first session. There is no question of that, is there?

White: I have yet to hear what the danger is in waiting.

Viner: Oh....

White: Oh, what? Let's specifically hear what the danger is, what conditions would confront - why the Treasury has other cash assets that if that kind of contingency should arise....

Viner: There is a possibility it will be forced in by other borrowing powers, into these other things, but I don't want....

White: If Congress is in session, it can always raise the debt limit. If Congress isn't in session, you can call a special Congress. If Congress isn't in session and you can't call a special Congress, you have other means to resort to. What are these dangers?

Viner: I would say that the Finance Minister calling a special Congress as a device whereby he meets a routine situation is certainly....

White: I am impressed by the vagueness with which these dangers are surrounded. It is amazing. After all, we are playing with a cost to the Government of something like 50 to 100 million dollars a year in interest.

Viner: Seven hundred million dollars a year.

White: No, it is 100 million a year. It is easy enough to figure out more if you accumulate it, as you will, because each year it tends to increase. There ought to be some specific danger specified rather than the mere statement that you may be confronted with some kind of emergency you may not foresee; Congress may not be in session; you may not be able to call a special Congress or resort to your special powers....

Viner: I would say the Secretary of the Treasury who allows himself to be in a position within a few months or half a year where he has to ask for a calling of a special session of Congress in order to acquire routine funds when he had all the time in the world to ask for them before is showing irresponsibility.

H.M.Jr: May I interrupt just one minute? Mr. Bell told me and Mr. Harold Smith that the President has to, in his budget message, legally show how he can raise the money.

Foley: There is a statute, Mr. Secretary.

H.M.Jr: Just tell me, is he right or wrong? In five minutes, I have got a press conference. Do you hold with Bell or don't you? Excuse me for being kind of short.

Bell: Read the short paragraph.

H.M.Jr: Would you do this for me? I am not feeling terribly well. Go into a huddle with Dan and see if the two of you can't agree whether the President does or doesn't, because I think it is terribly important. Just the two of you go into a huddle and tell me tomorrow morning.

Foley: Sure, because I don't know what Dan means and....

H.M.Jr: Would you mind? And tomorrow morning, tell me, because Harold Smith concurred with Dan. I think it is very important.

Viner: I don't see that that is your responsibility, Mr. Secretary.

H.M.Jr: It is only my responsibility ethically, that if it is there it is up to me. I think ethically it is up to me to bring it to the President's attention. You might say to me, "My son or my wife had a checking account and I know that they have overdrawn it," and say, "Well, it is not my responsibility, it is their own money," but I think it is up to me if they are overdrawing to tell them so.

Viner: But he has an officer whose function it is to tell him what his obligations are under this Act, and that officer is not in the Treasury. He is aware, you know, that he is responsible.

H.M.Jr: But he holds to this - well, I can't change myself. I still would like to do it.

Bell: You don't have to say it in this letter, but I think before this budget message goes up, the President should ask you.

H.M.Jr: I haven't seen the President once in the last month that he hasn't said something about his budget to me.

Viner: Oh, there ought to be a formal notification.

H.M.Jr: Oh, I am not going to say it in a letter, I want to know was Bell right or wasn't he when he told the Director of the Budget and me that you have to do something. I would just like to know for my own information so that if the President said to me, "Well, do I or don't I," I would like to know what is the correct answer. I am ever so much obliged to everybody and don't anybody feel down because I haven't taken their advice, and after all, that is why we have conferences.

White: You are not looking at me, because if so, I would have been down as hell a long time ago.

H.M.Jr: That is unfair to yourself.

This is in reply to your request for a statement showing how a deficit of $4,600,000,000 might be financed during the next 18 months without adding to the public debt.

It will be possible to finance a deficit of this size without adding to the public debt in the following manner:

(1)	Reduction of the cash balance now in the General Fund, including $250,000,000 of free gold, to about $500,000,000	$1,250,000,000
(2)	Issuance of silver certificates against free silver in the Treasury including current acquisitions	1,700,000,000
(3)	Replacement of gold in Stabilization Fund with dollar credit	1,800,000,000
(4)	Release of the balance of the increment from the 1934 revaluation of gold, hitherto held for the Federal Reserve Banks and Philippine Islands	142,000,000
(5)	Repayment of Treasury advances to government corporations	100,000,000
		$4,992,000,000

(There are other executive powers which, if invoked would make funds available in addition to those enumerated above; namely, further devaluation of the gold dollar, which would provide about $3,100,000,000 if it were reduced in weight to the full statutory limit; equal devaluation of the silver dollar, which would provide about $3,300,000,000; and the use of Thomas currency, issuable, however, only under certain important restrictions, which would provide $3,000,000,000. I am not discussing these measures in detail for the reason that I do not think you have their use in mind.)

1. Reduction of the General Fund. I now estimate that the working balance in the General Fund on January 1, 1940 will amount to $1,750,000,000. It would be possible by June 30, 1941 to reduce this balance to $500,000,000, in which case about $1,250,000,000 would be made available for current expenditure. A large balance has been carried hitherto as insurance against any possible difficulty in our quarterly financing of maturities and new money. In disturbed times, such as at present, there is something to be said for maintaining a large balance and I do not think it should be permitted to fall below $500,000,000. With excess reserves as high as they are now and with the additional gold that is

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certain to come in during the next year, taken together with the powers which the Federal Reserve System has, if necessary, to expand the credit base, there can be no question as to the ability of the Treasury to raise any amount of cash that it may possibly need through the sale of bills or notes, though possibly at higher rates. Furthermore, until the present $3,642,000,000 of unused gold and silver are fully utilized, they provide a ready source of funds to meet any emergency.

2. The Issuance of Silver Certificates. We have authority to issue silver certificates up to the monetary value ($1.29 an ounce) of the free silver in the Treasury. Under this authority we could during the course of the next year issue approximately $1.7 billion of silver certificates which would include the silver currently acquired.

Silver certificates have always been issued against silver at the rate of $1.29 per ounce even though the market value has been below that almost continuously since the 1870's. Additional issue of silver certificates is about the only likely way we can "use" the free silver in the Treasury. With $17.5 billion worth of gold and the expectation that we will get at least several billion dollars more in the next few years there can be no question as to the "soundness" of our monetary system from the point of view of metallic reserves.

3. Use of the Stabilization Fund Gold. We have the authority to transfer to the Treasury the $1,800,000,000 of gold now held for the account of the Stabilization Fund and establish dollar credits with the Treasury for that amount. To the extent that the Fund did not draw on such dollar credits the Treasury could use the balances for current expenditures or to retire outstanding public debt obligations. (There are about $5 billion of bills, notes and callable bonds which can be retired in 1940. It would be possible to select from that group such sums as it was desired to retire.)

To employ the Fund in this manner might be criticized as a violation of the Congressional intent with regard to the Fund. It was clearly not contemplated by Congress that the gold assets would be used to meet current expenditures. However, Congress did provide for the investment in government obligations of the assets of the Fund not currently need for foreign exchange operations. Whether the use of these funds to retire outstanding obligations in the manner suggested above would be regarded as different from the investment of those funds in government obligations is a debatable point. It might appear to the public as a device to use the Fund for current expenditures rather than as a means of investment in government obligations. This interpretation will find support in the fact that only six months ago the Administration made a last ditch fight to have the Stabilization Fund maintained for the purpose of stabilizing the exchange value of the dollar. Though use of the Fund in the manner described above would not destroy the usefulness of the Fund, it is susceptible to that interpretation.

(As an alternative the Fund, which continues until June 30, 1941, could be terminated at any time prior to that date by the President declaring the end of the emergency referred to in the Gold Reserve Act. Should the Fund thus be terminated its assets of $2 billion could be covered into the Treasury and the working balance increased to that extent.)

4. Use the balance of the increment resulting from the reduction in the weight of the gold dollar. This balance, in the amount of approximately $142,000,000, could be transferred to the working balance. This increment balance was appropriated or authorized to be used for specific purposes, namely, loans to industry through the Federal Reserve Banks and payment to the Philippines in connection with the reduction in the weight of the gold dollar. The sum involved, however, is not large and its transfer would have little practical importance.

5. Borrowing by government corporations to repay debt to the Treasury. Government corporations can borrow in their own name and repay amounts they owe the Treasury. There is about $100 million still due the Treasury which can be repaid in this manner.

It may be appropriate to point out various considerations involved in the use of the above sources of funds to finance the deficit.

1. At present there are excess reserves of $5 billion. This financing program would add almost $4 billion, and inflowing gold during the next 18 months will doubtless add several billion more. The existing powers to deal with excess reserves are inadequate to absorb the present high level of excess reserves let alone an additional $5 billion. If the excess reserves were increased through the adoption of these measures it would seem all the more necessary that additional powers should be granted to the Federal Reserve Board to absorb larger amounts of the excess reserves.

2. The adoption of the program suggested may arouse fears among some of the business and financial community of impending "inflation". They will also contend that the impending "inflation" will lead to a speculative inventory boom. Finally they may contend that there will be an undesirable degree of instability in the bond market because bond prices would rise now and fall later or they might claim that fixed income

yielding investments, both government and non-government, will decline in price despite the greater abundance of investment capital. My own view is that any harmful results that may ensue from the use of funds as described above would flow from the widespread discussion that the announcement of such a policy would create rather than from any direct economic consequences.

3. The criticism of these measures will be exploited to the full for political purposes during the coming months. All the critics of the Administration will join in the cry that we are beginning to resort to "crack-pot" monetary panaceas. They will say that Thomas currency is next, then further gold and silver devaluation, etc. Much political capital may be made of the bogie of "inflation", "monetary unsoundness", and "wild experimentation".

4. On the other hand, I need not point out to you the favorable political consequences of not having to ask Congress to increase the permissible public debt this year.

In the light of these considerations I would like to make a recommendation as to the procedure to be following in financing the deficit of $4.6 billion. In your Budget speech you may wish to include a statement which would indicate that the deficit will be financed through the sale of public debt obligations and the utilization of the cash resources of the Treasury.

I understand from Mr. Foley that you don't have to specify the exact amounts which you would do, either, so this might be a way of handling it.

During the coming months the Treasury will then proceed to decrease its cash balance by $1,250 million, utilize the balance of the gold increment of $142 million and raise $100 million through the repayment to the Treasury by government corporations. Thus $1.5 billion of the deficit will be financed with existing cash resources, leaving only $4.1 billion to be financed through public debt obligations. The bulk of this amount will be raised through the sale of United States Savings Bonds and Social Security obligations.

At the present time the debt of the Federal Government subject to the limitation of $45 billion in the Second Liberty Loan Act, is $40.5 billion. An addition of $3.1 billion in public debt obligations during the next eighteen months will still leave the public debt below the legal limitation. Thus, it will not be necessary to ask this Congress for an increase in the debt limitation.

TREASURY DEPARTMENT

WASHINGTON

December 18, 1939.

MEMORANDUM FOR THE SECRETARY:

Re: Budget action on Procurement Division estimate.

We were notified Saturday morning of the allowances made by the Bureau of the Budget on the estimate of the Procurement Division for the fiscal year 1941.

An increase of $403,000 was allowed over the appropriation for the current year: $230,000 to permit a limited transfer of emergency personnel to the permanent roll, and $173,000 for statistical inquiries pertaining to Government purchases.

No increase was allowed to cover the expansion of the Procurement Division's present purchasing functions as the Department had proposed.

This means that any extension of the work of the Procurement Division, along the lines of your instructions, will have to be financed out of funds to be transferred to the Procurement Division from the appropriations made to other branches of the Government.

Budget Director Harold Smith assured me on Saturday that the Budget Bureau would collaborate with the Treasury Department in securing the transfer of the funds necessary to permit the Procurement Division to take over all important purchasing for the nonmilitary branches of the Government in the District of Columbia effective July 1, 1940.

He feels, however, that the taking over of purchases in the field should be deferred until July 1, 1941, and his action on the budget estimate was taken accordingly.

The hearing of the Procurement Division estimate by the House Committee on Appropriations, on the foregoing basis, is scheduled for to-morrow morning, December 19.

GRAVES.

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ENG/mff

GRAVES.

OK. HMJr

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

184

DATE December 16, 1939

TO Secretary Morgenthau

FROM Mr. Dietrich

Mr. Livesey of the State Department called this morning and said that they had received a cable from Ambassador Daniels at Mexico City stating that the sudden weakness of the Mexican peso was due to a report that, in January, the United States would stop purchasing silver.

Mr. Beteta, Under Secretary of Foreign Affairs, stated to the Ambassador that it would be of value in shaping Mexico's financial policy if he, the Ambassador, could tell Mr. Beteta what course the United States would pursue in purchasing silver after January 1.

The State Department is anxious to answer this cable today and it proposes that Mr. Beteta be informed that silver purchases by the U. S. Treasury have been on a day to day basis for many months; that our silver policy is not given out in advance; and that we are unable, at the present time, to state what legislation Congress may consider with respect to silver purchases.

HMJr

December 18, 1939.

MEMORANDUM

TO: Secretary Morgenthau
FROM: Mr. Gaston

Al Goss spent an hour with me late this afternoon telling about his interview with Wallace, which occurred on Saturday, and other matters connected with the Farm Credit situation. Frosty Hill sent his resignation to the President last week, after he had received word through Wallace that the President would not see him until he had first submitted his resignation. The resignation stated (1) that it was submitted "at your request through Secretary Wallace;" (2) that Hill had had no opportunity to discuss the matter with the President; (3) that Hill would submit his views on the whole subject to the President at a later date. Steve Early informed Hill that he didn't wish to accept and deliver to the President a resignation containing these three statements and asked Hill to revise the resignation so as to omit them. Hill has been working on a redraft, with the understanding that it must be submitted before Wednesday morning. Goss told me that the draft Hill is now working on consists of thirteen pages and that he has advised Frosty to cut it down to the simple statement that he herewith submits his resignation. I suggested to Goss that to that simple statement Frosty might add a paragraph stating that it had been a privilege to work with the President and that he was in full sympathy with the Administration's efforts to advance the cause of the farmer and that he believed the cooperative credit system represented by the Farm Credit Administration was a great contribution toward that end.

Early in the interview with Wallace Paul Appleby was called in. Wallace and Appleby blamed the Farm Credit crowd for stirring up a row about the proposed changes. Goss argued that this was not true, that the row developed spontaneously as soon as news of what was to happen leaked out. Goss presented his idea of a board of seven men, including the Secretary of Agriculture and the Secretary of the Treasury, Ex Officio, the others to replace the Governor and the Deputy Governors, leaving only the Commissioners of the present set-up. Wallace indicated, after some argument, that the idea seemed reasonable and possible but on being asked by Goss to suggest to the President that he look into it, Wallace said he couldn't do that. As Goss rose to go Wallace told him that he would like to have him stay another minute as there was something else he wanted to talk to him about. This was the cue for Appleby to leave, which he did. Wallace then told Goss that he would like to have him stay as Land Bank Commissioner under the reorganization. Goss says he told Wallace that he would do that only under two conditions: (1) that if he were called to testify before a Congressional Committee, he would have to be free to say exactly what he thought; (2) that if he saw any signs that the cooperative feature of Farm Credit was to be abandoned, he must be free to protest and if necessary to resign and fight on this issue. Wallace, Goss says, assured him that he would accept both these conditions. Goss told me that he was torn, as are many others in Farm Credit, between sentiment, which dictates that they should resign in a body, and the fear that this action would greatly damage the Farm Credit set-up. Goss has little hope that anything will be done about his idea. He wanted me to thank you for what you had done. I told him you hadn't yet given up, but gave him no further indication of your plans.

WG

189

DEC 18 1939

My dear Mr. Secretary:

The receipt is acknowledged of your letter of December 16, 1939, and the enclosed draft of a proposed trade agreement with Cuba supplemental to the agreement concluded on August 24, 1934, together with a draft of an interpretative protocol. You state that it is contemplated that the supplemental agreement may be signed within a few days and you ask to be informed whether the Treasury Department has any objections to any part of the proposed agreement.

The Treasury Dept has carefully examined the text of the proposed supplemental agreement and the proposed protocol and has not found therein the possibility of any administrative difficulty which would warrant objection by me to the signing thereof.

Very sincerely yours,

(Signed) H. Morgenthau, Jr.

Secretary of the Treasury.

The Honorable

The Secretary of State.

EMS:hl 12/18/39
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ORIGINAL FORWARDED TO ADDRESSEE
FROM OFFICE OF THE SECRETARY

COPY

187

DEC 18 1939

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(Signed) H. Morgenthau, Jr.

Secretary of the Treasury.

The Honorable

The Secretary of State.

[illegible] 12-18-39

ORIGINAL FORWARDED TO ADDRESSEE FROM OFFICE OF ~~THE SECRETARY~~ Mr. Thompson.

By Messenger
12/18/39 4:56 P.M.

File to Mr. Thompson

PRICE POLICY - CLIMAX MOLYBDENUM COMPANY

To understand the Company's policy the following facts should be borne in mind:

War Demand and Experimental Period

1. Prior to 1916 the total world production of Molybdenum probably did not exceed 200,000 lb. in any one year.

2. The alloy steel industry as a whole was not interested in producing alloy steels containing Molybdenum for the following reasons:

a) There was no assurance of a sufficient supply.
b) There was not sufficient knowledge based on commercial experience regarding the merits of Molybdenum as an alloying element.
c) There was uncertainty as to price.

3. The World War created a temporary demand for Molybdenum; and while reliable data are not obtainable the figure of $5. per lb. of Mo in Ferro Molybdenum is probably close to the average price at which Molybdenum was sold during the entire war period.

4. Climax realized that the demand created by the war would be temporary and might be of short duration. The policy of building a mill and starting operations in the Spring of 1918 was based on two considerations, namely, there was a national need and there was an opportunity to determine more definitely by operations on a commercial scale the average grade which could be mined and the mining methods which could be used to advantage as well as to work out the metallurgy involved and, incidental to all this, to do a considerable amount of development work in the mine. The Company realized that the real job of developing the market for permanent peace purposes would begin as soon as this temporary demand ceased and that any unsold concentrates produced would be valuable for this purpose. The greater part of the Molybdenite Concentrates produced during these operations was sold by Climax to the Electrical Reduction Company at Pittsburgh, Pa., who converted the material and sold it in the form of Ferro Molybdenum.

We therefore cannot speak of a price policy by Climax Molybdenum Company until after the mine and mill were shut down on March 1, 1919. However, even during the period beginning March 1919 and up to the resumption of operations in August 1924, the price policy of Climax was not of a permanent or significant nature. The reason for this was that no appreciable demand for Molybdenum existed and that the business of the Company during that period was to interest the industry in making heats for trial purposes with the view of creating a permanent market. For this purpose Climax used the stocks of unsold material on hand after the cessation of its mine and mill operation. The sales from such stock during the period March 1, 1919 to the end of 1924 ranged all the way from $3.75 to $2.00 per lb. of Molybdenum contained in Ferro Molybdenum.

Sales and Price Policy Beginning with January 1, 1925 to Date

In developing the uses of Molybdenum in the United States the metallurgical field men of the organization contact the industry, primarily the men in charge of production, with the idea of recommending Molybdenum steels and irons in such cases where on the basis of authentic knowledge with regard to physical properties and its economic merits it can be shown to be at least competitive with other alloy irons and alloy steels. No attempt is made to place Molybdenum by high pressure or other sales methods.

The Company's present equipment at Climax, Colorado, furnishes a capacity to produce from 32,000,000 to 35,000,000 lb. of Molybdenum contained in concentrates per year. By increasing the capacity of the mill, this production can be readily increased to an average of about 42,000,000 to 45,000,000 lb. of Molybdenum contained in concentrates per year. The maximum annual demand for Molybdenum in the world's markets to date was reached in the year 1937 when it amounted to 30,000,000 lb. of Molybdenum contained in products. Of this amount Climax furnished about 22,000,000 lb.

In determining its price policy the Company naturally had in mind the expansion of the market for Molybdenum. In pursuing this aim the organization proceeded on the basis that a sound market for Molybdenum could be established only on its actual merits, and "MOLY ON ITS MERITS ONLY" is the Company's motto.

With this idea in view the laboratory at Detroit, Michigan, operated by the wholly owned subsidiary known as Climax Molybdenum Company of Michigan, was established in 1931. This unit of the Company's operation has constantly expanded its activities in the field of research and testing materials as well as in service to the industry. It is regarded as an authority on the subject of alloy irons and alloy steels in general. The information which is obtained by the laboratory's activities and by the data which it assembles in cooperation with the industry here and outside of the United States is published from time to time in book form and distributed to the entire industry as well as to others who are interested, such as universities and students. There is no charge for these publications.

It will be noted from the attached data on prices beginning with 1920 and up to the end of 1938 that starting with the year 1920 the Company reduced its price progressively until 1932, from which time on there was practically no change in price except in the year 1938 when the price for Molybdenum contained in concentrates was raised from 70¢ to 75¢. The object in doing this was to establish a difference in price representing more closely the cost of conversion.

Attention is also called to the fact that in January 1925 Climax started to manufacture Calcium Molybdate. The introduction of Calcium Molybdate by Climax was an important event in the history of the Company. The cost of manufacturing Calcium Molybdate is much lower than the cost of manufacturing Ferro Molybdenum. Calcium Molybdate displaced the use of Ferro Molybdenum to a large extent and the industry was benefitted by the difference in the price, as is evident from the attached data on domestic prices for the period of 1920 to 1938 inclusive.

In reflecting on the Company's price policy the following factors should be borne in mind, aside from the progressive reduction in price during the years preceding 1932:

1. The expansion of the market from about 200,000 lb. per year to 33,000,000 lb. per year is evidence that the effect of the Company's prices for Molybdenum on Molybdenum steels and irons left these steels more than competitive with other alloy steels and irons.

2. During the inflation period and throughout the depression following it, the Company's policy remained uninfluenced by these economic disturbances; in fact, instead of increasing prices during the inflation period it reduced its prices; and it may be stated in passing that by doing so it increased the uses of Molybdenum.

3. The expansion of the market which resulted from the ability of the company to insure a sufficient supply of Molybdenum, and which also was materially influenced by its work in the field of research, has made possible a production outside of Climax representing a potential amount of 8,000,000 lb. of Molybdenum contained in concentrates per year.

4. Stability in price, removing from the industry the factor of speculative risk.

In conclusion, it must be borne in mind that the final competition is between various types of alloy steels and alloy irons containing different and varying amounts of alloying elements. The Climax Company has no control over the prices of steel;this is a problem which confronts the steel industry and by its nature is rather complicated. However, in view of the fact that steel prices, and especially alloy steel prices, have a definite bearing on this question, we attach a memorandum and table on this subject.

There appears to be no reason for a change in the price of Molybdenum at this time. Molybdenum steels and irons, as above shown, are competitive with other alloying elements used in iron and steel. A reduction in the price of Molybdenum would mean practically nothing to the ultimate consumer, as will be seen from the following:

1. An average of only 5 lb. of Molybdenum per ton is used in steel. A reduction of 10¢ per lb. of Molybdenum, while considerably reducing Climax' profits, would only result in a reduction in cost of 50¢ per ton of alloy steel.

2. Assuming that the entire reduction of 50¢ to the steel fabricator would be passed on to the ultimate consumer, the effect would be a saving of 5¢ per automobile (assuming that the average amount of steel containing Molybdenum per car is 200 lb.). It will be seen from this example that the price policy of the Company should be primarily concerned with its effect upon the prices of Molybdenum steels and irons. The ultimate consumer's interest is only minutely involved.

Max Schott

March 1, 1939

P.S.-In dictating the above I failed to state that prior to 1931 Climax concentrates were converted into Ferro under a conversion contract. The Ferro plant constructed by the Company at Langeloth, Penna made possible the reduction in price of Ferro Molybdenum beginning late 1931 or early 1932.

Domestic Prices for Molybdenum Products

Year	Price
1920 - 1922	$2.00 to $2.75 per lb. Mo in Ferro Molybdenum
1923 - 1924	$2.00 to $2.25 " " " " " "
1/1/25-4/1/25	$1.58 per lb. Mo in Ferro Molybdenum
	$1.33 " " " " Calcium Molybdate
4/1/25-11/1/25	$1.50 " " " " Ferro Molybdenum
	$1.25 " " " " Calcium Molybdate
11/1/25-12/31/25	$1.50 " " " " Ferro Molybdenum
	$1.20 " " " " Calcium Molybdate
1/1/26-12/31/27	$1.45 " " " " Ferro Molybdenum
	$1.20 " " " " Calcium Molybdate
1/1/28-10/1/30	$1.20 " " " " Ferro Molybdenum
	$0.95 " " " " Calcium Molybdate
	$0.95 " " " " Technical Molybdenum Trioxide
	$0.83-1/3 " " " Concentrates
10/1/30-12/31/31	$1.00 " " " " Ferro Molybdenum
	$0.85 " " " " Calcium Molybdate
	$0.85 " " " " Technical Molybdenum Trioxide
	$0.75 " " " " Concentrates
1/1/32-12/31/37	$0.95 " " " " Ferro Molybdenum
	$0.80 " " " " Calcium Molybdate
	$0.80 " " " " Technical Molybdenum Trioxide
	$0.70 " " " " Concentrates
1/1/38-	$0.95 " " " " Ferro Molybdenum
	$0.80 " " " " Calcium Molybdate
	$0.80 " " " " Technical Molybdenum Trioxide
	$0.75 " " " " Concentrates

STEEL PRICING

March 1, 1939

During the period of the N.R.A. the pricing of steel rested partly in the hands of the American Iron & Steel Institute and they set up uniform extras and deductions for the steel industry as a whole. These standards were published and made available to the field. When the code was ruled unconstitutional, the responsibility of pricing was returned to the steel companies.

As we understand it each steel company acts independently in setting up price schedules today. The method of arriving at these price schedules is, however, very complicated. There are seemingly standards which are used in arriving at the various extras and usually the quoted extras will be about the same for all the steel companies producing the steel.

All steel is sold on a certain base price. There is a different base price for the various forms of steel that are marketed such as billets, hot rolled bars, cold finished bars, strip, spring steel, wire and stainless steel. There is also a different base price for plain Carbon steel and Alloy steel. In some cases it is not easy to determine whether the steel shall be classified as a Carbon steel or an Alloy steel.

We understand that there are some who believe that certain steels should be classified as an Alloy steel at times, and plain Carbon steel at times. It seems that some steels melted to plain Carbon practice can be satisfactorily rolled into plate but if these steels are rolled into bars of light section excessive scrap occurs due to cracking. This same steel, however, when melted under alloy practice may react satisfactorily without excessive loss when rolled into light bars. This shows the importance of the selection of scrap and careful melting technique in the making of certain analyses.

The base price for Carbon Steel applies to what is termed normal analysis based on the Sulphur, Phosphorus, Manganese, Silicon and Carbon contents. To each base price certain extras are added for such items as special chemical requirements (higher or lower contents than normal or narrow chemical limits) cleanliness, size and shape, quantity, manufacturers' tolerances and heat treatment.

The present base price for hot rolled Carbon steel bars made of Open Hearth steel is listed below.

> Hot Rolled Bars: $2.25 per 100 lb.; basing points located at Pittsburgh, Chicago, Cleveland, Gary, Buffalo or Birmingham.

Alloy steels carry a higher base price than Carbon steel. This higher price is required by the greater control employed in the making of alloy steel. The heats are often smaller than for Carbon steel. Greater care is exercised in the selection of scrap and improved melting practice is employed resulting in a cleaner and more uniform product

The present base price for hot rolled Open Hearth bars made of Alloy Steel is as follows:

> Hot Rolled Bars: $2.80 per 100 lb.; basing points located at Pittsburgh, Buffalo, Chicago, Bethlehem, Massillon and Canton.

In the case of alloy steels there is an alloy extra which must be added to the alloy base price. The alloy extra for many of the standard S.A.E. and other common analyses is regularly published. This figure is made up of two factors, namely:

1) The average cost of the alloys present.
2) Manufacturing expenses.

This latter item varies with the type of steel and the alloys present and includes a large number of factors, some of which are listed below.

1) The various alloy steels require different types of hot tops on the ingots due to there solidification characteristics. This means that some steels require deeper cropping than others resulting in lower yield.

2) Some steels have greater scale losses than others.

3) Chipping costs vary with the type of steel.

4) Popularity of the analysis: If the steel is popular and is stocked in warehouses, it permits an outlet for those heats which do not fall truly within the analysis specification. As an example, a company might place an order for S.A.E. 4140 (Chrome-Molybdenum) steel. After the heat is made the steel company might discover that certain bars rolled from the heat (this is another difference between Carbon steel and Alloy steel. Carbon steel is usually sold on ladle analysis while Alloy steel is sold on bar analysis) were too high or too low in certain chemical elements and, therefore, could not be shipped to fill this particular order. If the steel is warehoused, the steel company can probably dispose of these off analysis bars. If it is not widely warehoused, the steel company may be required to carry these bars in stock for a considerable time before disposing of them. They may, however, have other orders where this analysis can be substituted. Other things being equal, the alloy extra for a steel that is not widely used will probably be somewhat greater than it would if the steel were regularly specified.

5) <u>Competition:</u> The degree to which competition enters into the alloy extra figure is extremely difficult to evaluate. It will undoubtedly vary with the tonnage involved as well as with the particular analysis.

The quoted alloy extra for hot rolled Open Hearth bars for several of the more common alloy steels is given in the attached table. The table also contains a column which gives the approximate cost of the alloys present per 100 lb. The difference between these two columns represents the amount added to cover manufacturing expenses. As a matter of interest data are also included which show the percent increase in the cost of the steel over and above the actual alloy cost. In making these calculations, no attention has been given to the alloy base price.

In this tabulation the following prices are used for the various Alloys:

Nickel	-	$ .35 per pound
Chromium	-	.12 " "
Molybdenum	-	.80 " "
Vanadium	-	2.70 " "

196

Steel	Average Alloy Content	Approx. Alloy Cost per 100 lb.	Quoted Alloy Extra per 100 lb.	Alloy Extra Minus Alloy Cost per 100 lb.	Percent Increase In Cost Above Alloy Cost
2000	Ni .50%	$ .18	$ .35	$ .17	94.5%
2100	Ni 1.50	.53	.75	.22	41.5
2300	Ni 3.50	1.22	1.55	.33	27
2500	Ni 5.00	1.75	2.25	.50	28.6
Chromium Steel					
3100	Ni 1.25 Cr .60	.51	.70	.19	37.3
3100	(Ni 1.25-1.75)Cr .60	.60	.80	.20	33.4
X3140	Ni 1.25 Cr .75	.53			
3200	Ni 1.75 Cr 1.07	.74	1.35	.61	82.5
3300	Ni 3.50 Cr 1.50	1.41	3.80	2.39	169
3400	Ni 3.00 Cr .77	1.14	3.20	2.06	181
ium Steel					
5100	(Cr .60 - .90)	.09	.35	.26	289
40-50	(Cr .80 -1.10)	.11	.45	.34	309
ium-Vanadium Steel					
6100	Cr .95 V .18	.60	1.20	.60	100
ium-Molybdenum Steel					
4100	Cr .95 Mo .20	.27	.55	.28	104
4100	(Mo.25-.40) Cr .95 Mo .32	.37	.75	.38	103
ium-Nickel-Molybdenum Steel					
4320	Cr .45 Ni 1.82 Mo .25	.90			
4340	Cr .65 Ni 1.75 Mo .35	.97	1.85	.88	90.7
X4340	Cr .75 Ni 1.75 Mo .25	.90			
l-Molybdenum Steel					
4600	Ni 1.82 Mo .25	.84	1.10	.26	31
4800	Ni 3.50 Mo .25	1.42	2.00	.58	41
-Molybdenum Steel					
	(Mo .10-.20)	.12	.35	.23	191
	(Mo .15-.25)	.16	.40	.24	150