

DIARY

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RE CLOSING AGREEMENTS

March 1, 1940.
9:30 a.m.

Present: Mr. Magill ✓
Mr. Gaston
Mr. Bell
Mr. Blough
Mr. Sullivan ✓
Mr. Tarleau
Mr. Foley
Mr. Viner ✓
Mr. Helvering ✓
Mr. Mooney
Mr. Gayton
Mrs Klotz

H. C. Jr: Let's go ahead. What I asked this meeting for is this: We have got some difficult problems here and following my plan when I am not entirely sure of anything myself, I thought we would have a little debate here and I have asked Mr. Sullivan, who is in charge of this work, to present the thing. What I am going to try to do is be an impartial judge and if we permit Sullivan to get up and say one thought at a time and then I think if Magill or Viner want to interrupt him and ask him questions, or anybody else does - is that agreeable to you?

Sullivan: Entirely, sir.

H. M. Jr: He has got this thing down to the history of the closing agreements, which is the first thing. Then if you will indicate, Mr. Sullivan, when you sort of come to a break.

Sullivan: Yes. Well, that is merely in as background to refresh our recollections as to what led up to the present situation. The question arises because of a request by American manufacturers for prospective closing agreements relating to munitions contracts with foreign belligerents and realizing that if we were to execute such a closing agreement we would then be obliged to execute similar agreements in the case of manufacturers for domestic consumption and that that would open up an entirely new field in which prospective closing agreements were to be applied. We felt that it would be desirable to survey the entire situation before taking any forward step at all.

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Closing agreements first appeared in the statutes in 1921. At that time the statute of limitations ran for five years and there was a great deal of complaint, both on the part of the Government and on the part of the taxpayers, that it took entirely too long to close up any past year, and in 1921, at which time the statute of limitations was reduced from five to four years, closing agreements were adopted into the statute and the Bureau was authorized to execute them after there had been a determination and an assessment of the tax and after that tax had been paid.

In 1922 there were 117 such closing agreements and that increased to 834 closing agreements in 1927, but the House Ways and Means Committee had felt that this was merely a drop in the bucket, that we weren't making sufficient progress along that line, and they modified the statute in that year and dispensed with the necessity of the tax having been determined and assessed and paid and urged the Bureau to extend its policy of executing closing agreements. The Bureau did that. The Bureau was the moving party requesting the closing agreements. In fact, in every case where there was a change in tax liability, either upward or downward after audit and examination, a closing agreement was more or less insisted upon, as it was also in every case where the tax exceed \$50,000. That caused these closing agreements to jump from 800-odd in 1927 to 38,000 in 1928 and 141,000 in 1929. About that time the Bureau suddenly realized that it was losing a substantial amount of money and the taxpayers who discovered that there had been errors in the computation of their tax liability and who were foreclosed from attempting to recover that overpayment were pretty much worked up, because the Government itself had been the moving party asking for those closing agreements and that resulted in a necessary change in policy on the part of the Bureau.

They decided that they would execute closing agreements thereafter only when they were requested by the taxpayer or when there was some special reason why it was to the Government's interest to have

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a closing agreement executed, and immediately they started to drop in number. There were 87,000 in 1930, 4700 in 1931, and it ducked down to 161 in 1937.

In 1938, the law was changed to provide for the possibility of execution of closing agreements relating to a current year or a future year. Now, I think that is the - all I wanted to say on the background of the situation: Somebody else may want to comment upon it.

Magill:

I think that is the story as I know it. There is one other element in there, I think, and that is that in about 1933 or '34, as you know, there was, I think, a third restriction in the use of closing agreements, so far as the Bureau was concerned, and I think that it was at that time that this doctrine was introduced that you mentioned, that the closing agreement ought to be entered into only if it was to the advantage of the Bureau for some reason or other or if it was some kind of a special case, the reason for that being, I think, that the Bureau discovered that there were a large number of cases, among them fraud cases, in which closing agreements were sought for no particular reason except that the taxpayer wanted that assurance that the Government wouldn't be going after him any further, and hence it was thought desirable to tighten down on it a bit.

H.M.Jr:

Well, I am not satisfied with the explanation why the Bureau changed its policy from giving closing agreements to not giving them. From 1929 they started to give less and it seems to me that somebody ought to explain why at that time they changed. To be a little facetious, that might be a new reason given for the depression, because as your number of closing agreements became less, business became worse. It is almost a chart we could follow. I am not satisfied with the explanation why - first, why did they give 187,000 and why did they suddenly stop it? There must have been something.

Sullivan:

There were 141,000 closing agreements. That is a lot of closing agreements and a proper closing

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agreement has to be handled by very, very competent men who have plenty of time to do it and, as I get the story, there were a number of errors and yet the taxpayer couldn't go behind the closing agreement and there was a howl on the Hill.

H.M.Jr: But the initiative for a closing agreement in those days --

Sullivan:was on the part of the Government.

H.M.Jr: On the part of the Government?

Sullivan: That is right.

H.M.Jr: They asked for it?

Sullivan: That is right.

H.M.Jr: Oh, they would send it to the taxpayer?

Sullivan: That is right.

H.M.Jr: And the Government would demand a closing agreement?

Sullivan: That is right.

Viner: What were their means of obtaining the consent of the taxpayer, what did they threaten him with if he didn't consent?

Sullivan: I am not sure it is necessary to threaten at all. The taxpayer is always anxious to conclude his tax negotiations on any reasonable grounds and if he knows that it settles it entirely, that is inducement enough.

Viner: What happened was the two came to the agreement on the basis of their then knowledge as to what was a reasonable tax and then the Internal Revenue said, "Will you enter into a closing agreement on this?"

Sullivan: That is right. Now, there might have been a mere mistake of arithmetic; there might have been a

nipher or a decimal point misplaced. It is perfectly apparent to everybody. Yet, nothing could be done about it when that closing agreement was signed.

Viner: That didn't close against later discovery of fraud, did it?

Sullivan: No, nor did it preclude a - no, I guess we don't need to go into that yet.

Magill: Well, fraud wasn't so simple then, Jake. You see, you've got a lot of these things over here for signature where the Bureau has determined there is fraud in a closing agreement and then it has to be set aside. Well, it has to be set aside, I guess, more formally than it is entered into in the first place and there has been recently, for instance, this last week, a case in the Supreme Court in which a taxpayer was contesting the setting aside of a closing agreement on the grounds of fraud.

H.M.Jr: Well, I mean - it seems to me that - I wasn't aware of the fact that we had entered into as many closing agreements as mentioned here, but is anybody connected with the Bureau who wants to take either side of that question? Mooney, were you with the Bureau then?

Mooney: Yes. I would merely like to add to what Mr. Sullivan has said, that the initiative was taken by the Bureau and furthermore it is evidenced by the fact that at one time I believe the final closing agreement was, in effect, an agreement concerning the assessment of the tax, which is their regular form 870 now, as well as a final closing agreement. It was a combination of both, the idea being that it is advisable to have this signed by the taxpayer in order to close once and for all his tax liability so that when the taxpayer would agree to the deficiency, he would sign at the same time with knowledge that he was signing not only consent to the tax but a final closing agreement. Then it developed that later on because of some undiscovered deductions which the taxpayer was entitled to, which had been overlooked by him in the Bureau, he filed

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his claim for refund. He didn't know it at that time. He filed his claim for refund. Then he would be met with the fact that he had finally entered into an agreement which finally determined his tax liability and this agreement can't be set aside except on account of fraud or malfeasance or misrepresentation of facts, so he had to admit in that case the taxpayer had overpaid his tax but the statute would cover that.

Magill: May I ask there, Mooney, because I think that is very important, it may be what the Secretary is driving at. Sullivan said - that was a surprise to me - that in 1928 or '29 or along in there, there was a drive by the taxpayer against the closing agreement and that they - the men on the Hill were upset about the use of closing agreements. Is that so?

Mooney: That is a fact, and it is evidenced by the fact that with these taxpayers, after they had filed their claims for refund - when they were met by the fact that they had signed the final closing agreement at that time and were precluded now from getting a refund, that was what gave rise to the drive on the part of the taxpayers to not enter into these final closing agreements.

Magill: Is there really anything to be said to the taxpayer in that situation? What I have in mind is this: I should think those cases typically arise where some lawyer gets hold of the taxpayer after this case has been closed and says, "If you had had me in your employ, I could have saved you \$10,000, because here is a deduction you should have taken," and so on.

Viner: What about a new court decision?

H.M.Jr: Do you mind, just one at a time, please.

Mooney: That is true, possibly, to a certain extent, Mr. Magill, but there are other instances such as new court decisions that have just been mentioned. Likewise, in connection with an investigation of the taxpayer's liability for a subsequent year. Here is an item of deduction which

we say is not here. It isn't a deduction in the year 1935, it is a deduction in the year 1933. The statute is open for the year 1933. We could give the taxpayer's money back for that year, because we are going to propose a deficiency just by shifting his deduction from one year to another, but then he is faced with the proposition that here in '33 I find a final closing agreement. His liability has been finally determined. He can't get his money back. Such things as that. Furthermore, it worked to the disadvantage of the Government also, because subsequent to the time we had closed the taxpayer's case in connection, say, with an investigation of a subsequent year, we find an item which would produce a deficiency, then we were precluded, because the liability had been finally determined. We couldn't assess any further deficiency for that year in the absence of fraud, malfeasance or misrepresentation of facts.

Sullivan:

Nor, on the other hand, pay any refund.

Mooney:

Nor pay any refund. It worked both ways.

Sullivan:

Dr. Viner's question is whether or not a closing agreement is subject to a subsequent court decision which reverses the law in this situation. The answer is that the closing agreement is above that. It is subject only to a change in the statute.

H.M.Jr:

You mean there is no appeal?

Sullivan:

No.

Magill:

It is all done.

Sullivan:

The closing agreement contains the provision that it is subject to any future change in the law. However, it is not subject to a change because the court reverses opinions that have been formerly handed down.

H.M.Jr:

There is one statement you made which I would like to go into further and that is that these closing agreements cost the Government money.

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Practically everything that Mr. Mooney said is that the taxpayer's objection was that if he subsequently discovered something, he couldn't get any refund. Has any study been made on the 100-odd thousand closing agreements - I mean, who would have been the loser and the gainer, because practically everything you said was about the taxpayer who couldn't get a refund when he had found he had made some mistake.

- Mooney: That is true, but the shoe was also on the other foot.
- H.M.Jr: Where did it pinch more?
- Mooney: That is pretty hard to say.
- Sullivan: You can't tell.
- H.M.Jr: Then it is about 'even Stephen,' is that a pretty fair statement?
- Mooney: Yes.
- Sullivan: In the long run, I would anticipate it would be 'even Stephen,' but it would be even because of inequity on the part of the taxpayers.
- H.M.Jr: Then the statement that the Government lost money on this thing wouldn't necessarily be correct?
- Sullivan: No, I am telling you what the attitude of the Bureau was at that time as reported to me.
- H.M.Jr: No, but the impression I got was that through these closing agreements, that the Government lost money on them.
- Magill: I think the chances are that it did, but I still think the 'even Stephen' is probably the way to look at it, that is, why I say that is this: that the taxpayers probably would not sign one of these things unless they thought that from their point of view it was a pretty good break, or, to put it

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another way, the taxpayer had open to him the possibility of contesting this liability further in courts or before the Board or some place or signing a closing agreement. If he didn't think the thing was reasonably favorable to him, he would contest it and since taxpayers are shrewd and hire good attorneys, and so forth --

H.M.Jr: Sometimes.

Magill: Sometimes. The chances are that the scales would weigh a little in their favor on the closing agreements, I imagine, just as a general guess, but I think that it - it seems to me the main issue here - I don't wish to pre-judge this - is this: A lot of people in the country, including the Congressmen, think that the objective is to settle tax cases on their merits. The thing must be decided right, whatever that is, and that if there is a subsequent decision or a change in our philosophy, or something or other, everything must be reopened, in order to give everybody the benefit of this new situation, whatever it is.

Well, the other possible point of view which isn't so widely held, except by more technical people, is that the really important thing is not so much whether the cases are settled right or not as that they are settled, to get the job done and get it out of the way, which is very important to the taxpayer and very important to the Bureau, and you may find five years later that you could have made a \$10,000 better deal, but the chances are that it was worth more than \$10,000 to you to get the thing out of the way and not be fussing about it.

H.M.Jr: May I go back - was '28 the peak year?

Sullivan: '29, I think.

H.M.Jr: Let's take '28 or '29. Now, I am a manufacturer in '28 and '29. I want to expand my plant. Now, do I understand - let's say it was in '28. Do I understand that the Bureau would send for me and would urge on me a closing agreement in the year '28?

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Gaston: They didn't have prospective closing agreements then.

Sullivan: Everything that has been said so far relates to closing agreements on past transactions.

H.M.Jr: Well, look, give me - for the year, let's say, '28 or '29. I mean, what happened? Somebody was in there. Were you in the Bureau then?

Mooney: Yes.

H.M.Jr: Now, I am a manufacturer and I want to expand my plant by \$100,000, put a \$100,000 addition on it. What happened?

Sullivan: You couldn't submit that proposal or agreement.

Gaston: That case wouldn't come up.

H.M.Jr: What happened?

Gaston: They were dealing with the past, not the future.

Sullivan: You just went ahead and did it.

H.M.Jr: I want to get this. I want a typical example of what happened.

Magill: Your example would be this: You are the "X" Manufacturing Company and you file your return for 1927 and along about '29 or '30 the Bureau got around to examining it and you or your lawyers, or you had discussions with the Internal Revenue Agents over a dozen items, depreciation, perhaps some retirement of some securities, this that and the other thing, the liquidation of a subsidiary, or whatever that is, you may have had a dozen different questions. These salaries you paid your officers, and so forth. Well, finally you get down to the place where the Bureau said, "We will allow this, but we are going to disallow that," and so on, "and net, you owe us \$10,000." Then they say, "Now, we, having arrived at this conclusion, we want you to sign on the dotted line agreeing to pay \$10,000 and closing the case on that basis," and you talk

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to your lawyer, and so forth, and you say, "Well, it is worth \$10,000 to me to get it out of the way, so I will do that," and you do it.

- H.M.Jr: Supposing I refuse to.
- Magill: If you refuse to, the Bureau gives you a deficiency letter for \$10,000 or maybe \$25,000.
- Viner: That was what I had in mind. Didn't they call it the practice of raising the deficiency assessment if you didn't sign?
- Magill: I don't know whether they did or not.
- Viner: The taxpayer probably did.
- Bell: All Sullivan was trying to do was give you the history of the case up to '38.
- Sullivan: You asked me to pause when I got to a certain point.
- H.M.Jr: But this thing we are talking about isn't what I am interested in.
- Sullivan: That is what I told you, I was giving you the history of the closing agreements and I said that up to this time closing agreements were restricted to past transactions.
- H.M.Jr: But that wasn't emphasized. I want to just get the history. Supposing I said, "All right, I won't settle for my '27 tax." You were talking to me, I take it, along about in '32. Then what?
- Magill: The Bureau sends you a deficiency letter and says, "All right, we are going to assess you twenty-five."
- H.M.Jr: Is that what they did?
- Magill: That is what they would be apt to do.

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Mooney: I would like to take exception to that.

Magill: All right, then you would only assess them fifteen, and then you would take it to the Board of Tax Appeals or to the court. Maybe you would have to pay 25 or maybe 10 and maybe nothing, according to how you came out.

H.M.Jr: Give Mooney a chance.

Mooney: The Revenue Agent would audit the accounts and say, "Now, I think you owe \$10,000." You would agree that you owed \$10,000. Then the agent would say, "Now here, will you sign this agreement? This agreement consents to the assessment of tax, because we can't assess it until you agree unless we send out a 90-day letter and give you the right to go before the Board. We are desirous of closing this liability once and for all, so you have the right at this time to also sign this final closing agreement." If you do that, that is the end of it and the case can't be reopened thereafter except on the grounds of fraud, malfeasance and misrepresentation of fact.

It was a request that the taxpayers sign the final closing agreement for the purpose of finally closing the tax liability. If the taxpayer said, "No, I am willing to consent to this assessment," he would then sign the 870, which would permit us to assess the tax, but he would say, "I won't sign this final closing agreement because it is possible by reason of some court decision, change in the law, or change in the audit in a subsequent year, I will be entitled to a refund and I don't want to preclude my rights in that respect," particularly if the taxpayer was represented by counsel. Counsel would advise him against the signing of the final closing agreement and it would not be entered into. That is why, we found out, and I believe it is a fact that can't be denied that in the majority of these cases, the final closing agreement was not hurting the taxpayer who was represented by counsel. It was hurting the little fellow who wasn't represented by counsel. He

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had agreed to the determination made by the Bureau which would be correct at that time, based upon the tax that was assessed then. He would sign the final closing agreements, thinking it was advisable to once and for all settle his case. Then later on, because of the discovery of an item he was entitled to, when he filed his claim for refund he was the one that was precluded from getting the refund.

H.M.Jr: In this day of our Lord 1940, how do you do it today? Today we make no request for a final closing agreement. The initiative is taken by the taxpayer and then the Government will then go into the final closing agreement where there is no disadvantage to the Government and if it is good business proposition, enter into it. The only difficulty is that the initiative is with the taxpayer, but otherwise, you go through the same procedure?

Mooney: Right.

H.M.Jr: Is that the only difference?

Mooney: Yes.

Viner: On the retrospective ones.

Mooney: That is right, so far as the determination of tax liability based upon the returns that have been filed.

H.M.Jr: I mean, the difference between the taxpayer and the Bureau today, the taxpayer has to take the initiative. After he has done it, the mechanics are just the same.

Mooney: Yes, sir.

H.M.Jr: Then you enter into a closing agreement?

Mooney: Yes.

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- Viner: That is a retrospective closing agreement, not a prospective.
- H.M.Jr: Yes, right.
- Magill: How many did you enter into last year? Is that the only difference? How many did you enter into last year?
- Mooney: Very few. I haven't the figures, but roughly, I would say this. It is evidenced by the personnel that was necessary to handle these final closing agreements. In 1930, '29 and '30, we had about 62 people down in the Bureau functioning on these closing agreements.
- H.M.Jr: Isn't this done now in the field offices?
- Mooney: Not to the extent that it was done in these prior years. Today we have about two people down there that are able to handle the work in connection with the final closing agreements.
- H.M.Jr: I understand what happened in the roaring '28s and '29s --
- Sullivan: To the tranquil '30s?
- H.M.Jr: Shall we go on from there?
- Sullivan: In 1937 Mr. Oliphant had given a great deal of time to the idea of declaratory rulings, thinking that they would be helpful to taxpayers in interpreting the tax laws, and according to his device, machinery was to be set up so that before a ruling was made on any question, a taxpayer would have a chance to be heard and not only one particular taxpayer but all taxpayers whose tax liability would be affected by that particular ruling and then there was provision for quasi-judicial review of that ruling after it had been made, after which time that would be pretty binding on all of the people who found themselves in that particular situation and any person who had a similar interest could be heard, either at that hearing or at the time

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of the judicial review of it. That failed in Congress. A previous effort had been made to provide for the declaratory rulings and matters relating to Customs and it was defeated in Congress, but out of it all came the change in the law which removed the restriction of closing agreements to past taxable years, and under the law at the present time it is possible - it is legal to execute a prospective closing agreement. I think Mr. Oliphant contemplated this type of situation, that if a taxpayer requested a ruling as to what year in which Associated Gas & Electric stock became worthless, there would be a hearing, a ruling, a judicial review, and then that fact as established would prevail in the return of any person who was reporting a loss on that stock.

Under the present situation, under the present law, a closing agreement can be entered into between Mr. Helvering and myself determining that my Associated Gas & Electric stock became worthless in 1940, and yet that wouldn't prevent Mr. Bell from claiming that it didn't become worthless until 1941 and it wouldn't prevent Mr. Magill from claiming that it became worthless in 1939 or 1940. In other words, the closing agreement would be conclusive on the rights of merely the particular taxpayer who executed it with the Government, and I think that that distinction is something that it is pretty well to bear in mind, because I think that in one of our discussions a remark that you (Secretary) made led me to believe that you felt one closing agreement could set up a standard in the formula that would apply to all people in similar situations. That is not so under the present law.

I think it might be helpful if we sort of reviewed for a minute the type of closing agreement that has been executed since that law was changed, opening the doors to prospective closing agreements.

There have been a total, up until February 9, of 923 closing agreements executed in about 45

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different cases. The great majority of those have been in reorganization and liquidation cases. There are included in that number two closing agreements under the Vinson-Trammell Act. There are a couple of questions on the value of real estate. One of them in the TVA matter, but - and on the value of stock and forgiveness of indebtedness, but I think the significant thing about these closing agreements that have been executed up to now is that with the exception of the Vinson-Trammell Act, although they relate to prospective action, they are based upon definitely established facts that are just as sure as though they had transpired in 1938 or '39. Is that right, Mr. Gayton? Mr. Gayton has had charge of that work in the Bureau and I think it would be helpful if he would tell us about that.

Gayton: In what respect?

Helvering: What to require.

Gayton: The typical case of a reorganization, they are required to submit their plans that they intend to adopt. If it is a statutory merger, they are required to submit the papers that they intend to file with the different Secretaries of State to make it a statutory merger. The purpose of the transaction must be set forth in elaborate detail so that the Bureau can make sure it is a business transaction and not a mere tax avoidance example. All the minutes to be adopted by the stockholders and directors must be submitted, all under oath.

Sullivan: So that when you pass on the closing agreement, you have definite facts there that are just as surely established as though this were a completed transaction that had transpired a year or two ago.

Gayton: Yes, indeed, the assets to be moved must be specified and their cost determined on the basis to the corporation agreed to. Every taxpayer that is interested in the deal must come in and agree to a final decision.

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- Viner: In other words, you are not granting prospective closing agreements. It would have to be prophesied or forecast.
- Gayton: No, they are facts.
- Viner: But you are authorized to do so.
- Gayton: They are facts which will occur in the future and they must do it in accordance with their method laid down in the closing agreement. Then the answer is before them and the case is closed.
- H.M.Jr: I am still waiting.
- Sullivan: All right. The first departure from that principle occurred this fall when there was a great deal of publicity about closing agreements under the Vinson-Trammell Act. There were only two closing agreements executed. Those two closing agreements took the major part of the time of 10 men for three months and were finally consummated. A situation developed there that I am reminded of by Dr. Viner's remark, but these agreements that had been executed were really not prospective ones and I think Mr. Gayton answered that they were agreements in which the facts were certain. The importance of certainty, I don't think, can be overestimated.

Throughout October and November, we had repeated pressure from munitions makers, both those contemplating contracts with our own Army and Navy and those who were expanding their facilities for foreign orders, and they attempted to tell us in a great variety of ways that the - it would be impossible to go ahead with this situation unless we would agree to write off the entire cost of new facilities in the first year. We were repeatedly told that their plants would be junked, that it would be of no value at all after this one order was executed, and yet this week the President of Glenn Martin Company, at a speech reported in the Wall Street Journal, advised the trade that of all facilities, the aviation industry would be the least to suffer.

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Now, that is a change in attitude that has been produced in something less than two months.

H.M.Jr: Least to suffer from what?

Sullivan: Would be the least to suffer from wartime recession, that the demands for commercial planes in this country and the demands of our own Army and Navy would be adequate to keep those additional facilities employed. ✓

Now, in November these people were telling us that these plants would have to be disbanded and they wanted prospective closing agreements executed by the Bureau which would enable them to - which would enable them to write off 100% of the cost of those additional facilities when this one contract was completed. The Bureau refused to do that for two reasons. In the first place, they didn't believe that that would be the fact and in the second place, it was altogether too uncertain and indefinite. Had those closing agreements been executed, the entire cost of expansion of those plants would have been written off during the year 1940. ✓

Viner: To the loss of the companies. It would have been a disadvantage to them and an advantage to you that they should have done so.

Sullivan: I beg your pardon?

Viner: It would have been an advantage to the Internal Revenue that they should have presented that way.

Sullivan: I submit to you that that is purely an academic question and must always remain so, because whether or not a change in policy is going to result in a gain to the Government or to the taxpayer is something only an ouija board could foretell.

Viner: I don't think that is what the companies really wanted. It would have been foolish for them.

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Sullivan: We recognize that they were foolish.

Viner: I don't think that is what they wanted at all.

Sullivan: Well, that is what they requested.

H.M.Jr: Let me - I think it would be helpful to me, because this is all for my benefit, if you described these two closing agreements that we are talking about under the Vinson-Trammell Act.

Sullivan: I would be very happy to do so.

H.M.Jr: Let's talk about it, because this is all for my benefit.

Sullivan: The first closing agreement related to a contract between the War Department and the Colt Patent Firearms Company. It was a small contract for, I believe, 85 or 95 automatic small cannons to be used on aircraft. It was pretty much an experimental order and the dies and jigs and machinery, all except the heavy machinery, which it was necessary that they should make in order to be able to produce these guns, were absolutely useless for anything else except that particular gun, so we were confronted with a very - a comparatively simple problem, because without any closing agreement, as soon as they abandoned the jigs and dies they had bought to make this particular gun, they would be entitled to a deduction equal to the cost of that machinery to them. The only question that presented any difficulty there was the treatment of the other more or less standard additional machinery that they had to acquire for this purpose. That was machinery which would have not only salvage value but would have continued useful life after this contract was executed. However, a closing agreement with them --

H.M.Jr: What did you do?

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- Sullivan: We did for them exactly what would happen if they had no closing agreement when we allowed them to write off against the contract and for their income tax purposes also the special jigs, dies and tools.
- H.M.Jr: Over how long a period?
- Sullivan: Over the period of the contract.
- H.M.Jr: How long?
- Sullivan: They contemplated, I think, that it would take about a year and a half to make those guns and you see, under the Vinson-Trammell Act, they could not report by years. The reports are filed by contracts.
- H.M.Jr: Well, if it was 18 months, do you remember how much they could write off in the calendar year of '40?
- Sullivan: You mean on their income tax?
- H.M.Jr: Yes.
- Sullivan: I think they were allowed to write off the depreciation ratably over those two years, 50 percent a year.
- Viner: How about the standard equipment?
- Sullivan: They were given the same rights of depreciation as other standard equipment in the factory.
- Viner: What did they gain?
- Sullivan: Nothing, and nobody ever gains anything by a closing agreement except assurance. It is not at all possible by a closing agreement to confer upon the taxpayer any relief which he would be entitled to without it.
- Gaston: Well, he would be relieved from doubt.
- Foley: He would get his assurance before he bid what his tax situation is going to be. So in making

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up his estimates, he has some relation of the treatment he is going to get from the Bureau and can make his approximations with a little more degree of certainty.

H.M.Jr: Wasn't the price for these guns settled before we got the closing agreements?

Sullivan: No, sir. You will recall that the reason why you agreed, with the Secretary of War and the Secretary of Navy, to execute closing agreements in regard to the Vinson-Trammell contracts was because the manufacturers were protesting that they couldn't bid intelligently upon contracts unless they knew what their tax situation was to be.

H.M.Jr: Well then, they would come down here; I take it the Colt sought us out, did they?

Sullivan: I beg your pardon?

H.M.Jr: Did Colt seek us out?

Sullivan: Oh, yes.

H.M.Jr: Colt would come down here and they would say, "Now look, Treasury, we have an opportunity, or we have --" Were they singled out by the War Department? They weren't bidding, were they.

Sullivan: They were in this particular case, but that wouldn't be the ordinary case. They would say, "We are considering bidding on an article."

H.M.Jr: But in this case, they were sought out?

Sullivan: Yes, I think they were.

H.M.Jr: And we have an opportunity to build 95 special machine guns. But their attitude was, "Before we want to bid or accept this contract, we have got to lay out so much money and we want to know what our taxes will be," is that the attitude?

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- Sullivan: That is right. They are mostly concerned not with their income tax situation but with the Vinson-Trammell situation. In other words, what can they be assured they can put into their report under the Vinson-Trammell Act as cost, because they are limited to a 12% profit in that instance.
- H.M.Jr: I see. Well, in this case was there any plant involved?
- Sullivan: No, sir.
- H.M.Jr: It was just the machinery?
- Sullivan: That is right.
- H.M.Jr: Well, before we go on to the next contractor, does anybody want to ask anything about the Colt, because the next one involves a plant. This involves machinery.
- Gaston: What I wanted to ask was this: In the case of all these prospective closing agreements which you are dealing with, what you are dealing with is not absolutely the amount of the tax which will be assessed, but the principles which will be applied in estimating the amount of the tax, isn't that correct, John?
- Sullivan: That is right.
- Viner: With respect particularly to the rate of depreciation you will allow, isn't it?
- Sullivan: That is right.
- Gaston: Various other things.
- Helvering: Obsolescence and depreciation.
- Viner: That whole complex.
- Sullivan: That is correct.
- H.M.Jr: One other question in the case of Colt. Supposing that at the end of 18 months period, this gun is

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proved to be a success and the Army says, "We want to order another hundred," and the machinery - well, it is still there. What happens?

Helvering: They pay the tax on the entire property.

Sullivan: That is right.

Helvering: After it is charged off.

Viner: They have no more depreciation to charge off, because they have already been allowed 100%.

Sullivan: Just a minute. In Colt, there was an option for a further number of guns after that first one had been completed. In other words, when the Army tried this gun out, if they decided it was good, then they could have so many more and if the option were exercised, then that depreciation would be spread over the length of the subsequent contract.

H.M.Jr: But I take it at a lower price.

Helvering: A lower rate, yes.

H.M.Jr: A lower rate for the additional guns?

Sullivan: Yes.

Viner: Or a higher tax on the excess profits?

Sullivan: No, I think it was - no, because we were to know before the first contract period was completed whether or not that option was to be exercised, so on their Vinson-Trammell report, before they made it, on the first contract, they would know whether it was the depreciation - whether the depreciation was to be extended over a - more than one contract.

Viner: I think the question is this: Didn't the Navy, or the Army, whichever it was, did they have two prices in the contract, one on the basis of no no renewal of the contract, and the second and lower one on the basis of a supplementary contract?

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Sullivan: I didn't see that particular contract, Doctor, but I am very sure that the guns on a subsequent contract would be lower in price. They always are in both the Army and Navy contracts.

Foley: Well, the cost of that machinery wouldn't be included.

H.M.Jr: Just for my own - this was the gun that went into the Bell, wasn't it?

Sullivan: I don't know which plane it went into, sir.

H.M.Jr: Well, does anybody want to - we can come back to this point. Let's go to the next one.

Sullivan: Then along came Consolidated and Consolidated, as with almost all others, it wasn't a case of the taxpayer coming to us, it was a case of the Navy bringing him over to us.

Selvering: Aircraft?

Sullivan: Consolidated Aircraft, yes. In that case, the Navy certified that an entirely new plant of about two million dollars would become worthless in 18 months, that as soon as this contract was completed those entire facilities would be not worthless, but would have depreciated 60% and the request was for a closing agreement that all new facilities should be written off at the rate of 60% against the contract. That, we refused to do.

Negotiations continued over a period of three months and there was finally executed a closing agreement which the proper - the provisions of which were exactly the law, which would apply if the contract had been completed today and there was no closing agreement. There was a great deal of pressure there, because of additional plant to accord to them a rate of depreciation upon their new factory, out of line with the rates that prevail in other lines of industry, and we refused to do that.

Magill: Did you enter into a closing agreement with them?

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Sullivan: Yes.

Magill: What rate did you give them?

Sullivan: Just the usual rate that prevailed throughout the industry.

Viner: That is, you granted them no special obsolescence?

Sullivan: None at all.

Magill: Was that as compared to your 60% that they asked for?

Sullivan: I don't know what type of construction it was. I think they got 5%, but I am not sure. I haven't those closing agreements. I thought Ryland was coming over and was going to bring them. I think it was five.

Gaston: Per year?

Sullivan: That is right.

Viner: May I ask one question there? This concern, if it weren't that it was contracting with the Government and the price they were getting from the Government depended upon the arrangements they were making with you, would never have entered into that agreement with you, because they might have gotten a better obsolescence from the contracts, isn't that so? They have no interest now; they don't care what you do as long as the Navy will make it up for them in the price they pay them. This has no bearing on the taxpayers. It isn't dealing with the Navy or somebody else whose finds out what price they have to pay and say, "All right, we will pay you a price which covers that tax."

Sullivan: No, this isn't the ordinary case. These two are Army and Navy contracts.

Viner: Let me repeat my questions, because I think it is important for me that I get that answer. That taxpayer would never have asked you or consented

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to that closing agreement if he weren't dealing with the Government on a special kind of contract of that sort.

Sullivan: Oh, yes.

Viner: Why should he? You say you recognized no obsolescence there?

Sullivan: That is right.

Viner: There is going to be, in all probability, substantial obsolescence.

Sullivan: I would doubt that very much.

Viner: Well, there is certainly a chance of it.

Sullivan: Oh yes, there is a chance of it.

Viner: If there is a chance of it and it does occur, he will have a chance in the courts to get an allowance for this.

Sullivan: Yes.

Viner: If he doesn't enter into a closing agreement. He gains nothing by that except by his relations with the Navy.

Sullivan: And you seem to think because it is relations with the Navy he had to execute the agreement with us.

Viner: No, but he has to figure costs and he doesn't know what the taxes are until he knows what the costs are and his business normally isn't done on the cost-plus basis of that sort. The taxes are a matter of importance to the person who deals with the Army or Navy. You can double the tax and he will double the price to the Navy and the Navy will pay it and he doesn't care what you do to him.

Magill: Jake, isn't this true, too. I would like to be sure on that point. The tax, of course, is one

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element in his cost, but the depreciation on his building is another and much more important element. Now, if he is only going to get 5%, for instance, as against the 60, which he wanted in the first place, the amount he gets from the Navy is going to be very much less, as I understand it, under the Vinson-Trammell Act than it would be under what he wanted.

- Winer: In other words, he can't tell the Navy that he thinks his depreciation is going to 30% that year, although the tax people are only allowing him five. He has got to make his own cost estimate conform to what the Internal Revenue thinks it is going to be.
- Sullivan: That is correct.
- Winer: Then I take it back. It is a matter of concern to him, too. In other words, he is still capable of losing a lot of money on that contract.
- Magill: Yes, sure.
- H.M.Jr: Well, this was only with the Navy, wasn't it?
- Sullivan: That is right.
- H.M.Jr: Well, the way the thing was closed and according to this, there was no advantage in their having it. I don't see what the advantage was in their having it.
- Sullivan: I can tell you why he signed the closing agreement, if you want to know. It was Major Fleet, who is a very talkative gentleman, who had assured his Board of Directors that he was going to get a closing agreement out of the Treasury Department if it was the last thing he did.
- H.M.Jr: And he got one?
- Sullivan: He got one. It was signed about the middle of December and it was the same one that was offered to him on the 10th of October, with two minor revisions in our favor.

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- Viner: I think he was making a serious mistake for his corporation in doing that, in the light of what has been presented, that he has been trapped and that he should never have done this or he had trapped his corporation.
- Sullivan: I don't think he has trapped his corporation.
- Viner: I think he has, on that basis.
- Sullivan: Well then, according to your theory, any taxpayer is always a fool to execute a prospective closing agreement.
- Viner: No, it depends on whether the agreement is reasonable or not.
- Helvering: Well, you are discussing it from just a tax angle.
- Viner: Yes, I know. There may be other things there.
- Magill: As the thing works out, isn't he gambling really on what his income from aircraft is going to be in future years? I don't mean where it comes from, because if he should discover three or four years from now - the fact is, this plant is completely obsolete and he can't use it, and so forth. He can write it off, assuming that he has the income to write it off.
- Gaston: Yes, that would depend on the income he has.
- Viner: It is really more complicated. He may assume that his company is going to have a fortunate year over the next 10 years and that he is really fooling you by being able to postpone again the high profit years, the writing off of depreciation, which is really actually according to this year, so that it may be that both of you were smart.
- Magill: I think Sullivan is right, that the chances are on the figures he has given, the chances are this fellow hasn't made a very good deal from his own point of view, but at the same time I

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don't know you could say he has made a bad deal.

Viner: Supposing he thinks that the corporate tax is going to go up in the next five years. That would be an argument in favor of entering into this closing agreement, because he is postponing the writing off of the depreciation.

Magill: I think Mr. Gayton can testify to this better than I, but I think it is true that taxpayers are trying to postpone their depreciation at the present time rather than take it quick. I don't know if that is true in wartime contracts, however.

Viner: What was the rate? Was it five or twenty or fifteen percent, or, in other words, how long a life on the plant?

Sullivan: I think it was five.

Magill: Five, of course, is very low.

Sullivan: Well, of necessity, he was putting up a tremendous building there.

Helvering: And a permanent building.

Sullivan: Yes.

Blough: In terms of the income tax, it seems to me what has been said is quite pertinent, but when you are saying he has made a good deal for himself, aren't you leaving out of consideration the profit tax under the Vinson-Trammell Act?

Helvering: That is right.

Blough: I don't see how he can be making a good deal for himself with respect to the Vinson-Trammell Act.

Magill: No, I don't think he is.

H.M.Jr: I may want to come back to this, because this thing isn't clear in my mind, what we are talking about, yet, but I would like to just get the

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full - everything on the table and why you can do one and why you can't do the other, see. There are at present - well, I know of three. I have seen them with my own eyes. I haven't seen the others. There are three plants which have been built with foreign money. There is one for Glenn Martin in Baltimore and one at East Hartford for Pratt Whitney and one at Paterson for Curtis Wright. I have seen them with my own eyes. They have all been built with foreign money and I believe that the question of - well, the Vinson-Trammell doesn't come into this. I imagine all of their cases are pending before the Bureau now. They went ahead and built the plant and didn't ask for a closing agreement.

Sullivan: Pratt & Whitney did.

H.M.Jr: Did they?

Sullivan: Yes.

H.M.Jr: Well, the building is built.

Sullivan: It is now, yes.

H.M.Jr: The building is built and none of the three have a closing agreement.

Sullivan: That is right.

H.M.Jr: None of the three have it. All right, here are three buildings having been built. None of them had closing agreements before the building was built and just in the room here, I mean, how are we going to treat these three companies?

Sullivan: I would disapprove of executing a closing agreement with them. Now, bear in mind the development of this thing.

H.M.Jr: Excuse me. The reason I am - the case of Pratt & Whitney and Colt, the manufacturer wouldn't go ahead and enter into a contract until he had a closing agreement.

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- Sullivan: In the case of Consolidated and Colt.
- H.M.Jr: That is right. Here are three finished buildings and they are going to have to come to some kind of an agreement after the building is completed.
- Sullivan: Why?
- H.M.Jr: Why?
- Sullivan: Yes.
- H.M.Jr: Well, they are going to have to pay a tax on it.
- Sullivan: Yes, but why are they any different from any other taxpayers in the country?
- H.M.Jr: I am not saying that they are, but I am saying that here are three buildings which have been built. Now, how is the Bureau going to treat these three buildings, that is what I am asking.
- Sullivan: Just as they treat the other thousands of buildings that have been put up in the last year.
- H.M.Jr: How is that?
- Sullivan: All right, the premises are inspected, the type of construction is examined and it is determined what is the life of the building.
- Helvering: Entire, fireproof, concrete, steel construction, three percent.
- Sullivan: And the rate is imposed in accordance with the type of construction and the probable length of life of the building.
- H.M.Jr: I was going to say, there are these three companies who have completed their plants. Then there is another kind of case of - supposing you describe Atlas to these gentlemen.
- Sullivan: Well, in the Atlas case, the British Purchasing Agency wanted them to build a new plant. The Atlas people didn't want to do that, although the British offered them the funds with which to erect the plant. They didn't want to do that if it were to be treated as income at the

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time the advance was made, for fear that when the war ended and they abandoned the plant, it might occur in a loss year and although they would have a substantial deduction, there would be no income against which it would be offset, and so they finally executed a contract which contained a provision that the British would lend, say, for easy figuring, a million dollars and Atlas would execute to the Commission a note for a million dollars, non-interest bearing. Atlas would then erect the plant and there was established in the contract a formula by which certain credits were to be created against the repayment of the note. There was to be a credit of one cent a pound upon delivery and of course those amounts would become income at that time.

The important provision was that at the end of the contract or at the end of ten years, whichever occurred the sooner, Atlas would decide whether they were to abandon their plant or convert it into a warehouse and have it revalued, and when that was done, there was to be created a credit equal to the difference between the new value of the converted facilities and the adjusted cost basis of the plant, which amount was to become a credit against the repayment of the loan and which, of course, would be treated as income at that time.

The Bureau gave them a ruling in which they held that a loan would not be income at the time it was made.

Hercules Powder came along. They were offered a similar proposal by the British and they wanted a closing agreement which would determine practically all of the debatable tax questions that would arise in any way connected with the company during the life of that contract and we wouldn't give it to them. We offered them a similar ruling to that which was given to the Atlas and they said no, the only other basis upon which they would execute this contract would be that the British would pay them the day they signed the contract 125% of the cost of the new plant and that is where the matter stands today.

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- H.M.Jr: And that is - how about duPont?
- Sullivan: The duPont situation is about the same. I mean, they are letting Hercules fight the battle for them. I am not so sure how much ammunition they are furnishing to Hercules, but --
- H.M.Jr: Well, what we are getting at is - we are getting down to the case. This is the thing which is more or less on the carpet right now, is the Hercules case.
- Magill: What would happen to this 125%?
- Sullivan: That would be income in 1940, assuming that the payment were made and the contract were executed.
- Magill: Are you sure of that?
- Sullivan: Are you suggesting that it might be a capital contribution?
- Magill: I am just wondering.
- Sullivan: Well, I would wonder the other way on that one, Ros. They have made every effort to sell us the bill of goods on capital contribution and we haven't agreed. In the first place, it isn't intellectually honest and in the second place, it doesn't jibe with the facts and the negotiations that have occurred.
- Viner: If they scrapped the plant at the end of 12 months, that would be gross income with an offset at the same amount or value of the cost of the plant in the course of 12 months. Otherwise, you would let them deduct 5% depreciation.
- Sullivan: No, it would be much greater, because these munitions plants are really just shacks, corrugated sheet. The allowable rate of depreciation is very much greater. It might easily run as high as 20%.
- Magill: I was just thinking out loud and the way that works out is that if Hercules scrapped the thing

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at the end of the year, they would get 100% deduction in substance, but they would have to scrap it in order to get the 100% deduction.

Sullivan: They can abandon - you can get the same deduction, Ros, with a bona fide abandonment. You don't have to tear down a building.

Magill: I don't know, under that Tidal insurance case that came up from Philadelphia, would you be sure of it?

Sullivan: That was a question of obsolescence and where that went off the hoops was the fact that that didn't result from external factors. That was an amalgamation and a planned proposition.

Magill: Do you think this is external?

Sullivan: Yes, I do. It is a matter over which the particular company involved has no control. That is what I mean when I use that particular adjective.

Viner: This company might conceivably keep this plant going and scrap another plant that it had. It might decide that this had been slightly better located and if it was going to scrap, it would scrap the other side.

Sullivan: It gets a comparable advantage from the scrapping of the other.

Viner: No, it may have already deducted 70% depreciation on the other.

Sullivan: I know, but you wouldn't want to get an extra 75% depreciation out of that other building, would you?

Viner: No, the other building - let's say it was a --

Sullivan: Then the answer to that, Doctor, is that if that plan is economically useful and that is the reason why they are not scrapping it, they are not entitled to any deduction.

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- Viner: I would like to see some authority for that, either economic or accounting or legal.
- Sullivan: I haven't any brief on it. It seems to me that is sheer common sense, that if a building has economic use, then on what ground do you justify giving them a deduction for abandoning?
- Viner: A hundred percent. You are defining obsolescence of abandonment and I say the only place I know - and I have hunted - where I can find the identification of abandonment and obsolescence is in the Bureau of Internal Revenue literature and nothing else.
- Sullivan: What is your definition of obsolescence?
- Viner: Loss of value because of special external things like disappearing of the market value of the product or like a new product which makes this way of doing it excessively costly. ✓
- Sullivan: Let's go ahead on your basis. Here is the plant they are not abandoning because they are going to continue to use it.
- Viner: That is right.
- Sullivan: Instead of abandoning that, they abandon another plant. They are allowed to take whatever value is left in the old plant. Do you think on abandoning the old plant they should be allowed to take the same deduction they would get if they abandoned the new one?
- Viner: I would say the abandonment is required. The only function of abandonment is to tell you there has been a hundred percent obsolescence, but even that has no special value. It might be ninety-nine percent.
- Sullivan: Well, you say they leave that plant up. Are they manufacturing in it?
- Viner: Well, sure - that is irrelevant.

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Sullivan: Then isn't the plant economically useful?

Viner: Certainly.

Sullivan: Then why should they be given a deduction on it? What difference does it make whether they are manufacturing powder for the British or manufacturing dynamite for American contractors?

Viner: None at all.

Sullivan: Then why give a deduction on it?

Viner: If there has been loss of value through external circumstances of this sort, that is what obsolescence means.

Sullivan: What is the loss of value if the plant is still running? What is the loss to them?

Viner: What you are describing is physical operations. They are not value operations. The product they are producing may have fallen in price because someone else may have devised methods of producing it more cheaply.

Sullivan: I don't think you can go into that matter of refinement.

Viner: That refinement is the basic notion of obsolescence and has been there for all time.

Sullivan: But your concept of obsolescence is one that has never been recognized by taxing authorities.

Viner: The word is older than you or I.

Sullivan: But your concept of it isn't older than you or I.

Viner: I beg your pardon. It was the Internal Revenue that did the investigating.

Sullivan: I am afraid we are getting off on something else.

Viner: Oh, I don't think so. I think that is the basic issue. The rest is just machinery.

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H.M.Jr: Let me start off again. Let's look at this thing from three sides. In just a minute I am going to ask Magill if he minds stating this case from three standpoints. Here is the proposal. In the first place, there is a buyer who needs a lot of powder and he can't buy it because all the present production in this country is engaged. You can't buy this powder. From my standpoint, it doesn't make any difference. It might just as well be shoes. I want to buy a million pairs of shoes and I can't buy them because the entire product or production of the country is engaged. All right, now, I come in and I am the buyer and I want to buy a million units of something. I can't get it. I go to Mr. Manufacturer and I say, "I want to buy," and the whole question comes up in his mind, in the first place, where he is going to get the capital from, second, if he builds his plant his attitude is, "Before I build it, I want to know how much taxes I have to pay on this operation," and then thirdly, the Government comes in, you see, and "What is our share? Under the law, should we tax this man for his cooperation?"

What I am going to ask you to do, if you will, is to state it from three viewpoints, the Government, the manufacturer and the buyer, you see. I mean, put it three different ways for me, and then let's - from my standpoint, it doesn't make any difference what it is, but - and there will be other cases and that is why I am interested. There will be constantly more and more cases of a buyer who wants to buy a product of which the output is entirely sold out. It is going to require additional plants. Do you see what I want? Grope your way into it, but I want this thing stated that there are three people, three principles, the Government, the buyer and the manufacturer. Let's take a look at it through the eyes of each of the three.

Magill: As I get your proposition, the buyer --

H.M.Jr: I mean, what I want you to do for me - these other people, I guess they are all above this, but for

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me, I am your one pupil and - Mrs. Klotz and I - everybody else understands this and this is a proposal you are laying before your class, you see, for us to think about, so first you lay down the problem, right?

Magill: Now, you are talking my language.

H.M.Jr: You are laying down this problem to this class. Here is the problem, pupils, and then you would ask, I take it, in your class, questions which would bring out and develop the problem, wouldn't you?

Magill: Correct.

H.M.Jr: What I am trying to say in the best way I can is this, but I want you to restate it here as a class. We are trying to learn something about taxation and I have given you the problem. I want you to put it back and then ask the questions from these experts which would develop the three viewpoints. Am I clear?

Magill: Yes.

H.M.Jr: I take it that is the way you would do in a class you are trying to teach.

Magill: Yes.

As I understand the situation, and I may not have the facts exactly straight on that, because I have had nothing whatever to do with these foreign contracts --

H.M.Jr: It isn't necessarily foreign contracts.

Magill: No, I understand. Here someone comes along and he wants a million pairs of shoes. Let's take shoes instead of powder, and the manufacturer said, "Well, I can't make them with my present equipment and I don't like your contract very much anyway, because after I get done making the million pairs of shoes, I will have expanded to that capacity and what am I going to do with it after I get done? I get into a lot of trouble,"

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and whoever is buying is so anxious to get the shoes that he says, "Well, we can take care of that, I presume, in either of two ways. We will either build you the factory, give you a million dollars for that purpose, we will loan you the money, if you want, and you can build the factory, or we will pay you five dollars a pair for the shoes, instead of four, so that you yourself can build the factory and you will have that extra profit that you can use for that purpose." There are various ways in which the buyer might offer to do this.

Now, if I may say there, I am not quite so sure as Mr. Sullivan is about this capital contribution as speaking of the case, that is, whether if the buyer advances a million dollars to the seller for the purpose of building a plant, that it is necessarily going to be held that that million dollars is income, because it so happens that there are a lot of cases, including one by the Supreme Court, the Cuban Railroad case back there --

Sullivan: And the Chamber of Commerce cases.

Magill: But the Cuban Railroad case is the only Supreme Court case I know of. Cuba advanced a lot of money to an American railway company to build this railroad and the question was whether the advance was income to the railroad company and the Supreme Court said no. Now, this is not very satisfactory and I don't think any one has been very clear as to what the case stood for and no one can bet any money on what Mr. Justice Douglas would hold today, with respect to that proposition which occurred five years ago, or something like that, but as Mr. Sullivan says, in addition to the Cuban Railroad case, there are a lot of tax appeals cases in which you, up at your farm, wanted to get electric lights and there were no electric light poles near your house and the company said, "Well, we will give you electric light but you have got to pay for the poles," and that was a thousand dollars. So you give the company a thousand dollars and they put up the string of poles and give you the electric lights. There is a thousand dollars income to the company.

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There have been a lot of cases that have said no, it is not. So I would think --

Viner: Whom do the poles belong to when they are put up?

Magill: They are the company's poles and there are a lot of cases of switch tracks and any amount of cases - Chamber of Commerce, that situation, or the Chamber of Commerce of Fishkill wants to get in a canning factory and they say, "We will give you a thousand dollars or we will give you a piece of land," or something or other, "if you will build here." The company says, "O. K., here is that income." There are lots of cases where it is not.

Elough: No depreciation has ever been allowed on those assets.

Magill: You have no question of depreciation, because you don't get that far. The substance of the case is that this is not a capital advance. It is not income, and that is that, as far as the company is concerned.

H.M.Jr: Just one second and we will come back. Could you skip that particular thing and then come back to it? I don't want to get bogged down on rules of the Supreme Court for the moment, but I can see this is important. I want it done just like a classroom. I want to follow it.

Magill: I would say to the class and I would say to you - and I think this might satisfy Sullivan - that in my own opinion this is a very moot question. I don't know how it would be decided. I don't know whether this case is like the Cuba railroad case or whether it isn't. I don't know whether the Cuba railroad case would be decided today the same way, so it is - I would debate that with the class if I were going through this performance.

Well now, secondly, from the point of the company.

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- H.M.Jr: Excuse me. Sullivan, we will come back and go over the thing just as many times - I am trying to get the problem stated.
- Sullivan: I have got it.
- Magill: The company's general point of view, I suppose, from what has been said here, is the same as we - in general, as when Mr. Ford comes around to a tire company and says, "I want to buy 20% of your output for my Ford cars." The tire companies, I understand, don't like those contracts, because they had experience when Mr. Couzens was running Mr. Ford's plant that he would enter into a contract like this and get the production jacked up to take care of Mr. Ford's cars. Then Couzens would come around and say, "Unless you take a dollar off the price of your tire, I am going to leave you flat. I will take my contract and give it to Goodrich." So the companies don't like to obligate so much of their output to a single purchaser, and of course in our shoe case or powder case, it seemed worse, because they know perfectly well in some period of time they are not going to need these facilities at all, or an equivalent amount of facilities. I think you can see readily enough why the company doesn't want to get into it.

The second aspect of the company's point of view is this: They know that they are going to make a lot of money from these contracts, currently. That is why they go into them. They also know, if past experience is any guide, that in the next few years, whenever that is, after the war is over, they are going to be in the dumps. They are not going to have any income. The Bureau of Internal Revenue is going to tell them that the depreciation goes on over this period whether they have income or whether they don't, and from the company's point of view, therefore, they are very anxious to get the cost of that plant charged, as far as possible, against the years in which they have the big income and not possibly charged against future years in which they may have little or no income.

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From the company's point of view, you get the further factor that Dr. Viner has adverted to, namely, that the new plant presumably will be a more modern and up to date affair than the existing plant. Consequently, if the company is cut down to its normal output, what the company will probably do, what it would like to do, would be to use the new plant rather than the old plant, because it is apt to be more up to date and more efficient, and so forth, so if they are going to abandon anything, it will be the old plant.

Well then, as you see, Mr. Sullivan and his friends on the Bureau will say, "Well you haven't abandoned this at all, you are using this plant all the time. You are not entitled to any particular deduction on account of the obsolescence, because what you abandoned were these old facilities and not the new ones."

Well, now again, I would leave that, if I might, with the class, at exactly the same point I would leave the first point as to the buyer. That is, the problem, so far as the taxpayer is concerned, the American company is covered with a great deal of doubt and confusion and he knows that he is going to be in trouble. He knows he is going to be fighting with the Bureau for years on the proposition. I was saying earlier this morning to somebody around here that I participated once in one of these wartime obsolescence cases under the 1918 Act and the case was finally decided by the Court of Claims in 1937. In other words, it took them 20 years to get it established as to what the situation was. Well, it so happens that they won, finally, but it was not a complete victory, if there ever was one, because meantime they had spent as much on the lawyers as they had recovered, so they would be the first to feel that this was just exactly the kind of contract that they don't want to get into, too expensive.

I think, from the point of view of the Government, there is one of the - Mr. Sullivan has

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mentioned one set of factors and I want to put another one before you with not any undue emphasis, because all I am trying to do - I don't know whether I am doing it or not - is to put this before you on a perfectly even keel.

H.H.Jr: You are doing what I asked you to do.

Wagill: The one side of it is this: If Pratt & Whitney erect this factory and they want a closing agreement in advance, it is true that it takes a lot of work to determine on what basis a closing agreement can be entered into with them and what the depreciation rates should be and try to foresee the situation. You need an extremely competent man to do it and fortunately the closing agreement machinery at the present time is in the hands of very competent men in the Bureau. They are doing a very good job. But you need first rate men and it is a hard job and it takes time and so it is easy to see why the Commissioner may say, "Well here, if we give this kind of treatment to these two or three fellows, we are going to get asked for many others and we are going to need a lot of men and it will be a lot of work and we are pre-judging all these things and that isn't very satisfactory," and let's take the cases such as these that you have described where the facts are pretty clear and can be set forth on a piece of paper and you don't have to go to East Hartford to see what the situation is.

Now, the other side of that, to complete the story is this, that as you can see, sooner or later the Bureau is going to have to decide that question anyway. Sooner or later they have got to decide what the depreciation is on this plant and what is to be done about obsolescence and abandonment and all these. Now, it is perfectly true it is much easier to decide anything after the event than before the event. It is much easier to decide depreciation on a factory after the thing is built and before it is sitting there and it is much easier to decide any tax after it has been concluded

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than it is in advance. Nevertheless, I do feel that - I think what you come down to as far as the Government is concerned is this, basically, how much are you interested in two things, first, how much are you interested in having these contracts made; how much are you interested in this flow of business to the United States. Do you regard this as, on the whole, a desirable thing from the general point of view of the economy as a whole, because I look at it as a much bigger thing than what the convenience of the Bureau of the Internal Revenue is. You have got to look at it from the point of view of the nation as a desirable thing. Should it expand for this purpose and sell powder and whatnot? I don't know and I think you yourself pretty well have to decide that.

H.M.Jr: I can answer that question.

Magill: I imagine you could.

H.M.Jr: Do you want me to answer it now?

Magill: You don't need to, but you can if you want to.

H.M.Jr: You are putting it on the basis I want.

Sullivan: With it being based on an assumption.

Magill: If there are any assumptions I haven't stated, we should bring them out.

Sullivan: Excuse me, Ros, I will come back to it.

H.M.Jr: Magill has done a remarkable job of this for me. He is absolutely cold as to what has been going on here and he has done just what I have asked him to do. In order to help - I have two interests in these things. From the standpoint of national defense, the best thing that has happened to this country is when the French came in here and gave us the money with which to build up these engine factories. Congress wouldn't do it. We got this money instead of having - the way we had last January, '39, some 5,000 men

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working in all of the engine factories in the United States, we have now got a little over double that. We just didn't have the people and with foreign money we are building up our airplane engine plants so that we have the plant capacity to take care of our own needs in case we should get into a critical situation where we have to defend ourselves and I am impressed particularly in this industry by what a very, very slow job it is to train people in order to do airplane engines, so it has been a tremendous windfall from the standpoint of national defense.

From the standpoint of the companies - that - they have everything to gain. They have nothing to lose, because the money is advanced entirely by foreigners. Now, that also holds true to powder. I have been going into this powder business and our powder capacity is very, very limited and they want to come along and buy this powder and we don't need the capacity at present, but it is all there. If the plant is there, we have it in case this world situation should get worse, so I can't see from the standpoint purely of national defense that this isn't altogether to the good.

But now there is an entirely different question why I am so interested in this thing and that is the thing - has nothing to do with national defense and has nothing to do with the Allies wanting to - and this is what I said the other day, in the frame of mind that I have a business instead of being what I am. I am 10 years older. I am 60 or 65. I have no children. I have got a nice business and making a good profit. I don't - my plant is running at capacity and I am booked up for a couple of years. Let's say I am in the machine tool business or in the shoe business or - and somebody comes along and he wants to give me an order and with all the uncertainties, all the fights and all the difficulties that I have to go through, I say, "Well, I am sorry, it isn't worth it," and I think the discouragement for American manufacturers on domestic business, the more I

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listen to this thing, if I was in that business, I wouldn't build any new plants, because I wouldn't be bothered with all the trouble.

Now, the more I listen to it, the more I am convinced that if I was in business the less I could see of these fellows, the happier I would be, and I want to be corrected in my belief and the two things are the same. I mean, the man - whether it is an order to build powder or engines or build - some paper man just went into the business of building Victor records. Where it gives them a new operation and I have got to build a new plant and this whole question of how the Bureau is going to treat this thing - I mean, to me, I want this thing settled in my own mind, because it is a tremendous question.

Magill: That is right.

H.M.Jr: And they are parallel, because the question I have, it doesn't make any difference whether I have got a nice little business up in Albany and it is going along like a house afire and I have arrived at the point - I don't want any more business, or whether I am at the duPont and also had a nice business and the Allies are begging me to build an additional plant and give them additional powder. I mean, the frame of mind American business men are in, when they have an opportunity to go ahead, I think there is something wrong with us. But, everything that I say here is within the room. Maybe I am over-emphasizing a little bit, but I have to make my point and I would like to be proven right or wrong.

Now, in order not to have Sullivan's blood pressure go through the ceiling - you people have what is in my mind. Do you want to say something?

Sullivan: Yes, I do. When I say that I thought Mr. Magill's remarks were based on an assumption, the assumption was that the execution of prospective

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closing agreements would accelerate business and I think your own experience in the last five months has disproved that. You have seen the biggest growth of commercial aviation this country or any country has ever known and it has been accomplished without closing agreements.

- H.M.Jr: I have said this publicly. Publicly, I have defended the Bureau first, last and always. You know that. Helvering, I mean, I have gone around and made that statement two or three times.
- Sullivan: First of all, I would like to discuss for just a minute the Cuban railway case and the Chamber of Commerce --
- Magill: On your assumption, I am just a little curious, because I didn't intend, and I don't think I did in any way say - I didn't intend to assume one way or the other. I don't think I mentioned it.
- Sullivan: You didn't, Ros, but the assumption was implied.
- Magill: I will say for the record, if you want, that in my judgment, and I have said this to that young man over there (Helvering) and probably his friends on both sides, that my judgment is that the two great jobs that the 1938 Revenue Act did were, one, to provide for future closing agreements and two, to provide for litigation of the statute of limitations. Those were the two good things we got. As a matter of fact, I will match them against most anything that has been done in any Revenue Act in 20 years.
- H.M.Jr: Who was in charge at that time?
- Magill: I don't know, a fellow called Tarleau or Kent or somebody.
- H.M.Jr: I see. Where was Magill?
- Magill: Out in the haystack fast asleep.

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So your assumption is correct, although I don't think it has anything to do --

- H.M.Jr: The point gets down - we have the machinery to make future commitments and in this particular case we are not using it.
- Sullivan: And the question at issue is whether or not closing agreements are going to be used to handle all phases of every taxpayer's future tax liability situation, because you can't give it to Hercules Manufacturing Powder or Great Britain and then refuse to give a closing agreement to a fellow who is considering setting up a trust fund.
- H.M.Jr: What about that?
- Magill: Your first statement is exaggerated, as you know, that no one would ask you to deal with all phases of everybody's tax liabilities.
- Sullivan: That is what we have got to anticipate.
- Magill: You can anticipate, if you want to, but I would say they are still not going to do it. What I mean by that is this: You take any cooperation, Hercules or anybody else, for a settlement of any given year's tax liability. They will have 25 or 50 questions they will iron out with the revenue agent. They are not going to ask you in advance for a ruling on each and every one of those 50 questions. What are they going to ask you for? They are going to ask you for rulings on situations in which there really is grave doubt as to what you are going to do with them, in the case, for instance, of your reorganizations, or in the case of these new plants and things of that sort. Now, secondly, I am glad you gave me an opportunity to say this. Mr. Sullivan and I - and I daresay Mr. Helvering - are concerned about where you are going, that is, you might be willing to grant a closing agreement in the case of these three or four people

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that are now in front of you, but what about the several hundred that may come down Pennsylvania Avenue wanting the same thing? Well, one possibility, it seems to me, in this type of situation, is to apply the kind of test I was trying to suggest a minute ago, that is, the test of public interest in these things. Is this case one in which there really is some public concern as to whether or not this fellow does what is involved or is it a case of your trust situation - you certainly wouldn't deal with it on that basis. If I asked you what you were going to do to me if I set up a trust for my wife and children along such and such lines, you may or may not want to give me a closing agreement, but at least I couldn't qualify on any test of public interest in this situation.

W.B.Jr:

Let me ask you this. Is there any precedent for this, to say that future closing agreements would only be entered into when it is a question of new plant expansion?

Magill:

One thing I would be fairly sure of, and that is I wouldn't like to see them limited to that case, because you will certainly have other cases. I take it that most of the cases Mr. Gaston has handled have not been cases in which there was plant expansion contemplated. Isn't that true? You have had reorganization cases and all other sorts of things, so I don't think you ought to limit it to that category. You ought to give him more freedom than that.

Conversely, I am not at all sure that you ought to give it to a taxpayer in all cases in which there was a new plant expansion contemplated.

Gaston:

There is a question of novelty and uncertainty involved, isn't there, Ross? The novelty of the transaction, the proposed transaction, and the degree of uncertainty with respect to tax liability in that kind of a transaction.

Magill:

Yes. You see, of course, the plain fact is on

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these closing agreements, this is one aspect. This is the one that concerns you, now. The fact is that there are a number of very large realms, problems in connection with the income tax, in which everybody is in great uncertainty as to what the result is going to be and it is very hard to make conjectures when you haven't any idea how you are going to be taxed. I think you can fairly say - I should suppose, as you have said, that the building of a plant for aircraft by Pratt & Whitney is a matter of great public interest, a matter of great concern. It may mean the employment of several thousand additional men, and so forth. Now, at the same time I think we are all conscious of what Mr. Sullivan says, that it may be true that that plant is good for '40-'41 and isn't worth a darn after that. It may be worth - that plant may be perfectly good for the expected life - physical life of any such plant. It may be good for 15 or 20 years and it may be today you will find it very hard to tell which is the fact.

Nevertheless, I had better state one assumption that I do have in my mind and that is the one I mentioned a minute ago. I always thought, ever since I cut my teeth in this business, that the really important thing is to get tax cases settled, get the agreement. People then can go on and do their work and that is what you want them to do, and of course if you settle them today and the Supreme Court grinds out a decision ten years from now involving today, you may find that you have settled on the wrong basis. We are finding that all the time today. The Supreme Court is exploring new fields every time it hands down opinions. But I still think that the welfare of the country and also the welfare of the Bureau - I don't mean to speak for the taxpayers - lies in getting this grist ground instead of piling it up in the back of the shop until you have all the light you can possibly obtain with respect to it. If you follow that latter rule, you just don't get cases settled.

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Sullivan: May I interrupt at that point? You are not getting anything done in advance with a closing agreement; the same work will have to be done subsequently when the returns are filed.

Magill: Well, much less work.

Sullivan: Oh, I don't think so, because you have got particularly to examine that particular return to see if the facts are consistent with the facts set forth in the closing agreement.

Magill: The one I participated in was this TVA situation and as Mr. Gayton said, the facts on that as to what the TVA proposed to do and what the Commonwealth & Southern proposed to do were laid before the Bureau and the Bureau came to a conclusion as to, in that case, the legal method which should be employed in the taxation of the transfer of those properties, and so forth.

Well now, it is perfectly true that when the returns are filed for 1939, it will be necessary for the Bureau to examine them as it always does, to see whether or not in this case, whether or not the Commonwealth & Southern did carry out the terms of the arrangement which they said to the Bureau they were going to carry out.

Now, how much of an examination is that? You can bet your boots in a case involving that much money, that the attorneys for the company and the company itself have done every damned thing they know how to do to make the transaction conform with what they told the Bureau. They are just as aware as you are of the importance of exact conformance with the facts which they gave to you and I should say in 99 out of every 100 cases, you would find that the taxpayer had carried out exactly what he told you.

All right, if he has, then you have already given him a statement as to how the thing is

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to be handled and that is the end of it and you do not need in 1941 or '42, or whenever you examine the case, to go into it very carefully, when it has now been decided in advance to what the legal incidents of this transaction are, so I should think it is obvious that the examination of the Bureau after one of these closing agreements is done with will in most cases at least be very, very much less than the one if you never had any such consideration.

- Gaston: I would like to make a comment that even if you had to do all the work over again, just the same as if there had been no prospective closing agreement, if in certain cases a plant was built and men were put to work who would not have been put to work if there hadn't been a prospective closing agreement, then it wouldn't matter if you did have to do the work all over.
- Sullivan: I will agree with that, that if these benefits are here, the additional work should be no real deterrent, but I think there are some other things we have to decide before we get that far. Now, the basis of all - excuse me.
- H.M.Jr: Go ahead, I will wait.
- Sullivan: The basis of this whole thing is that it is going to quiet down American business men and give them a confidence that will enable them to proceed and I say that that is a false premise because on every one they come into us with, where they want closing agreements, they want a closing agreement which will entitle them to things the Bureau will not grant, which are not reasonable, and the type of closing agreement or ruling that we offer to them in conformity to the present law doesn't satisfy them at all and will not, and the only way the business men who are calling for closing agreements will be satisfied will be to give them some immunity, some benefit. they do not think they are entitled to under a reasonable application of the present law.

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Viner: Oh, I don't think that is --

Magill: John --

Sullivan: Wait a minute, excuse me, just a minute now. We have seen this thing happen in just two cases. In Vinson-Trammell, the Colt case, they were perfectly reasonable throughout the operation. They were splendid. In Consolidated, they were the other way around. They wanted something extra all the time and we wouldn't give it to them. We have many other applications pending over there for closing agreements under Vinson-Trammell where the demands are entirely unreasonable. We have been subjected to substantial criticism of the taxpayers and the service departments because we would not execute those closing agreements which were entirely unreasonable. Now, I would like to call to your attention one thing, that if the practice is invoked of executing closing agreements with one specific group who will come in and get the first closing agreements and subsequent developments in their particular trade are such that those previous closing agreements are revealed to be unreasonable, we certainly wouldn't execute similar closing agreements with future manufacturers who applied for them and hence we would be conferring a preference on those we now execute them with, that would almost confer a monopoly on them. We are trying to forecast too much into the future with these closing agreements.

H.N. Jr: On that basis, you had better never enter any agreement, because if you ever make a mistake, you are always giving that fellow a preference.

Magill: Look, John, you were talking - you were talking to a different point. No one would urge you, certainly I wouldn't, to enter into a closing agreement with anybody, Consolidated or anybody else, on a basis which you regard is contrary to the law and your regulations and practices, and so forth. In other words, as I understand it, the issue which you were

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presenting to us here was what your policy was going to be with respect to entering into closing agreements in cases in which the taxpayer presented something to you which was within the law, and he wants a determination of what you will do in that case within the law and within the regulations.

H.M.Jr:

May I just say something? In the first place, at no time since I have been here have I asked anybody connected with the Bureau to do anything which I didn't think was first, fair from the standpoint of the Government. I don't have to even defend my record on that.

In order to make a little progress, I would like to offer this as a suggestion. We have a particular problem which has been handled in a particular way. It may be the right way. That is the Atlas Powder. We have refused to give them a closing agreement. What I would like to do is just discuss Atlas, then see if amongst you people here we can decide from the Government's standpoint what would be fair, not whether we should give them a closing agreement, if we were going to give them a closing agreement, what kind of a closing agreement would be fair. Then, having agreed in the room here what kind of a closing agreement would be fair, then take that and apply it around and what kind of trouble would it get the Bureau in, because, having done it, we immediately would make it public and I just want to say one other thing. The reason I have insisted on publicity on all of these things is simply - and I have said this again and again - that in case we did make a mistake, it would be immediately brought to our attention by the public and therefore, I have insisted that every agreement we have gone into would be made public, so if there was anybody - because we had one Senator who was very much interested in the Colt contract and I said we would make it public and immediately it was made public, all interest dropped. There has

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been no criticism. I wouldn't be ashamed of making a closing agreement and subsequently finding we were wrong, because I am sure the Bureau does - does many things every day where the Bureau is wrong. They always make mistakes. We are all human. So the fact that we might make a closing agreement in which we might be wrong, to me isn't an argument why we should not do it. In order to get this thing down, I would like to confine the discussion for a little bit not to should we or shouldn't we, but let's say we are going to give these people a closing agreement, see, and from a Government standpoint, what would be a fair closing agreement, then, having agreed on that, let's say, "Well, what possible damage can this do to the Internal Revenue?" Who else would come in, and all the other things, you see. Let's just take that angle for a minute. I am going to ask you (Sullivan) what, in your opinion, should we or shouldn't we - what, in your opinion, as the man responsible, would you feel would be the fair kind of agreement for the Government to enter into with Atlas. Which is the one that is pertinent?

Sullivan: Hercules.

H.M.Jr: All right, then, Hercules.

Sullivan: If there were to be prospective closing agreements executed on unknown and predicted facts, a closing agreement could be executed there in that case, a good --

H.M.Jr: Unknown and predicted?

Sullivan: Unknown but predicted forecasts.

H.M.Jr: Can you have that? How can you have unknown and predicted.

Sullivan: That is right. A prediction isn't anything you know and that is what we would have to proceed on.

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- H.M.Jr: Anyway, you go ahead.
- Sullivan: Hercules comes to us and says, "We don't know what the situation is going to be during the next four years in which we are fulfilling the orders under the contract." They think it is going to be so and so and so and so. "We would like a closing agreement with the Government here. We have decided to go ahead with the loan formula. We would like --"
- H.M.Jr: You will have to give him more information.
- Sullivan: It is the same loan formula as the lease I told you about. The British lend the money to them in the first instance and a note comes back. At the end of the contract, the note is to be repaid, less such credits as are credited during the life of the contract.
- Foley: John, isn't the answer to the Secretary's first question simpler than we are making it here and can't we confine our discussion to the second question, namely, the effect of giving a closing agreement to Hercules in this instance? You haven't given him a Commissioner's ruling and wouldn't it be a very simple matter to translate into a closing agreement what you have in the ruling?
- Sullivan: Yes, it would, but that isn't what Hercules wants.
- Foley: I understood that was what the British wanted.
- Sullivan: That isn't what Hercules wants. That is right, and that is what I thought Hercules was getting to when they left my office at a quarter past 12:00 and they were going to submit one question to Mr. Burrus and Mr. Rylander and they got over there at 2:30 and they had a list of questions.
- H.M.Jr: Now, from a Government standpoint, what would be fair, see, what would be fair, that is what I am asking.

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Foley: You will agree, John, that you can put everything in a closing agreement that you have in the room here.

Sullivan: I do agree.

Foley: Well, let's start from there.

H.M.Jr: That is good.

Helvering: Could I just say a word?

H.M.Jr: Sure. You have been very good.

Helvering: In the Atlas Powder case, we had a ruling in which we said to them that this loan advanced to them by the British Government wouldn't be treated as income. Now, that could just as well have been a closing agreement as it was a ruling.

Sullivan: That is right.

Helvering: I thought it had the same standing, myself, when I signed it. I considered it as having the same standing as though it had been a closing agreement.

Gaston: But it doesn't bind the future Commissioner.

Helvering: No.

Foley: The only problem, as I understand it, was whether or not the vehicle we used was a closing agreement or a Commissioner's ruling. The British sat here and said that Hercules would feel a lot better about this if it were binding upon the future Commissioners and not just upon Guy Helvering and I thought that the only problem that we discussed here was whether or not the precedent that we would establish by giving effect to this ruling through a closing agreement would have on future situations of this character, were we letting ourselves in for such an administrative problem that it would bog down the operation of the Bureau. I thought that was the situation.

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Sullivan: It would be perfectly simple if that were so, because obviously the Bureau could execute a closing agreement in any case where it could give a ruling.

Foley: That was why I kept quiet when we were discussing it here in the room.

H.M.Jr: Which time?

Foley: The other time when John and Herbert and Dan --

H.M.Jr: I think you are correct now.

Sullivan: No, I think not, sir.

Gaston: I think we have been getting aside into the question of what should be gone into in a closing agreement, which is not the main question at issue.

Sullivan: I think I can explain to you how important it is, although it isn't the main question. Hercules was in the office. They left to get the same information, the same ruling on that one specific point and they got over there at 2:30 and they had nine complicated points about which I doubt if the Bureau would care to give even a ruling and that is why I say, you start off on the simple premise that you can give a closing agreement wherever you can give a ruling but that isn't going to solve the problem.

H.M.Jr: But following the lead Foley has just given me, wasn't what the British asked was if we could have a closing agreement, we then feel we could get these people to sign a contract with us?

Sullivan: That was what the British said, yes, sir.

Magill: I guess I am the only one in the room that is -- as to really what this is all about in the case of Hercules or Atlas, or whoever it is. Now, I am up to this point. As I understand it, the British want a loan. Hercules, is it, is that the one?

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Sullivan: That is right.

Magill: They want a loan of a million dollars to build a plant, is that right?

Sullivan: That is right.

Magill: Then every time Hercules turns out a bag of powder, there is to be a cent credit on the loan.

Sullivan: A cent a pound.

Magill: And that, everybody agrees, is income. The loan isn't income and the repayment is.

Sullivan: You mean the credits against the repayment?

Magill: Yes. Now, as I understood you, you had one other string to your bow, that by and by you will get to the point where \$450,000 of this loan has been paid by these means of these cent a pound credits. There is still a \$550,000 company. What are you going to do there?

Sullivan: If the building is abandoned, there is a credit against the loan of \$550 million.

Magill: You mean the British credit Hercules if they abandon?

Sullivan: That is right.

Magill: What do they contemplate in abandonment?

H.M.Jr: Demolishment.

Sullivan: Not necessarily. If the machinery is taken out, the insurance is cancelled, there is no maintenance, no supervision, no upkeep, that is abandonment. You don't necessarily have to tear down the building.

Magill: Is it expected that would be defined in the British-Hercules contract?

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- Sullivan: Well, it would relate to the present regulations on abandonment, but it could be defined.
- Magill: At that point, there would \$550,000 more which you would hold as income.
- Sullivan: That is right.
- Magill: Well now --
- H.M.Jr: In the last year of the contract.
- Sullivan: That is right and that would be offset by the deduction whenever that may occur.
- Viner: But the one million dollars spent in building the plant would have been counted as expense deducted from gross income, wouldn't it?
- Magill: Not at all. Now, could you enter into a closing agreement these points I have mentioned?
- Sullivan: Yes, we could.
- Magill: Then what else does Hercules want?
- Sullivan: I am sorry I haven't their list of nine questions, but in one of them they wanted a closing agreement as to the reasonableness of corporate salaries for the next ten years. Would you consider it wise to incorporate that in view of the shifting opinions on that subject?
- Magill: No, and I don't see that you need to. I mean, so far, I take it, we are primarily concerned here with the British-Hercules arrangement.
- Sullivan: That is right, but instead --
- H.M.Jr: Excuse me, John, and again saying if we do come to an agreement, all right, here is a pattern. What damage or what harm or pressure can that set on American industry, good or bad?

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- Magill: Now, of course, the reasonableness of corporate salaries, any of us can see what their point is there. They are saying, "Well, if we are going to be doing millions of dollars worth of business for the British, the President of our company ought to be paid more money and we want something on that," but then aren't you getting pretty well away from this British contract and shouldn't you --
- Sullivan: No, because the other eight things they demanded in their ruling were no further away than that example I have given you.
- Magill: All right --
- Foley: You didn't give them a ruling on that, John.
- Sullivan: No, they didn't ask for a ruling.
- Magill: John, you have got to draw two lines here, it seems to me, and the boys will buck but still I think you have got to draw the line. First of all, we would all agree just as a matter of rock bottom foundation that you can't give any of these people rulings of closing agreements or anything else that are not justifiable under the law and under the regulations as they stand.
- H.M.J.: Amen!
- Magill: That is obvious and if they come in and say, "Well, we want this," and you say, "Under the regulations, you can't have it," that is the end of it, it seems to me.
- Foley: That is right, Ros, and the reason all this heat is in this discussion is because some of these manufacturers got the idea that we were going to give them more than they had ever had before by way of closing agreements and we had to go through all the grief of that thing. Now, I think we have got that all behind us and the thing that John and the people in the Bureau are afraid of is if we open it up, we are going to have to go through

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the whole thing again. That, I am not convinced about, and I think that is the only thing for us to discuss here today.

Sullivan: That is the real issue here. I think we are all in accord with Mr. Magill when he says that a closing agreement could be issued - executed, which would embody the feature in the ruling in the Atlas case, which was the same problem. Now --

Magill: I don't see why you can't come out publicly and say, "Now, everybody in the Treasury is --" It is one of the ways, we just happen to be administering it now and everybody comes in the front door and there isn't any back door by way of closing agreements, or anything else and we will enter into them when it appears to be in the public interest to do so, but we do it on the basis of law and if you don't like the law, go up on the Hill and ask the boys to change it.

Mooney: May I ask a question, as a pupil?

Magill: You have got to go to the registrar and pay your money first.

Mooney: I would like to hear from Mr. Magill how far removed the question of whether we should enter into a final closing agreement is to the reasonableness of the compensation of the officers of the company for the succeeding ten years, how far removed that is from the question of whether or not we should enter into a closing agreement now as to the amount of depreciation or obsolescence upon the building, based upon the conjecture of what business or economic conditions are going to be in the future, when the war abroad is going to terminate and how the war abroad is going to affect business conditions in this country.

Magill: Aside from the "have you stopped beating your wife" part of it, I will answer it as best I can. Let me, if I may, do what I would do

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with my class. I always like to start with the thing which seems reasonably plain and then move on from there to the dubious case. The situation that seems to be reasonably plain is the Hercules case as it is so far presented, and it is certainly a lot plainer than the reasonable salary or depreciation situation. Why? Because this, I take it, presents to Mr. Helvering and Mr. Foley and the rest of them a pure question of law. Here is a proposed contract. Your facts are agreed. There isn't any doubt about the facts. And that is the case that Mr. Sullivan and Mr. Gayton advised us is the kind of one on which future closing agreements can most happily be entered into here. Your facts are settled and all you have to do is interpret the law and apply it to the facts. So it seems to me that is a good case for a closing agreement.

Now, we all know that the reasonableness of salaries, the reasonableness of depreciation is at best a mixed question of fact and law, that there are various possibly disputed factual elements that have to do with it. It is not easy to get the facts straight and you can never be sure that you have all the facts in your possession. Hence, for that reason, you can certainly fairly go slow and indeed, I might even, if I knew more about it than I do, I might join Mr. Sullivan in a suggestion that if the question is primarily a factual one that you won't close it with a closing agreement because it is just too hard to find out all of these things in advance. Now, I don't know. Your difficulty is in trying to decide now the certain reasonableness of salaries.

Now, on the depreciation, I think there is this small additional element to bear in mind and that is that I have always felt the Bureau made too much fuss about depreciation, as to whether the rates should be this or that, because assuming that it is not a fly-by-night taxpayer, but it is a company which is going

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to be in business year after year and the Bureau is going to be in business year after year and tax rates are not going down, at least not very markedly, well, it doesn't make a terrible lot of difference, so far as the Bureau is concerned. It does to the taxpayer. It doesn't make so much difference whether you let him have six percent or five percent this year or indeed, whether you let him have fifty or ten.

Now, it undoubtedly amounts to a lot of dollars in the particular case, but bear in mind that in any event all you are going to give him is the total cost of what he has laid out on the plant and the corporate is a flat rate, so that from many points of view I don't think, as I say, I don't think depreciation is worth quite the amount of ammunition you expend.

- Viner: You are assuming full carryover provisions.
- Magill: Yes, so that if the Hercules people say, "We would like to depreciate that thing a hundred percent over this British contract," and your engineers look into it and find the chances are they will use it to make dynamite even if the war should end at Christmas, well, it would be the type of case where I would think you might arrive at a closing agreement on the basis of putting the difference on some kind of a formula that you might adopt, that you might say, "Well, we won't give you a hundred percent. We will give you fifty."
- Mooney: It doesn't make so much interest, so much in dollars and cents. What difference does it make, then, as far as that thing is concerned, when you allow them five percent on their building or if you should allow them 60 percent?
- Magill: All I am saying - I realize that I am sticking my neck out by making any such statement as I am, because it is one of these relative statements which you can't - it isn't black

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and white. You notice what I said was, I have always had the impression for a long time that the Bureau spends too much time on depreciation rates. Obviously it is important and in many cases it is very important and in some it may be vital, but if you are dealing with a reputable taxpayer - and you will be in some of these cases - I can see where it might be perfectly legitimate to sit down around the table with him and say, "Now, we think that it is a fact that you are going to be good for ten years. You are going to be manufacturing some time, so we think on the basis of that assumption you are not entitled to full depreciation. We think a ten percent rate, or a six percent rate, or some other rate would be about right. He says, "Well, I want 100%". Well, as I say, I can conceive of cases where it would still be good policy on the part of the Bureau to sit down around the table and arrive at a result. Now, I can also see, as Mr. Sullivan can and does, that there will be some cases where he just can't sit down around the table, because he isn't that kind of a guy. I would get him out as quickly as you can, but there will be cases --

- Viner: How far can you go under the law upon the restrictions under the present law?
- Magill: You can go a long way because of wear and tear.
- Foley: Jake wants to interject the other problem. I think we have to talk about the mechanics first.
- Magill: When you talk about that, I will leave the room and let you and Jake argue it out, because I don't know about the mechanics.
- Belvering: I agree with you, Magill, that it does not matter what the rate of depreciation is if it is anywhere near at all, because we only charge out the 100%, but I think you were here when Congress cleared this up and were going to compel the Bureau of Internal Revenue after they found depreciations to reduce it arbitrarily to 20 to

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25%, and that resulted in the promulgation of Treasury Decision 44-22.

Magill: Right.

Helvering: So we are not as free as your remark would lead us to believe.

H.M.Jr: For my purposes, this does not help me any. What I am going to come back and back again to, the thing I said, supposing we enter - in the first place, there is no reason why we can't enter into a closing agreement with Hercules or anyone else.

Magill: The door is wide open.

H.M.Jr: Coming back - and I asked Mr. Sullivan, "Is there, in your opinion, certain factors which in your opinion were legal and proper for us to agree in advance on a contract that Hercules wants to enter into with the Allies?"

Sullivan: Yes, sir; and they will not execute such a closing agreement.

H.M.Jr: Up to now the background has been, not as to whether the facts are reasonable and legal, but I think facts - listen close, Ed - facts, discussion has been that we will not enter into any closing agreement.

Sullivan: That is a matter of policy.

H.M.Jr: What I am saying here is, aren't there certain bases, basic agreements, which would be legal and proper for Hercules or anybody else for us to enter into a closing agreement? Is the closing agreement something we should not use under any circumstances?

Sullivan: I think the answer to your question is --

H.M.Jr: Because your position is, as I have understood it, no closing agreements under any circumstances.

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Sullivan: May I state what I think the issue is?

H.M.Jr: Am I right?

Sullivan: You are right. I think the issue is whether or not we should go ahead and execute prospective closing agreements in the restricted legitimate field recognizing that there is going to be a tremendous demand for prospective closing agreements in the illegitimate field, which will undoubtedly cause a great deal more dissatisfaction and unrest among American business men than prevails today.

H.M.Jr: That's one way of putting it. I have learned here this morning, certainly so far, that there is no reason, legal, ethically or morally or any other reason why we should not enter into a closing agreement with anybody.

Sullivan: Except in so far as it opens up the doors.

H.M.Jr: But there is no reason - there was a law and instrument for that purpose. Is that right?

Magill: That's right.

Sullivan: That's right.

H.M.Jr: What I would like to do, again boiling this down, because I can deal better with the concrete than theoretically, what I would like you to do for me is take Magill and Foley and these people and see if you people could agree from the Government standpoint what would be reasonable for us to agree to in a closing agreement with Hercules.

Sullivan: I can give you that right now.

H.M.Jr: No, they will want to argue on that.

Sullivan: Excuse me. I think this will be helpful. We would agree - at least I would - to give them a closing agreement that incorporated the ruling in the Atlas case, which said merely that the loan was not income at the time it was made.

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- H.P.Jr: That is something new you are saying.
- Sullivan: No. And the reason, I have said before, is because of the things it opens up and here it is, on the 17th of February these men from Hercules went with Mr. Rieling in the Bureau and they stated that a closing agreement that incorporated merely the ruling, that one provision that this loan would not be treated as income, would not be enough and they would not execute a contract and one of the things they demanded was a closing agreement that would uphold the various terms and conditions with respect to this loan which would make it impossible for the British ever to collect anything back on the loan regardless of how the contract worked out. In other words, they were asking us for a closing agreement that would uphold a loan as not being income when the terms of the contract were such that it could not be a loan in anything except in name.
- H.P.Jr: But, John, if I am sitting across the table from you and you consistently tell me you won't give me a closing agreement, I am arguing on one basis, an entirely different basis from you and say yes, I will give you a closing agreement if you will be reasonable.
- Sullivan: Oh, no! Excuse me. Mr. Rieling asked them if a closing agreement embodying the ruling in the Atlas case would satisfy them and I am giving you part of the answer they gave to them in response to that question.
- H.P.Jr: But you have never intimated to them, Hercules, that you would give them a closing agreement.
- Sullivan: No, sir, I never did, but Mr. Rieling asked them if such a closing agreement would be satisfactory.
- Wiley: John, I think the confusion here is that the British said that they wanted the Treasury to give Hercules a closing agreement embodying what the ruling contained and I thought that

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was what we were debating that day in the Secretary's office.

Sullivan: I think that was the only question that they raised, but I knew about this other matter.

Foley: Well, if we limit ourselves to that, would you be willing to incorporate in the closing agreement what is in the ruling?

H.M.Jr: This is entirely important and I didn't get it. Ed, state your question again, please.

Foley: I am asking John, if you would be willing to embody in a closing agreement what is contained in the ruling that the Commissioner has already executed.

Sullivan: I say that that can be done, Ed. I say that once you get into these closing agreements you are then opening up the entire field and you run the risk of incurring great disadvantages in proportion to the small advantages you get.

Foley: I recognize that, John. I think that is a policy question that we can debate, but what I want to know is, would you be willing to recommend that we use the closing agreement instead of the ruling? That is all the British asked the Secretary.

Sullivan: Yes, that is all that they asked him. No, I would not recommend it because I believe that the trouble - the difficulties you are going to get into, are going to far outweigh the advantages.

Foley: Then I think we can eliminate what would be a fair closing agreement, because, as I understand it, the British only want you to substitute a closing agreement for the ruling and what is in the ruling can be put into a closing agreement and it would be fair.

Sullivan: Yes, it would be.

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- Foley: Then I think we are talking about only one thing, and that is whether we are letting ourselves in for an impossible administrative problem if we open up the door and we give Hercules a closing agreement.
- Belvering: We could give Atlas a closing agreement on the same ruling.
- Magill: I don't see where you are. Nobody has asked me, but I don't see where you are on that point, because we all know that the Commissioner and Mr. Foley maintain an interpreting division for the purpose of giving out rulings in situations of this general character where the question is one of law and that is all this question is. Now, if we have brains enough to make rulings on these questions, it seems to me we have brains enough to make closing agreements and I don't know why you shouldn't do it. I don't know why it opens the door, John, because the next fellow that comes along, you have got - well, I can think of two answers to him right away. He starts talking about reasonable salaries, for instance. You say first of all the reason we entered into this closing agreement is that there is a great public interest involved. That was reason number one why we thought it was important to get the thing settled and you certainly wouldn't require much effort to prove it was a matter of rare public importance.
- Secondly, it involved a question of law. It doesn't involve any questions of fact. That is the kind of thing we handle every day. We have 350 lawyers who do that sort of thing. If you want us to rule on some fact question, that is something entirely different and we will have to take that under advisement and we probably won't do it at all.
- Belvering: Of course, if the Hercules want a closing agreement on the advanced loan they are getting, there is no reason why the closing agreement can't be made instead of the ruling and that may satisfy them more from the standpoint that they may think I will only be over there signing a ruling two months or two years or whatever it

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is, and some fellow coming in my place afterwards will overrule it, while they wouldn't in the closing agreement overrule it.

H.M.Jr: Guy, the whole point that I want to keep saying over and over again is that all of this discussion is only in my own office here, it is no where else. I couldn't help but feel that when the English were asking that we give them a closing agreement instead of a ruling, the facts being the same, that opposition was unreasonable.

Helvering: Of course, as far as I was personally concerned in signing the ruling in the Atlas case, it had just the same effect as a closing agreement, but you could never convey that to the taxpayer and he has a right to say that some other Commissioner or other Secretary might overrule it.

H.M.Jr: But rather than - and Sullivan feels so strongly about this thing - and I have given him 100% support, and that is why I want this meeting and if we don't get anywhere, I want two or three more, but I am more convinced today after these couple of hours than I was before that if we gave this - made this ruling a closing agreement that we might be making it that more easy for these people to place orders here and I - talking on the economic fund, practically every Government economist, just as I submitted, working in the various departments is saying that we are going into a constant falling business level and the only thing that they can see on the horizon that might offset this - and they are all in agreement, I have yet to find one that isn't - would be some orders from abroad. But that answers the question. They are all agreed that this talk of the Federal Reserve index dropping down and that is another reason why I am so interested in these - and all of the orders that these - at least, that is what they say for the time being, are stymied pending more or less this decision. It is a pretty big thing we are talking about and why don't we do this: Wouldn't you like to do this, Sullivan, because - do you want time to think about it and we will meet after lunch?

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- Sullivan: If there is to be any departure from the present situation, it would be very specifically limited to the field in which rulings are now used. How does that strike you?
- Mooney: In other words, do I understand you to mean this, that in any case in which the Commissioner of Internal Revenue would issue a ruling, there would be no objection to the issuance of a closing agreement?
- Sullivan: Yes.
- Mooney: But in a case where the Commissioner of Internal Revenue felt that he wasn't justified in rendering an opinion because the facts were not certain enough from which he could draw a conclusion, he would refuse to enter into a ruling or a final closing agreement, but in cases which he would enter into a ruling, he would enter into a closing agreement if the taxpayer requested?
- Sullivan: How does that strike you, Tom?
- Mooney: I am a hundred percent for that.
- H.M.Jr: Wait a minute, Mr. Helvering has got to talk.
- Helvering: As I say, Mr. Secretary, if the facts are presented as in this loan question in the Atlas case, there we know just what is going to happen. Now, I issue a ruling on that. I am just as willing to give them a final closing agreement, because I think we are absolutely right, but I wouldn't want to go into some crystal gazing as to what might happen to the length of the contract, what the depreciation would be and whether or not they would have income at the end of it to offset the depreciation and all that.
- Gaston: As to that, you wouldn't issue a ruling.
- Foley: You wouldn't give them a ruling.

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- H.M.Jr: What Mr. Mooney stated in technical language, I gather, boiling it down the way I understand it, is that if you were willing to give them a ruling, and they asked for a closing agreement instead of a ruling, would you be willing to give it to them?
- Helvering: Absolutely.
- H.M.Jr: Is that it?
- Magill: There is one point that I take it we are all aware of, that is that at present you men give a closing agreement in the kind of a case in which you would give a ruling. What I am trying to cover is this, that you only rule now on transactions, as a general rule.
- Sullivan: Oh, no.
- Mooney: Oh, no.
- Foley: This ruling that he has given, Ros, is on a future transaction.
- Magill: That is all of that, then.
- Mooney: That comes back to our old reasonable salary issue; for instance, we might have a case involving the year 1938 in which the question involved was a reasonable amount of salaries. We would reach a conclusion mutually agreeable to you and the Government. We would have no hesitation about entering into a final closing agreement as to what the liability was or that we would close the case on a basis of allowance of so much salary, but we would not want to enter into a final closing agreement that this amount will be considered a reasonable salary for the next consecutive five or ten years. You would agree with us?
- Magill: Certainly. I would think it is entirely reasonable.
- H.M.Jr: Tarleau, have you got anything to say?

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- Tarleau: No, I think the conclusion that you have reached is perfectly sound and it is certainly in line with what we had in 1938. It does give that amount of certainty. Of course, as will be pointed out, I suppose, very shortly, you have done part of the job. You have certainly answered the British who wanted a closing agreement rather than a mere ruling. Now, beyond that, of course, is a vast number of questions on which people might like both rulings and closing agreements in order to expedite transactions and in which you haven't decided anything as yet. For example, you take your matter of your plant, Mr. Secretary. That still isn't under our inspection. We haven't gotten that part of the discussion under way.
- H.M.Jr: No, but I mean the same way if a man came in and asked for a ruling because he wanted to build an extension to his plant, and you would normally give him a ruling --
- Tarleau: If we would give him a ruling, we would give him a closing agreement.
- H.M.Jr: What I want to do is - I realize this is important. I want to give Sullivan and Helvering and you people a chance to think this over a couple of hours. I don't want to rush you and I would like to see them again at 2:15, which gives you a couple of hours to think it over and think of new objections, and so forth and so on. Do you see? I take it you are going to take the 4:00 o'clock, aren't you?
- Magill: At your service.
- H.M.Jr: So that gives Sullivan a chance and anybody else to think this thing over. I don't want to rush anybody. You will come back at 2:15 and we will continue the discussion, but it is along the lines that I wanted the discussion to take, but I don't want to rush anybody.
- Guy, I want you to think it over and I want you to come back and say, "Now wait a minute, if we do this thing - I have thought of this and that and so forth."

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- Helvering: We gave a great deal of thought to the Atlas ruling.
- H.M.Jr: What we are saying is that this thing now in the case of Hercules or Mr. "X", we are willing to give him a ruling or a closing agreement. I want you to think it over a couple of hours and what are the things you haven't thought of, because after all, if we decide to go ahead with it, then it is up to Mr. Sullivan to continue. I mean, he is carrying the ball for me.
- Sullivan: I think those who have more liberal views toward the situation should reexamine the situation and make up their minds whether or not they think that is going to be adequate.
- Magill: I don't know. I have been reflecting on that, too, John, and it seems to me this is certainly the situation as to these future agreements. We have always thought, I think, we had better proceed a step at a time. It is not easy to forecast the whole future as to what the policy is to be any more than - now, here all of our minds as lawyers work much better on concrete situations than on any other kind and you have got here, as I understand --
- H.M.Jr: Including farmers, too.
- Magill: You have got here a concrete case that we are trying to arrive at a policy on. Now, when duPont or somebody else comes down on some other kind of a case, I would be disposed to take a look at that when it comes and see what you want to do about it. In other words, if I am a liberal, and I don't know whether I am or not, I wouldn't be much interested in going very much beyond, at this minute, what we have said here.
- Gaston: It is far enough to go right now.
- Magill: Take a crack at it and see how that works and when somebody wants some more, let's see what that looks like.

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- Helvering: The only thing I object to, I don't want to have these fellows come in and ask us to determine that we will guarantee to them that United States Steel will be 88 in 1945. That is what some of them are asking.
- H.M.Jr: If you could, I would like to come around and see you after this meeting.
- Magill: Introduce us to that fellow, will you?
- Helvering: That is what they are asking.
- Sullivan: That is right.
- H.M.Jr: I again say, Guy, in the whole time you and I have worked together, I don't think I have ever asked you to do anything unreasonable, from the standpoint of the Government and I am not going to begin now, but I don't want to feel that the position we are taking is unreasonable and I have felt it was unreasonable.
- Helvering: Of course, I could say this as well now, Mr. Secretary, as I could in two hours or two days, but the ruling in Atlas company, the way we handled that, we studied it very carefully. We went over it very thoroughly and that could be made a closing agreement just the same as it could have been made a ruling.
- H.M.Jr: I don't want to rush Sullivan.
- Sullivan: You are not rushing me, sir.
- H.M.Jr: Do you want to clean it up right now?
- Sullivan: Sure, if the other boys are satisfied.
- H.M.Jr: Who are the other boys?
- Sullivan: Dr. Viner has had some other questions here.
- Viner: I think this is just a question of administrative procedure; the difference between the Commissioner's ruling and a prospective closing agreement is important in the long run but minor in terms of the 1940 economic situation. I have no opinions one way or the other.

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- H.M.Jr: I know what Viner has, but this conference is on closing agreements.
- Viner: I have no opinion one way or the other.
- H.M.Jr: I don't want to get into the question of obsolescence at this time and I am not prepared for it mentally. I haven't prepared. I mean, the point that we are now, as far as I am concerned - you gentlemen have helped me to see this thing more clearly. I mean, I am going to talk with Viner and I want to find out more and maybe we will have another session on what he has.
- Viner: I would like to make clear my position that as far as the discussion has gone this morning, I don't think I have a thing to say on that question. I like the drift of the decision, but it is an administrative procedure question. I have no judgment on the matter. The men who have had experience with how these cases come up and how formal you can make a commitment are the ones to have the judgment. I would have none at all. My own feeling is that the drift has been all right, but I don't think it is very important in the light of what I thought was the broader question that was up. I was wrong.
- H.M.Jr: Well, your broader question may come up in its turn, but it wasn't for this morning. Who else do you (Sullivan) want to ask?
- Sullivan: Well, I don't know whether this satisfies Mr. Gaston or not.
- Gaston: Yes, it does, John. I think it is enough of a step to take at this time.
- Sullivan: Because you remember when you and Bell and I talked about it last. That was the only thing - we brought up this very question as to whether or not the same amount of effort went into a ruling that went into a closing agreement and I said yes, and that they were virtually the same thing except that the succeeding Commissioner or Secretary could except.

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- Gaston: I couldn't see then why the material that went into a Commissioner's ruling couldn't go into a closing agreement and I thought it would be an advantage to the taxpayers in the way of assurance of future Commissioners to do that and I am still at the same point, but I don't think we are prepared now to go further.
- Viner: Doesn't a closing agreement also give the taxpayer better protection against an adverse court decision?
- Mooney: Oh, yes.
- Viner: So it is not merely against a new Commissioner, it is also against - in other words, the court would respect a closing agreement even though for succeeding cases it tells you, "Don't do it that way." It makes it still more valuable to the taxpayer.
- Helvering: The main objection they make is that the Commissioner is uncertain in his terms. This may be ten years from now when it is finally closed. But the court decision would make no difference.
- H.M.Jr: Well now, John, you are going around the room. Who else do you want to ask?
- Sullivan: I was wondering about Roy Blough.
- Blough: I think the economic progress depends a whole lot on the certainty and stability and that the closing agreement permits the making of certain and stable situations for the business man and that it would be a distinct benefit in encouraging business commitments. It seems to me that aside from the administrative aspect, on which I wouldn't want to pass any judgment, that from the point of view of taxation and economics it would be a desirable move to make.
- H.M.Jr: Do you mind saying it again?
- Blough: I was saying I wouldn't want to pass any judgment as to the administrative aspects, but

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assuming those to be taken care of, from the point of view of economic effects, it seems to me it would be a distinctly valuable thing to do this, because it does stabilize and make certain some portion of the future and therefore helps business men to make up their minds and to make commitments.

H.M.Jr: You are talking my language.

Sullivan: Ed, what do you think about it?

Foley: I am satisfied, John.

Sullivan: Well, Mr. Tarleau and all the Bureau men are satisfied. I think that when the announcement is made it should be pretty definitely set forth that this is to be - the work is to be carried on within the limits in which rulings are now issued. That is a detail to be worked out.

H.M.Jr: Now let me ask, how is Mr. Sullivan feeling?

Sullivan: Mr. Sullivan is very happy about this.

H.M.Jr: So?

Sullivan: Yes, sir.

Magill: Well, I would think you would want to be careful in the announcement you make, if you do make an announcement.

Foley: Why do we have to make an announcement? All we do is change the procedure.

Sullivan: I think that is only fair, Ed. We have been turning them down.

H.M.Jr: Well, we only make it after we have made a closing agreement.

Sullivan: I meant when the first one you made --

Viner: Then I suppose you would say in general you will, leaving you a loophole.

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- Sullivan: No, Ed, I meant in the press release at the time the first one is announced. If Hercules is given one, it should be given the same publicity that the Colt closing agreement was given.
- Foley: Oh, sure.
- Sullivan: And the Atlas ruling. I think you want that, sir, don't you?
- H.M.Jr: Yes.
- Magill: I think you want to watch this. I am saying this in fairness to you, because I take it your position is - you are quite uncertain as to what your course ought to be. I personally would hate to see you announce in any way that this is far as we are ever going to go, we are extending our policy to this degree but this is all we are ever going to do, because I think it is quite possible that this situation may so develop that within a relatively short time you may want to make closing agreements or it may become economically desirable to make closing agreements in some other classification of cases which at present we could not very adequately define, so I would personally hate to see you make an announcement in which you say we are going to do this, but don't ask us for anything more.
- Foley: I agree with that, Ros. I don't think we have to make any general announcement. What they are talking about is that each time we enter into one of these closing agreements, after it has been executed, we give a general announcement as to that particular closing agreement and that has been our policy, but we make no general statement as to any change in procedure in the Bureau.
- Caston: We publish these in the bulletin the same as we do a ruling.
- Foley: Sure.

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- H.M.Jr: Well, the policy that I would like to see followed if we go ahead with this is that as we take each step forward, the facts are given to the public. We don't have to interpret them. Here are the facts. We have done this. Here you are.
- Helvering: Now, in this publicity, we make many closing agreements that we never publish at all or never think about them in these corporation reorganizations. On all public agreements, there is no necessity for it.
- Viner: How about prospective ones? Could you give the publicity only on prospective ones?
- Flough: These reorganization cases are prospective.
- Magill: I don't know why you shouldn't do it. That is the Commissioner's job, I take it. I don't know why you don't do it on the same basis you do on the rulings. He makes thousands of rulings a year which are published in the Internal Revenue Bulletin.
- Helvering: No, I meant a press release, Ros. I thought maybe we could confine this to these questions about these special contracts, about munitions and airplanes.
- H.M.Jr: Let's be very frank. If you publish a ruling - do you publish a ruling in your bulletin?
- Helvering: Yes.
- H.M.Jr: Do you publish closing agreements in your bulletin?
- Helvering: No, I don't think we do.
- Magill: He publishes about one in ten of his rulings.
- H.M.Jr: I think you ought to publish your closing agreements.
- Magill: The same way you do your rulings.

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- H.M.Jr: The only reason I am insisting on press releases on anything to do with munitions is that I sit here and try to do the best job that is humanly possible, but the only way I can keep in tune with public sentiment is to let them know when I am doing something, which is different. It has to do with war. Therefore, on a thing like this, I want the public to know about it. If I am wrong, it gives me a chance and I won't have to come down here a couple of years from now and spend six months of my life before the investigating committee. Therefore, I think what I am doing is right, but I don't know what 130 million people think and the only way I can find out, when I am doing something now with the belligerent nation is to give it out and there is nothing secret about what I am doing.
- Helvering: But I just wanted to clarify the --
- H.M.Jr: That is why I want all this publicity.
- Magill: I think that is a good line to hew to, if you want to, that as a general thing you will give publicity on the munitions situations and as a general thing you will give publicity to other situations only on the basis that you give publicity to rulings today, that they are a matter of general interest.
- H.M.Jr: All right, gentlemen. Now, John, once more, if there is anything in your mind on which there is the slightest doubt or that you can't carry out enthusiastically on this thing, I will give you another chance this afternoon.
- Sullivan: No, sir.
- H.M.Jr: If there is anything in the back of your head that you are not entirely satisfied on --
- Sullivan: I haven't the slightest mental reservation about the execution of a closing agreement on a matter on which we would be willing to issue a ruling. Beyond that, I am not willing to go.

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H.M.Jr: Well, no one is asking you to.
 Thank you all.

Conference re closing agreements
March 1, 1940.

- A. History of closing agreements.
- B. Difference between Oliphant plan and present law.
- C. Field in which closing agreements are now being executed.
- D. Distinction between these cases and truly prospective cases.
- E. The development and expansion of closing agreements in Vinson-Trammell cases.
- F. The administrative difficulties involved in further extension of the program.
- G. Disadvantages of possible impairment to revenue.

NAVY DEPARTMENT
BUREAU OF SUPPLIES AND ACCOUNTS
WASHINGTON, D. C.

A18-1/P(123)(00)

1 March 1940

CONFIDENTIAL

MEMORANDUM FOR
ADM. HENRY MORGENTHAU, JR.,
THE SECRETARY OF THE TREASURY.

SUBJECT: Anglo-French Purchasing Board requests release of
smokeless powder by United States Army and Navy to
replace a 4 months' productive capacity amounting
to 2,000 tons lost by a recent explosion in England.

Enclosure: (A) Memorandum request of the Anglo-French Purchasing
Board for the above release.

1. Acting upon the above request, the President's Liaison Committee
has been able to obtain the following concessions from both military branches
of the United States Government:

From the Navy.

The Navy is willing to surrender 4 months' capacity from the
DuPont Company, which Company is now delivering to the Navy at the
rate of 150,000 pounds of smokeless powder per month, 4 months being
equal to 600,000 pounds of normal capacity at the present rate of
deliveries. It is possible that the DuPont Company, by reason of
the Navy's surrender of deliveries during the next 4 months, may by
shift operations increase the quantity of production which the Navy
might expect to receive during this 4 months period. But the quantity
surrendered by the Navy is at least 600,000 pounds.

From the Army.

Due to the fact that the Army has recently released 600,000 pounds
of smokeless powder to the Government of Finland, and because of a definite
loading program now being carried out, the Acting Secretary of War
desires to limit the release of powder to the Anglo-French Purchasing
Board to a definite quantity, i.e., 1,200,000 pounds during the four
months, March, April, May, and June 1940. This release will pertain to
powder under contract with the Hercules Powder Company, Wilmington, Del.

2. The Committee will await your instructions before taking further
action.

RAY SEAR,
Rear Admiral, S.C., U.S.N.
Member, President's Liaison Committee.

CANNON NITROCELLULOSE POWDER

EMERGENCY REQUIREMENT FOR GREAT BRITAIN

Reason for requirement:

As a result of an explosion at one of the important cordite factories in Great Britain, an unexpected shortage of 2000 tons of cannon powder has developed. As all calculations of requirements had been based on the assumption that the maximum capacity of all British factories would be available, it is not possible to secure any replacement of these 2000 tons from Great Britain. The deficit can only be made up from outside sources, and by the employment of nitrocellulose powder which, although not the standard charge, can be used in certain British guns.

Position of American supplies:

The only U.S. manufacturers of cannon nitrocellulose powder (apart from the U.S. Government) are the du Pont and Hercules companies. Their plants are already fully occupied in producing material for the U.S. Government and it has not therefore been possible to obtain from them any material to meet the British emergency requirement.

Negotiations with both du Pont and Hercules are in hand with a view to the erection of a new plant or plants for the production of cannon nitrocellulose powder for Great Britain (or France) in the United States. It will, however, be many months before any new factory for cannon powder is in production and this source of supply cannot meet the present situation.

Possibility of U.S. Government concessions:

Provided the U.S. Government are prepared to make the necessary concessions, it might be possible to meet the emergency requirement in two ways:

- (a) From existing stocks already held by the U. S. Government.
- (b) By switching over the production from existing plants from U. S. Government orders to the manufacture of material for Great Britain.

It is recognized that under procedure (b) there will be some delay in meeting the requirement but, even so, a concession of this kind of the U. S. Government would be extremely desirable.

Quantity of powder required:

Owing to shortage of time and lack of a range of British powder in North America, it has not been possible to carry out the extensive ballistic tests with modern cannon nitrocellulose powders.

which would have enabled a decision to have been made as to the suitability of a large range of sizes of powder for British guns. Some tests have, however, been made in Canada and, subject to final confirmation by Great Britain (which has been asked for by cable), the following types of powder would be suitable:

- (1) Material of web thickness 0.021" (multi-perforated) and of composition 87 parts nitrocellulose of nitrogen content 13.1%, 10 parts dinitrotoluene, 3 parts dibutylphthalate, and stabilized with one part diphenylamine.
- (2) Material of web thickness 0.0225" and of composition 85 parts nitrocellulose as in (1) 10 parts dinitrotoluene, 5 parts dibutylphthalate with 1 part diphenylamine. It is understood that material of this kind approximates to the standard U. S. powder for the 75 mm. A.A. gun.
- (3) Material of composition as in (2), but with web thickness 0.021". It is understood that powder of this kind was formerly used in the 75 mm. U.S. Pack Howitzer which is regarded as to some extent obsolescent.

If material of the above types is not available, or if the quantities which can be obtained are insufficient, any cannon nitrocellulose powder which would be expected to give ballistics equivalent to the above types would receive the most serious consideration by the British authorities.

E. Whitworth

28, 1940

Anglo-French Purchasing Board

C. T. Ballantyne
CHARLES T. BALLANTYNE
Secretary General

March 1.

See memorandum of 3/4 and diary entry of 3/12 when HM, Jr spoke to Woodring who said he had o.k'd the release of the powder and did not know what Louis Johnson was talking about in the memo attached.

*Protective Mobilization
will you speak
the about the*

WAR DEPARTMENT

WASHINGTON

March 1, 1940.

MEMORANDUM FOR THE PRESIDENT

SUBJECT: Priority on Supply of Smokeless Powder for the
British Government.

Your attention is invited to the third paragraph of
the attached memorandum of February 29, 1940, to the Chairman
of the President's Liaison Committee.

Powder is one of the critical items for which the
stock is below requirements for the Protective Mobilization
Plan.

Louis Johnson

Acting Secretary of War.

1 Inclosure.

February 29, 1940.

MEMORANDUM FOR THE CHAIRMAN, PRESIDENT'S LIAISON COMMITTEE.

SUBJECT: Priority on Supply of Smokeless Powder for the British Government.

1. Reference is made to informal request by Secretary Morgenthau, transmitted by you on February 28, 1940, concerning powder making capacity which the War Department might release for the next four months to offset the loss of British capacity at Waltham-Abbey.

2. A study of the problem in the War Department indicates that during the months of March, April, May and June, 1940, delivery schedules for cannon powder to the War Department from two commercial sources and Picatinny Arsenal will total 4,475,000 pounds. Of this quantity, all of the deliveries from one of the commercial sources and from Picatinny Arsenal are required for use on complete round or propelling charge orders for the fiscal year 1940 ammunition production program. Of the deliveries from the second commercial source, 300,000 pounds are ~~designated~~ assigned to loading orders and 1,800,000 pounds are for war reserve. However, a recent concession of 600,000 pounds of the capacity for war reserve bulk powder was made to the Government of Finland, leaving a net available capacity for powder in this category of 1,200,000 pounds.

3. The War Department does not desire to release any of the remaining capacity already contracted for, but if the President decides to accommodate the British Government, it is believed that the release should be limited to the 1,200,000 pounds being manufactured for the war reserve. The loading program should not be disturbed, since any diversion from the needs of this program would cause a serious disruption of War Department procurement under the current armament appropriations.

Acting Secretary of War.

Copy for The President.

THE WHITE HOUSE
WASHINGTON

March 11, 1940.

MEMORANDUM FOR

THE SECRETARY OF THE TREASURY

FOR YOUR INFORMATION AND
RETURN FOR MY FILES.

F. D. R.

THE WHITE HOUSE
WASHINGTON

March 9, 1940.

MEMORANDUM FOR THE PRESIDENT:

In connection with the attached, Louis Johnson informs me that the Navy has promised, under certain circumstances, to furnish six hundred thousand pounds of smokeless powder that they have in reserve.

E. A. Tamm
E. A. Tamm

STRICTLY CONFIDENTIAL
TREASURY DEPARTMENT

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INTER-OFFICE COMMUNICATION

DATE March 1, 1940

TO Secretary Morgenthau
FROM Mr. Cochran

When talking with me this morning in regard to daily sales of dollar securities, Mr. Pinsent spoke of the extended conversations which his Embassy is now having with the Department of State in regard to economic problems, particularly the decline in British purchases of American agricultural products. Mr. Pinsent stated that in making their case the British Embassy was obliged to utilize much of the confidential information which he has conveyed to Secretary Morgenthau in recent weeks in regard to British financial resources. Pinsent wanted us to know this, lest we might be surprised to find that some of the figures obtained for the Secretary of the Treasury and given to him in strictest confidence are now available to the Department of State. Pinsent stated that most of their arguments were with Dr. Feis.



TREASURY DEPARTMENT

INTER-OFFICE COMMUNICATION

DATE March 1, 1940

TO Secretary Morgenthau

FROM Mr. Cochran

CONFIDENTIAL

Following yesterday's decline to 3.92-1/2, the rate for sterling exhibited a somewhat steadier tendency today. After opening at 3.92-1/2, sterling advanced to 3.93-1/2 by noontime. During the afternoon, the quotation eased in a thin market and closed at 3.93.

Sales of spot sterling by the six reporting banks totaled £418,000, from the following sources:

By commercial concerns.....	£ 262,000
By foreign banks (Far East, South America and Europe).....	£ 156,000
Total.....	£ 418,000

Purchases of spot sterling amounted to £446,000, as indicated below:

By commercial concerns.....	£ 254,000
By foreign banks (Europe and South America).....	£ 192,000
Total.....	£ 446,000

The following reporting banks sold cotton bills totaling £22,000 to the British Control on the basis of the official rate of 4.02-1/2:

£ 19,000 by the Guaranty Trust Co.
3,000 by the National City Bank
£ 22,000 Total

The other important currencies, with the exception of French francs and Canadian dollars, which moved in sympathy with sterling, showed almost no movement during the day and closed as follows:

French francs	.0222-7/8
Guilders	.5311
Swiss francs	.2242-1/2
Belgas	.1690
Canadian dollars	13-3/4% discount

We sold \$400,000 in gold to the Central Bank of the Argentine Republic to be added to its earmarked account.

We purchased \$3,400,000 in gold from the earmarked account of the Bank of Finland.

The Federal Reserve Bank of New York reported that the Swiss Bank Corporation, Zurich, was shipping from Switzerland to its New York agency \$2,988,000 in gold, for sale to the U. S. Assay Office.

The Federal Reserve Bank of New York received cables from the B.I.S. and the Netherlands Bank requesting it to apply for a license to transfer approximately 15,000 ounces of gold (about \$560,000) from B.I.S. Account #2 to the account of the Netherlands Bank at the Federal Reserve Bank. B.I.S. Account #2 is gold owned by that institution. The Treasury granted permission to the Federal to make this transfer.

In the past fortnight, the Bombay quotation for spot silver worked up gradually from an equivalent of 39.26¢ on February 14 to yesterday's rate of 41.12¢. It was reported that this upward movement was caused by a demand for silver in Bombay stimulated by the rumor that the import duty on silver would be raised at the end of February. Official notice was received in New York today that no change in the import duty was contemplated by the Indian government and today's Bombay silver quotation registered a decline of 7/16¢ to 40.67¢.

In London the spot silver price was fixed at 20-3/16d, off 5/16d, and the forward fixing price was 20-1/4d, off 3/16d. At 35.67¢ and 35.60¢ respectively, the U. S. equivalents reached a new low level since the outbreak of the war. Local speculative reselling was reported to have been responsible for the downward movement in the London prices, and Indian interests were buyers on the fall.

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

In New York we made nine purchases of silver totaling 522,000 ounces under the Silver Purchase Act, all of which consisted of new production from foreign countries. Ordinarily, this type of silver is offered to us for forward delivery but today one refining company made an offer of 82,000 ounces on a spot basis, which was accepted. The remaining 440,000 ounces was purchased for forward delivery.

By telephone this morning, Mr. Knoke gave me the following information in regard to Russian balances with the Chase Bank. As of February 20, the cash account of the Russian State Bank with the Chase Bank amounted to \$3,800,000. At the close of business on February 28, this account was \$2,200,000. During the same period the letter of credit account remained stationary at \$7,000,000. The Amtorg cash account with the Chase declined from \$2,000,000 to \$1,700,000 and Amtorg letters of credit were fixed at \$2,200,000. The principal in-payments to the Russian State Bank account during the period under review were: \$1,500,000 from the Swiss Bank Corporation and \$750,000 from the Rotterdam Bank (presumably in payment for gold which the Netherlands purchased from Russia.) Out-payments from the Russian State Bank account included \$1,000,000 to letters of credit, \$3,000,000 to Amtorg and \$350,000 to the International General Electric.

CONFIDENTIAL

With reference to Dr. White's question raised in the staff meeting yesterday about a "\$25,000,000 increase in Russian credits in New York", I read back to Enoke the following sentence from his letter of February 23: "Foreign official funds in this market increased \$24,200,000 during the week. About one-half of this increase was for the account of Russia and reflected in part the sale of gold imported in the previous week and in part credits opened in this country on behalf of Russia. We are at present discussing this credit item with the reporting bank to determine whether it is the type of transaction which should be included in our figures." From this it will be seen that only about one-half of the increase of \$24,200,000 was attributed to Russia. Enoke told me that the Russian gain was something over \$13,000,000. This resulted in part from the Russian gold shipment of \$5,600,000 which came recently from Vladivostok to San Francisco, and in part from the fact that the Chase Bank started, for the first time, to include in its weekly capital movement reports to the Federal as a Russian credit the amount set up with the Chase Bank for letters of credit. The funds for such letters of credit had been taken from the Russian State Bank cash account with the Chase. The above paragraph reveals the division of Russian funds into cash and letters of credit. The setting up of these letters of credit began only in December when American exporters were no longer willing to grant credits to Soviet Russia. It became necessary, therefore, for a letter of credit to be established and a corresponding amount was set aside by the Chase Bank from the cash balance of the Russian account. The Chase Bank only realized this last week that it had omitted reporting these items as credits, and there is still a question with the Federal Reserve Bank of New York as to whether they should be so listed. The matter is still under consideration.



CONFIDENTIAL

TO:

3-1-40

SECRETARY MORGENTHAU

97

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---Statement being put out by Mr.
Jones this afternoon.

JPC, Jr.

From: MR. COTTON

COPY

IMMEDIATE RELEASE

FLA-17

FEDERAL LOAN AGENCY

WASHINGTON

March 1, 1940

STATEMENT BY JESSE JONES, FEDERAL LOAN ADMINISTRATOR

The President has advised me that he will sign the Export-Import Bank capital increase bill, and the Trustees of the Bank have allocated \$20,000,000 for additional loans to the Finnish-American Trading Corporation for account of Finland, also \$15,000,000 to the Bank of Sweden to finance American exports to Sweden, and confirmed \$10,000,000 to Norway, heretofore announced.

The proceeds of these loans may only be expended for purchases in this country and no part of the money may be used for arms, ammunition, or implements of war listed in the President's proclamation under the Neutrality Act of 1939, except commercial aircraft. The Act increasing the Bank's capital permits loans for the purchase of aircraft exclusively for commercial purposes. We have had no applications for loans to buy aircraft.

TREASURY DEPARTMENT

INTER-OFFICE COMMUNICATION

DATE March 1, 1940

TO Secretary Morgenthau
FROM Mr. Hase *HA*
Subject: Wheat export sales and other market data from the Federal Surplus Commodities Corporation.

- Feb. 19: There was very little trading in cash corn. One cargo was sold to go from the Atlantic Coast to the United Kingdom.
- Feb. 21: At the start of the crop year, July 1, 1939, it was estimated that the world might import about 584,000,000 bushels of wheat. From indications now, it is quite probable that this figure will be revised downward to 520,000,000 or even less.

In Northern China there is a scarcity of wheat, made more acute by alleged price fixing and the commandeering of stocks by Japanese and Chinese authorities. Japanese residents are obtaining what they need at a fixed price but the Chinese population, particularly the poorer classes, are unable to obtain any cereals at all.

- Feb. 23: Wheat shipments have been interrupted because of a shortage of ships. All Norwegian and Danish freighters, even though under long term charter contracts with North and South American firms, have been commandeered by their respective governments and ordered home immediately.

Spain is in the market for good quantities of wheat and yesterday made arrangements to take about 6,000,000 bushels of French wheat, which is surprising in view of the fact that France is in the war. Spain has also arranged to take 15,000,000 bushels of Argentine wheat and would be interested in some American wheat if it could be secured at competitive levels.

There is some speculation as to what European yields will be, in view of the fact that the weather throughout Europe this year has been the coldest for over 500 years, although the varieties of wheat grown in Northern and Central Europe are usually resistant to extreme cold.

Secretary Morgenthau - 2

Feb. 24: Argentine wheat shipments for the week were almost 4,000,000 bushels. Evidently shipments of the present week will be heavy, too, for five ships were chartered Saturday to carry wheat from Argentina to Antwerp at a price equivalent to 85 cents per bushel.

Argentina is also beginning to realize that the corn crop there is apt to be one of the largest on record, and that later on all available ships may be needed to conduct trade in that cereal.

Feb. 26: Private reports yesterday indicated that the Australian crop might be as much as 250,000,000 bushels. If so, this will be the largest crop ever raised by that country. If the private reports prove to be correct, it means that Australia has a supply in the form of carryover and exportable surplus of 200,000,000 bushels of wheat and this, with the present supply in Canada of about 350,000,000 bushels, is certainly ample enough to take care of the world trade.

March 1, 1940
12:50 p.m.

HWJr: Hello, Joe.

Joseph P.
Cotton:

Yes, Mr. Morgenthau. I'm over here at a meeting that Mr. Jones called suddenly this morning.

HWJr: Yeah.

C: He wants to put out a statement on this -- forecasting loans to Finland and Sweden, which he says he has cleared -- he had a wire from the President saying that the President was going to sign the -- this bill increasing the Export-Import Bank capital and wanted him to go ahead. I -- he said he hadn't been able to talk to you about it although he had tried to get you.

HWJr: That's right.

C: I'd just like to -- perhaps I could just read you the statement - it's very short - to show you what it -- what it would involve.

HWJr: Go ahead.

C: He says, "The President has advised me that he will sign the Export-Import Bank capital increase bill, and the trustees of the Bank have allocated 20 million dollars for additional loans to the Finnish-American Trading Corporation for the account of Finland; also 15 millions to the Bank of Sweden to finance American exports to Sweden and that the proceeds of these loans can only be expended for purchases in this country, and so on, and not war materials."

I asked Judge Moore, representing the State Department over here, whether the State Department wanted to reconsider this whole skin Navy and Loan policy in view of what's happened since the bill went into Congress and now, and he -- he said no, but I mean -- he perhaps -- I mean, he didn't seem to consider it. This is -- this is of course -- virtually commits us to go on ahead, although in terms it's an allocation

- 2 -

rather than -- than a formal authorization. It just seemed a very -- rather important thing and Mr. Jones sprang it -- I -- we didn't know it was coming along.

HMJr: Where are you talking from?

C: I'm talking from his office.

HMJr: 20 million for Finland?

C: Yeah.

HMJr: And 15 for Sweden.

C: Yeah.

HMJr: Does that leave any for China?

C: Well, he only -- he said that he was going to do something for China and that the feeling up on the Hill is in favor of that too and he intends to work it out but he didn't want to -- he didn't think it was wise to say anything about it in this statement.

HMJr: Why not? I'd like to have them all announced. I'd like to have the 20 million announced for China.

C: I see.

HMJr: Definitely!

C: Well, I -- I'll bring up that point.

HMJr: Yes.

C: Well, how do -- it seems to me, although it's primarily a State Department responsibility, that this thing ought to be rather carefully considered. I mean, it certainly, to a layman, it looks as if Finland was going down, but.....

HMJr: Well, has he got -- he has the approval of the President?

- 3 -

C: Yes.

HMJr: Well, why don't you do this, if you could go in the meeting and tell Mr. Jones that I'm free now - I've been in the meeting all day - and I'd like to talk to him. You see?

C: Right.

HMJr: And if you could stand by.

C: I'll do that, and I'll bring up the point about China.

HMJr: Yes, but if you could do it in the next five minutes.

C: I'll do it right away.

HMJr: Will you?

C: Right.

HMJr: Ask him whether he'd mind coming to the phone and you could stand by and listen.

C: Yeah. It just seems -- the obvious point seems to me, Mr. Morgenthau, is that -- I mean, it looks awful late on these Finnish and Scandinavian things, but.....

HMJr: Well, if it was my sole responsibility, I'd vote yes.

C: Well, I'd be inclined to too, but it's -- I wondered why, as a matter of procedure, it was necessary to put out a statement which would virtually commit the Government, that's all.

HMJr: I don't know. But I mean, as far as they are concerned I'm willing to have you vote yes.

C: Right.

HMJr: But I'd like them to ^{include} / the Chinese thing.

C: Well, I'll tell him that and.....

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HMJr: See if you can't get him to the phone.
C: All right. Fine.
HMJr: And I'll -- I'm here. I'll hang up but I'm here.
C: Right, sir. Thanks a lot.

March 1, 1940
12:55 p.m.

Jesse
Jones: Hello, Henry.

HMJr: I hear you're going to spend a little money.

J: Well, we thought we hadn't called on you for a long time, we'd better call on you.

HMJr: God, I need -- you're making Marriner Eccles look like a piker.

J: I understand that you want to lend this money all to Haiti.

HMJr: No, not all, but I would like if you're going to make an announcement, I'd love to see you tell them you're going to lend 20 million to China.

J: Well, I think we need a little -- a little further investigation on China. We're going to reserve 20 million for China.

HMJr: You are?

J: Oh, yes.

HMJr: I see.

J: But I think we'd better -- in that I need -- I called you earlier this morning and you were.....

HMJr: Well, I was in a tax meeting.

J: And I wanted to discuss that with you.

HMJr: Yeah.

J: And I want to go in -- particularly into the details of the China matter with you.

HMJr: Well, I'm ready any time you are, but I was -- I locked myself up on a tax matter.

J: Yeah. The -- Finland is the thing that's uppermost in everybody's mind right now.

- 2 -

HMJr: Yeah.

J: And so.....

HMJr: The only question I had, the way Joe Cotton read it -- I mean, are you safe in announcing this before the President signs the bill?

J: Perfectly. He told me to go ahead.

HMJr: He did.

J: Yeah. He wired me last night.

HMJr: To -- I mean, before he signs it.

J: He said he would sign it and we could go ahead.

HMJr: I see. Well, if you're safe on that that's O.K. I'm with you.

J: I just want to say something today as quick as we can on Finland.

HMJr: Yeah.

J: And I put in Sweden there for -- because they want to the stuff, and I expect they are going to help Finland also.

HMJr: All right. And you are going to earmark 20 million for China?

J: Certainly so.

HMJr: Well, any time you're ready, Jesse, I am.

J: O. K.

HMJr: Give me a little notice.

J: All right. Fine. Thank you.

March 1, 1940
3:15 p.m.

HMJr: Hello.

Operator: Mr. Purvis.

Arthur
Purvis: Hello.

HMJr: Purvis.....

P: Yes; good afternoon, Mr. Secretary.

HMJr: How are you?

P: Very well, thank you. I just got back from Ottawa.

HMJr: Good. Mr. Purvis, I have been working on this powder business, you see?

P: Yes, sir.

HMJr: And I have made this much progress but it's always subject to the approval of the Commander-in-Chief.

P: Quite.

HMJr: It may be possible to get from Dupont.....

P: Yes.

HMJr:on Navy release 150 thousand pounds a month for four months.....

P: Yes.

HMJr:of smokeless powder.

P: Yes.

HMJr: And from Hercules, a million 200 thousand pounds for March, April, May and June.

P: That's a million 200 thousand pounds in total over March, April, May and June.

HMJr: From Hercules.

- 2 -

P: Yes.

HMJr: The one case 600 thousand.

P: Yes.

HMJr: And the other case a million two.

P: Yes, quite.

HMJr: Now, one is a Navy release; the other is an Army release.

P: Oh, I see. (Laughs)

HMJr: You see?

P: Yes, I do.

HMJr: Now, the thing that I thought that you might be finding out is this: This isn't easy and I don't want any flare-back, you see?

P: No, quite.

HMJr: Could you find out whether Dupont and Hercules -- how many shifts they're working. You see?

P: Yes.

HMJr: And if they're only working, say -- one or two, would it be possible for them to go to three shifts.....

P: Yes.

HMJr:during those four months.

P: Yes.

HMJr: And whatever the extra charge would be I should think you would be willing to pay it.

P: Yes.

HMJr: But it would make it look better from our standpoint.

- 3 -

P: Oh, yes. We wouldn't have any worry about the extra charge at all.

HMJr: Do you see what I mean?

P: Oh, I see exactly what you mean.

HMJr: During those four months' period both with the -- both with Dupont and With Hercules.

P: Yes.

HMJr: The -- getting the final approval from the President if he thought it was wise.

P: Yes, quite.

HMJr: It would make it better all around if it was -- if during those four months' period while they were working on those two orders they would go to three shifts.

P: I'll find out the possibilities and whether they are on them now or whether they're not.

HMJr: Yes.

P: And I'll let you know.

HMJr: Will you?

P: I will.

HMJr: And then, always bearing in mind when I tell you that you have the green light that the formal way will be that we'll be asked formally to do this by each company.

P: Yes, yes, yes.

HMJr: I mean, that the Hercules and Dupont will formally request -- let me just get this -- the Navy contract is Dupont and the Army contract is Hercules.

P: Yes, that's right.

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HMJr: And in each case the formal request will come from the company to the Navy and the Army.

P: Yes.

HMJr: Do you see?

P: I see.

HMJr: That all will look much better.

P: Yes, exactly.

HMJr: Now, I'll know -- I'll know by Monday or Tuesday.

P: Will you?

HMJr: Oh, yes.

P: Good. That's very good indeed.

HMJr: But if you could let me know by Saturday, because I hope to -- I have an appointment to see the President Sunday.

P: Yes, I see. I shall do that without fail.

HMJr: So, if you could let me know Saturday sometime.

P: I'll get that this afternoon.

HMJr: I'll be in the office from ten to twelve Saturday.

P: Oh, you will? Good. Thank you very much; I'll get that.

HMJr: Now, one other thing.

P: Yes?

HMJr: I read in the paper that you bought 20 million dollars' worth of bombers from Douglas.

P: Well, that -- that 's the formal contract of something that was done about two months ago.

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WJr: Oh, because nobody here in the Army or Navy seems to know anything about it.

P: Oh, it's merely -- it's merely -- it's something of the same nature -- I -- I'm sure it has been on our list to Collins for many, many, many weeks, but I'll check that. You see?

WJr: Good.

P: Naturally it's -- it's something which is half-way akin to the Curtiss-Wright contract which has taken some time to formalize, though I find that wasn't by any means all our people bought.

WJr: I see.

P: But it's -- it's something which I think will have been on the list for at least seven or eight weeks. However, I will check on that.

WJr: Please, because they don't seem to know about it. At least Admiral Spear, who is acting in Collins' place, knew nothing about it.

P: Well now, if that's so there -- there would -- it would mean a very serious slip on our list which we really, I felt, had gotten down to a pretty fine point. But I'll check that up, Mr. Secretary.

WJr: And -- well, that's that. And you got my message, didn't you, that I was the high Government official who said there was nothing doing on giving the orders to three companies?

P: Oh, yes I -- (Laughs) -- I got that.

WJr: Good.

P: I -- I think on that the -- I had a talk yesterday in Ottawa for a few minutes with Henry Phillips (?)

WJr: Yes.

P:who is trying to get rid of one or two Canadian things and get down here, and I told him that I was

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very anxious that he should have a talk with you promptly if you could arrange it.

HMJr: Oh, yes.

P: Now, Plevin and Jacquin should be here also in the very early future. Would it be all right for all three of them to come at once?

HMJr: Surely.

P: Good.

HMJr: When you come down I'll tell you why I had to do that. It was somebody -- it was all over Washington and it came from somebody on our side and I -- I just had to do it that way.

P: Yes.

HMJr: I don't think it did you any harm.

P: It -- I don't think so -- I really don't, because after all, as I see it now, we start afresh with -- with a problem that's got to be reconciled. We're going to have the great advantage, I find, Mr. Secretary, of having on this side of the water people who will have a very high degree of technical ability to decide. I think -- I think they've set the calibre -- they are sending the calibre of people which will prevent this eternal cabling back and forth.

HMJr: Well, there was a whispering campaign here about favoring three companies, you see?

P: Yes, I see. Well of course I can see how you can't very well tolerate that.

HMJr: And I thought the best way was just to kill it.

P: Yes. Good.

HMJr: All right.

P: Thank you very much, sir.

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HMJr: And you will let me know tomorrow?

P: Yes, I will.

HMJr: Thank you.

P: Thank you.

HMJr: Goodbye.

GROUP MEETING

March 1, 1940.
4:30 p.m.

Present: Mr. Gaston
Mr. Viner
Mr. Cotton
Mr. Sullivan
Mr. Cochran
Mr. Foley
Mr. Thompson
Mr. White
Mr. Haas
Mr. Schwarz
Mrs Klotz
Mr. Bell

H.M.Jr: I see you got trimmed in the Export-Import Bank.

Cotton: Well, perhaps so.

H.M.Jr: How did the thing go over there? If you don't understand my reference, I am referring to your haircut when I say you got trimmed.

Cotton: Oh no, that was yesterday.

H.M.Jr: In my talk with Jones, I thought this was interesting, did I understand that there is now 20 million for Finland and 15 million for Sweden, is that right, and over the telephone they agreed to earmark 20 for China.

Cotton: Yes.

H.M.Jr: But wouldn't announce it. They were trying to get him to announce it today.

Anything else happen over at the Export-Import?

Cotton: Well, there was quite a long discussion on the general situation. I guess there was nothing important. It was sort of a rambling discussion, nothing terribly definite.

H.M.Jr: O. K.

Then the other thing, how did your thing go last night, Harry?

White: I thought very well. They certainly were very

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interested in it, at any rate. They were supposed to adjourn sharply at 9:00 o'clock, but they asked questions until about 10:30.

H.M.Jr: How many Congressmen did you have?

White: There were about 30-odd persons there, I think, and I imagine over 20 of them were Congressmen. There was one Senator, Senator Thomas.

Gaston: Elmer?

Foley: From Oklahoma?

White: Oklahoma.

Gaston: Utah.

Foley: No, that is Oklahoma.

White: The silver-haired fellow.

H.M.Jr: You were satisfied?

White: Yes, I think so.

H.M.Jr: Has anybody got anything? I am coming in tomorrow at 10:00 to see Leroy-Beaulieu.

What you (Sullivan) told me early this morning, will that keep until Monday?

Sullivan: Yes, sir.

H.M.Jr: Does he (Foley) know about it?

Sullivan: He does.

H.M.Jr: That will keep?

Sullivan: He keeps it.

H.M.Jr: I mean, will it keep until Monday?

Sullivan: Yes. I am leaving tonight.

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H.M.Jr: What you told me will keep?

Sullivan: Yes.

Cochran: I have a wire here from Mr. Nicholson which he desires communicated to Mr. Lochhead, if you approve. I also wish to show a copy of it to Gaston.

H.M.Jr: You two fellows decide. Did you get off that cable to that Consul?

Cochran: I left it on your desk this morning.

H.M.Jr: I gave it to Sullivan yesterday?

Sullivan: I thought you did.

H.M.Jr: I think so.

Sullivan: I haven't seen it.

H.M.Jr: It is in your hands. You had it in your hands.

Sullivan: I think I did. I will look for it the minute I get back there. I haven't laid eyes on it since.

H.M.Jr: Well, you better.

Sullivan: I hope so.

Cochran: I have copies of it.

Sullivan: I was just thinking of that thing when you mentioned it, wondering where you or I put it.

H.M.Jr: You don't want to put it off.

Sullivan: I bet you handed it to me. I wouldn't bet I have still got it, but I think you handed it to me.

H.M.Jr: Before you go, it is one of the most interesting things in the - in the Consul in Birmingham.

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It is an amazing statement of the way the English machine tool fellows feel about our business and the way they feel about their own government. It is amazing. I want more information.

Sullivan: Do you want me to give that to Mr. Cochran?

H.M.Jr: Yes.

Cochran: It is all right to go now?

H.M.Jr: Yes, but I thought he might want to ask something.

Cochran: I got from the State Department this afternoon the instructions which they sent out calling for the information. Commerce has been interested in it and I have the memorandum here which Commerce gave the State Department.

H.M.Jr: Oh, that is the way it came in?

Cochran: Yes, sir.

Sullivan: Incidentally, Stilwell told me that they had sent to England enough machine tools to pave the streets over there at least six times, and he didn't --

H.M.Jr: Well, this memorandum is very interesting. I would just suggest if anybody wanted --

Thompson: I have a little report on political activity. I don't know whether you want it now.

Bell: That will keep until Monday, too.

(Discussion off the record)

H.M.Jr: I will take it home with me.

Thompson: Mr. Helvering is in entire accord with it, although he didn't sign it.

H.M.Jr: O. K., I will see you all Monday.



HEADQUARTERS

TREASURY DEPARTMENT

UNITED STATES COAST GUARD

WASHINGTON 1 March, 1940.

From: Spagent, Shanghai, China.
To : Mr. Dietrich.

Message from Mr. Nicholson.

With the consent of the Secretary of the Treasury,
please mail the following to Mr. Lochhead:

"United American Asiatic Corporation of Hongkong today shipped ex motor vessel Torrens 119 long tons and 865 pounds bulk wood oil to Interchemical Corporation of New York at 24 3/4 American cents per pound cost and freight. Insurance and war risk effected New York. Is this shipment for ultimate account of Universal? If not, the oil probably smuggled out of China. This may be an investigation. Mr. Jacques Maguite of suspected third international connections who is now in Hongkong is vice-president of United American Asiatic Corporation of New York. If interested see Gorman of Customs Bureau for report on Maguite. Otherwise the above information is strictly confidential."

Note: Underlined words probably should be "bear".

Treasury

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PARAPHRASE OF TELEGRAM RECEIVED

From: Rangoon

To: Secretary of State

Date: March 1, 1940.

STRICTLY CONFIDENTIAL

Only war reexports to China during the first half of February consisted of two French tanks worth 80,700 rupees or 24,000 American dollars and supplies from the United States consisting of aircraft parts including some radio equipment, explosives and powder valued at 733,500 rupees or about \$220,000. The airplane materials were valued at \$56,000. \$164,000 was the value of the other American shipments.

RECEIVED
MAR 1 1940
U.S. DEPARTMENT OF THE TREASURY

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE March 1, 1940

TO Mr. Thompson

FROM

Mr. Haas *GA*

In response to your request of December 26, 1939, there is submitted herewith for the Division of Research and Statistics a memorandum listing, with brief descriptions, the studies or projects completed or under way, and the names of persons working on each, for the month of February 1940.

DIVISION OF RESEARCH AND STATISTICS

Report of Studies or Projects Completed or Under
Way, and the Names of Persons Working on Each,
for the month of February 1940

For convenience of reference, the studies listed are grouped under general subject heads.

The names shown for persons working on each project include only those who participated fairly directly, as explained in the introductory note to the corresponding report submitted on December 28, 1939. No attempt has been made to cover also persons whose responsibility in each particular case was mainly in planning, supervising, or consulting.

Financial Analysis

I. Projects or studies completed

1. Reviews of current developments in the high-grade securities markets were prepared, and memoranda were transmitted to the Secretary on the following dates: February 6 and 20. - Mr. Haas, Mr. Murphy, Mr. Lindow, Mr. Turner, Miss Eyre, Mr. Conrad

These reviews contained, in addition to analysis of the current situation, special studies, as follows:

- (1) Factors responsible for the growth in the volume of excess reserves (Review of February 6, page 3). - Mr. Turner
- (2) The price movements of British and French Government securities since July 1938 (Review of February 6, page 5). - Mr. Turner
- (3) Comparison of the yields on the new Triborough Bridge Authority bonds with comparable yields on United States Treasury bonds and notes (Review of February 20, page 3). - Mr. Lindow
- (4) The movement in rights values during the past year (Review of February 20, page 4). - Mr. Lindow
- (5) Growth of the over-all public debt in the United States since 1913 (Review of February 20, page 4). - Mr. Lindow

2. Memorandum on the setting for the March financing was prepared, and was transmitted to the Secretary on

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February 28. - Mr. Haas, Mr. Murphy, Mr. Tickton,
Miss Eyre

This memorandum contained the following special studies:

- (1) Discussion of who holds the issues to be refunded. - Mr. Tickton
- (2) The volume of "short" maturities of United States Government direct and guaranteed securities outstanding during the past four years. - Mr. Tickton
- (3) Discussion of the special position of high-coupon obligations refunded in advance of maturity. - Mr. Tickton

3. Yield rates on United States securities, direct and guaranteed, on the basis of over-the-counter closing quotations were calculated daily. These were summarized each day in a table showing for each issue the closing price and yield that day, the change in price and yield from the preceding day, and the price range since date of issue and also for the years 1939 and 1940 to date. A chart for each issue was kept up to date showing recent daily price and yield figures together with comparative monthly data since 1933 or since date of issue. - Mr. Brown, Mr. Moody, Miss McCoy
4. Five proposals of the RFC, including one for the Export-Import Bank, that the Secretary of the Treasury request that corporation to purchase the preferred stock of banks, were examined. - Mr. Murphy, Mr. Turner, Miss Eyre
5. Tables and charts showing estimated cash income and outgo of the Federal Government were revised on basis of data available in February. - Mr. Tickton
6. A table showing the amount of food-order stamps issued by the Federal Surplus Commodities Corporation was brought up to date as of January 13, 1940. - Mr. Tickton
7. Memorandum to the Secretary regarding employment in the aviation manufacturing industry, February 1. - Mr. Lindow
8. Memorandum on the budgetary aspects of the farm program was prepared in response to a request from Under Secretary Bell, and was transmitted to him on February 5. - Mr. Lindow
9. Comments on the Budget speech of Senator Taft, which was delivered in Chicago on January 5, 1940, were prepared in

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response to the request of Mr. Schwarz, and were transmitted to him on February 6. - Mr. Murphy, Mr. Lindow

10. Memorandum on the changes in the amounts of public debt outstanding since 1933 was prepared in response to a request of Under Secretary Bell, and was transmitted to him on February 7. - Mr. Murphy, Mr. Lindow, Mr. Tickton
11. Memorandum on the statements of the President and of Mr. Thomas Dewey with respect to debts was prepared in response to a request from Under Secretary Bell, and was transmitted to him on February 7. - Mr. Haas, Mr. Murphy, Mr. Lindow, Mr. Tickton
12. Chart on the administrative structure of Federal lending agencies was prepared in response to a request from Mr. Bartelt, Commissioner of Accounts and Deposits, and was transmitted to him on February 10. - Mr. Lindow, Mr. Tickton
13. A letter, for the signature of Under Secretary Bell, commenting on the bill S. 3265, "To further amend the Federal Farm Loan Act by increasing the limitations of loans," was reviewed and initialled, February 19. - Mr. Lindow
14. A letter, for the signature of Under Secretary Bell, commenting on the bill S. 3283, "To extend to closed building and loan associations and for the liquidation of assets of such associations the same assistance that is now extended to closed banks and for the liquidation of their assets," was reviewed and initialled, February 19. - Mr. Lindow
15. Memorandum regarding the reason for the increase in money in circulation during the past 12 years was completed in response to a request from Under Secretary Bell, and was transmitted to him on February 26. - Mrs. Wadleigh

II. Projects or studies under way

1. Preparation of summary data and charts on United States securities and on the relation of the market for United States securities to that for other high-grade securities, to preface the charts on prices and yields of individual issues of United States securities. - Miss Eyre
2. Statistical (graphic correlation) analysis of factors affecting high-grade interest rates. - Mr. Turner

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3. Study of the relationship between the yields and maturities of high-grade securities immediately preceding prior major bear markets in such securities. - Mr. Turner, Mr. Conrad
4. Comparison of relative amplitude of price fluctuations of long-term and short-term securities. - Mr. Lindow, Mr. Conrad
5. Study of the effect of the size of the issue on the prices and yields of U. S. securities. - Mr. Lindow, Mr. Conrad
6. Chart and annotations with respect to the factors influencing the movement of interest rates during the last World War. - Mr. Turner
7. Discussion of various problems encountered and solutions devised in connection with war borrowing. - Mrs. Wadleigh
8. Memorandum comparing and contrasting war and depression deficit-financing. - Mrs. Wadleigh
9. Preparation of composite chart on unemployment for the Secretary's chart book. - Mr. Lindow
10. Estimate of distribution, by classes of holders, of direct and guaranteed Federal securities outstanding June 30, 1939. - Mr. Lindow

Revenue Estimates

I. Projects or studies completed

1. The regular monthly statement was prepared for the Office of the Commissioner of Accounts and Deposits showing the latest revised estimates of receipts, by months and by principal sources of revenues, for the period February 1940 through June 1941, and was transmitted on February 5. - Mrs. Stanley
2. The regular monthly summary comparison of estimated receipts and actual receipts in January and in the first seven months of fiscal year 1940, on the daily Treasury statement basis, was prepared, February 6. - Mrs. Stanley
3. The regular monthly detailed comparison of estimated and actual receipts in January 1940 and in the first seven months of the fiscal year 1940, based on the collections classification, was prepared, February 28. - Mrs. Stanley

- 4. In the light of the latest information the Budget estimates of March income tax receipts were reexamined. - Mr. Leahey, Mr. Driver
- 5. A limited computation of corporate earnings data, by quarters, for calendar years 1936-1939, inclusive, was studied from published reports in the standard business services, by years and by broad industrial groups, for use in the estimation of the corporation income tax base. - Mr. Leahey
- 6. A detailed study and analysis was completed of recent trends in customs duties by tariff schedules and by geographical areas, as well as a broad analysis of the recent trends of nondutiable imports. - Mr. Wilson
- 7. The 57 page agenda of the proposed meeting of the General Committee on Statistics of Income was studied and members of the staff attended the meeting which was held on February 12. - Mr. O'Donnell, Mr. Driver, Mr. Leahey, Mrs. Stanley
- 8. Suggestions were prepared for the Subcommittees on the Statistics of Income concerned with the business classification of sole proprietors and with the proposed tabulations to be made of data from the 1939 returns in connection with the Public Salary Tax Act, and two meetings of these Subcommittees in the Statistical Section of the Bureau of Internal Revenue were attended. - Mr. Driver
- 9. Several conferences were held with the Statistical Section of the Bureau of Internal Revenue in deciding on the way of handling the tabulation of data from the 1939 corporation income tax returns so that the tables would be best adapted to revenue estimating purposes. - Mr. Leahey
- 10. Proposed tables for use in compiling data from estate tax returns filed during the calendar year 1939 were reviewed. - Mrs. Stanley
- 11. Estimates were prepared of the revenue effect of each of the following nine proposals for raising additional revenue from the individual income tax. Work requested by and completed for the Division of Tax Research (Request of January 19). - Mr. Driver
 - (1) A flat rate tax of 35 percent of the present combined individual normal and surtax with a limitation that the added tax should not exceed 35 percent of the

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net income remaining after present Federal income taxes.

- (2) What rate and corresponding limitation for the suggestion in (1) above would yield \$300 million?
 - (3) A graduated normal tax on present base (additional to the present 4 percent rate) as follows: 2 percent on the first \$2,000 of taxable base; 4 percent on the next \$2,000; and 6 percent on the balance, with the limitation that in no case should the additional tax exceed 10 percent of the net income remaining after present Federal income taxes.
 - (4) What bracket rates for the suggestion in (3) above would yield \$300 million?
 - (5) What would the yield in (3) above be if the rates were made applicable to surtax net income instead of income subject to the normal tax?
 - (6) What bracket rates for (5) above would yield \$300 million?
 - (7) A flat tax of 1 percent on surtax net income under present law.
 - (8) A flat 10 percent tax on unearned net income defined as all income which is not at present defined as earned income.
 - (9) What rate for the suggestion in (8) above would yield \$300 million?
12. Estimates of the revenue effect of the following proposals were completed in response to a request from the Division of Tax Research (Request of January 17, 1940):
- (1) Each of the four attached individual income surtax rate schedules, giving effect to the suggested changes in the personal exemptions noted on the respective schedules. - Mr. Driver
 - (2) An additional 1 percent individual income normal tax rate. - Mr. Driver
 - (3) An additional $1\frac{1}{2}$ percent corporation income tax rate. - Mr. Leahy
 - (4) An increase in the tax on beer from \$5.00 to \$7.00 per barrel. - Mrs. Stanley

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- (5) An increase in the tax on distilled spirits from \$2.25 to \$2.50 per gallon. - Mrs. Stanley
- (6) A one-half cent increase in the gasoline tax. - Mrs. Stanley
13. Nineteen estimates of revenue effects based on eleven proposed surtax rate schedules for the individual income tax were prepared in response to a request from the Division of Tax Research for the Joint Committee on Internal Revenue Taxation, and were forwarded by Assistant Secretary Sullivan to Representative Doughton, Chairman of the Joint Committee and to Mr. Stam, Chief of Staff, on February 14. - Mr. Driver
14. Estimates were prepared of the revenue effect of allowing corporations with five or less stockholders to file income tax returns and to be taxed as partnerships. Work requested by and completed for the Division of Tax Research, February 16. - Mr. Leahey
15. Estimates were made of the revenue effect of each of three amendments to the income tax law as proposed by Senator LaFollette, relating to reduced exemptions and increased normal tax and surtax rates, singly and in combination. These estimates were made in response to a request from the Division of Tax Research and were forwarded to the Senator by Assistant Secretary Sullivan. - Mr. Driver

II. Projects or studies under way

1. Request dated October 30, 1939, from the Division of Tax Research.

Revenue effect of:

- (1) With respect to individuals.

- (a) Redefine short-term capital gains and losses to include only gains and losses realized upon sale or exchange of capital assets held twelve months or less instead of gains and losses from assets held eighteen months or less as at present; and correspondingly redefine long-term gains and losses to include in the first statutory period those taken into account upon assets held more than twelve months but not more than twenty-four months instead of those upon assets held more than eighteen months but not more than twenty-four months as at present; assuming all other provisions with respect to the treatment of capital gains and losses remain unchanged. - Mr. Driver

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- (b) Redefine short-term capital gains and losses to include only gains and losses realized upon sale or exchange of capital assets held twelve months or less instead of gains and losses from assets held eighteen months or less as at present; correspondingly redefine long-term capital gains and losses to include those taken into account upon assets held more than twelve months instead of more than eighteen months as at present; and provide for the same treatment of all long-term capital gains and losses as at present accorded capital gains and losses from assets held more than twenty-four months. - Mr. Driver
2. Improvement of method of estimating farm income, for revenue estimating purposes. - Miss Rastall, Mr. Smith
 3. Investigation of average hourly earnings as a factor in forecasting payrolls for revenue estimating purposes. - Miss Rastall, Mr. Smith
 4. Projects for revising and improving the methods of estimating revenues from the following taxes: - Miss Rastall, Mr. Smith
 - (1) Lubricating oil.
 - (2) Wines, domestic and imported.
 - (3) Transportation of oil by pipeline.
 - (4) Electrical energy.
 - (5) Tires and inner tubes.
 - (6) The seasonal distribution of the revenues from the cigarette tax.

Economic Conditions Related to Fiscal
and Revenue Matters

I. Projects or studies completed

1. Memoranda on the business and price situation were prepared and transmitted to the Secretary on the following dates: February 5, 14, 20, and 26. - Mr. Haas, Mr. Daggit, Mrs. May, Miss Rastall
2. A table and a chart showing employment under the Works Projects Administration were brought up to date

- 9 -

and transmitted to the Secretary on the following dates: February 6, 23, and 26. - Miss Rastall

3. Memoranda summarizing reports from Federal Surplus Commodities Corporation on wheat export sales and market data were prepared and were transmitted to the Secretary on the following dates: February 1, 8, and 23. - Mr. Daggit, Mrs. May
4. A memorandum on retail bread prices was prepared and was transmitted to the Secretary on February 1. Thereafter it became necessary to substitute a monthly memorandum for the previous weekly one, because the Bureau of Labor Statistics discontinued its weekly series on retail bread prices. - Mrs. May
5. Method of estimating unfilled orders of U. S. Steel Corporation was completed. (Data used on Chart 1 were attached to business memorandum of February 5). - Mr. Daggit, Mr. Smith
6. Method of estimating output and inventories of finished products of U. S. Steel Corporation was completed. - Mr. Daggit, Mr. Smith
7. A review of the Division's forecasts of the New York Times weekly business index was prepared in response to request, and was transmitted to Mrs. Betts on February 16. - Mr. Chevreux
8. A memorandum on "The Business Outlook" was reviewed on February 27 at the request of the Secretary, for the purpose of discussion. - Mr. Haas
9. A report was prepared for the Secretary on the Business Outlook meeting held in the Federal Reserve Board Room on February 28 by representatives from a number of Government departments and organizations. Report was transmitted on February 29. - Mr. Haas

II. Projects or studies under way

1. Index of unfilled orders.

An attempt is being made to improve our information on the volume of unfilled orders by working out a composite index based on data from individual industries. Work on the U. S. Steel Corporation, a large and representative segment of the steel industry, was completed during February. - Mr. Daggit, Miss Rastall

2. Indications of business maladjustment.

Various indications of business maladjustments, shown in graphic form, are being brought together for convenient reference. - Mr. Daggit

3. Export trends.

Since the trend of exports is likely to be an important business factor during the coming year, a project has been started which is designed to interpret export movements in terms of their business significance. A number of charts are in preparation, and a study is under way to determine the number of points in the FBE index represented by exports of steel. - Mr. Daggit, Mrs. May, Mr. Chevreux

4. Forces determining trends of basic commodity prices.

This project involves individual price studies for various basic commodities, a number of which have been completed, which are intended eventually to be combined into a general index representing the basic price trend, after allowance for the effect of supplies, industrial demand, and other separable factors. - Mr. Daggit, Mrs. May, Miss Rastall

5. Trends of individual commodity prices and price factors during the World War period.

This project is patterned after the general study of prices and price factors, 1913 to 1922, made in October, but deals with six individual basic commodities - wheat, cotton, hogs, steel, copper, and zinc. The project is designed to determine the principal price factors associated with the wartime rise and subsequent collapse of prices of these commodities. - Mr. Daggit, Mrs. May

6. Index of commodity stocks.

This project is designed to develop a composite index of basic commodity stocks as a measure of one important factor in the general price level. Stocks of 16 important industrial materials, expressed in terms of their net effect on prices, are being compiled for this index. - Mrs. May

7. Index of goods inventories.

A better index of inventories of finished goods is needed as an indication of business maladjustments, with a breakdown as between inventories of finished goods held by

- 11 -

manufacturers and those held by others. An attempt to develop such an index is under way. - Mr. Daggit, Miss Rastall

8. Index of buying on deferred payments.

A study of the volume of installment buying and consumer credit has nearly been completed. This study is designed eventually to provide a monthly index of the volume of buying on deferred payments, which at times is an important business factor. - Mrs. May

Actuarial Problems

I. Projects or studies completed

1. Board of Actuaries of the Civil Service Retirement and Disability Fund.

The Board of Actuaries, of which the Government Actuary is a member, approved tables of factors for use in connection with the joint and survivorship options of the Civil Service Retirement Act. The Board also prepared regulations in connection with the amendment of the Civil Service Retirement Act. - Mr. Reagh, Mr. Brown

Memoranda were prepared by the Board regarding the "Amendment of the Civil Service Retirement and Disability Act in accordance with Senator Bulow's suggestions of October 13, 1939," and showing cost estimates of amending the Act in accordance with H. R. 3702, 76th Congress, 1st Session. - Mr. Reagh, Mr. Brown

2. Retirement plan of the Alaska Railroad.

H. R. 8046 "To amend section 1 of the Act entitled 'An Act for the retirement of employees of the Alaska Railroad, Territory of Alaska, who are citizens of the United States,' approved June 29, 1936," was referred by the Bureau of the Budget for comment. A report was made on February 13. - Mr. Reagh

3. Preparation of amortization schedules for use by the Reconstruction Finance Corporation.

Mr. J. Morgan Glover, of the R. F. C., requested assistance in the preparation of a schedule amortizing a \$10,000,000 loan, the terms of which provide for rates of interest of 2½ percent, 3½ percent, and some unknown

rate less than 5 percent such that the rates would be equivalent to a uniform coupon rate of $3\frac{1}{2}$ percent. This work was completed on February 19. - Mr. Brown

II. Projects or studies under way

1. Calculation of joint and survivorship annuity tables.

A recent amendment to the Civil Service retirement law permits retired employees to elect a joint and survivorship annuity in lieu of a single life annuity. The Board of Actuaries has submitted a new mortality table for use in computing the amount of the joint and survivorship annuities payable under the amended law. Computations have been completed for the extensive tables required for this purpose and the tables are being put into final form. - Mr. Reagh, Mr. Brown

2. Preparation of interest tables for use by the State Department under the Foreign Service retirement law.

The Foreign Service retirement law requires that records of contributions with interest be maintained in respect to each individual coming under the retirement law. Interest tables are practically completed to facilitate the maintenance of these records and to record the data in a form suitable for use in actuarial valuations of the fund. (Under the recent amendment to the Foreign Service Retirement Act actuarial valuations are made by the Treasury Department). - Mr. Reagh, Mr. Brown

3. Estimate of the cost of lowering the optional retirement age of Foreign Service Officers from 60 to 55 years.

A request to prepare this cost estimate was received from Mr. Hosmer, Chief of the Office of Fiscal and Budget Affairs, of the State Department. This work is pending due to difficulties encountered because of the lack of basic data. - Mr. Reagh, Mr. Brown

4. Retirement Committee of the President's Committee on Civil Service Improvement.

This Committee is making a comprehensive study of the Civil Service retirement law. Its report will recommend several changes designed to improve the present service. A revised draft of the report has been prepared and will be reviewed at a meeting of the Committee in the near future. - Mr. Reagh, Mr. Brown

- 13 -

5. Study of horse race results.

This study was undertaken at the request of the Legal Division, for use in connection with the Annenberg case.

The results of some thirteen thousand horse races have been recorded on punch cards, and are being tabulated to show the financial results of betting under various systems and of following the selections of different expert handicappers. The results are expected to prove that it is impossible to exercise skill to any important extent in betting on horse races - that is, that such betting is primarily a matter of chance rather than of skill.

During February no progress was made on this project due to the fact that the tabulating equipment of the Bureau of Customs, Section of Statistics, was not available for our use. - Mr. Reagh, Mr. Brown

6. Report of the Civil Service Assembly of the United States and Canada on "The Retirement of Government Employees".

A first draft of the chapter on "Financing the Plan" is in process of preparation. - Mr. Reagh

7. Retirement of employees of the land-grant colleges.

S. 1850 "To aid the States and territories in making provisions for the retirement of employees of the land-grant colleges" was submitted by the Bureau of the Budget for comment. A report is now in process of preparation. - Mr. Reagh, Mr. Brown

Other Projects or Studies1. Treasury Bulletin.

Data were prepared or reviewed for the January issue of the Bulletin, as follows:

Prepared -

Average yields of long-term Treasury bonds and high-grade corporate bonds. - Mr. Lindow, Miss Eyre

Reviewed -

Amount of interest-bearing debt outstanding, the computed annual interest charge and the computed rate of interest. - Mr. Lindow

- 14 -

Estimated customs duties and taxes, and value of dutiable and taxable imports, by tariff schedules. - Mr. Lindow, Mr. Wilson

Estimated receipts from taxes imposed by various revenue acts on imports. - Mr. Lindow, Mr. Wilson

Computed duties collected, by countries. - Mr. Lindow, Mr. Wilson

Treasury criminal cases. - Miss Michener, Mr. Lindow

2. Other material for publication.

- (1) Report of the Central Statistical Board for December 1939 and January 1940 was reviewed, at the Board's request, February 1. - Mr. Haas, Mr. Reagh

3. Correspondence.

Replies were prepared to letters of inquiry on subjects relating to the work of the Division, and letters drafted elsewhere and submitted to the Division for that purpose were reviewed. - Miss Michener, Miss Ziegler, and other members of the staff in appropriate fields of work.

During February 268 letters were received in the Division and 251 were handled as required.

4. Charts.

Charts are prepared and continually brought up to date for use in memoranda and in chart books on special subjects, and corresponding photographic, photostatic, and multilith work is carried on. This is done in the Graphic Section under the supervision of Mr. Banyas. A statistical report on the work of the Graphic Section for the month of February is attached.

Work completed in the Graphic Section, Division of
Research and Statistics, February 1 to 29, 1940

Type of work	For Division of R & S	For Others	Total
<u>Graphic:</u>			
<u>New charts:</u>			
Total charts completed	46	6	52
<u>Charts brought up to date:</u>			
3 bond chart books brought up to date	24 (times)	-	24 (times)
All other charts brought up to date	663	15	678
<u>Miscellaneous:</u>			
Total jobs	8	3	11
<u>Photographic:</u>			
<u>Photographs:</u>			
Total jobs	51	38	89
Number of-			
Negatives	66	79	145
Contact prints	218	729	947
Enlargements	75	151	226
<u>Photostats:</u>			
Total jobs	88	13	101
Number of-			
Lettersize copies	320	144	464
All other copies	584	284	868
<u>Multilith:</u>			
Total jobs	-	4	4
Number of-			
Zinc plates	-	66	66
<u>Miscellaneous:</u>			
Total jobs	1	2	3

Statistical Report on Work Completed by the
 Graphic Section, Division of Research and Statistics, by months,
 beginning January 1940.

Type of Work	Jan.	Feb.	Mar.	Apr.	May	June	Total
A. Graphic							
New charts completed	41	52					
Charts brought up to date	773	678					
Bond book charts completed	57						
Bond books brought up to date	-	24(times)					
Miscellaneous jobs completed	49	11					
B. Photographic							
<u>Photographs:</u>							
Total jobs	69	89					
Number of-							
Negatives	179	148					
Contact prints	192	947					
Enlargements	604	226					
<u>Photostats:</u>							
Total jobs	137	101					
Number of-							
Letterise copies	2,561	464					
All other copies	781	868					
<u>Multilith:</u>							
Total jobs	2	4					
Number of-							
Zinc plates	65	66					
<u>Miscellaneous:</u>							
Total jobs	6	3					

March 1, 1940

Dr. Feis

Mr. Cochran

Will you kindly send a cablegram along the following lines:

"AMERICAN CONSUL, BIRMINGHAM, ENGLAND

The Secretary of the Treasury has read with much interest Consul Wilkinson's despatch Number 368 of January 29 on the machine tool industry which has provided most timely and helpful information. Secretary Morgenthau would appreciate receiving further reports on this subject. It is specifically suggested that effort be made to report upon the question of plant expansion in other Birmingham industries, preferably those producing engines or airplanes if any, and that explanation be made of the treatment accorded such plant expansion by British tax authorities."

WMS
HED/rmm 3/1/40

PARAPHRASE OF TELEGRAM SENT

TO: American Consul, Birmingham, England

DATE: March 1, 1940, 5 p.m.

NO.: 3

Consul Wilkinson's despatch No. 368 of January 29 was read by the Secretary of the Treasury with much interest. The despatch has provided information which is most timely and helpful. Further reports on this matter would be appreciated by the Secretary of the Treasury. He makes the specific suggestion that effort be made to report on expansion of plant in other industries of Birmingham - preferably those which produce engines or airplanes, if there are any producing these products - and that the treatment which is accorded such plant expansion by the tax authorities of Great Britain be explained.

HULL
(FL)

EA:LWW

GENERAL E M WATSON
SECRETARY TO THE PRESIDENT
EN ROUTE TO WASHINGTON

MARCH 1, 1940

THANKS FOR YOUR MESSAGE OF FEBRUARY TWENTY NINE. I WILL
TAKE BOTH APPOINTMENTS. REGARDS

HENRY MORGENTHAU JR

"CLEAR"

*Sent 4 pm
March 1 pm*

GENERAL E M WATSON
SECRETARY TO THE PRESIDENT
EN ROUTE TO WASHINGTON

MARCH 1, 1940

THANKS FOR YOUR MESSAGE OF FEBRUARY TWENTY NINE. I WILL
TAKE BOTH APPOINTMENTS. REGARDS

HENRY MORGENTHAU JR

"CLEAR"



DEPARTMENT OF STATE
WASHINGTON

March 1, 1940.

The Secretary of State presents his compliments to the Honorable the Secretary of the Treasury, and encloses for his information a copy of telegram No. 38 of February 15 sent to the American Embassy, Rome, Italy, with regard to certain payments to Italian silk exporters.

TO THE SECRETARY
TECHNICAL ASSISTANT
OFFICE OF THE

12 2 21 1 11 AM '40

TECHNICAL ASSISTANT
RECEIVED

22

TELEGRAM SENT

February 15, 1940.

6 p.m.

AMERICAN EMBASSY

ROME

38.

FROM TREASURY.

Concerning current situation Italian silk products cable whether payment of 4 lira per kilo of raw silk content on Italian exports to United States has been abolished and amount Ufficio Serico Italiano plans or has planned to pay to Italian silk exporters during silk year 1939-40 and whether any changes in such payments have occurred during present silk year.

HULL
(GSM)

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AMERICAN EMBASSY

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TREASURY DEPARTMENT

143

INTER OFFICE COMMUNICATION

DATE March 1, 1940

TO Secretary Morgenthau
FROM Joseph P. Cotton, Jr.

Re: Export-Import Bank action in connection with Scandinavian Loans, and Mr. Jones' press statement of today.

In view of the President's assurance to Mr. Jones that he will sign the bill recently passed by Congress to increase the capital of the Bank, the Bank took action today to "allocate" \$20 millions to Finland, and to authorize loans of \$15 millions to Sweden and \$10 millions to Norway. On the basis of this action Mr. Jones proposes this afternoon to make public the statement, copy of which was sent up to you earlier this afternoon. It should be noted that the \$10 millions commitment to Norway is intended in substitution for a commitment in a similar amount hitherto made by the RFC.

Mr. Jones discussed the general situation rather fully. He said that Congress passed this legislation in the expectation that it would be made use of for an immediate loan to Finland, and that the President specifically approved the proposed action which he sought to have the Bank adopt. There was a little discussion as to whether or not the time had not passed when aid to the Scandinavian countries might be conducive to the desired results. Mr. Jones frankly said that the Finnish loan could only be considered sound upon the assumption that a negotiated peace will terminate the war between Russia and Finland, of which he apparently has some hope. In view of the risks in this situation he thought it desirable that the Bank should act merely to "allocate" resources in the case of Finland while definitely authorizing loans in the case of Sweden and Norway. By "allocate" he means that the Finns should be permitted to continue to purchase beyond the existing \$10 millions credit so long as the situation would appear to justify helping them. Before getting in touch with you on the telephones I asked Judge Moore whether, in view of the course of events since the Export-Import Bank bill was introduced in Congress, the State Department did not wish to reconsider its position in respect to loans to Finland and Scandinavia in general. The response was in the negative. I also asked whether anybody in the group had any reliable figures showing the extent of allied aid to Finland and whether any attempt to trade upon the proposed action of this country to obtain assurances of allied help were contemplated. The answer was that nobody knew of any reliable figures and that the State Department did not desire any arrangement with the allies in this matter. I also asked whether anybody in the group had seen any purportedly

- 2 -

reliable report as to the military situation in Finland. The response was in the negative.

Mr. Noble expressed some apprehension that the action taken might be a disservice to Finland if it contributed to the continuance of a war in which there is little hope of a successful outcome from Finland's standpoint.

There was considerable discussion as to the advisability of including in Mr. Jones' statement reference to Sweden and Norway as well as Finland. Objections were tentatively put forward by Judge Moore and Mr. Noble, but were overruled by Mr. Jones, who said that he assumed full responsibility for the public statement. Incidentally, neither Mr. Jones nor Judge Moore cleared this statement with Mr. Hull.

In connection with the Swedish loan, Mr. Jones pointed out that last year Sweden had an adverse balance with the United States of approximately \$50 millions; that the situation was undoubtedly worse now; hence that Sweden could not continue to buy from the United States on anything like the scale which prevailed in the past unless afforded credits. He also said that in view of the action being taken and the statement being made including reference to the several Scandinavian countries, it would be difficult in the future to avoid doing something for Denmark. He was, however, leery of this situation because of geographical proximity to Germany.

Mr. Jones indicated that the action taken would go far to exhaust the anticipated additional resources of the Bank resulting from recent congressional legislation. The Bank at the present time is committed over and above the old \$100 millions to the extent of about \$30 millions, which, plus the "allocation" and authorizations made today, result in total commitments of \$175 millions, leaving a noncommitted balance of only about \$25 millions. In this connection he said that he had no intention of laying aside the Chinese matter and that he had found the Committees of Congress sympathetic. There was some discussion as to whether it would not be desirable to include a reference to China in his statement. The China matter he discussed with you over the telephone. Mr. Jones said that he was ready to go ahead with a \$20 millions loan to China and that the only point which he was doubtful about was the capacity of the Chinese to export tin. He was against any reference to China being included in the statement because he felt that certain problems in this connection remain to be worked out. He said he intended, however, to go into the matter fully next week.

It should be noted that the action taken by the Bank today commits all but a small portion of its increased resources. Mr. Jones said that this of course left little, if anything, for Latin America, but that we

- 3 -

would have to cross this bridge when we came to it as in the past. This, of course, means in practice trading with the RFC to get them to do part of the business. In this connection the possibility of a small loan to Colombia, should the debt settlement eventuate, and the Brazilian steel project were touched upon. Mr. Jones evidenced considerable interest in the steel project situation and said that he would like to get those U. S. Steel people who had been to Brasil down here.

A.P. C.P.

Prepared by: Mr. Murphy
Mr. Lindow
Mr. Tickton
Mr. Haas

146

TREASURY DEPARTMENT

CONFIDENTIAL

INTER OFFICE COMMUNICATION

DATE March 1, 1940

TO Secretary *Morgenthau*
FROM Mr. Haas *HAAS*
Subject: Selection of Issues for the March Financing

I. Selection of Maturities of New Issues

The maturities of new Treasury issues should obviously be selected to accord, as far as possible, with the preferences and interests of both the market and the Treasury. This may, of course, involve some concessions on the part of each.

With respect to the preferences of the market, a sharp distinction must be drawn between those issues which the prospective purchasers plan to hold to maturity and those issues which they plan to turn over at a profit, either immediately or at some later date. As far as the market's preference for new issues to hold is concerned, there can be no question but that such preference is for short issues.

Allowing, however, for the natural desire of the holders of the maturing securities to obtain as large a premium as possible on their exchange subscriptions and for the greater ease with which such premiums may be obtained on medium- or long-term securities, the current preference of the market for a new security to be issued at the present time seems to lie in the early Fifties. Beyond this point the preference curve falls sharply, and we are advised that any attempt to place a new issue beyond the middle Fifties would probably meet with sharp resistance on the part of the market; and that, even if such an issue were initially successful, it would be followed by widespread secondary distribution.

As against these market considerations, the fiscal interests of the Treasury would seem to call for an intermediate- to long-term maturity.

Chart I shows (on the left-hand side) the amount of public debt (direct and guaranteed) first callable or maturing in each calendar year; and (on the right-hand side) the cumulative amount of debt callable or maturing through each year. It will be noted that none of the debt now outstanding becomes first callable in the years 1952 to 1954, inclusive, while none

Secretary Morgenthau - 2

Finally matures in the years 1957 and 1958, and maturities in 1955 and 1956 are very light. The "real" maturities in 1954, moreover, are substantially smaller than appears from the chart, since \$1,037 millions of the "nominal" maturities of that year are in the form of a 4 percent issue first callable ten years earlier.

It would seem, then, that the preferences of the Treasury and the market might best be reconciled by an issue with a two- or three-year call period, beginning in the early and extending to the middle Fifties. The offering of such an issue should probably be coupled with that of a Treasury note for the benefit of the holders of the maturing securities who prefer to take the sharp sacrifice in yield involved rather than accept a longer security.

II. Coupon-Carry on Issues Being Refunded

As we pointed out in our memorandum of February 28, the coupon-carry (i.e., the interest accrual at the coupon rate) between March 15 and June 15 amounts to $27/32$ on the $3-3/8$ percent bonds and to $12/32$ on the $(1-1/2)$ percent June notes. These coupon-carries represent the approximate premium values of the two issues, respectively, in the absence of any refunding offer whatsoever. Only that part of the premium on a new issue which is in excess of these coupon-carries represents a real margin of safety, as far as the new offering is concerned.

It is clear, therefore, that a larger premium on the new issue is necessary to insure the exchange of the $3-3/8$ percent bonds than is necessary to insure that of the June notes. There are only \$353 millions of the bonds outstanding, however, as compared with \$738 millions of the notes. It would, consequently, seem desirable that some method should be found by which the position of the bonds and notes might be more nearly equalized, so that the full extra premium necessary to make the exchange offering attractive to the holders of the bonds would not also have to be given to the holders of the notes.

It is suggested that this objective can best be accomplished by making a special adjustment with respect to all the $3-3/8$ percent bonds exchanged for new bonds, such as to give them the equivalent of their full $3-3/8$ percent coupon (but not double interest) up to June 15. The value of such an adjustment would vary with the coupon of the new bond. In the

case of a 2-1/4 percent issue, it would be about 9/32. Such an adjustment, while it would apply to the bond alone*, would permit the premium on the entire new issue to be shaved by that much without impairing its real margin of safety.

III. A Technical Difficulty in Pricing

The pricing of an intermediate bond on the present occasion involves greater than usual technical difficulties. Chart II shows the yields of Treasury bonds having two-year, three-year, and five-year call periods, respectively. Separate curves are fitted to the yields of the bonds with each call period. Only bonds with coupons of less than 3 percent have been included.

It will be noted that the curves connecting the points for bonds with three-year and five-year call periods, respectively, pass through, or practically through, all of the points without difficulty. The curve connecting the points for bonds with a two-year call period, however, passes through only three of the four points while the other point falls considerably off the curve. The latter issue -- the 2-1/2's of 1950-52 -- has a higher premium than the two adjacent issues, but this hardly seems adequate to account for the full amount of the difference in yield. This issue has a premium of about 5-1/2 points as compared with premiums of 3 and 3-1/4 points on the nearby issues -- the 2-1/4's of 1951-53 and the 2's of 1948-50, respectively.

As a result of this unusual irregularity in the yields of the outstanding issues, the pricing of new issues in the very early Fifties is subject to considerable variation, depending upon how much weight is placed on the yield of the outstanding 50-52's as compared with those of the other two issues just referred to. On the whole, estimates of probable prices appear to have greater reliability for first call dates beginning about 1952.

IV. Selection and Pricing of Particular Issues

The attached table shows the probable yield basis, the probable premium, and the "real margin of safety" of a number of issues deemed to be suitable for refunding the June notes and bonds. The table is divided into two parts, the upper part showing the issues selected for consideration if no

* And only on exchanges into new bonds.

interest adjustment is made on the June bonds, and the lower part showing the issues selected for consideration if an interest adjustment of the type previously discussed should be decided upon.

The bonds suggested for use in case no interest adjustment is made have been selected so that their initial gross premium would be about $1\frac{5}{8}$ points. Their "real margin of safety" ranges from $22\frac{1}{32}$ to $28\frac{1}{32}$. In the case of the bonds suggested for use if an interest adjustment is to be made, the basic initial premium has been reduced to about $1\frac{3}{8}$ points. The "real margin of safety" of the various issues in this case ranges from $24\frac{1}{32}$ to $27\frac{1}{32}$.

It is suggested that the 1 percent note due September 15, 1944 (originally issued last December) should be reopened at seven-eighths of a point premium if no interest adjustment is to be made and at three-quarters of a point premium if such an adjustment is to be made. In the prices given in the table, there is a differential of from $6\frac{1}{32}$ to $14\frac{1}{32}$ in favor of the bonds over the notes (including, where relevant, the interest adjustment). This is probably large enough to insure that the major portion of the exchanges would be for bonds, but still offers a reasonably "free" choice to those investors with a preference for notes. The differential could, of course, be readily adjusted either in the direction of weighing the scales more heavily in favor of the bonds, or of offering a somewhat more "even" choice to investors preferring the notes.

No new note issue has been suggested. This is partly because no 5-year or $4\frac{3}{4}$ year note would fit satisfactorily into a dual pricing scheme and partly because it is improbable in any event that sufficient of the new notes would be taken to justify a new issue. For these reasons, it is believed that it would be much more satisfactory to reopen the September 1944 note (now outstanding in the amount of only \$283 million) than to start a new issue.

It will be observed that the 10-12 and 10 - 12-1/2 year bonds suggested in the table do not fit in very well with the maturity schedule of Treasury bonds. These issues have been included as possibilities, however, because of the strong feeling in some quarters that any longer issue would be unwise.

Attachments

Probable Premiums on New Issues
(Basis of closing bids, February 29)

	Probable yield basis	Probable premium	"Real margin of safety" 1/ 30
	(Percent)	(Percent)	(Decimals are thirty-seconds)
<u>Issues suitable in case no interest ad- justment is made</u>			
<u>Note</u>			
Reopen 1's due 9/15/44 at 7/8 premium (now selling at 102.05)	1.09		.14
<u>Bond</u>			
10-12 year 2's due 3/15/50-52	1.83	1.17	.22
11-1/2 - 13-1/2 year 2-1/8's due 9/15/51-53	1.96	1.22	.27
12-15 year 2-1/4's due 3/15/52-55	2.09	1.22	.27
13-1/4 - 15-1/4 year 2-1/4's due 6/15/53-55	2.10	1.23	.28

Issues suitable in case interest ad-
justment is made on June bonds as
suggested in this memorandum

Note

Reopen 1's due 9/15/44 at 3/4
premium (now selling at 102.05)

1.13 .18

Bond

10 - 12-1/2 year 2's due 3/15/50- 9/15/52	1.86	1.09	.25
12-1/2 - 15-1/2 year 2-1/4's due 9/15/52-55	2.12	1.13	.27
14-16 year 2-1/4's due 3/15/54-56	2.14	1.10	.24

Treasury Department, Division of Research and Statistics March 1, 1940

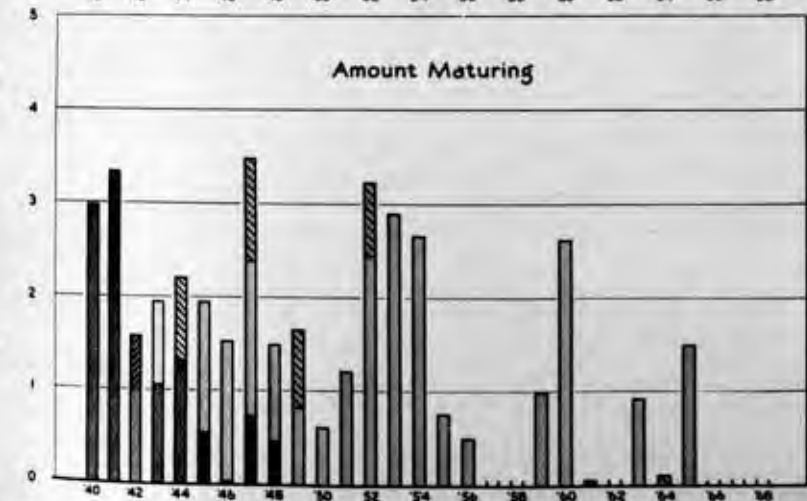
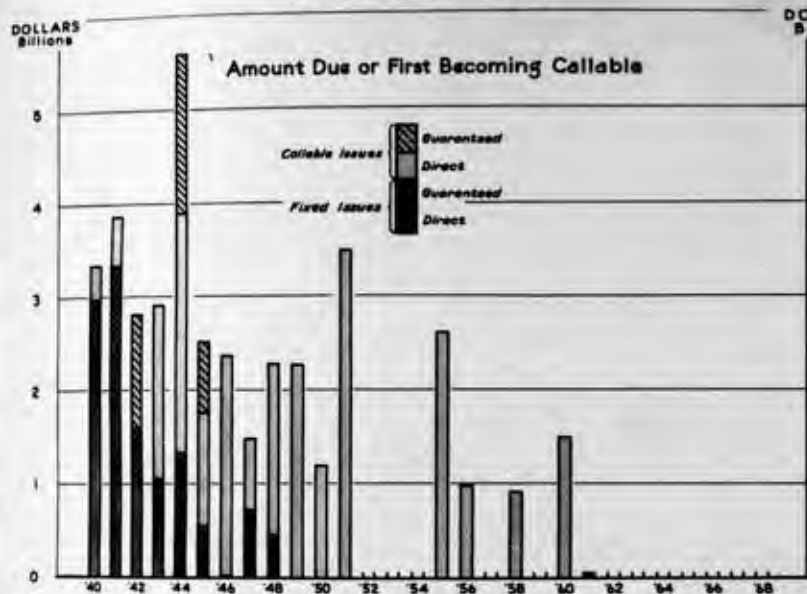
Applicable to exchanges of 3-3/8 percent bonds. The margin of safety on the June notes is, of course, larger.

Chart I

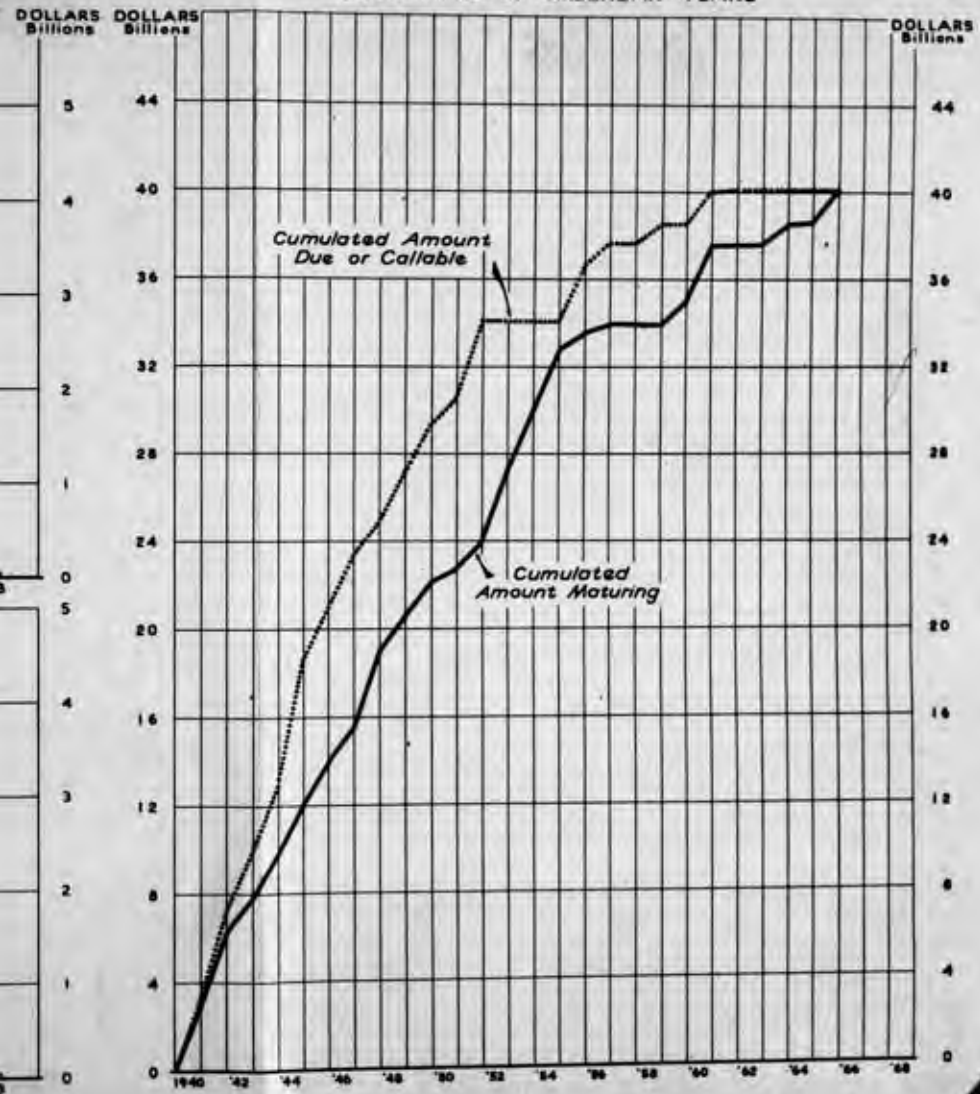
MATURITY SCHEDULE OF INTEREST BEARING PUBLIC DEBT, FEB. 1940

Including Guaranteed

BY CALENDAR YEARS



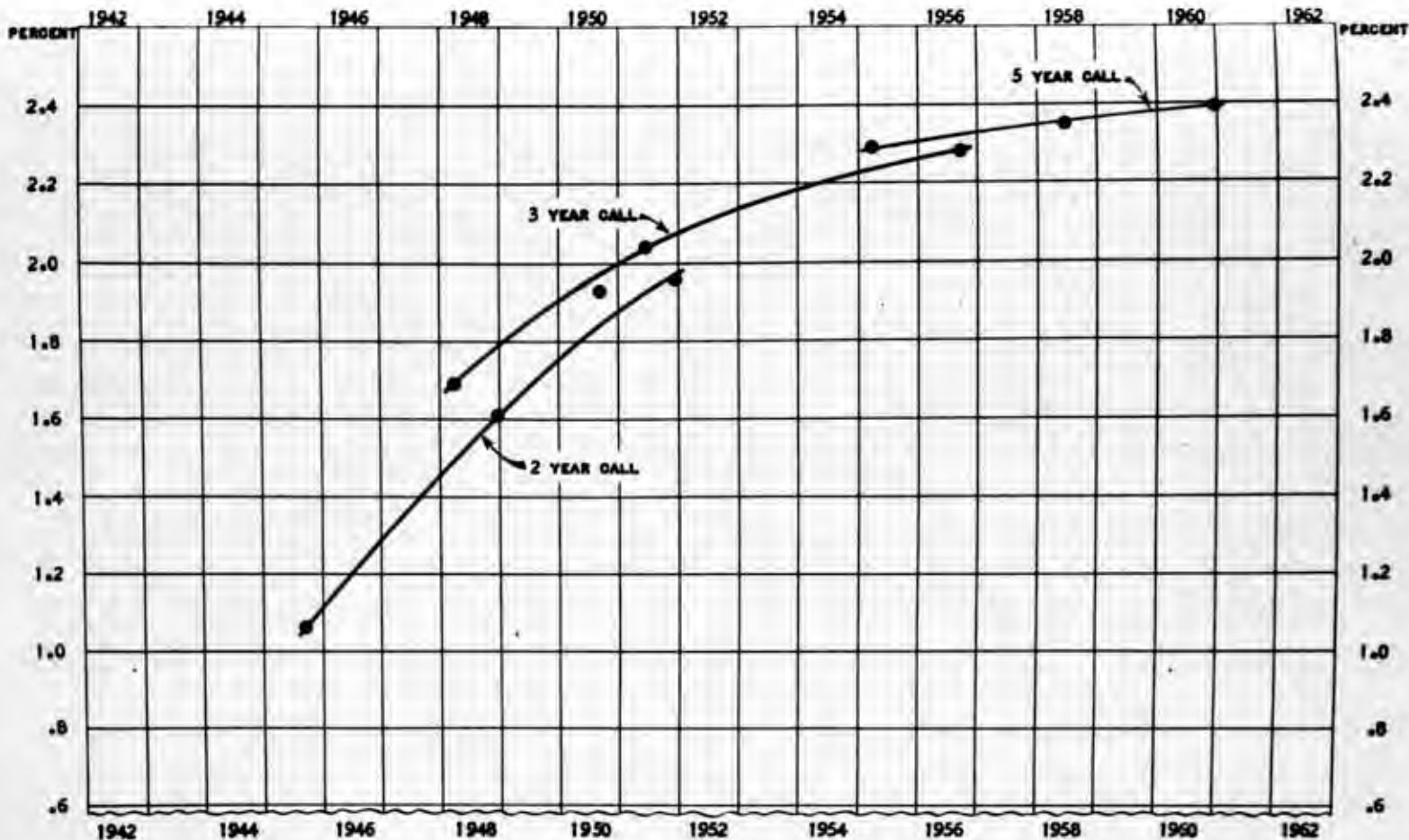
CUMULATED BY CALENDAR YEARS



* Excluding (1) Postal Savings Bonds; (2) U.S. Savings Bonds; (3) Adjusted Service Bonds; (4) Special Issues to Government Agencies and Trust Funds.

YIELDS OF TREASURY BONDS WITH 2 YEAR, 3 YEAR AND 5 YEAR CALL PERIODS*

Based on Closing Bids, February 20, 1940



* EXCLUDING ISSUES WITH 3% OR HIGHER COUPONS

3-1-40

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THE SHORT VIEW AND THE LONG IN ECONOMIC POLICY

BY
JACOB VINER

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THE SHORT VIEW AND THE LONG IN ECONOMIC POLICY

Presidential Address Delivered at the Fifty-second Annual Meeting of the American Economic Association, Philadelphia, Pennsylvania, December 27, 1939

Once upon a time an academic economic theorist, by some freak of fate not likely to be often repeated, got himself slightly entangled in the machinery of formulation of government economic policy. What I plan to tell you tonight reflects largely, though not I hope too explicitly, what the process of policy-formulation did to his academic theorizing, and what his theorizing failed to do to the process of policy-formulation.

As an active participant in the policy-making process, the academic theorist suffers from a number of handicaps more-or-less peculiar to himself. For purposes of teaching, or of acceptable writing for his restricted audience of fellow-theorists, his conclusions are of little importance; and what matters above all is the rigor and elegance of his manner of reaching them. For policy, on the other hand, conclusions are vital, and often are all that is vital. For the purposes of academic theorizing, the premises the theorist starts from may without serious penalty be arbitrarily selected, narrowly restricted in range, and purely hypothetical in nature. But the selection of premises controls the conclusions reached, and for policy-determination it is therefore vital that all the important variables be covered by the analysis, and that the conclusions be not affected by the use of premises which are irrelevant for their purposes or less realistic than it is possible with the aid of available information to make them. To violate these rules in policy-making is to be guilty of the grossest irresponsibility. If he is not to be wholly in the way of the policy-maker, therefore, the theorist must emerge from his ivory tower,—which is almost as hard as to return to it.

The theorist's habitual methods of analysis are such as to lead to "right" or "wrong" answers to manufactured problems, the premises and the criteria of rightness being so chosen as to make this not only possible but necessary. For the policy-maker, however, the problems are for the most part not of his own devising, but are presented to him by outside forces, in vague and ill-defined fashion, and what he asks of his advisers consists as much of help in determining what the problems are as of help in finding solutions for them. The theorist here is likely to find himself uninformed and unskilled.

The theorist's analysis is ordinarily couched in descriptive as distinguished from normative terms. If choices as between social values influence his thought, these choices are largely left implicit in his selection of premises, and are rarely, and then usually apologetically, expressly avowed. The policy-maker, however, is rarely satisfied with purely descriptive analysis. He insists that he be advised not only what will be the objective consequences of a specific line of action, but whether or not these are desirable consequences. While he has always some notions of his own with respect to the values which policy should serve, in my experience he always demands of his economists that they guide him also in the determination of what is socially desirable, and he expects the economist to acknowledge and to display some professional competence in giving such guidance.

There are always a number of different values to be considered, moreover, and satisfaction of one often involves disregard of the other. This makes necessary a sort of weighing process, in which the decision is presumably made partly on the strength of quantitative information as to the number of persons affected by alternative courses of action, their economic status and needs, and so forth, and partly on the basis of a qualitative ranking of values in terms of some sort of scale of worth. The theorist as such here also lacks experience. He is hampered, moreover, by his tendency to dissect the mental processes by which decision is reached in such matters, and he tends to feel and to give discomfort by his reluctance to express in definite and assured terms the conclusions which he knows he has reached only by vague and imperfectly communicable processes of thought.

The effect of the action on the subject is all that the theorist has been trained or conditioned to think about with respect to public policy. The official and the legislator, on the other hand, should, and in any case invariably do, think also of the effect of the action on the actor. The economist conditioned to the purity of abstract thought is liable to be unreasonable in his refusal to recognize that the official, in choosing his time for action and his manner and degree of action, must give regard to their impact on his relations with superiors, colleagues, Congress, and the public, and to their effect on the prestige of his agency and the morale of his staff. But the official must operate in this way if those with whom he has to deal from day to day are to give him that cooperation and good will which are essential not merely for his own personal success and comfort but for the satisfactory execution of his functions.

The higher officials in Washington, whether they be political appointees or career men, in my opinion, need make no apologies for their standards even to college professors, elect of the elect though we be. As far as I have observed, the higher officials in Washington as a group work as hard,

as disinterestedly, cooperate in common tasks as loyally, think as straight within their own special fields of competence, as does the ordinary run of college professor. They certainly do not live on the moral heights continuously, but they are called upon more often than academic men to rise to them, and, in my honest judgment, they respond to the call as often and as fully as in all probability we ourselves should under like circumstances.

In one respect in particular, of special interest to economists, I have observed them with ever-increasing admiration—namely, their patience and generosity in their dealings with their economic advisers. In the course of expounding the economic verities, the economists repeatedly expose their divided counsels. They especially reveal that conflict within their ranks between ancient dogmas and resurrected or newly-invented heresies with which much of the remainder of my talk will deal. Those officials who come into frequent contact with squads of economists, as they note the repeated conflict of testimony, must feel at times like the English judge who remarked that he had for years been trying motoring cases in which two cars, each of them on the right side of the road and each of them stationary, had been involved in a head-on collision—or even like that magistrate in a native court in Ceylon who, disgusted by the flagrant contradictions in the evidence of the successive witnesses, said to the officer of the court: "Call the next liar." This failure of the economists to speak as with one voice is a severe trial for the officials. I suspect, however, that they would find us even more trying if, when unpalatable advice was offered by one economist, they could not feel that there was a good chance that with a little search another economist could be found happy to swear that the advice which had been given was incredibly bad economics, or even was "orthodox" or "sound" economics, which are now very forceful epithets indeed in some high quarters.

To proceed with my catalogue of the handicaps of the economic theorist as a policy-maker. The economists of my generation and earlier were trained to concentrate on so-called long-run analysis in their pure theorizing. When they ventured into the discussion of questions of public policy, they accordingly tended to be preoccupied with the long view, with the effects which a given action would have on the more distant future, and to disregard or to weigh lightly its more immediate effects. A good illustration of what I have in mind is the famous poor-law controversy in England in the 1830's. The leading economists of the time all emphasized the allegedly injurious effects on the productive capacity and the will to work and to save of the poor which would result from generous, long-sustained, and assured poor-relief to the able-bodied. They stressed even more the growth of population and the consequent impairment of the basic earning power of labor which they believed would ultimately result

from any substantial liberation of the poor from dependence solely on their own efforts for the means of subsistence of themselves and their children. The extreme conservatives and the extreme radicals of the time—who, as so often in history, were on the same side on a specific issue—and also the humanitarians and clergy, stressed in opposition to the views of the economists the moral and political rights of the needy to be given food and shelter with a minimum of humiliation and of deliberate interference with their accustomed patterns of family and social life. In this instance, as in many others, it was possible plausibly to picture the clash between the long view and the short as a clash between the humane and the hard-hearted, although the economists of the time of course insisted that the policy they advocated, while immediately severe, would ultimately prove to be the kinder of the two to the poor.

Although it is obviously not without direct relevance to present-day problems, I am not concerned here with the merits of this ancient controversy. I have cited it only to help make clear the differing turn which may be given to public policy accordingly as the long view or the short is dominant, and to illustrate the characteristic approach of the orthodox economist, from that day to this, to policy questions.

Now this habit of taking the long view is not only characteristic of the orthodox economic theorist, but in the discussion of matters of economic policy it is often the principal characteristic by which he can be distinguished from other professional economists or even from the intelligent layman.

In the day-to-day process of adapting public policy to meet felt needs, on the other hand, the problems always manifest themselves in the form of immediate pressures of one sort or another, and the legislator or official tends to look for correspondingly immediate solutions. This is "natural" behavior, in the sense both that it is what one should expect to occur, and that it has its socially useful aspects.

Legislators and officials are typically busy and harried men. Except under the special circumstances of major election campaigns, when the pattern of party debate may by chance turn on the relative merits of the long-run programs of the contending parties, and except for the occasional opportunity of the legislator or the official to divest himself of the cares of the moment and, assuming the rôle of the statesman, to give patient examination to the needs of the future, there is constant preoccupation with the problems which are immediately pressing, and little stimulus to take thought as to whether the proffered solutions are likely to prove lasting ones. There is especially little urge to go hunting for problems which are not yet felt as such but which may prove troublesome in the distant future.

It would be a mistake, however, to take for granted that the immediate

solution, the quickly-working one, is of necessity a defective one. The immediate solution to a problem no doubt frequently serves also with tolerable satisfaction as a permanent one, and in some cases may well be identical with the optimum permanent solution. Many problems, moreover, are themselves temporary in nature, and require therefore only temporary solutions. The immediate solution may be the only one for which public acceptance is obtainable, so that there is really no choice. There are circumstances, moreover, under which even a benevolent dictator, with no need to give heed to public clamor, would be wise to adopt a partial and temporary, but quick-working, solution in preference to a more complete and more lasting one which would yield its benefits only after considerable delay. Mr. Keynes, speaking with at least a trace of the accent of revelation, has told us that in the long run we'll all be dead. What I presume he meant by this apparently crystal-clear dictum was that if we took the long view, we, including our otherwise potential posterity, would—or might—all be dead—or dead or unborn—before that view could justify itself. This warning is scarcely much needed either by the public official or by the ordinary legislator, but for the reasons I have stated and not only because in respectable communities the dead and the unborn cast no votes. But for the academic economist it is a sound warning, and perhaps even a needed one. In times of severe social strain there may be real menace of catastrophe if there is not resort, even at the cost of bad after-effects, to a quick-working remedy which tides the economy over the crisis. At such times, the patience of the orthodox theorist may be out of place. But in the past, at least, such times have come only rarely.

Closely related to the habit of the theorist of preoccupying himself with those effects of proposed legislation which are more distant in time is his habit of searching for the repercussions of legislation which are so-to-speak more distant in space. Politicians are experts in tracing one kind of repercussion, the *political*. But they are indisposed to take account of *economic* repercussions, as the history of tariff controversy abundantly demonstrates. This indisposition, I think, they share with the general lay public, to whom, in matters of economic analysis, one step at a time is enough, if not too much. And since what the public doesn't know can't hurt the legislator, he has at least no selfish motive for following the theorist in his unsteady and circuitous wanderings from the proximate to the secondary, to the tertiary effects, and is content to act in terms of the seen, with worry about the unseen left to the economic theorist as a sort of occupational psychosis.

I do not include in my list of the handicaps peculiar to the economic theorist as a participant in the policy-formulating process two items which would probably appear high on such a list if prepared by those with whom the economist works—namely, first, his ignorance as a rule of the

legal framework and legal folklore to which legislative drafting and the administration of the laws must conform; and second, his lack of experience and insight with respect to what is and what is not administratively feasible. These are omitted, however, not because the ordinary economist does have command of these skills, and not because they are unimportant, for such is decidedly not the case in either instance. But barriers to effectiveness of this general type, instead of being peculiar to economic theorists, are common to all kinds of specialized participants in a cooperative enterprise such as policy-formulation which makes demands upon a wider range of skills than single individuals can reasonably be expected to possess. The lack of legal and administrative training on the part of the economic theorist may be regrettable, but it is not fatal as long as he is not permitted to decide policy questions all on his own.

In the ordinary course of events, policy is, of course, ultimately decided not by the technical experts as such, whether they be economists or engineers or political scientists or sociologists, but by the legislators and the responsible executives with the aid of advice by the experts. That excellent formula, "The expert *should be* on tap, not on top" would be almost equally valid if it went, "The expert *is* on tap, not on top." This applies no more and no less to the economist than to the other professions—except for the lawyer, who is on tap *and* on top, and omnipresent, omniscient, omnipotent, and omnivorous in addition. In the process of tapping the experts for their specialized knowledge and skills, the technical equipment of one profession provides the offset for the gaps in the capacities of the others. And for those many things which in a world not clearly designed for full comprehension by man are beyond human knowledge, the lawyer always stands ready to provide precise formulae acceptable to the Supreme Court as unambiguous expressions of legislative intent.

Even with these two items omitted, the list of handicaps of the academic economic theorist as a participant in the formulation of public policy which I have given is discouragingly long. Others, moreover, would probably think they could easily make it even longer and even more discouraging to the theorist. Let it be clear, however, that I am not identifying the few "academic economic theorists" with economists in general, and that I recognize that there are many other types of economists whose serviceability in policy-formulation and in other activities of government has been amply and unquestionably demonstrated.

The non-theoretical economist, in particular, or the economist who disclaims any theoretical prejudices, is in fact much more adaptable to public service than the economic theorist with some body of theory to which he remains faithful, whatever its species. The non-theorist can adjust himself quickly to the changing flow of events and issues. He is not bound by any set mode of analysis. His mind but lightly encumbered by doctrines,

dogmas, preconceptions, or even in some cases thoughts, the fortunate man can move freely in any direction, wherever the wind may list. If he feels the need for guidance, there is always available today yesterday's position of his official superiors and tomorrow the different position they took today. In finding good-sounding reasons for what has already been decided upon, he has a distinctive and useful function, both because the vitality of the democratic process is dependent upon our continuing to believe that it provides us with reasonably wise and beneficent government, and also because statesmen's intuitions have often a genuine economic logic dimly in their background. He shares also with other types of economists the useful rôle of finding good uses for bad laws, and thus contributes to the most important function of the art of public administration: the making of silk purses out of legislative sows' ears.

The handicaps of the academic theorist of the older dispensation as a useful member of a policy-formulating staff are probably even more clearly visible to other members of the *economic* profession than to members of *other* professions. There is in fact a definite cleavage between the habits of thought of this species of theorist and those of other groups in the profession, including many of those who help guide Leviathan in its daily gyrations. The continued depression has obviously made a deep impression on the latter, and made them impatient of or even violently hostile to the traditional corpus of economic theory, which they look upon as an instrument for the exercise of the tyranny of the dead mind over the living. They seem to believe increasingly that its rôle has been, even in the long-past days of its almost unchallenged dominance, "to light fools the way to dusty death." The world it approvingly describes of atomistic competition, and the ethical approval which, as they read it, it translates to the actual world by its failure clearly to contrast the ideal with the real, make it appear to them too far divorced from the present-day realities and values to warrant faith in its usefulness as an aid to the guidance of social policy. Instead of the economy of effective competition, of freedom of individual initiative, of equality of economic opportunity, of steady and full employment, pictured in the traditional theory, they see an economy dominated by giant corporations in almost every important field of industry outside agriculture, an economy marked by great concentration of wealth and economic power, and great disparity of income and of opportunity for betterment. They note the apparently unending flow of evidence from investigating committees and courts of the flagrant misuse of concentrated economic power. They observe with alarm the failure of our economy for ten successive years to give millions of men able to work and anxious to work the opportunity to earn their daily bread. And seeing the actual world so, they refuse to accept as useful for their purposes a type of economic theory which as they read it either ignores these evils or treats

them as temporary, self-correcting aberrations or excrescences of what is basically a sound economic system. Having rejected the conventional picture of the system, they tend increasingly to adopt another one, rapidly approaching equal conventionalization, but following another pattern, in which the evils are inherent in the system and cannot be excised without its drastic reconstruction and its substantial operation by government.

Their account of the traditional economic theory is not wholly a caricature, but it is overdrawn and distorted. It deliberately disregards the failure of government to behave according to the rules laid down by the orthodox theory as necessary if its conclusions are to have practical validity, and it especially overlooks the long line of great men in the orthodox tradition, by no means already at an end, who by no stretch of the imagination can be charged with having exploited it to protect evils against reform. But this is in the present connection significant only as it prejudices these zealous reformers against utilizing for their own good purposes the aid the old doctrines can still furnish. Their picture of the evils of the present economic system may also be painted in too strident colors, but it is undoubtedly close enough to the truth to make complacency indefensible. Where in my opinion they are most gravely in error, however, is that in rejecting lock-stock-and-barrel the traditional economic theory, they are abandoning habits of mind and analytical tools which are still essential if evils are not only correctly to be identified but are to be ascribed to their proper causes, and if remedies are not to be advocated which may prove worse than the diseases they are prescribed for.

As a by-product of the breach with the older body of doctrine, the economic profession is tending to wipe out that line of cleavage which in this country has been so marked almost since the foundation of the Economic Association between the teachings of the professional economists, on the one hand, and the practices of government and the beliefs of the lay public, on the other hand. I, for one, would welcome this reconciliation if it resulted from our final conversion of the lay public. I think, however, that the reverse has happened to a substantial extent, and that economic doctrine is now following public opinion and government practice much more than it is influencing them. For obvious reasons which have no counterpart in this country, this is now of course the routine situation in totalitarian countries. Its occurrence in this country is not, I am certain, due to any significant extent to a new subservience of the profession to external opinion. Its explanation lies largely, I think, in the fact that under the impact of depression conditions the economists have in large numbers abandoned the traditional economic doctrines, with their emphasis on the long view, and have turned instead to the short view which government and the lay public have always tended to take. It is true that in adopting the short view many of the younger economists have not merely taken

over the lay notions bodily. Some of them have, in fact, given them a theoretical elaboration which for subtlety, refinement, and elegance need make no apologies to the older economics, and which remains faithful to older theorizing in at least one respect, that the tradition of unintelligibility to the layman is scrupulously observed. It is the quality of the judgment displayed, and not the quality of the analytical skill, which I venture to question. No matter how refined and how elaborate the analysis, if it rests solely on the short view it will still be close to the layman's economics and still be a structure built on shifting sands.

My aim this evening is not to praise the old-fashioned economic theorist, but only to help protect him from premature burial. The strongest line of defense I find available is the argument that he is the special custodian for society of the long view in economic matters, and that even in troubled periods that view is entitled not to undisputed dominance but to a full hearing. Since its value with reference to any specific issue can be tested only empirically and therefore only after a substantial period of time has elapsed, I shall present my case for the long view forward by taking the long view back into history with respect to several of the doctrines in the orthodox tradition. Not to make it too easy for myself, I shall deal only with doctrines that have been so conventionalized through time that they seem to the short-viewers flagrant examples of the freezing of doctrine into dogmas whose venerability is their only claim to virtue.

An underlying characteristic of the orthodox Anglo-American economics during its entire period of dominance was its basically optimistic outlook on the prospective trend of events. As a cursory inspection of the files of presidential addresses before the American Economic Association and its English prototype would confirm, the economists of the time believed that, despite wars, mistakes in government policy, and cyclical disturbances, private initiative, technological progress, and the improvement and wider diffusion of education had resulted in and would continue to result in a slowly rising secular trend of per capita income, enjoyed by steadily-growing populations. Imbued with this moderately optimistic long view, the economists listened neither to the occasional prophets of impending and lasting woe nor to the more frequent peddlers of patented devices for antedating the millennium. For the period up to 1914 at least, they proved on the whole to have been right. In the flush days of the 1920's, however, we were told: that what was then would continue to be, forever and ever; that the problem of the cycle had been solved by the Federal Reserve Board; and that we had entered upon a new era of perpetual boom. The great bulk of the economic profession, taking the long view, refused to give credence to this blissful picture. How right they proved we are unfortunately only too well aware. The perpetual boom having come to its dramatic end, it later subsequently became increasingly apparent that all the days

of the 1930's were to be black, or gray. Some economists, simulating too closely, I think, the technocrats' over-emphasis of the purely technological elements in economic process and under-emphasis of the compensating and stimulating functions of the price system, and responding too sympathetically to the prevailing depression, have announced a second new era, but this time an era of perpetual gloom, the advent of the stagnant economy. There is even developing among the preachers of the new pessimism impatience with talk in terms of the concepts of business-cycle analysis, as carrying the unnecessarily optimistic implication that what goes down may some day come up. I have no doubt myself that these economists have genuinely succeeded in finding historical trends in our economic structure and process which operate to make the attainment of full employment increasingly difficult. But that must always have been true, and the weight to be attached to such findings should not be decided until equally ardent search has been made for factors operating in the opposite direction. Here, I take it, is an instance where appeal to the long view may save us from accepting as an adequately historical approach what fuller appeal to history would suggest was rather a hysterical approach.

It has long been standard dogma that budgets must be annually balanced, and that public debts must not be allowed to grow indefinitely. Governments, of course, have frequently violated the dogma, and not only have such violations not invariably been followed by disaster, but it would be a difficult task to disprove the proposition that in a substantial number of instances they proved highly beneficial. But as I read the history of the budget-balancing dogma, it developed as a convenient rule-of-thumb protection against the defense of uncontrolled expenditure and continuous deficits by the plea that the appropriate time for budget balancing was not quite yet but just around the corner. I am even convinced that most of the distinguished advocates of budget balancing during the nineteenth century would have conceded, though no doubt grudgingly, that even a continuous growth of public debt, given a moderate and asymptotic pattern of growth, would not in fact necessarily lead to disaster. On this question of the menace of a growing debt that virtuoso of the long view, Adam Smith, maintained his usual balance. When, during the American Revolutionary War, a young friend, Sir John Sinclair, lamented to him the misfortunes, presumably financial, in which the war was involving Britain, and exclaimed, "If we go on at this rate, the nation must be ruined!" Adam Smith replied, "Be assured, my young friend, that there is a great deal of ruin in a nation."

But when for the old dogma that budgets should be annually balanced there is substituted a new dogma that budget balancing is merely a fetish, that as long as there are unemployed resources, whatever the cause of

the unemployment, governments should point with pride to their lusty and bouncing deficits, instead of apologizing for them or shamefacedly concealing them as if they were born out of wedlock, the long view tells me that while this may not be the road to ruin it at least blazes a trail to it. It must not be forgotten that spending in itself is for the spender the supreme pleasure, is the politicians' delight, and that what temperance in resort to it has prevailed in the past has been wholly due to the belief that somebody, some day, would have to be taxed to pay the bills. Even if this belief were properly to be regarded as completely a myth, it would still be one of the large class of highly useful myths.

Two related theses of the liberal tradition in Anglo-American thought have been: first, that under a system of free individual enterprise a higher level of economic well-being was attainable than under any other form of economic organization; and second, that a society organized on this economic basis was the only one compatible with the maintenance of political democracy. These, of course, are dogmas, not axioms, one economic and the other political in nature. Now that political democracy is under attack, frankly from the fascist right and as menacingly though not as frankly from the communist left which, like the serpent, licks its victim over before it swallows it, the political dogma has become increasingly acceptable even to those who reject the economic dogma. My concern here, however, is only with the economic dogma, whose acceptability has been destroyed or seriously impaired even for many economists by ten years of sustained and severe depression.

There are perhaps some economists who would deny that an individualistic system is at all desirable economically. This view I will not discuss, since even if I were to reject a substantially individualistic system on economic grounds, I should still prefer it, on non-economic grounds, to what seems to me to be its only practicable alternative, a comprehensively-planned economy under which, as some one has said, "All our hairs would be numbered, and all gray." There are many, however, who hold the view that while a system of free individual enterprise would be ideal if attainable, it is no longer possible in these modern days of great concentration of ownership and control of productive facilities, where the economic units are to a large extent huge corporations and trade unions rather than the single individuals of traditional economic theory, and where such competition as persists tends increasingly to be competition between giants instead of the atomistic competition of orthodox theory, and therefore to be cost-raising rather than price-reducing.

When, some four or five generations ago, freedom of private initiative was first systematically advocated as the ideal basis for an economic system, the menace of monopoly to the proper working of a system so organized

was clearly perceived. It was then widely believed, however, that, although business-men admittedly found abhorrent the impact upon themselves of other persons' competition and grasped every opportunity to escape it, monopolistic power could not come into being on a large scale, or at least could not long maintain itself, except with government aid and sanction. In justice to those who were of this view, it should be noted that the grant of a corporate charter was then universally regarded as the grant of a special privilege potentially dangerous to society, and it was therefore then assumed as a matter of course that such grants would be made only sparingly and would be jealously circumscribed, in each specific instance, by restrictions as to permitted size, nature and range of activities, and right of participation in the civil liberties enjoyed by genuine individuals.

Whether now, after several generations of unrestrained grant of corporate charters and of great development of mass-production requiring large economic units for its operation, it is still possible, through proper regulation and restriction by government of the activities of large corporations, to restore an essentially competitive price system, is a question to which I freely confess I do not see a clear answer, although I look forward eagerly for much-needed enlightenment to those sessions of this meeting where this question will be discussed by an exceptionally-qualified group who, I have reason to know, have been giving it very serious and disinterested consideration. The only point I wish to make now is that the old dogma, that monopoly power is basically the product of governmentally protected or sanctioned special privilege and will not survive on a large scale if such special privilege is withdrawn or kept to its practically minimal limits, still has sufficient plausibility to warrant further inquiry. It seems to me a reasonable hypothesis, one worth examination, for instance, that if much of the impressive array of governmental encouragements to monopoly could be removed, or, where removal was impracticable, if government regulation were directed to foster cyclical patterns of price-behavior following the competitive pattern, the chief evil product of monopoly, the price-inflexibility problem, would shrink to easily tolerable dimensions.

Consider for instance, some of the elements in the prevailing pattern of government relationship to monopoly and to price-inflexibility. Promiscuous issue of wide-open corporate charters by the states; until within the last year or two slack and faint-hearted enforcement of the anti-trust laws, already gutted by court sabotage; protection of monopolistic price-structures by the federal tariff; positive encouragement of monopolistic price-practices by such legislation as the N.R.A. act, the Webb-Pomerene act, the Guffey Coal act; so-called "fair-trade" laws which compel business-men to act as if they were monopolists even if they wish not to; concealed protection of monopoly by doctored building and other ordinances; tacit encouragement to monopoly through acceptance in government contracts,

systematically and without protest, of identical bids and of list prices higher than even the monopolists can obtain in what remains of the open market; approval, and even enforcement, for regulated industries such as railroads, of rate policies which make rates behave even more perversely, as far as cyclical flexibility is concerned, than the prices of unregulated monopolies; encouragement to and protection of labor monopolies; deliberate schooling of agriculture in the pleasures and profits of monopolistic behavior.

The record of government encouragement to monopoly, when looked at in conjunction with government's spasmodic efforts to enforce competition and its intermittent clamor against monopoly, reminds me, and justifiably so, of an old cartoon I once saw, depicting a political demonstration in the streets of London, in which the determined-looking marchers carried two banners, one of which bore the slogan, "NO MONOPOLY!" and the other the slogan, "NO COMPETITION!"

All that I suggest, therefore, with respect to the dogma that free competition can substantially survive if government gives it due protection and encouragement, is not that its validity under modern conditions is obvious, but that we have not the right definitely to reject it before it has been given an honest and thorough test.

As a final illustration of the possible survival of usefulness of old dogmas which were the product of the long view, I cite the proposition that the timidity of capital makes the maintenance of "business confidence" necessary if investment is to be maintained at the level required for sustained prosperity. According to this dogma, the capitalist will hoard his own money, or will send it abroad—be there any safe place to send it—and will refrain from borrowing other people's money for investment purposes, if even a faint shadow is cast on the political security of his investment. The spokesmen for capital have found this dogma very much to their liking, and have been claiming for some six years that a political shadow *has* been cast over the security of their investments, and that this has been responsible for the low rate of new investment, and consequently for the persistence of depression. To reinforce their claims, they have done their trembling in public, with vocal accompaniments.

There is no specific invocation of old dogmas, I understand, which the economists of the new enlightenment regard as more absurd, more insubstantial and unsubstantiated, than the claim that the timidity of investment capital under the impact of political fears has been a significant factor in causing the low rate of new investment of the past six years or so. The capitalist, they agree, is a timid beast, but they assert that it is only the risk of loss he is really timid about. He invests, they say, when he sees a clear chance of profit, and hoards when he doesn't, regardless of whether the

government of the day is stroking his fur or barking at him. They point out that the annual volume of new investment was even smaller in 1931 and 1932 than in any year since 1933, although if in these earlier years political shadows were being cast on the security of investment they could not have been more than mere foreshadowings of prospective shadows. They cite also the substantial recovery of the new investment level in 1936-37, when capital was still insisting that it was scared. They have even produced a statistical proof that "confidence" has nothing to do with the volume of investment, which takes the form of a demonstration that the rate of investment is so highly correlated with the rate of retail sales or of consumers' spending that no other factor need be invoked to explain its major fluctuations.

To my perhaps naïve mind, the dogma still carries some shreds of credibility, despite those weighty inductive refutations. As I understand it, the dogma is not that the degree of confidence in the intentions of government with respect to invested capital *alone* governs the rate of investment, but merely that some minimum degree of such confidence is a necessary condition of the continuance of investment at a high level. The correspondence of the rate of investment with the rate of retail sales seems at least as available to support the thesis that the rate of investment determines the level of national income, to which thesis even the most timid capitalist will happily subscribe, as to support the argument that the rate of spending of income governs the rate of investment. But the only practical lesson I care to draw from the possible validity of this dogma of the timidity of capital in the face of political threats is that, if government has any designs on capital, it would be wiser to bite before and bark afterwards, if bark it must.

I hope—but do not expect—that I shall not be misunderstood as holding that full and invariably appropriate guidance for government policy under present-day conditions can be found in the old dogmas or in what could until recently be called "accepted" economic doctrine. I know no economist who would take this position, and if one were to be found I should agree that he was trying to make a fool's paradise out of his private ivory tower. My claim is much more moderate and, I hope, much more sensible. What I contend is that for various reasons, but chiefly as a psychological reaction to the impact of continued and acute depression, some economists have been discarding too indiscriminately their inherited intellectual ballast, with the result that they sway too easily with each passing wind. With apologies to you for the form in which I state my claim, I contend merely that there is life in the old dogmas yet. I concede that new light is needed and all that I ask is that our minds be kept open to acceptance, strictly and only on their merits, of both the old lights and the new.

Nor do I ask for a sympathetic hearing for the old dogmas in the belief

or desire that such a hearing would lead to a cessation or even slowing-up of the present endeavors to find remedies for prevailing evils through positive government action. Obedience to some of the old dogmas would in fact lead to an intensification of governmental action. As far as I am concerned, I have been much more impressed by the undue inertia of government in the face of acknowledged evils than by its rash venturesomeness in action, although I think I have seen both qualities displayed. It is not a middle way between action and inaction, therefore, which I urge. It has been said that throughout all the history of man Confucius alone succeeded in making the middle way either emotionally exciting or intellectually stimulating, and I have my doubts even about Confucius. As many persons who appeal to the middle way use the term, it really becomes a disguised plea that we should halt between the premises and their conclusions. That is not what I am pleading for. Let evils be dealt with, promptly and decisively. But in choosing the manner and direction of action, let us pay heed to the old as well as the new wisdom, and let us especially beware of old poisons in new bottles.

JACOB VINER

University of Chicago



TREASURY DEPARTMENT
WASHINGTON

155

OFFICE OF
COMMISSIONER OF INTERNAL REVENUE

ADDRESS REPLY TO
COMMISSIONER OF INTERNAL REVENUE
AND REFER TO

March 1, 1940.

IT:P:CA
CAA

REPORT FOR SECRETARY MORGENTHAU:

In regard to closing agreements under the Vinson-Trammell Act, there were no developments during the week.

Commissioner.

March 1, 1940.

IT:FC
CAA

REPORT FOR SECRETARY MORGENTHAU:

In regard to closing agreements under the Vinson-Trammell Act, there were no developments during the week.

[Signed] Guy T. Helvering

Commissioner.

CAA/MSA

JR

GRAY

Paris

Dated March 1, 1940

Rec'd 12:35 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION ONE)

FOR THE TREASURY FROM MATTHEWS.

Reynaud delivered last evening one of his usual lucid and admirably phrased radio talks "explaining" the new financial and restrictive measures and the need therefor in words which the public can well understand. Financially he said France has held its ground, while economically it has slid rapidly downhill. "To produce less and consume as much as before, that can not long continue." Thus far the situation has been faced utilizing capital reserves. "Not only have we drawn on our domestic reserves but we have had recourse to our reserves abroad. In order to make purchases abroad gold has to be delivered. If we ran into our gold reserves very little, it was because during the first three months of the war we had a massive repatriation of capital, but to live on repatriated capital is also to use up reserves.

MURPHY

Regraded Unclassified

JR

GRAY

Paris

Dated March 1, 1940

Rec'd 1:17 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m.

(SECTION TWO)

The Government let this go on indefinitely". Turning to the rise in prices of the past several months and the ensuing demand for increased wages he explained in simple words what the vicious circle of inflation means. "If satisfaction is given to all demands for increases everyone will have more banknotes in his pocket. But will that result in an extra chop at the butcher's or an additional pair of shoes at the shoe store? Obviously no. The new wave of banknotes will create a new wave of price raising without improving anyone's position and the whole circle will be started again."

On the financial side he said: "We have signed but one financial decree: that approving a convention with the Bank of France. The object of this convention is to mobilize two categories of reserves for our foreign and domestic payments.

For our foreign payments we are putting aside a fraction of our war treasure, the use of which will henceforth be secret to escape the enemy's eyes.

CSB

MURPHY

HSM

GRAY

Paris

Dated March 1, 1940

Rec'd 3:05 p. m.

Secretary of State,
Washington.

278, March 1, 3 p. m. (SECTION THREE).

"For our domestic payments we have drawn part of the reserve which the Treasury had with the Bank of France which resulted from the fact that in November 1938 the gold stocks were revalued at a price below their real value. I shall not enter into technical explanations but shall say at the risk of offending German propagandists that the franc's value will be the same tomorrow as it was yesterday and that the total of the Bank of France's temporary advances to the Treasury will remain the same.

Tax returns and subscriptions to armament bonds have been such that the circuit is now closed. This agreement with the bank is merely an act of foresight."

With reference to relaxation of exchange control formalities between Great Britain and France he said: "Another decree signed today supplements the Anglo-French financial accord by eliminating exchange control formalities on commercial transactions between France and Great Britain. The scope of application of the Franco-British financial accord must be further extended.

CSB

MURPHY

HSM

GRAY

Paris

Dated March 1, 1940

Rec'd 3:05 p. m.

Secretary of State,
Washington.

278, March 1, 3 p. m. (SECTION FOUR).

We have a weapon which will serve after the war to reconstruct a livable Europe. America recognizes Anglo-French collaboration as a basis for such future economic reorganization of Europe. Past mistakes will not be repeated."

Today's Journal Officiel contains the following financial restrictive and economic measures included in the program:

One. The pertinent articles of the brief decree approving the convention with the Bank of France read as follows:

"Article I. The convention reached February 29, 1940, between the Minister of Finance and the Governor of the Bank of France of which the text is annexed to the present decree is hereby approved.

Article II. For the duration of hostilities the exchange stabilization fund established by Article 3

of

hsm -2- No. 278, March 1, 3 p. m., (Section 4) from Paris
of the law of October 1, 1936, is authorized to invest
temporarily its available franc assets in three months
Treasury bills."

MURPHY

CSB

JT

GRAY

PARIS

Dated March 1, 1940

Rec'd 4:25 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION FIVE)

Two. The attached agreement with the Bank of France reads as follows:

"I - revaluation of reserves - reimbursement of pre-war advances to the state.

Article 1. The Bank shall proceed to the revaluation of its gold reserves and its available assets in foreign exchange under the conditions established in Article 1 of the agreement of September 25, 1936 on the basis of a gold weight of 23.34 milligrams nine hundred thousandths fine per franc.

Article 2. The increase in value resulting from the revaluation provided in the foregoing article shall in conformity with the provisions of Article 8 of the convention of November 12, 1938 be applied in due amount to the definitive reimbursement of the provisional advances granted to the public Treasury by the Bank of France in application of Article 3 of the aforesaid convention.

The non-reimbursed balance shall be covered from available

-2- #278, March 1, 3 p.m. (SECTION FIVE)

able assets of the exchange stabilization fund.

II - cession of gold by the Bank of France to the state and delivery in payment of negotiable Treasury bills.

MURPHY

CSB

Paris

Dated March 1, 1940

Rec'd 3:10 p.m.

Secretary of State,
Washington.

278, March 1, 3 p. m. (SECTION SIX).

"Article III. The Bank of France shall cede to the state for the exchange stabilization fund the gold appropriated from its cash on hand to the amount of 30 billion francs on the basis of 23.34 milligrams of gold nine hundred thousandths fine per franc.

Article IV. In settlement of the cession provided for in Article 3 of the present convention the Bank of France shall receive in the nominal amount of 30 billion francs Treasury bills of three months maturity bearing interest at the rate in force for ordinary 75 to 105 day Treasury bills and negotiable on the market.

Article V. The Bank of France shall enter on a special line in its balance sheet of assets the nominal amount of negotiable bills which it is receiving in execution of Article 4 of the present convention.

It shall open in its balance sheet of liabilities under the heading 'compte annexe d'interets' an account for the purpose of receiving the necessary amounts for interest service due to purchases of these bills in case they are placed on the market.

CSB

MURPHY

JT

GRAY

PARIS

Dated March 1, 1940

Rec'd 4:51 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION SEVEN)

"The conditions for the administration of the two aforesaid accounts shall be governed by an exchange of letters between the Minister of Finance and the Governor of the Bank of France.

In case of the retrocession of gold by the state to the bank the total of negotiable bills provided for in the preceding articles shall be reduced by an equivalent amount.

If the total of negotiable bills held in portfolio by the bank is less than the total of the retrocession a new convention shall determine the conditions of the operation.

Article 7. The total of negotiable bills received by the bank in execution of the present convention shall not be included in the statistics of productive circulation serving as basis for the calculation of the charges and stamp taxes provided by the laws and conventions in effect.

Article 8. The state shall pay the bank as reimbursement for expenditures undertaken by it through the operation
stipulated

-2- #278, March 1 (SECTION SEVEN) from Paris

stipulated in the preceding articles, a commission equal to three per mille per year on the total nominal amount of negotiable bills delivered to it.

MURPHY

CSB

JT

GRAY

PARIS

Dated March 1, 1940

Rec'd 4:36 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m., (SECTION EIGHT)

"this commission shall be paid quarterly in advance at the moment of the delivery of the negotiable bills and their successive renewals.

III. New advances to the state.

Article 9. The Bank of France agrees to grant the state on demand of the Minister of Finance, in addition to the advances provided in article one of the convention of September 29th, 1938, provisional advances to a total of 20 billion francs.

Article 10. In return for the advances agreed to in application of article 9 of the present convention there shall be delivered (to the bank) Treasury bill of 3 months maturity without interest and renewable until reimbursement of the afore said advances.

Article 11. The Bank of France shall receive as reimbursement for expenditures undertaken by it for the service of the advances stipulated in article 9 of the present convention

vention

-2- #278, March 1, 3 p.m. (SECTION EIGHT) from Paris
vention a commission of five per mille per year of the
actual total of the aforesaid advances.

MURPHY

CSB

JT

GRAY

PARIS

Dated March 1, 1940

Rec'd 4:55 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION NINE)

"Article 12. The provision stipulated in Article 8 of the convention of November 12, 1938 for the reimbursement of advances granted in conformity with Article 3 of the aforesaid convention shall similarly be applied to the definitive reimbursement of the advances stipulated in Article 1 of the convention of September 29, 1938 and in Article 9, of the present convention.

The total advances granted in execution of Article 9 of the present convention shall not be included in the statistics of productive circulation serving as a basis for calculating the charges and stamp taxes provided by the laws and conventions in effect".

MURPHY

NPL

JT

GRAY

PARIS

Dated March 1, 1940

Rec'd 4:25 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION TEN)

Four. A decree relative to expenditures abroad. It provides that each year, beginning with 1940, an estimate of public and private expenditures and receipts abroad shall be drawn up and that no expenditures abroad shall be contracted or paid in excess of these estimates. The estimates shall be divided according to their category into annual French commercial or financial credits abroad. Each Ministry shall draw up its own estimate of expenditures payable abroad or in foreign exchange including private imports placed under its control by the law of July 11, 1938. The estimates shall be approved by decree endorsed by the Prime Minister and the Ministers of National Defense, War, Foreign Affairs and Finance, and the approval for estimates of expenditures and receipts shall be separate.

MURPHY

CSB

JT

GRAY

PARIS

Dated March 1, 1940

Rec'd 5:49 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION ELEVEN)

Article 5 of the decree reads: "In order to facilitate equilibrium of the foreign balance of payments the Minister of Finance may stipulate the currency of settlement applicable to certain foreign commercial transactions". Article 6 provides that pending the drawing up of ~~these~~ estimates the total expenditures abroad which may be contracted or paid shall be fixed each month by the Prime Minister and the Ministers of National Defense, War, Foreign Affairs, and Finance. A decree endorsed by the aforesaid ministers and the Minister of Colonies shall fix the conditions of application of the foregoing measures to the colonies, protectorates, and mandated territories.

MURPHY

NPL

JT

GRAY

PARIS

Dated March 1, 1940

Rec'd 5:15 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION TWELVE)

FIVE. A decree supplementing the decrees dated October 13 and November 18 concerning purchases abroad (my telegrams numbers 2499, October 17, 6 p.m. and 2839, November 27, 7 p.m. and despatches numbers 4104, November 17 and 5453, December 15). The decree dated November 18 is modified (Article 2 bis new) to provide that all contracts involving expenditures abroad executed either directly in France or by pertinent administrations must be approved by the Minister of Finance. Similarly Article 2 ter new provides that contracts payable in francs on budgetary credits which stipulate partial or total delivery to the state of supplies purchased abroad in view of their retrogression to the state must be approved by the Ministry of Finance prior to ordering of said supplies.

MURPHY

NPL

Paris

Dated March 1, 1940

Rec'd 3:15 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION THIRTEEN)

(The next six decrees published in today's Journal Official are designed to restrict consumption).

SEVEN. A decree provides that as of April 1, 1940 every person residing in France must be in possession of an individual and non-transferable ration card. The various categories of foodstuffs, articles or products to be rationed will be fixed by subsequent decree, the quantities to which each person is entitled being determined by his age and occupation. Cards are to be applied for and obtained from the Mairie of the district in which the applicants resided on March 1, 1940. A card must be exhibited before a commodity listed thereon can be purchased.

MURPHY

CSB

JT

GRAY

PARIS

Dated March 1, 1940

Rec'd 5:20 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION FOURTEEN)

Eight. The provisions of another decree, which will enter into effect on the dates to be set by the Minister of Agriculture, relate to : (a) manufacture and sale of only fixed quality breads; (b) limitation on the amount of bread to be served in public eating places (150 grams per person for a meal costing more than 15 francs, 300 grams if the cost of the meal does not exceed this sum); (c) closing of pastry, confectionery and chocolate shops three days per week and prohibition at such times of the sale of products normally sold in them by grocers and other establishments dealing in foods, and (d) manufacture and sale of only fixed quality chocolate.

MURPHY

NPL

JT

GRAY

PARIS

Dated March 1, 1940

Rec'd 5:30 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION FIFTEEN)

Nine. A decree on which the Minister of Agriculture is also authorized to set the effective date, pertains to limitations on the consumption of food in all public eating places. A meal may not consist of more than two principal dishes only one of which may be meat. Vegetables are not to be considered as part of a principal dish. Restaurant menus are to list but nine dishes for any one meal the number being reduced to seven on "meatless" days.

Ten. A decree fixes at 2% the amount of bean flour which may be mixed with flour used for the manufacture of bread.

Eleven. A lengthy decree provides for a stricter control over and reduction in civil and military consumption of gasoline.

MURPHY

NPL

JT

GRAY

PARIS

Dated March 1, 1940

Rec'd 5:25 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION SIXTEEN)

Twelve. A decree forbids the sale or "free offer" on three days a week of alcoholic spirits and aperitifs to be consumed in the premises of restaurant, bar, etc. Commencing July 1940 moreover the retail sale for consumption off the premises of such drinks shall be limited to quantities of not less than two liters. (Three of the decrees published deal with agriculture).

Thirteen. A decree provides for the sale to the farmers for this spring's sowing of "Florence-Aurore" wheat seeds at the current price for native wheat seeds.

Fourteen. A second concerns the cultivation by the troops of lands situated in evacuated areas.

Fifteen. The ~~third~~ authorizes the reduction of customs duties on tractor parts.

MURPHY

NPL

JR

GRAY

177

Paris

Dated March 1, 1940

Rec'd 3:45 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION SEVENTEEN)

Sixteen. Certain additions are made to the decree dated September 9, 1939 concerning the control of prices (my telegram 1999, September 16, noon) they define various illegal practices which tend to circumvent the provision of the decree prohibiting any increase in the production, wholesale or retail prices of merchandise or foodstuffs above levels existing on September 1, 1939.

Seventeen. Another decree is designed to further exports from France: duties or taxes levied in France on the materials entering into a product manufactured in the country will be refunded when the product is exported abroad.

MURPHY

WVC

JT

GRAY

PARIS

Dated March 1, 1940

Rec'd 6:35 p.m.

Secretary of State,

Washington.

278, March 1, 3 p.m. (SECTION EIGHTEEN)

Eighteen. A decree calls for a census of all women and girls desirous of obtaining employment. Should the number thus listed be less than the existing demand for feminine labor, a decree may be issued providing for a compulsory census of all available women(?) The women and girls covered by it may if necessary be requisitioned.

Nineteen. A second labor decree relates to apprenticeship regulations during time of war.

Twenty. A further decree introduces certain changes in the decrees of October 30, 1935 and July 28, 1937 relating to the control of expenditures in the public administrations and the army. The various financial control committees created by such decrees are to exercise a strict supervision over all proposed public disbursements with the object of preventing waste and effecting all ^{possible} economies. Special "economies services" are to perform a similar function with the armed forces.

MURPHY

NPL

Regraded Unclassified

JT

GRAY

PARIS

Dated March 1, 1940

Rec'd 6:02 p.m.

Secretary of State,
Washington.

278, March 1, 3 p.m. (SECTION NINETEEN)

Today's JOURNAL OFFICIEL likewise contains two other items of interest: An arrete with respect to the rente fund concerns the utilization of its available resources; and notice to approved intermediaries from the Foreign Exchange Office contains the pertinent necessary instruction with reference to the relaxation of exchange formalities covering Franco-British commercial transactions (my telegram No. 273, February 29, 6 p.m.).

The first reactions in banking circles which I have been able to gather today to the foregoing comprehensive program have been generally favorable and the censored press of course likewise has in general registered its approval. With respect to the gold measures my banking friends seem to take the view that the government was wise and foresighted to take these steps during the present period of calm and relative financial ease.

MURPHY

JRE:NPL

REB

GRAY

Paris

Dated March 1, 1940

Rec'd 5:55 p. m.

Secretary of State,
Washington.

278, March 1, 3 p. m. (SECTION TWENTY)

There is, however, a slight undertone of anxiety in certain quarters lest certain elements in the population may be or are being kept below the bare minimum subsistence level.

The securities market was firm but not particularly active. French industrial issues particularly chemicals and utilities advanced while rentes were down fractionally. Official exchange rates are unchanged.

Couve de Murville was obviously pleased when I conveyed your message through him this morning and said that he was sure Minister of Finance Reynaud would greatly appreciate it.

(END OF MESSAGE)

MURPHY

RL

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Rio de Janeiro

NO.: 79

DATE: March 1, 1940

Reference is made to my telegram no. 78 of February 29, 7 p.m.

I was again reminded today by Aranha that President Vargas will leave Rio on the 6th of March, so if a debt settlement is to be made, it must be done before that date. (The Minister of Finance is ill and plans to leave March 8 to spend some time in the south.)

Aranha again stated firmly that he believed the interrelationships contained in the Aranha plan were fair; it is his belief that so far as concerns the underlying equities, Grades I and II would be given even more advantage over Grade III by a court of law and equity than the new plan provides. He repeated that the only reason he had offered to increase Grade III as much as he has (which he said was done against his better judgment) was to satisfy us. He added that because of this he would have to begin Grade IV (which are also Federal loans) at 45% instead of 40% in order to compensate French bondholders for the loss of further application of the gold clause in franc loans.

He

-2-

He said that in other respects his offer stands as I have already reported it to you. As it works out, he said, the United States bondholders, who hold only 35.4% of the capital amount of Brazil's foreign indebtedness, would receive 38.1% of the proposed payments, while the British bondholders, who hold 60.8% of the total, would receive only 59.1%.

It has been difficult for me to secure these favorable percentages. (At the present time we have no unfavorable balance of trade with Brazil about which we can even talk, while Great Britain and France have unfavorable balances which are rapidly growing.)

CAFFERY

EA:EB

MARCH 1, 1940.

Shipping Situation

There have been no pronounced changes or outstanding developments this week up until today.

Time charter and net form charter rates are firm on a restricted volume of business. Free vessels of suitable nationality are somewhat scarce and charterers who require ships are fearful of running the market up on themselves.

A vessel was chartered to move grain from the River Plate to Ireland at approximately \$35.00 per ton and 82½¢ per 100 lbs. was paid for a steamer to carry grain from the North Atlantic range to Ireland. \$4.10 was paid for a charter in the West Indies trade, reflecting a strengthening in that market which will be intensified in a short while when the sugar grinding is completed in Cuba.

A strong demand is reported for ships to move coal to Italy, an American-flag steamer being paid \$17.50 per ton. This market should also go higher as press reports are that Great Britain will stop the movement of coal from Germany to Italy.

The quantity of grain on hand at New York is constantly decreasing and is not being replenished. This is due to the rail rates to the outports being lower than to New York and it probably will not be until navigation on the barge canal is open, several weeks hence, that a building up of the stocks at New York will commence again.

On February 1st there were at New York in railroad cars and elevators, and in boats, 4,281,000 bushels, whereas today there is a little over 3,000,000 bushels on hand.

-2-

The export freight moving through New York continues at about the same pace - an average of about 750 cars per day lightered for export. The railroad lighters on demurrage Thursday, February 29th, were 96.

The railroads have in covered storage awaiting export, 3170 cars, compared with 2143 cars on January 3. The space thus occupied in railroad facilities is only one third of that available.

Railroad carloadings are decreasing weekly although still running far ahead of the same period last year. The decline is attributed principally to a falling off in steel production for domestic use; the export demand for steel is expanding.

The rate on grain to Antwerp - which is practically the only market aside from Ireland in northern Europe where the ocean freight rate is not fixed by the government of the country - is holding firm around 85 - 87 $\frac{1}{2}$ per 100 lbs. The nearby situation is strong from the ship's standpoint but the announced entry of the Holland America Line into the North Atlantic to Antwerp trade will have a depressing influence on future rates.

Daniel Harris

185

BUREAU OF FOREIGN AND DOMESTIC COMMERCE
OFFICE OF THE DIRECTOR

3/2/40

From DIRECTOR

To Hon. Henry Morgenthau, Jr.
Secretary of the Treasury

For

Sent to you at the request of
Mr. Noble, Under Secretary of
Commerce.

James W. Young
James W. Young

ECONOMIC DEVELOPMENTS

SUMMARY OF THE CURRENT BUSINESS SITUATION—February passed without any signs of an expansion in the basic factors of demand which would bring a near-term reversal in the business downturn.

The flow of new orders is still generally restricted and below the volume of production.

Industrial output has declined sharply during the past two months and even with this reduced rate of activity, backlog orders of unfilled orders have been lowered further.

Consumption has eased off from the high December position.

The latest data available, as of the end of January, show a further substantial increase in inventories.

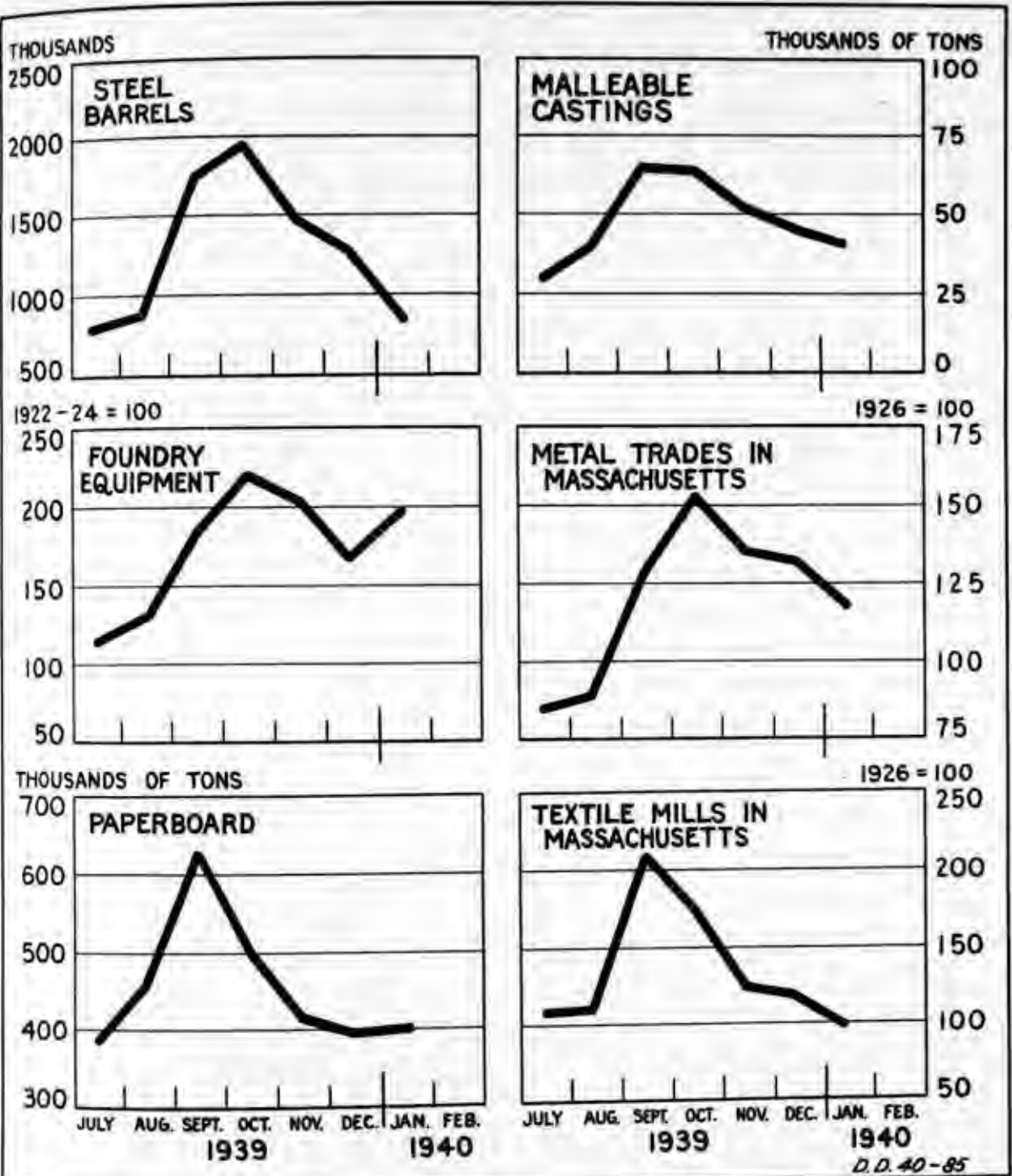
The only major factor to resist the weakening tendency in business so far this year is export trade.

REVERSAL OF NEW PURCHASING which is essential to halt the decline has not appeared. There has been sporadic purchasing in some lines of business, and, of course, a seasonal rise in some consumer goods industries. In the durable goods industries, however, which hold the key to the business prospects, there has been no indowment in February of a renewed buying movement. High export demand in some lines has made for exceptions—e.g., aircraft and machine tools. In the aggregate, new orders apparently did not improve from the January position which was lower than that of December.

ILLUSTRATIONS Several new order series are shown on the accompanying charts. Our tabulation from the monthly industry survey shows the following change in incoming business for 223 corporations:

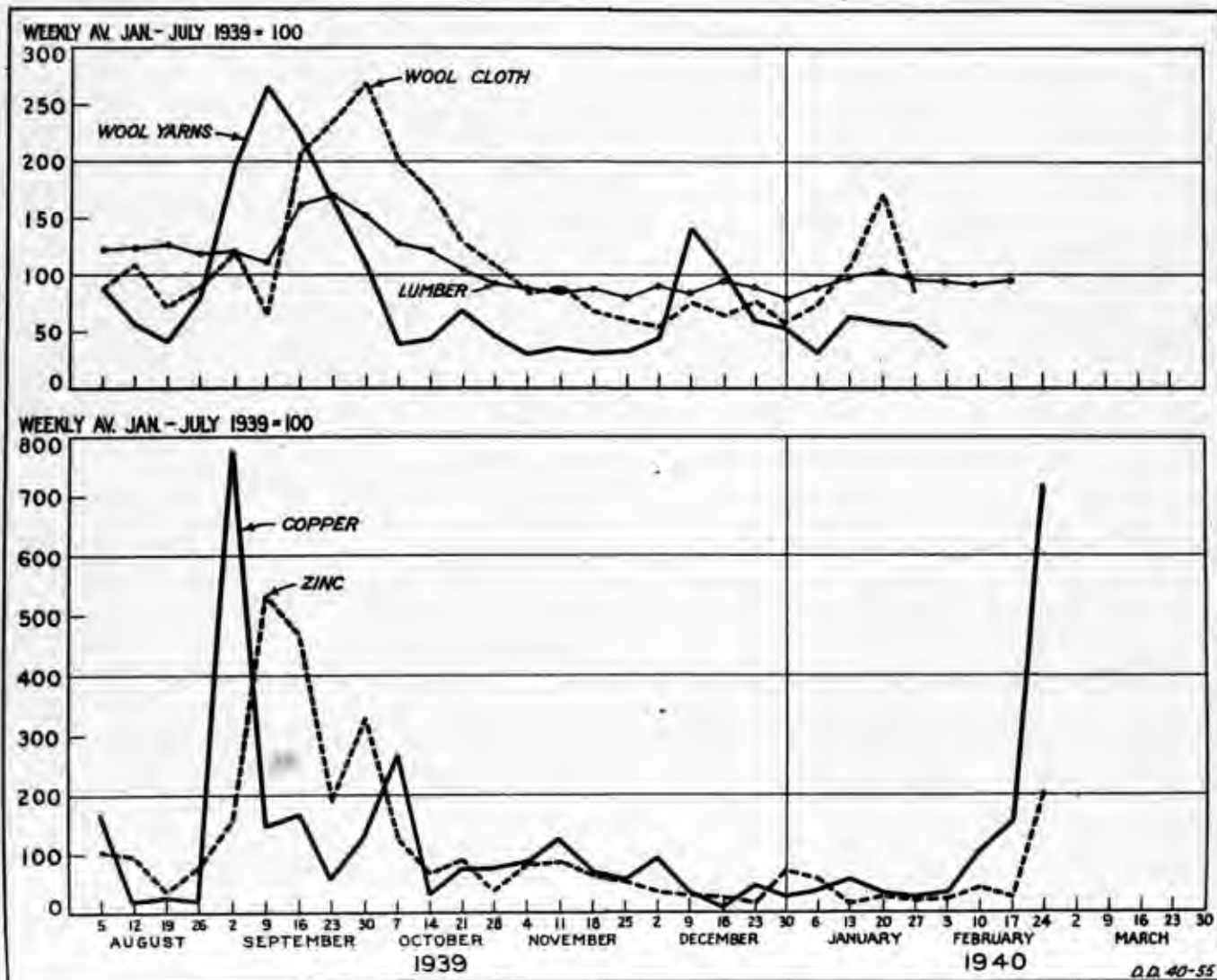
	Percent Change	
	January 1940 from	
January 1940 -	\$294.5 million	
December 1939 -	310.4 "	- 5
January 1939 -	264.7 "	+11

SHORTLAGS New orders are still below the rate of shipment and consequently, unfilled orders on the books are being reduced. If new buying does not develop soon an extension of the recession in industrial production can not be avoided. This situation is not confined to the durable goods industries. In textiles, for example, the recent high rate of output can not be sustained much longer with the current rate of ordering.



NEW ORDERS RECEIVED BY SELECTED MANUFACTURING INDUSTRIES, 1939-40

NOTE.- THE INDEXES OF NEW ORDERS (VALUE) RECEIVED BY TEXTILE MILLS AND METAL TRADES IN MASSACHUSETTS ARE COMPILED BY THE ASSOCIATED INDUSTRIES OF MASSACHUSETTS. THE OTHER SERIES ARE THOSE REGULARLY SHOWN IN THE SURVEY OF CURRENT BUSINESS AND REPRESENT QUANTITY, EXCEPT THE INDEXES FOR "FOUNDRY EQUIPMENT" WHICH ARE ON A VALUE BASIS.



D.D. 40-55

- 2 -

CONTRACTION OF INDUSTRIAL PURCHASING has had as a corollary the weakening in the prices of raw commodities. The February index of 16 basic industrial raw materials recently made available by the Department of Labor averaged about 116 (August 1939=100) as compared with the December peak of 129.6; thus more than one-third of the post-August price rise in these commodities has been cancelled. On the average prices of farm products and feeds eased off during January and February, though some important commodities moved against the general trend.

EXAMPLES of price changes:

<u>Series</u>	<u>Unit or base</u>	<u>Dec. High</u>	<u>Jan. 27</u>	<u>Feb. 29</u>
Copper	\$ per lb.	12.90	11.50	11.50
Tin	"	52.90	45.90	47.70
Cotton	"	11.11	10.42	10.72
Hogs	\$ per cwt.	5.88	5.40	5.35
Steers	"	8.88	8.88	8.63
Wheat	\$ per bu.	1.09	0.99	1.03
Wholesale Price Indexes:				
Farm products	1926=100	68.5	69.2	69.4*
Foods	"	72.1	71.4	71.0*
Other commodities	"	84.4	84.0	83.3*
Textile products	"	78.6	76.7	74.2*
Hides & leather products	"	104.4	103.9	102.7*
Raw materials	"	73.6	73.3	72.9*
Seminufactures	"	83.5	81.2	79.6*

*Week ended February 24.

SIGNIFICANCE: In the main, the wholesale price situation has been one reflecting the decline in business activity and the uncertainty concerning spring business. Some commodities have recently risen in price because of special factors. Tin quotations, for example, rose slightly after the lowering of the export quota and foreign sales were a contributing factor in the late February increase of copper prices. The rise in wheat prices has resulted from the supply situation; cotton prices have been aided by foreign sales.

PRODUCTION TRENDS have not changed from the situation described in last week's report. It may simply be noted that the decline during the first quarter has been more rapid than the advance during the final quarter of 1939. Recall that the index last August was 103 and that now it is but little above that figure.

EXAMPLES:

<u>Trend Strong</u>	<u>Trend Weak</u>
Machinery	Textiles
Electrical Equipment	Fuels
Aircraft	Shoes
Machine Tools	Steel
Automobiles	Paper

SIGNIFICANCE: Certain industries, dominated by the war and national defense, can be expected to hold to a high level of production against the trend—e.g., aircraft, machine tools, shipbuilding. Others still at a high level, however, can not be expected to resist any general recession in business for an extended period—e.g., automobiles, industrial machinery, electrical equipment.

THE CONSTRUCTION INDUSTRY enters the active spring building season with a far smaller backlog of public work than in 1939 when the tremendous awards under the 1938 Public Works program were on the books. Consequently stimulus from this source will be much less than 12 months earlier. Construction undertakings financed from private funds have held at a high level. Residential building contracts have been running about on a par with year-earlier volume—a position that is but moderately lower on a seasonally corrected basis than last summer. Private construction other than residential has been somewhat higher than a year ago though not showing signs of attaining any such volume as that in the first half of 1937. The awards of contracts for factory building did not record major gains in the fourth quarter of last year and there are few indications of any major increase in this field.

EXAMPLES:

Construction Contracts Awarded in 37 Eastern States
(Thous. of Dollars)

	<u>Dec. 1938</u>	<u>Jan. 1939</u>	<u>Jan. 1940</u>
Total	389,439	251,673	196,191
Public	279,403	147,916	92,532
Private	110,036	103,757	103,659
Residential	71,883	66,936	60,034
Nonresidential	29,389	28,553	31,476
Commercial Buildings	13,957	17,326	15,924
Factory Buildings	7,028	7,092	12,865

Source: F. W. Dodge Corporation.

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SIGNIFICANCE: This area has been looked to as a major source of positive stimulus this year. Last fall with the sharp advance in general activity, some increase in construction occurred, but this trend was not maintained. So far this year, however, new undertakings did not show signs of major expansion which might offset recessive tendencies in other areas of the economy.

THAT TOTAL INVENTORY HOLDINGS should be accumulating at a less rapid rate than during the late months of 1939 is a reasonable deduction from the character of the current business pattern. Just as the business expansion of last autumn was based so largely upon the increase in this volatile investment area, so now the rapid decline in activity appears to be the result of lessened stock accumulation. No doubt this will show up to a greater degree when data for February become available. During January there was a further substantial increase in inventories although even in that month the rate of increase was apparently a little lower than in December.

The change is indicated by the following data:

	<u>Manufacturers</u>	<u>Wholesalers</u>
	(December 1938=100)	
1939		
June	98.5	104.1
October	101.5	112.7
November	104.5	112.6
December	107.5	110.8
1940		
January	109.8	116.6

SIGNIFICANCE: Wholesalers' inventories increased about 5 percent in January—a seasonal rise is usual—after a much less than seasonal decline in the previous month. There was, however, a smaller increase in manufacturers' stocks in January than in December and these in total are in the neighborhood of four times as large as wholesalers' holdings. The major question here continues to be the attitude of business toward the higher inventory holdings which, by the end of March, will probably reach a new peak. Liquidation from that level is still a possibility, if the down-trend in business is not promptly reversed.

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REDUCTION IN THE FLOW OF INCOME PAYMENTS as early as January is indicative of the broad character of the business contraction. The decline in this slow moving index was 0.4 points in January on a seasonally adjusted basis, with the figure for that month 89.4 (1929-100). There is little doubt that a more sizable decrease in the income payments index will be shown by the February figures. Nonetheless, the flow of income is still relatively high.

EXAMPLES:**Annual rate of income payments**

January 1940 -	73 billion dollars
Average 4th quarter of 1939 -	72 billion "
Year 1939 -	70 billion "

SIGNIFICANCE: The interesting fact about the situation is the promptness with which income payments turned downward. This has been reflected in the more-than-seasonal downturn of retail trade though automobile sales were a conspicuous exception.

FOREIGN TRADE NOTES

Italy: The stimulating influence of the war evidently is not sufficient to counteract some of the fundamental difficulties in the Italian economic situation.

The increase in the cost of living, as reflected in the price of many ordinary foodstuffs and articles of clothing, is very pronounced in spite of the price control by the Government. It is anticipated that the use of ration cards will be extended shortly to a number of commodities, such as soap and olive oil. Coffee is now limited to about one-eighth of a pound per month, and the supplies of sugar, tea, olive oil, soap, meat extracts, and a few other foodstuffs, have on many occasions been so small as to allow the sale of only small quantities to each customer. The measures adopted by the Government to curtail consumption are regarded by the Italian public as a result of the war and also in the nature of a preparation for Italy's eventual participation.

The efforts of the Italian Government to bring about the repatriation of Italian capital from abroad through the importation of essential commodities have been unsuccessful in spite of the fact that the Government was willing to approve applications for such imports without asking any questions as to the source of the exchange. The payment of a premium of 20 percent on foreign exchange surrendered by Italian exporters of certain commodities, which has been announced by a secret circular, is equivalent to a disguised devaluation of the lira.

Brazil: It is reported that important German firms, unable to obtain supplies of electrical equipment from Germany, are now buying local stocks of such materials as batteries for flashlights, radios, doorbells, sockets, bulbs, and similar products, covering articles of any origin and practically at any cost. This marks an effort on the part of those firms to remain in business. A firm representing one of the largest German firms has bought out a Brazilian manufacturer of certain types of flashlight and other batteries. It is reported that in buying up the supplies of local dealers, the firms representing German manufacturers are requiring signed agreements that the previous owners of stocks or factories will not engage in the same type of business for a period of 3 years.

Belgium: The British restrictions on the shipment of lubricating oil to Belgium have affected American companies using Antwerp as a distribution center. The accumulation of stocks at Antwerp is taken as a basis for British restrictions on additional shipments.

Dominican Republic: The loss of the French market for Dominican coffee is a serious blow to the growers, since coffee is the third largest Dominican crop, sold mostly to France. The difficulty in finding an alternative market in the United States is due to the inability of the Dominican exporters to guarantee a fixed quantity of a certain grade or to furnish coffee of the quality demanded by the American market. While the Dominican coffee is of a good type, the methods of picking and drying are inadequate to satisfy the American standards.

WEEKLY WHOLESALE PRICE INDEXES

(1926 = 100)

Group	1939			1940		Percent increase Feb. 24, 1940 from	
	Feb. 25	Aug. 26	Sept. 16	Feb. 17	Feb. 24	Feb. 25, 1939	Aug. 26, 1939
All commodities	76.8	74.8	79.3	78.3	78.6	2.3	5.1
Farm products	67.7	61.1	69.7	68.6	69.4	2.5	13.6
Foods	71.4	66.7	75.5	70.5	71.0	- 0.6	6.4
All commodities other than farm products and foods	80.4	80.4	82.4	83.3	83.3	3.6	3.6
Hides and leather products	92.4	92.6	98.3	103.1	102.7	11.1	10.9
Textile products	65.6	67.4	71.4	74.4	74.2	13.1	10.1
Fuel and lighting materials	73.4	73.2	74.1	73.0	73.0	- 0.5	- 0.3
Metals and metal products	94.5	93.5	94.9	95.3	95.3	0.8	1.9
Building materials	90.0	89.7	90.7	93.2	93.0	3.3	3.7
Chemicals and drugs	76.0	74.2	77.1	77.5	77.7	2.2	4.7
House-furnishing goods	86.6	87.0	87.1	89.6	89.5	3.3	2.9
Miscellaneous	73.0	73.1	76.1	77.2	77.2	5.8	5.6
Raw materials	70.9	66.2	73.0	72.4	72.9	2.8	10.1
Semimanufactured articles	74.4	74.4	82.0	79.6	79.6	7.0	7.0
Finished products	80.4	79.3	82.3	81.4	81.5	1.4	2.8

Source: U. S. Department of Labor, Bureau of Labor Statistics.

SELECTED COMMODITY PRICE SERIES

Commodity	Unit	1939			1940	
		March 1	August 30	Sept. 13	Feb. 21	Feb. 28
Copper, electrolytic, New York	\$ per lb.	11 1/4	10 1/2	12	11 1/2	11 1/2
Lead, prompt shipment, New York	do	4.75	5.05	5.30	5.00	5.25
Zinc, New York	do	4.84	5.14	6.64	5.89	6.14
Iron, straits, New York	do	45 7/8	49 3/4	1/2 75	46 7/20	47 7/20
Rubber, plantation, New York	do	16 3/4	16 13/16	22 1/2	18 7/8	18 15/16
Wool, light native cows, Chicago.	do	10 1/2	11	15	13 1/4	13 1/4
Wool, 13-15 denier, 75% scripps, N.Y.	\$ per lb.	2.34	2.72	3.21	3.08	3.03
Cotton, middling, aver- age 10 markets	\$ per lb.	8.67	8.53	9.01	10.70	10.75
Print cloth, 60x64, 38 1/2 inches, N.Y.	\$ per yd.	4	4 5/8	5 3/8	5 1/8	5
Wool tops, March 1940 futures, New York.	\$ per lb. 2/	81.2	81.5	111.9	99.4	99.7
Sugar, raw, 96°, duty free, New York	do	2.80	2.92	3.70	2.83	2.88
Cocoa, Acra, New York	do	4.75	4.38	6.45	5.35	5.32
Coffee, Santos, No. 4, New York	do	8	7 5/8	7 3/4	7 1/2	7 1/2
Wool, cash, Chicago.	do	6.72	5.65	7.75	6.07	6.00
Soybean oil, March 1940 futures, N.Y.	do	2/ 7.05	2/ 5.61	2/ 7.30	6.98	6.90
Wheat, May 1940 fu- tures, Chicago	\$ per bu. 1/	.68 3/4 2/	.67 1/4 2/	.85 3/8	1.05 1/2	1.03 1/2
Hogs, good and choice, 220-240 lbs., Chi.	\$ per cwt 1/2	8.10	6.88	8.13	5.25	5.35
Beef, medium, 750-1,100 lbs., Chi.	do	9.13	8.38	8.88	8.63	8.63

Nominal. 2/ March 1939 futures. 1/ December 1939 futures. 1/2 May 1939 future.
Hogs weighing 220-250 pounds.

Sources: All commodities, with the exception of wool tops, cottonseed oil, hogs, and
beef, are taken from the Journal of Commerce; wool tops and cottonseed oil are taken
from the Wall Street Journal; and hogs and beef are from the U. S. Department of
Agriculture, Bureau of Agricultural Economics.

COMPOSITE PRICES OF PIG IRON, STEEL SCRAP, AND FINISHED STEEL

Date	Pig Iron ^{1/}	Steel Scrap ^{2/}	Finished Steel ^{3/}
	(Dollars per gross ton)		(Cents per pound)
1939:			
February 28	20.61	15.68	2.286
August 29	20.61	15.68	2.236
September 19	22.61	19.25	2.236
October 3	22.61	22.90	2.236
November 28	22.61	18.98	2.261
1940:			
February 20	22.61	16.71	2.261
February 27	22.61	16.71	2.261

^{1/} Based on average for basic iron at Valley furnace and foundry iron at Chicago, Philadelphia, Buffalo, Valley and Southern iron at Cincinnati.

^{2/} Based on No. 1 heavy melting steel quotations at Pittsburgh, Philadelphia, and Chicago.

^{3/} Based on steel bars, beams, tank plates, wire, rails, black pipe, sheets and hot-rolled strip. These products represent 85 percent of the United States output.

Sources: The Iron Age.

PRICES OF PETROLEUM PRODUCTS - IN BULK AT GULF COAST PORTS

Date	Motor gasoline, 65 octane	light fuel oil, number 2	Diesel oil, ships' bunkers,	Bunker oil, grade "A", cargoes
	(Cents per gallon)		(Dollars per barrel)	
1939:				
March 1	4.50 - 4.75	3.25 - 3.375	1.45	0.675 - 0.70
August 30	4.75 - 5.00	3.375 - 3.75	1.45	0.75 - 0.80
September 13	6.25 - 6.875	3.875 - 4.00	1.45	0.825 - 1.00
1940:				
February 21	5.50 - 6.00	4.125	1.70	1.00 - 1.05
February 28	5.50 - 6.00	4.125	1.70	1.00 - 1.05

Source: Flatt's Oilgram.

RECEIVED
 10:30
 DEPT. OF THE TREASURY
 OFFICE

Remond

Collins 198
L 6 > 4

March 1/40

Will you please call Mrs. Klotz with reference to the Secretary's conversation this afternoon with Mr. Purvis and advise her that ^{the} depending inquiry for the 300 Douglas bombers with spare engines and air screws are covered by item 3 in statement C of the original British list showing the status as of December 27th, filed by Mr. Purvis with Captain Collins on January 5th. The engines were completed on February 20th and covered 150 of these bombers with spare parts. This transaction is appearing as an order placed in statement A covering the period February 19th to 24th, which statement will be filed with Captain Collins in the ordinary way.

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Berlin, Germany (via Bern)

DATE: March 2, 1940, 9 a.m.

Rec'd: March 5, 1940, 10:05 a.m.

NO.: 534

With apparent conviction, official sources in Germany state their impression that there is serious intention on the part of the Government of the U.S.S.R. to deliver the quantities agreed upon in the February 11 trade agreement. However, these sources point out that the February 11 agreement provides essentially only for the exchange of commodities, and that the Russian and German Governments have not as yet carried on negotiations to the end of establishing such thoroughgoing economic cooperation as was agreed on by the French and the British. They make specific reference to the fact that no arrangements have been made for any extended use of experts from Germany in organizing transportation and production in the U.S.S.R. Transportation facilities are adequate for handling the volume of trade which the agreement envisaged, German officials insist. They point out that in addition to shipping facilities in the Baltic and in the Black Sea, there are eight points of rail contact.

A report has come to the Embassy that under the agreement, Russia is to export to Germany during the next year -

Petroleum

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Petroleum products	900,000 metric tons
Cotton	100,000 tons
Apatite (phosphate)	500,000 tons
Manganese	300,000 tons
Feed grains	800,000 tons
Bread grains	200,000 tons
Various ores	1,000,000 tons
Including iron ore....	600,000 tons
" chrome ore..	100,000 tons
Flax	15,000 tons
Timber	18,000,000 marks worth

In addition to the above contingents it is reported that Russia will export to Germany various amounts of the following: pig iron, scrap iron, platinum, bran, oil seeds, butter, technical and edible oils, and fish meal.

END SECTION ONE.

KIRK.

PARAPHRASE, SECTION TWO, TELEGRAM NO. 534 OF MARCH 2, 1940 FROM BERLIN.

The quantities mentioned above should, on the basis of customs values in 1937, have a total value of about 300,000 (?) marks. Deliveries at the rate of 90 million marks per year must be added to this for the commodities promised by Russia under the August 19 trade agreement, and perhaps 30 or 40 million marks for oil seeds, platinum, and other minor commodities about which the Embassy can get no detailed information. Russia would presumably furnish goods to Germany in the amount of something over 400 million marks during the next year, if she lives up to the two trade agreements; this amount would be approximately one-seventh of what Germany imported in 1938 from enemy countries and those which the blockade had cut off. There is little possibility, it is admitted, that total imports from neutral countries of Europe other than Russia can be increased over the levels for 1938, and it is admitted that decreased imports from other countries will offset the increased shipments of oil from Rumania.

Trade lost for Germany through the blockade could not be made up by the imports from Russia under the new agreement; however, certain important commodity needs would be fairly substantially relieved if not filled by such imports.

Thus, petroleum products from Russia in the amount of one million tons, in addition to a possible increase in imports

- 2 -

imports from Rumania of one million tons - compared with deliveries in 1938 from Rumania - would be more than 40 percent of net imports by Germany in 1938, which aggregated 4.8 million tons. It has been reported that Germany is actually accumulating oil reserves in view of the present military inaction and the prohibition of civilian passenger automobile operation. There is some confirmation for the belief in view of the fact that oil is still a fair traffic in Berlin of delivery vehicles which perform services not strictly essential to war and civilian needs. However, Germany would obviously not be provided with the oil reserves necessary for offensive operations over a long period, compared with the campaign against Poland in September, by obtaining oil from Russia; it is reported that Germany consumed one million tons of oil in that offensive.

END SECTION TWO.

KIRK.

The amount of 100,000 tons of cotton to be imported from Russia - about one-eighth of all that Russia produces - contrasts with the amount of 250,000 tons of spinning cotton imported by Germany in 1938. On this point it has not been possible for the Embassy to obtain expert opinion, but it is possible that if the delivery of the 100,000 tons of cotton is effected for Germany, it may be sufficient to satisfy domestic consumption for the present, in view of the severe rationing restrictions as introduced recently having diminished consumption.

It may be that the manganese contingent of 300,000 tons will be sufficient, although in 1938 426,000 tons were imported into Germany, and 550,000 tons in 1937. The Embassy has heard, in this regard, that an even larger amount would have been granted Germany by the Russian negotiators, but the German negotiators favored increased supplies of other commodities and refused a larger amount of manganese.

Approximately one million tons of phosphate have previously been imported by Germany each year; she would be able to satisfy about one-half of her import requirements through Russian deliveries of 500,000 tons of this commodity. Phosphate is of the greatest importance to agriculture in Germany, and it is believed that her inability to get phosphate from former sources of supply should result, after two years, in a decrease in crops. However, it is

to

- 2 -

to be noted that deliveries from Russia, which presumably will be imported via the Baltic, will probably not get to Germany in time for use during the present crop year.

The feed grains to the amount of 800,000 tons which Russia will presumably export to Germany under the agreement contrasts with the imports during 1938, from countries now cut off by the blockade, of barley, oats, corn and minor cereals to the amount of 2.16 million tons. It is possible that the imports from Russia this year might only restore fodder supplies to present insufficient levels if it is confirmed that the cold spell which has just come to an end has caused considerable spoilage of potatoes which were stored for feeding hogs, and if the grain crop this next season should suffer due to bad planting and cultivating conditions because of the continued excessive snowfall and continued cold weather. During 1938 Germany imported from enemy and overseas countries 780,000 tons of wheat and rye, as contrasted with the 200,000 tons of bread grains to be imported from Russia under the agreement. However, Germany's major worries at present do not include the bread grains situation.

The iron ore in the amount of 600,000 tons to be imported by Germany from Russia is only a small fraction of that taken by Germany in 1938 from countries with which it can no longer trade, in the amount of 9.7 million tons.

Iron

- 3 -

Iron ore could technically still be imported by Germany from Norway, some 1.1 million tons having been imported from that country in 1938. However, no iron ore was imported from Norway during the first four months of the war, according to available information, so that something like 10.8/^(million?)tons would be the deficit for Germany, measured by her full peace time requirements. This deficit, according to observers here, could be filled only partially and that very gradually through increased exploitation of mines in Germany and in Sweden.

With regard to the flax contingent of 15,000 tons, this is slightly greater than the amount imported in 1938, which aggregated 14,000 tons, enemy and overseas countries supplying less than 2,000 of this amount.

Timber from Russia is of relatively less importance to Germany in view of her access to the forests in Poland; this explains the low quantity of 18 million marks which the agreement is said to provide for.

It may be said of the new trade agreement, in resumé, that while it may help Germany substantially, it will not meet the full war-time requirements of Germany for such important commodities as petroleum products and iron ore and feed grains necessary to overcome the shortages in meats and fats.

It is requested that the Treasury be informed of the foregoing. END MESSAGE.
EA:LWW

KIRK.

PARAPHRASE OF TELEGRAM SENT

TO: American Embassy, Rio de Janeiro

NO.: 48

DATE: March 2, 1940

Reference is made to your telegrams 78 and 79.

We have made as vigorous a presentation as possible of the matter to White and have taken it up separately with Traphagen of the Bondholders Council. The Executive Committee will consider it at a special meeting which will be held Monday morning. As soon as possible thereafter we will telegraph you.

HULL (AAB)

EA:EB

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE March 2, 1940

TO Secretary Morgenthau
FROM Mr. White
Subject: Shipments to U.S.S.R.

Following are details of the S.S. Norbryn which sailed March 1 for Russia:

Domestic exports:	
Industrial machinery	\$1,501,528
Brass ingots, strips and castings	880,684
Copper and products	846,210
Electrical machinery and apparatus	289,094
Ferro-vanadium	118,063
Molybdenum ore and concentrates	80,178
Bismuth metal	62,987
Stainless steel sheets	21,035
Scales and balances	8,959
All other commodities	30,457
Total domestic exports	\$3,837,195
Re-exports:	
Straits tin	245,186
Standard T/N Shellac	46,875
Liquid Latex	23,028
Tantalite ore	7,026
All other commodities	3,609
Total re-exports	<u>325,724</u>
Total cargo	\$4,162,919

cc: Mr. Gaston
Mr. Basil Harris
Mr. Cochran

March 2, 1940

To: Secretary Morgenthau
From: McHugh

Admiral Spear called up at 12:55 and dictated the following message to me. He said he thought it might be of use to you when you saw the President tomorrow:

"For the information of the Secretary of the Treasury. We have received this morning in the Navy Department an oral request from the Minister of Finland that the Navy or the U. S. Government supply 150 pursuit planes. The Navy is investigating and taking the preliminary steps to gather the information, but it will be suggested to the Finnish Government that they submit their request to the President's liaison committee - Captain Collins, Chairman."

STRICTLY CONFIDENTIAL

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TREASURY DEPARTMENT

INTER-OFFICE COMMUNICATION

DATE March 2, 1940

TO Secretary Morgenthau

FROM Mr. Cochran

Mr. Chen called on me today at 12:15. He stated that Dr. Buck was due to arrive in Washington on Sunday and Mr. Sheahan on Tuesday or Wednesday. Mr. Chen had not yet procured much information on the question of the Irrawaddy River prospects. He stated, however, that he understood that the road across Burma from the head of navigation to the Chinese border was in very bad condition. The Chinese Government had approached the Burmese Government with the view to obtaining the construction of a new road, for which the Chinese Government was willing to pay. The Burmese Government had refused, presumably because it did not want competition from this source with the Burmese railway, which is Government owned. Chen stated that his people were receiving favorable rates and other good treatment at the hands of the Burmese railway and would hesitate to do anything now which might jeopardize their good relations with the Burmese railway and the Burmese Government.

Mr. Chen is remaining in Washington until next Thursday evening.



Re VESTING OF FRENCH SECURITIES

March 2, 1940.
10:10 a.m.

Present: Mr. Leroy-Beaulieu
Mr. Cochran
Mrs Klotz

Leroy-B: I received a cable when I arrived yesterday by which - that was two days ago - which said I was to come and see you as soon as possible in order to let you know why we have done this convention with the Bank of France and in the cable they told me that I had to tell you all that was in the letter which was supposed to have been brought to me by Mr. Pleven, but Mr. Pleven is still in Lisbon. He is waiting for the plane.

H.M.Jr: Isn't he on the Washington?

Leroy-B: No. He and Jacquin are in Lisbon since last Monday. On the Washington, there is Mr. Rist and Mr. Ashton-Gwatkin.

H.M.Jr: You know they were to come over here quietly.

Leroy-B: Yes.

H.M.Jr: You saw the publicity yesterday out of Paris?

Leroy-B: Yes.

H.M.Jr: The understanding was they were to come over very, very quietly.

Leroy-B: Yes.

H.M.Jr: But all this announcement came out of Paris yesterday.

Leroy-B: Yes.

H.M.Jr: They also said that everything must be very quiet and they would just drop in to see us.

Leroy-B: The only thing that I know is that the Embassy was instructed to go and see the State Department and to ask them what they thought about this coming --

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H.M.Jr: Before or after it was given out?

Leroy-B: Before. Saying that it was to be given out, yes.

H.M.Jr: Oh, they cleared it in the State Department?

Leroy-B: Yes, in the State Department.

H.M.Jr: O. K.

Leroy-B: So I can't give you any more, I think, about the convention than you have from Matthews.

H.M.Jr: That is right.

Leroy-B: Because the only thing I know is that already ten days ago and I see that what I read in the papers is what I was told when I left, but I think from what I heard from Cochran yesterday, you know all the details.

Cochran: Yes, we have it.

H.M.Jr: That is right.

Leroy-B: So then as far as the vesting of securities is concerned, I have here a message for you from the Minister of Finance which I brought in French and which I translated into English, but then I don't know whether the translation is absolutely diplomatically correct, because it is mine.

H.M.Jr: It is good enough.

Leroy-B: Yes.

H.M.Jr: Did they have a swimming pool on the boat coming back?

Leroy-B: Yes, but they didn't use it because it is an open one.

H.M.Jr: "1) The Minister of Finance has studied with special attention the various observations and suggestions made to his Financial Attache by

- 3 -

the Secretary of the Treasury in reference to the financing of the purchases made by the French Government in the United States of America. Like Mr. Morgenthau himself, the Minister of Finance has been concerned over this important question.

"2) The estimate of the requirements of France in dollars for her payments in the United States during the first year of the war was the subject of a communication from the French Embassy on behalf of Mr. Paul Reynaud, and this estimate contained all necessary reservations as to its final character.

"The same communication indicated the conditions under which the expenses made during the first months of the war were covered.

"3) The question of financing expenses abroad during the war has been examined by the French Government, in close collaboration with the British Government, in the spirit of the financial agreement concluded on December 4, 1939, of which Mr. Morgenthau was duly informed.

"It was recognized that if the two allies, in order to meet their payments in dollars, have to utilize all their available resources, gold reserves, currency, bonds and stocks, this problem at the present time presents itself under quite different conditions for each of them.

"4) In the first place, the distribution of the resources of France and of Great Britain is not identical. The latter has available in total and proportionately, a much greater amount of dollars in stocks and bonds than France. The liquidation of these bonds would normally constitute an important item in the financing of purchases, but in the case of the French Government it would constitute a relatively unimportant item.

- 4 -

"Moreover, from a purely practical point of view, it should be recalled that the inventory of currency and bonds held abroad by French citizens is now being undertaken and that no step can be considered until this inventory has been completed and its results are available.

"5) For these various reasons, the French Government has agreed with the British Government that the latter would be free to undertake first the recall and disposal of the American bonds owned by its citizens. This procedure seems to take into account the concern expressed by Mr. Morgenthau.

"6) In the light of these observations, the Minister of Finance is anxious to establish with Mr. Morgenthau as close a contact as possible in reference to all decisions to be made concerning the questions raised by the American Treasury.

"The Minister will not fail to inform Mr. Morgenthau, as soon as they are available, of the results of the inventory of American bonds and stocks held by French citizens.

"Furthermore, he is in a position to give Mr. Morgenthau the assurance that no French transaction on the United States stock market will take place without prior consultation with the American Treasury. The recent suggestions which Mr. Morgenthau sent through Mr. Leroy-Beaulieu will be examined with the greatest care.

"Mr. Paul Reynaud wishes to express his personal thanks to Mr. Morgenthau for his initiative and he interprets his suggestions as an indication of the interest which the Secretary of the Treasury takes in the solution of the difficulties which the war has imposed on the Allies, and wishes to re-affirm his continued willingness to cooperate under the stipulations of the tripartite agreement still operative."

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Lobby-5:

So, I should like, Mr. Secretary, to add a few amendments on this to tell you exactly how I found my Minister and how we had to come to this conclusion. When I came there, I found him a little upset by my cables and then he told me, "I don't know what the situation is. It was very difficult for the British and I wish you would tell Mr. Morgenthau why and how we reached this conclusion." We, as you know haven't been as rapid as the British when the war started to make a decision about those foreign stocks. We first said we would make an inventory. The first results of this inventory were indicated to Matthews in Paris and they showed that the amount of American stocks owned by French people didn't seem to exceed roughly between 150 and 200 million dollars and the second indication given was that they seemed to be much more widespread in the population than we had first thought.

We had a very big number of exceedingly small returns and we were very much amazed to see that the man in a small place, a small village, even in the south of France, should have one U. S. Steel or two General Motors, so it made a problem from the political point of view a little different because we couldn't ask the people when they delay which, as I told Cochran, was the first of February for the civilians and the first of April for the mobilized people. There were two different dates. We put in a thousand and they - Mr. Morgenthau wonders - and to say that the delay of the first should be put to the first of March or something like that, it seemed to us exceedingly hard to do, so I told them I didn't think that was your wish, because the people there are - you know how French people are. They are always exceedingly upset by this financial consideration and, for instance, I would see my brothers at the front and the first thing they asked me was about what about these returns, how can we do it without taking a furlough, and so on, see, and it is true of

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many people when they are there, they have to first have their leave to see their bankers and stockbrokers and see even how they stand. So I don't think --

- H.M.Jr: I understand it is difficult.
- Leroy-B: Yes. We have five million men mobilized between 20 and 50. That is over half of our population between 20 and 50.
- H.M.Jr: They are actually mobilized?
- Leroy-B: Yes.
- H.M.Jr: They don't work in the factories in uniform?
- Leroy-B: Oh no, never, that is the Army.
- H.M.Jr: And they don't, say, put 50,000 men in factories or on the railroad?
- Leroy-B: No, those are not mobilized.
- H.M.Jr: Are the men who are working the railroads mobilized?
- Leroy-B: No. You see, we have a hundred divisions at the front, which means about two million and a half and then you have all the services, supply services and all that, you see, and then behind the lines you have to have some, too, so that made the problem different from us and the British, so what I wanted to avoid was that the British should say when we begin, and I thought it was perhaps possible to concentrate on the Franco-British Communique and be asked by you to send us American securities, to invest our securities and that the Franco-British Communique on the fourth of December had said when the British start first, because their problem was different. They have over a million pounds of securities, you see. We have 150 million dollars.
- H.M.Jr: Bit I don't want you to tell the French soldiers mobilized, "We have got to take your one stock of General Motors away from you because that

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so-and-so Morgenthau is insisting on that."

- Leroy-B: No, we won't do that. You see, that was a problem.
- H.M.Jr: It is very nice for you.
- Leroy-B: No, I didn't say so.
- H.M.Jr: No, but I got that all right. I hope that isn't the way it develops.
- Leroy-B: No, no.
- H.M.Jr: Because I want to go back some day to France.
- Leroy-B: No, but I wanted to tell you that because it is a fact which is probably ignored in this country but which Cochran is aware of, because he knows how the distribution of wealth stands in France and this particular little thing, you see, say, of two General Motors, is so sacred a thing which he has put away in order that if he dies, or things like that, his daughter should have it, and those things - it wouldn't even be possible to vest them the first of April. That is only between you and me.
- H.M.Jr: I am not crowding you on this. Don't --
- Leroy-B: No.
- H.M.Jr: No. If you have any such --
- Leroy-B: Then I am glad to hear that.
- H.M.Jr: Oh no, all I have done is to ask. I have never even inferred that I have urged them to do this.
- Cochran: No, sir, you just asked as to an estimate as to what their needs would be for this year and how they are going to be met, by sale of securities, by gold, or by what.
- Leroy-B: Then we are under the impression, I think, it is because when you asked us to start, you know, to sell under this scheme directly with the companies, so they got the impression that we are in a hurry.

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H.M.Jr: No, that is not correct.

Leroy-B: So I thought it might be --

H.M.Jr: I wish you would get this --

Leroy-B: Possibly we could meet your wishes by saying when the British start to collect, then we would start later on.

H.M.Jr: I want you to get this. At no time, I am confident, have I ever urged the English or the French. All I was trying to find out was this, was to get some indication from the two governments what proportion, how they were going to raise their money for this coming year, what proportion was gold, what proportion was securities and estimates, and that I don't even know whether I asked for it, but the British gave me a breakdown of what they were going to spend that money for in this country, which I think was voluntary. As far as I know, I never asked for it, but please tell Mr. Paul Reynaud that I am simply - I simply raised the question so that I would be informed and I explained that if I knew, it would be easier for me to answer the constant criticism of our buying all the gold in the world, but at no time, nor do I now urge you to do it.

Leroy-B: I am glad to hear that, because it was my personal impression, you see, and I told Mr. Reynaud, "I think you are too nervous about the thing and I am sure that when I come back with this message Mr. Morgenthau will quite understand the situation," you see.

H.M.Jr: Did he maybe pick that up in London?

Leroy-B: I don't know, but I found them a little nervous and the idea they had was that there was some - after a certain date that you would refuse buying gold, or things like that. I don't know how they got this information.

H.M.Jr: I would like to know whether they picked that up in London.

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- Leroy-B: I think it came from London, because I don't say I can show you my cables. I never gave them the impression that there was anything --
- H.M.Jr: I would like to know where they got that from and from whom. It didn't come from this office.
- Leroy-B: No, I think it was the whole thing, you know, of this past - about what happened, about what such and such a man says and with Vandenberg speaking one way on the gold and other - from those two principal men, and the whole thing, you see.
- H.M.Jr: Well, if nothing else, at least you can clear up what I should think would be very important for Mr. Reynaud to know.
- Leroy-B: Yes.
- H.M.Jr: Not only wouldn't I press you, but I would consider it improper for me to press you.
- Leroy-B: Yes.
- H.M.Jr: All I asked for now was information. I can say about what it says here, as far as I am concerned, it is entirely satisfactory.
- Leroy-B: I see. Then as far as the information is concerned, we gave you some time ago from the Embassy a very rough estimate of what our - of what we thought our needs would be, I think.
- Cochran: Yes, the Counselor came in --
- Leroy-B: The Counselor of the Embassy. The Secretary wasn't there.
- H.M.Jr: Somebody has been doing something malicious around here and I would like to know where it comes from. It doesn't come from my office and after all, I am the only person who is authorized to speak on these matters.
- Leroy-B: Yes, and so this rough estimate was 35 billion francs.

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Cochran: That was on February 15, I think.

Leroy-B: Of course, this estimate is perhaps no longer right. For instance - well, aviation, it all depends on what is going to be done, you see, by this new aviation purchase and it may be that if we have more for aviation we would have less for machine tools.

H.M.Jr: Well, I carry a figure - as I say, there is so much happening that - the last cable that I saw was from Matthews in which he said that the French Government would be spending about 45 million dollars a month in this country.

Leroy-B: Yes.

Cochran: That is right.

H.M.Jr: Is that the last?

Cochran: Yes.

H.M.Jr: I can't remember it all, but that is the last number of dollars a month.

Leroy-B: That doesn't - 35 billion francs. Yes, it is 600 million dollars. Well, you see, I think that we will be soon in a position to give you a little more precise information on that. So far as our reply is concerned, Mr. Secretary, I think we will be able to give you a little more information because when I left Paris they were making this inventory of all the different Ministers to know what their requirements were and after that there was planned an order to know exactly what foreign - they would need and then to make sort of a program, they said, "Well, if we need so much for....., then we won't buy any Dutch cheese or we won't buy any --" You see, all of that, because the different Ministries gave us such huge figures that Mr. Reynaud was very anxious and said, "If that is so, I don't know how I can finance it." After all, he has only three billion dollars in gold.

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- H.M.Jr: I understand he cut this thing in half and then this airplane thing came along and it went right back to the original figure. Is that right?
- Leroy-B: That is about right. You see, the first figure we got from all the Ministers put together, was the figure which reached nearly a hundred billion francs for 1940. That is in dollars, pounds, and everything, of which about 60 billion francs were in pounds.
- H.M.Jr: Are you giving us new, fresh figures today?
- Leroy-B: No, I mean that is what was asked by the Ministers, so then they had to have a conference with the Finance Minister and the Prime Minister to cut this figure down and this will be done probably before, I think, the end of the month. We have to agree.
- H.M.Jr: Then when they get the new figures, if you will tell Mr. Reynaud to let me have them and until then we take these as the most recent figures.
- Leroy-B: Yes. When we get more recent figures, I will give them to you (Mr. Cochran).
- H.M.Jr: Please get this over to Mr. Reynaud. I am asking for information, which is one thing I would like to have if he wants to give it to me.
- Leroy-B: He will give it to you, all right.
- H.M.Jr: And the other thing is, the last thing in the world I am going to say to the French Government is, "I am putting pressure on you to sell your securities."
- Leroy-B: I am very glad to hear that.
- H.M.Jr: I am disturbed to think that there have been so many people in our own Administration who were not in complete sympathy with what I was doing with the English on securities, and those people normally stay in London.

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Leroy-B: I see what you mean, yes.

H.M.Jr: And I think if you talk a little bit - and I just wondered if possibly somebody put something up in London and passed it on, you see, which would not necessarily represent what Mr. Roosevelt and I think.

Leroy-B: Yes.

H.M.Jr: See?

Leroy-B: Well, maybe that was it, Mr. Secretary. I don't know. I should hate to report the information, but it may be that, because I had the impression it came a little from London and I know that somebody in your Administration who usually stays in London came to Paris on his way here and he may have given a false impression.

H.M.Jr: I would like to know, because I know that Lord Lothian is quite disturbed about what has been going on, as far as France is concerned and what happened in this country while he was here. Ask Pinsent about it.

Leroy-B: Yes, I saw Pinsent yesterday.

February 18th, 1940.

MESSAGE FOR MR. MORGENTHAU
FROM MR. PAUL REYNAUD.

1) The Minister of Finance has studied with special attention the various observations and suggestions made to his Financial Attaché by the Secretary of the Treasury in reference to the financing of the purchases made by the French Government in the United States of America. Like Mr. Morgenthau himself, the Minister of Finance has been concerned over this important question.

2) The estimate of the requirements of France in dollars for her payments in the United States during the first year of the war was the subject of a communication from the French Embassy on behalf of Mr. Paul Reynaud, and this estimate contained all necessary reservations as to its final character.

The same communication indicated the conditions under which the expenses made during the first months of the war were covered.

3) The question of financing expenses abroad during the war has been examined by the French Government, in close collaboration with the British Government, in the spirit of the financial agreement concluded on December 4, 1939, of which

....

Mr. Morgenthau was duly informed.

It was recognized that if the two allies, in order to meet their payments in dollars, have to utilize all their available resources, gold reserves, currency, bonds and stocks, this problem at the present time presents itself under quite different conditions for each of them.

4) In the first place, the distribution of the resources of France and of Great Britain is not identical. The latter has available in total and proportionately, a much greater amount of dollars in stocks and bonds than France. The liquidation of these bonds would normally constitute an important item in the financing of purchases, but in the case of the French Government it would constitute a relatively unimportant item.

Moreover, from a purely practical point of view, it should be recalled that the inventory of currency and bonds held abroad by French citizens is now being undertaken and that no step can be considered until this inventory has been completed and its results are available.

5) For these various reasons, the French Government has agreed with the British Government that the latter would be free to undertake first the recall and disposal of the American bonds owned by its citizens. This procedure seems to take into account the concern expressed by Mr. Morgenthau

6) In the light of these observations, the Minister of Finance is anxious to establish with Mr. Morgenthau as close a contact as possible in reference to all decisions to be made concerning the questions raised by the American Treasury.

The Minister will not fail to inform Mr. Morgenthau, as soon as they are available, of the results of the inventory of American bonds and stocks held by French citizens.

Furthermore, he is in a position to give Mr. Morgenthau the assurance that no French transaction on the United States stock market will take place without prior consultation with the American Treasury. The recent suggestions which Mr. Morgenthau sent through Mr. Leroy-Beaulieu will be examined with the greatest care.

Mr. Paul Reynaud wishes to express his personal thanks to Mr. Morgenthau for his initiative and he interprets his suggestions as an indication of the interest which the Secretary of the Treasury takes in the solution of the difficulties which the war has imposed on the Allies, and wishes to re-affirm his continued willingness to cooperate under the stipulations of the tri-partite agreement still operative./.

18 Février 1940.

MESSAGE POUR M. MORGENTHAU
de la part de M. Paul REYNAUD

1.- Le Ministre des Finances a étudié avec une attention particulière les diverses observations et suggestions faites à son Attaché Financier par le Secrétaire de la Trésorerie, au sujet de la couverture des dépenses du Gouvernement français dans les Etats-Unis d'Amérique. Il est, comme M. Morgenthau, préoccupé de cette importante question.

2.- L'évaluation des besoins en dollars de la France pour ses paiements aux Etats-Unis pendant la première année de la guerre a fait l'objet d'une communication de l'Ambassade de France, de la part de M. Paul Reynaud, cette évaluation étant accompagnée de toutes les réserves qui s'imposent quant à son caractère définitif.

La même communication a indiqué les conditions dans lesquelles les dépenses des premiers mois de la guerre ont été couvertes.

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3.- La question de la couverture de ses dépenses à l'étranger pendant la guerre a été examinée par le Gouvernement français en liaison étroite avec le Gouvernement britannique, dans l'esprit de l'accord financier du 4 Décembre 1939 dont M. Morgenthau a eu connaissance.

Il a été reconnu que si les deux alliés devaient être conduits pour faire face à leurs paiements en dollars à utiliser toutes leurs ressources disponibles, réserves d'or, avoirs en devises, portefeuille de valeurs mobilières, la question se posait actuellement pour chacun d'eux dans des conditions sensiblement différentes.

5.- En premier lieu, la répartition des ressources de la France et de la Grande-Bretagne n'est pas la même. Cette dernière a, en chiffres absolus et proportionnellement, un portefeuille de titres en dollars beaucoup plus important que la France. La réalisation de ces titres constituerait normalement un mode de financement substantiel : pour le Gouvernement français elle ne peut être qu'un appoint.

D'autre part, d'un point de vue purement pratique, il faut rappeler que l'inventaire des devises et valeurs détenues à l'étranger par des Français est en cours et qu'aucune mesure ne peut être envisagée avant qu'il soit terminé et que ses résultats soient connus.

3.

5.- Pour ces différents motifs le Gouvernement français a convenu avec le Gouvernement britannique que ce dernier serait libre de commencer d'abord la réquisition et la vente des valeurs américaines détenues par ses ressortissants. Cette procédure paraît répondre en fait aux préoccupations exprimées par M. Morgenthau.

6.- Sous le bénéfice de ces observations, le Ministre des Finances est désireux d'établir avec M. Morgenthau un contact aussi étroit que possible pour toutes les décisions à prendre au sujet des questions soulevées par la Trésorerie américaine.

Il ne manquera pas en particulier de lui faire connaître dès qu'ils seront en sa possession, les résultats de l'inventaire des valeurs mobilières américaines.

Il peut, d'autre part, lui donner l'assurance qu'aucune opération française sur le marché des valeurs des Etats-Unis ne se fera sans consultation préalable de la Trésorerie américaine. Les suggestions récentes que M. Morgenthau a fait transmettre par l'intermédiaire de M. Leroy Beaulieu seront examinées avec un soin particulier.

7.- M. Paul Reynaud tient à remercier personnellement M. Morgenthau de son intervention : il y voit une nouvelle marque

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de l'intérêt que porte le Secrétaire de la Trésorerie à la solution des difficultés que la guerre crée aux alliés , et de son désir de coopération dans le cadre, toujours vivant, de l'accord tripartite.

TREASURY DEPARTMENT

INTER-OFFICE COMMUNICATION

DATE March 2, 1940

TO Secretary Morgenthau

FROM Mr. Cochran

STRICTLY CONFIDENTIAL

Mr. Leroy-Beaulieu, Financial Counselor of the French Embassy, was received today at 10 o'clock by Secretary Morgenthau. Mrs. Klotz and Mr. Cochran were present, and during the first part of the conversation the stenotype operator took notes.

After Leroy-Beaulieu, who had returned from France two days ago, had delivered to Secretary Morgenthau certain messages from Minister of Finance Reynaud, the stenotype operator left the room and an informal conversation followed. Mr. Leroy-Beaulieu presented to the Secretary a clip of machine gun cartridges taken from a German Messerschmidt plane which had been brought down in France by an American Curtiss plane. Leroy-Beaulieu's brother had given this souvenir to Leroy-Beaulieu who, in turn, desired Secretary Morgenthau to save it, considering the latter's helpful interest in the Allies' aviation program. Leroy-Beaulieu stated that the Curtiss planes were proving their superiority on the western front. Leroy-Beaulieu did not have precise information in regard to the latest and speediest type of Messerschmidt plane which, the Secretary understood from Mr. Ziegler, had been produced.

In accordance with the Secretary's request, Leroy-Beaulieu gave a picture of the European war situation. He was not able to predict what would happen this spring. He said there were definitely two schools of thought. His own opinion was that the Germans would be extremely foolish to start a big offensive with their army. He said they made this mistake in 1914 in their attacks against Belgium and Northern France. To launch a big military campaign now would cost them heavily in the copper, steel and other materials for which they have the greatest need. He thought the wiser plan from the German standpoint would be to wear down the Allies. He is definitely of the opinion that the Allied blockade of Germany as now operated will not be successfully effective. He emphasized that Germany has through her conquest of Poland and Czechoslovakia acquired thirty million slaves who can be forced to work long hours producing the agricultural requirements of Germany, with no remuneration above that necessary to keep them barely alive. Leroy-Beaulieu thought the two articles absolutely necessary to Germany's conduct of the war are petroleum and iron ore. He mentioned northern Sweden as the important source of the iron ore now reaching Germany. In this connection Secretary Morgenthau asked me if the Department of State maintains an office at Narvik, the port from which it is understood most of this iron ore is shipped. When I replied negatively, the Secretary instructed me to write a letter to Secretary Hull requesting the sending of an American Vice Consul to this port. (I am first checking information on Swedish iron ore shipments. Narvik, the port mentioned by Leroy-Beaulieu, is in Norway.)

Leroy-Beaulieu stressed the difficulty of the British carrying out an effective patrol of the northern waters. He gave an interesting insight into the problems England is experiencing in its own shipping trade as a result of German submarines and mines, the latter still being responsible for more sinkings than the former. Leroy-Beaulieu stated that the seaports on the west of England are inadequate to take care of the imports coming from overseas, with the result

that ships from the Americas and the Far East are frequently routed around the north of Scotland and brought down to eastern and channel ports of England. Making this trip through the northern waters they suffer serious losses at the hands of the enemy. Not only are the ports inadequate, but the railway connections between ports and the industrial and population centers of the British Isles are insufficient. Even the domestic coal carrying trade by coastal vessels has broken down this past winter.

With respect to French freight traffic, there have been comparatively few sinkings. To mine the Mediterranean Sea and that part of the Atlantic Ocean which borders France on the west would require German planes to cross over French territory. This would be very perilous because of the detectors on the French-German border which could at once report the planes passing the frontier and call out combat planes to stop them before reaching the waters desired to be mined. For this same reason it is comparatively simple for the Germans to approach the mouth of the Thames, flying over water, and then to attack London, only five minutes distant by air from the coast. Leroy-Beaulieu stated that the French convoys from America went directly to Casablanca, Morocco, when carrying airplanes. This southern route below the Azores avoids the danger area. The planes are assembled at Casablanca and flown to the continent. At present Leroy-Beaulieu thinks the transport of planes is about keeping up with the delivery of planes by American manufacturers in this country. Ports such as Bordeaux and Marseilles are used for the receipt of materials other than planes.

Leroy-Beaulieu explained in considerable detail the reasons why there was delay and hesitancy over agreeing to a tremendous Allied plan for purchasing American planes. It was not only necessary for the French and British to be in accord on this idea, but it also raised a big question for the French Minister of Finance who, considering his limited resources, could not treat the airplane program as an isolated project, apart from the needs of other Departments of the Government. In this connection, Leroy-Beaulieu stated that France had ample artillery equipment, except perhaps for an increased supply of airplane detectors to aid the artillery. He emphasized the need of obtaining airplanes from the United States. At the same time, the French wanted a program followed which would permit them to obtain machine tools, aluminum, etc. from the United States in ample quantities to enable them to carry out the French manufacture of planes.

Referring to an estimate submitted to the Secretary on February 1 by the French Embassy with respect to French expenditure over the first year of the war, Leroy-Beaulieu stated that this estimate would have to be revised depending upon the airplane purchase program adopted and upon other factors. He was of the opinion after being in the United States only two days that sentiment for the Allies here is not as favorable as when he left this country in January. He referred particularly to the arguments being put forward by the State Department in favor of the Allies, particularly Great Britain, purchasing more agricultural products. Leroy-Beaulieu thought that the Treasury realized very clearly that France must conserve her foreign exchange and other financial resources for absolutely necessary articles, those to be obtained from the United States being principally airplanes. He insisted that France was obliged to make certain purchases from Turkey and other countries of the Near East or see these countries thrown directly into the arms of Germany. Consequently, he felt that the American authorities and people insisting upon the Allies buying agricultural products here in present circumstances were definitely taking a position inimical to the Allied cause.

During the informal part of the conversation, the Secretary gave Mr. Leroy-Beaulieu considerable information in regard to his efforts to coordinate the machine tool and airplane manufacturers in this country. There was also an exchange of views in regard to prospects for plane deliveries, but Leroy-Beaulieu contributed nothing new on this subject.

Leroy-Beaulieu stated that detailed information in regard to the economic problems of the Allies would be available with the arrival of Messrs. Rist and Ashton-Swatkin next week on the S.S. Washington. When the Secretary remarked upon the publicity which was attending their mission, Leroy-Beaulieu volunteered that the French Embassy communique in regard thereto had been first submitted to our Department of State.

Leroy-Beaulieu got on to the subject of Finland. He noted with regret that American papers evidently had not received or carried full information in regard to the extent of the assistance which has been given Finland by France. He stated that as early as December 15 the French Government had sent airplanes to Finland, with civilian pilots, and that the total number thereof has reached 100; the British have provided 150. He stated that France had also sent important quantities of guns and rifles, without which the Finns could not possibly have fought successfully as long as they have.

In discussing the European military situation, Leroy-Beaulieu stated that France had 100 Divisions at the front, as compared with 130 by the Germans. The British have along the western front only 6. He stated that in 1914 the number of British Divisions was only 4. He emphasized the slowness of training and sending British soldiers to the Continent. He admitted that the British big requirement is for manning their navy. At present France has 10 Divisions in Syria.

Leroy-Beaulieu stated that the Ministry of Finance and the top officials in the other ministries are all in Paris. Only certain unimportant and subordinate services are located in the center of France. Most women have returned to Paris, but have left their children in the country. Taxis and subways are functioning almost normally except that certain subway stations have been converted into air raid shelters and cars no longer stop there. The rationing system now being adopted he thought was quite rigid. He remarked upon the tendency of French people to gather in restaurants and cafes at night in present circumstances to keep in touch with each other and suffer less unhappiness from the blackout.

In the official part of the conversation, the stenotype notes will record the French observations upon the difficulty of making a census of foreign securities held by French citizens, 5,000,000 of whom are under arms. Leroy-Beaulieu stressed the delicacy from a French political standpoint of requisitioning such securities suddenly, particularly when held in small numbers by private investors.

When Leroy-Beaulieu left the Secretary's office he spoke with me for a moment in the reception room. I stressed the urgency of his explaining to his

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Minister of Finance the Secretary's exact attitude in the matter of dollar securities held by the Allies. Leroy-Beaulieu told me that he thought the misunderstanding in France had come principally from London, and specifically from Ambassador Kennedy. He stated that Couve de Murville, the young French official who succeeded Rueff as Director of the Movement of Funds section of the Ministry of Finance, was quite astonished that Ambassador Kennedy should call on him, while passing through Paris, and discuss this question. Leroy-Beaulieu did not know just what this conversation had been. I reminded Leroy-Beaulieu that the Treasury had not only refrained from recommending any early vesting of French securities, but had even recommended a delay in the entire allied procedure that would permit study of the possibility of certain blocks of securities being disposed of before actual vesting orders might come out.



TREASURY DEPARTMENT

233

INTER-OFFICE COMMUNICATION

DATE March 2, 1940

TO Secretary Morgenthau

FROM Mr. Cochran

STRICTLY CONFIDENTIAL

The foreign exchange market was featureless today. After opening at 3.92-3/4, the rate for sterling moved within a narrow range and closed at 3.92-7/8.

Sales of spot sterling by the six reporting banks totaled £287,000, from the following sources:

By commercial concerns.....	£ 203,000
By foreign banks (Europe).....	£ 84,000
Total....	£ 287,000

Purchases of spot sterling amounted to £280,000, as indicated below:

By commercial concerns.....	£ 170,000
By foreign banks (Europe and Far East).....	£ 110,000
Total....	£ 280,000

The following reporting banks sold cotton bills totaling £198,000 to the British Control on the basis of the official rate of 4.02-1/2:

£ 159,000 by the Guaranty Trust Company
20,000 by the Irving Trust Co.
13,000 by the National City Bank
6,000 by the Bank of Manhattan
<u>£198,000 Total</u>

The other important currencies closed as follows:

French francs	.0222-3/4
Guilders	.5312-1/2
Swiss francs	.2242-1/2
Belgas	.1690
Canadian dollars	13-5/8% discount

We sold \$1,600,000 in gold to the Central Bank of the Argentine Republic to be added to its earmarked account.

The State Department forwarded to us a cable stating that Mocatta and Goldsmid, London, shipped \$1,058,000 in gold from England to the Banque Belge pour l'Etranger, New York, for sale to the U. S. Assay Office.

The Bombay silver quotation was unchanged at 40.67¢.



DEPARTMENT OF STATE
WASHINGTON

March 2, 1940.

My dear Mr. Secretary:

As promised you this morning, I am enclosing a copy of a strictly confidential memorandum left by the British Ambassador with the Secretary of State on February 14 relating to British purchases of agricultural products in the United States and a copy of a supplementary memorandum of February 16 amending the memorandum of February 14. There is also enclosed a copy of a memorandum of inquiry and comment which Secretary Hull handed to the British Ambassador on February 21.

Sincerely yours,

Herbert Feis

Herbert Feis
Adviser on International
Economic Affairs

The Honorable

Henry Morgenthau, Jr.,

Secretary of the Treasury.

MEMORANDUMStrictly
Confidential

Points for discussion with Mr. Hull on purchases
of agricultural products.

I.

The outbreak of war will compel the Allies to reorganise their economic life from top to bottom in order to be able to cope with Germany's aggression. The precedents of previous wars are now completely overpassed. Germany has organised herself for years on a quasi wartime basis, and totalitarian government has turned by an easy transition to totalitarian war in which the maximum proportion of the nation's energy is devoted to the war, and the satisfaction of ordinary human needs in Germany is out down to the lowest possible point. To meet a menace of this kind the Allies are forced to make similar efforts to put the maximum proportion of their energy into the conduct of the war and to reduce the ordinary consumption of the population to the minimum. Their national production as a whole can be increased in certain directions by organisation and by the progressive utilization of all the man-power available after the needs of the fighting forces have been provided for. But the total national production is limited, and if the maximum effort is to be made to win the war, a very high proportion of the national production has to be consumed for the purely destructive purposes of the war itself. Only the residue of the national production, changed to some extent in its composition by the process of foreign trade, and supplemented directly or indirectly

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indirectly by the dissipation of foreign assets, is available for the consumption of the population. This is not a matter which depends on governmental policy: it is a matter of necessity. A failure to reduce the consumption of the population to the lowest point consistent with health and efficiency would mean one thing only: that the Allied Governments were not exerting their maximum effort to win the war, and that the war would be correspondingly prolonged or victory endangered. Moreover, it is certain that in proportion as the war lasts the pressure on the population to tighten their belts and consume less must be progressively increased. The organization and the necessary strengthening of our fighting forces takes time, and as it proceeds ever-growing supplies of munitions will be required.

In Great Britain the reorganization falls loosely under two heads:

On the one hand Great Britain is introducing a rationing system at home in order to diminish the consumption and importation of luxuries and non-essentials. Thus the rationing of bacon, butter, meat, etc., has already been announced. If the war lasts long it is certain that these restrictions will be increased, partly to enforce savings as the only means of financing war expenditure without uncontrollable inflation, and partly because of the difficulty of paying for imports and of the necessity of economising shipping.

On the other hand Great Britain will have to appropriate the dollar securities belonging to its
nationals

nationals, and tender its available gold, in order to pay for the large volume of munitions and other essential war supplies which it must purchase from the United States and which it cannot pay for either by exports to the United States or by triangular trade with the British Empire countries in the sterling area.

We have not been informed of the exact amount of dollar exchange which Great Britain can obtain by requisitioning dollar securities. The Federal Reserve Bulletin for December estimated at \$735 millions the negotiable securities held in Great Britain, and at \$2,000 millions the British gold reserves. While not accurate these figures represent broadly the facts. They represent the total capital assets of Great Britain which must as the war proceeds be gradually transferred to the United States, until they are exhausted, for essential war purchases.

II.

The present estimate of the British Treasury of the balance of payments between the United States and Great Britain during the first year of war is as follows:

Estimated U. K. Purchases in U. S. A. in First Year of War.

Handwritten notes:
 1000000000
 1000000000
 1000000000
 1000000000
 1000000000

	(million £)	% of total
Raw materials:-		
Cotton	26	24.36
Other	22	6.60
Foodstuffs(a)	22	18.23
Oil	25	12.89
General manufactures	43	21.83
Machine tools		
Purchases by Air, Military and Naval Services:-		
Aircraft	23	
Munitions	12	
Other	3	
	197	100.00

Handwritten annotations:
 45.6 (bracketed around 24.36 + 6.60)
 35.4 (bracketed around 18.23 + 12.89 + 21.83)
 21.1 (bracketed around 23 + 12 + 3)
 6 Merchant Ships (written next to 43)

Estimated

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**Estimated U. K. Receipts from U. S. A. in
First Year of War.**

	(million £)	£ of total
U. K. exports to U. S. A.	30	
Net balance of invisible exports	-6	32
U. K. adverse balance		102 145

(a) includes Cuba and U. S. dependencies, to be excluded in a revised statement.

III.

Estimates of transactions between the United States and the rest of the sterling-using area, i.e. the British Empire - other than the United Kingdom - excluding Canada, Newfoundland and Hong Kong but including Egypt, Sudan and Iraq) are as follows:-

(million £)

Exports to U. S. A.		85
Imports from "	55	
" invisible	-2	87
Favourable balance		28

leaving a net estimated adverse balance for the whole of the sterling area of

¹¹⁷
£134 million

While we derive help from the rest of the sterling area in the form of their favourable balance with the United States and their production of newly-mined gold we have to provide foreign exchange for their requirements as well as for our own, and their requirements are greatly increased by higher freights and high prices, particularly for oil which they buy in great quantities from foreign sources.

What counts is the total amount of the adverse balance

balance resulting from purchases by the sterling area from countries outside that area, which have to be met by sales of gold and foreign securities. The total adverse balance of trade of the area has been and undoubtedly will be still more gravely affected, apart from war purchases, by a reduction in the volume of exports, by higher prices for imports and by very greatly swollen payments to neutrals in respect of shipping.

It might be thought that the newly-mined gold production of the Empire would provide an additional resource which could be utilised for the purchases from the United States of the agricultural and other non-essential goods which have to be restricted in order to preserve our gold reserves and dollar securities for our essential war purchases from the United States. There is unfortunately no such possibility. The total adverse balance of the sterling area with countries other than United States which will have to be covered in gold or foreign exchange will certainly exceed the current gold production of the sterling area.

IV.

The estimated adverse balance of the United Kingdom with the United States in the first year of war shown in II is ¹⁴⁵ £202 millions, amounting at \$4.02 to the £ to ⁵⁸³ \$811 millions.

The net adverse balance of the United Kingdom (deducting the surplus on services account from the deficit on commodities account) during recent years of peace has been:

Year

<u>Year</u>	<u>Million dollars</u>
1934	- 202
1935	- 204
1936	- 125
- 1937	- 199
- 1938	- 308

or an average for 1934 - 1938 of \$208 millions. The deficit on commodities account for 1939 is estimated at \$355 millions and although the surplus on services account is not known it is almost certainly less than the \$95 millions estimated for 1938. It will therefore be seen that the adverse balance of the United Kingdom with the United States for the first year of war is likely to be three times the average of the last years of peace.

The statement in II of estimated United Kingdom purchases in the United States in the first year of war shows that this deficit on commodities account is due to purchases of strictly military supplies as defined in the Neutrality Act to an extent less than 20 percent of the total. Purchases of (a) raw materials, foodstuffs and oil account for 46 percent and of (b) machine tools and general manufactures for 34 percent. Difficulties of classification make it impossible to give any precise analysis, but generally speaking it can be said that Great Britain is buying from the United States in the first year of war

<u>Less of:</u>	and	<u>More of:</u>
Raw materials (other than cotton)		Cotton.
Foodstuffs		Oil Products.
Semi- and finished manufactures (other than machine tools)		Machine Tools.
		Aircraft.
		Munitions.

It is not known whether or not purchases of ships from the United States by the British Ministry of Shipping are included in this estimate. The value of such purchases up to February 3, 1940, was \$7,210,625.

The figure for military purchases however only takes into account orders which have been already placed and makes no provision for the immensely larger aircraft and other armament programmes now under discussion, nor for the plans for greatly increased purchases of propellants and other essential war supplies which are having immediate consideration. The indirect beneficial influences of these huge potential expenditures on the American raw material and agricultural industries should not be underestimated in any calculation of the effects of the Allied war purchasing policies on the American agricultural economy.

V.

So much for the first year of war. But it must be remembered that in measuring our visible resources against our prospective requirements from the United States the Allied Governments must be prepared for a war which may last three years or even more, and that the drain on our gold and foreign exchange assets to provide for essential war purchases on the present scale, leaving aside the expenditure which will be necessitated by these contemplated programmes, will be considerably higher in succeeding years than in the first year of the war. The additional orders for aeroplanes under consideration but not yet ordered provide for a further expenditure of about \$1,000,000,000, including

including the cost of capital construction and taxation. There are also large additional orders for propellants on the way. It will take some time for our military purchases in the United States really to make themselves felt and moreover as the manufacturing capacity of Great Britain becomes progressively more fully employed we shall necessarily have to turn more and more to the United States and other foreign countries for additional purchases which will inevitably be found to be required by our expanding fighting forces. This will add to the drain in two ways. Larger purchases will probably have to be made and, secondly, owing to the exhaustion of the manufacturing capacity of Great Britain, we shall probably be unable to restrict our purchases in as large a degree as at present to raw materials and will have to buy more manufactured goods. It is of course quite impossible to estimate what the effect on the balances of payments in the second year of the war may be. But if there were an adverse balance on United Kingdom account up to £162,000,000 in the first year it is likely to be far greater in the second year.

The foregoing points to the fact that these contemplated programmes will bring a long way nearer the date when Great Britain will have transferred to the United States all its dollar resources and all its gold reserves, and will be forced to discontinue the purchase of any further supplies (beyond the small amount which can be paid for by United Kingdom merchandise exports and the favourable balance accruing from the rest of the sterling area) whatever the effect on the war may be.

In

In order to postpone as long as possible this date, unless there is an unforeseen change in the whole situation, far more drastic restrictions on the consumption of even relatively essential supplies at present purchased from the United States will have to be imposed on the British civilian population. The whole population may be compelled to live at a rigidly controlled standard of living in order that they may see the war through to the end.

VI.

It is in these circumstances that the British Government have had to consider the intake of imports of agricultural products from the United States, and the following are notes on the situation of the more important of them as Lord Lothian sees it.

TOBACCO. At the outbreak of the war there was rather more than two years' stock of American tobacco in Great Britain. At the time the British tobacco buyers had bought about one third of their normal needs from the 1939 crop, and the British Government ordered a discontinuance of the allocation of any further dollar exchange for the purpose. It is understood that the Commodity Credit Corporation of the U. S. Department of Agriculture bought the unsold two-thirds and is holding it with an option up to July 1st, 1941, to the British tobacco buyers, in consideration of approximately \$1,000,000 which they have expended on handling charges, etc., to buy it later.

No statistics are available as to present stocks in Great Britain of United States tobacco but the latest available estimates indicate that consumption may be expected

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expected to decrease and that present stocks may last for more than two years. This estimate is conjectural and confidential. It is difficult to say how far the British Government will feel it necessary to lessen tobacco consumption as a paramount measure of war economy or whether, as was the case in the last war, the demand of the soldiers in the field for tobacco will force up their consumption. Moreover it is necessary to hold tobacco for a considerable period to mature it properly and it would seem that it will not be possible to use up the whole of the existing stock before buying fresh supplies.

The essential fact in the tobacco problem is that provision has been made for taking care of the 1939 crop and there remains for discussion and consultation between the United States Government and producers on one side with the British Government and buyers on the other, the problem of the provision to be made for taking care of the customary United Kingdom intake of the 1940 crop.

This position had not changed since October but in January there was injected the question of the future British purchases of tobacco from Turkey and Greece which aroused public and political attention to the whole tobacco situation. A considerable exchange of views and information on this question has taken place between the two Governments but the British Government are ready and willing to discuss it more exhaustively with the object of placing it in its true perspective, especially in the eyes of the United States public and producers.

The

-11-

The recent agreement with Turkey has been rendered necessary by the fact that Turkey is an essential bastion in the defensive arrangements of the Allied Governments and Turkey has made it a condition of its adherence to the Allied Cause that it should be given a large loan of approximately £50 million for armaments and that tobacco should be taken to the amount of about £570,000 a year for 20 years as the service of this loan. Similarly in order to maintain Greece, another vital element on the Allied side in the Mediterranean, it has been necessary to enter into an arrangement whereby the United Kingdom will take about £500,000 worth of tobacco per annum so long as the war trade agreement between the two Governments remains in force. His Majesty's Government regrets that war necessities thus make it necessary for it to commit itself to buying Mediterranean tobacco for so long as twenty years but the total amount which it is committed to buy is less than one tenth of the normal consumption of American tobacco in the British Isles.

APPLES. Similarly, and solely impelled by the necessity of preserving dollar exchange for the purchase of essential supplies, the British Government decided in September that it would be unable to purchase apples and pears from the United States as these were in the nature of a luxury and it is possible to obtain reduced supplies from Canada which do not involve the use of U. S. dollar exchange. The

British

British Government, however, have been under strong pressure from Italy to buy certain raw materials, e.g. sulphur, mercury and hemp, and agricultural produce, including apples. Stoppage of Italian imports by sea of coal from Germany and Poland will cause a proportionate reduction in Italian exports to Germany, which is by far Italy's best market for agricultural produce, and acceptance by Italy of this fundamental change in her economic relations with Germany is dependent on Great Britain buying some Italian agricultural produce which would otherwise be unsaleable. We do not want to buy any produce from Italy and to do so will cause difficulties with domestic and Empire producers, but our relations with Italy cannot be jeopardised by a refusal to negotiate. Purchases will, however, be kept at the lowest figure possible without wrecking negotiations.

We had contemplated expending £250,000 in Italy on apples but in deference to American feeling it has now been decided to cut out this item. We shall also try as far as possible to avoid buying any Italian agricultural products for which the United States is an alternative source of supply. We may however have to buy some rice, although this will cause trouble with Burma and Queensland.

The British Government would not have negotiated for these purchases except that the effect of the embargo on German exports would otherwise be to inflict such damage on Italian agricultural producers as possibly to bring Italy into the war against us, or at least make her a very unbenevolent neutral, with most serious consequences to the Allied strategic position.

COTTON.

COOTON. British purchases of American cotton during the first months of war have on the other hand been very greatly in excess of purchases in corresponding months of previous years and provision of dollar exchange appears to have been made for maintaining them at that high level during the first year of war, but there are serious difficulties which may become acute in the shortage of shipping. The criterion for such continued provision however must increasingly be what is essential for the war. The supply of cotton to be manufactured for the export trade is a war essential, but for domestic use it may not be.

LUMBER. The State Department will have received information from the British Government departments concerned as to the contemplated large purchases of American lumber, including Southern pine. Here again there are serious difficulties in providing the necessary shipping.

BACON AND HAMS. In September the British Ministry of Food placed maximum prices on imported bacon and hams and in January, when a surplus importation was threatened, they were subjected to import licences to enable the Ministry to secure proper control in order to regulate prices and ensure the best use of the quantities imported. In the meantime the bacon which Canada exports to the United Kingdom is being replaced by bacon imported into Canada from the United States, and according to a recent press cable from Toronto in precisely the same quantity.

LARD. Similar treatment in regard to prices and import licences has been applied to lard. It is stated by the U.S. Department of Commerce that prices have not been attractive for substantial exports of lard from the United

States

States to the United Kingdom. Nevertheless the British Ministry of Food is authorizing large purchases of lard from the United States but is bound to resist the pressure from Chicago packers to raise prices against it and French buyers.

PORK. In consequence of the addition of bacon and ham to the list of goods which may not be imported except under licence the American packers were on the point of sending to the United Kingdom large quantities of pork, possibly as much as £700,000 worth, which we do not want. Pork will therefore be added to the list of meats subject to the import licences, and the addition is regarded as a perfectly logical and justifiable corollary to the action which had to be taken in regard to bacon and ham.

CANNED MEAT. The same action will be taken in regard to canned meat, which in any case would have to be added to the list on purely currency grounds.

GRAIN. We have no adequate information in Washington on the present and prospective situation of British purchases of wheat, flour, corn and barley. The British Ministry of Food is interested in some acquisition of American corn.

CANNED AND DRIED FRUITS. We have no estimate of probable purchases.

CANNED VEGETABLES. The United States Department of Commerce reports exports to the United Kingdom in the last six months of 1939 to have been more than twice as great as in the same period of 1938, and in December ten times more than in December of 1938.

CANNED

CANNED SALMON. Packers report a heavy demand from the United Kingdom.

ROBIN AND TURPENTINE. PHOSPHATES. British purchases of these economies are a substantial contribution to the economy of southern States.

VII.

To sum up, British wartime purchases benefit some branches of American agriculture directly and all indirectly, so long as dollars and ships are available, but adversely affect others notably tobacco and apples. But with the increasing stringency in the availability of dollars and ships, and with the likelihood of severe restrictions having to be imposed on civilian consumption in Great Britain for the essential purpose of financing a long war to a successful issue, cash purchases of non-essential American agricultural products and even of those now regarded as essential, must be reduced to a minimum. Further, in addition to these considerations of dollar exchange and shipping and civilian restriction of consumption, imperative political considerations which are vital if the Allies are to win the war may necessitate the diversion of purchases of some agricultural products from the United States to other countries. It is no part of the policy of the British Government in imposing restrictions, in reducing its purchases in the United States, and in buying elsewhere commodities which could be supplied by the United States if the means of payment were available, to divert trade from the United States to other countries. That diversion is imposed on us by war necessity and by the "cash" and "carry"

'carry' requirements placed on Great Britain for the conduct of its wartime trade with the United States. It will come to an end when the war is over.

VIII.

His Majesty's Government fully appreciate the concern of the United States Government as to the effects of the British, in co-ordination with the French, wartime purchasing policies on American agricultural interests, particularly on those of the tobacco producers; they desire equally with the United States Government to consider with them all aspects of these effects and all practical suggestions for reducing to a minimum avoidable disturbances to the American agricultural economy; they would be glad that the consultations which have taken place between Mr. Cordell Hull and Lord Lothian and by Mr. Herbert Feis and Mr. Pierrepont Moffat with Sir Owen Chalkley should continue; and for their part they are preparing for the British government departments concerned to have full and frank discussions with the American Chargé d'Affaires and Agricultural Attaché of the American Embassy in London on all the issues involved. They are also hopeful that the forthcoming visit to Washington of Mr. F. Ashton-Gwatkin and Monsieur Rist, economic experts of the British and French Governments, will provide an excellent opportunity for conveying the views of these Governments to the appropriate departments of the United States Government and for reporting to their own Governments on the situation as they find it is viewed here

BRITISH EMBASSY,
WASHINGTON, D.C.
February 14, 1940.

Strictly Confidential.

Attached is a revised statement of estimated United Kingdom purchases in the United States in first year of war, excluding U.S. dependencies and Cuba, to be substituted for statement on page 4 of British Embassy memorandum of February 14, 1940.

The reduction of £17 million in this revised estimate is principally accounted for by exclusion of purchases of

	<u>£</u>
Petroleum from Netherlands West Indies	17,000,000
Sugar from Cuba and U.S. dependencies	4,000,000
Hemp from Philippines	800,000
Reduction in estimate of machine tools likely to be procurable by end of August, 1940	12,000,000
and by the inclusion of	
Tobacco purchased from 1939 crop	7,000,000
Merchant ships	6,000,000
and by the revision of other items.	

In consequence of this reduction of £17 million compared with the figure shown in the memorandum, the estimated adverse balance of the United Kingdom is reduced to £148 millions, and of the United Kingdom inclusive of the rest of the sterling area to £117, or at the rate of \$4.02 to the £ to \$583 millions and \$470 millions respectively. The necessary corrections should therefore be made on pages 2, 4 and 8 of the memorandum.

The estimated percentage distribution of purchases shown

- 2 -

shown on page 7 of the memorandum should also be corrected, as follows:

Military supplies	21.1 percent	
Raw materials, food- stuffs, tobacco and oil	45.5	•
Machine tools, general manufactures and ships	35.4	•

BRITISH EMBASSY,
WASHINGTON, D.C.

February 16, 1940.

Estimated U.K. Purchases in U.S.A. in First Year of War.

		Million £ (f.o.b. values)	<u>Percentage of total.</u>
Raw Materials:			
Cotton	25.0		
Iron & Steel	9.0		
Lumber	3.5		
Wood pulp	2.0		
Other	<u>9.5</u>	49	27.22
Foodstuffs			
Cereals and cereal prod- ucts	3.5		
Hog products	2.5		
Fruit	4.5		
Canned salmon	1.5		
Other	<u>1.0</u>	15*	7.22
Tobacco (1939 crop)		7	3.89
Petroleum		13	7.22
General manufactures		23	12.78
Machine tools		31	17.22
Merchant ships		6	3.34
Air, Military and Naval services:			
Aircraft and engines	19.5		
Munitions	13.0		
Naval	3.0		
Other	<u>2.5</u>	<u>38</u>	<u>21.11</u>
		<u>180</u>	<u>100.</u>

* Provisional estimates subject to modification owing to price factor or otherwise.

February 21, 1940.

MEMORANDUM

It is recognized that the British Ambassador's memorandum of February 14, as amended by the memorandum of February 16, is tentative in its various estimates. The following comments are likewise in part tentative and in any event would be subject to amendment to correspond to any further changes which might be made by Lord Lothian in his memorandum.

I

Foreign Exchange Resources of the United Kingdom

The great importance to the United Kingdom of its gold and foreign capital assets is fully understood. It may be inquired, however, why the estimate of "the total capital assets of Great Britain" which is given on page three of the Ambassador's memorandum should include only gold and negotiable dollar securities and should omit

(a) The British short-term balances in this country, estimated by the Federal Reserve Board to have been 595 million dollars at the end of August, 1939.

(b)

- 2 -

(b) The British "direct and other investments" in the United States cited in the same survey.

(c) British direct and security investment in third countries which if liquidated at all are likely to be sold to American investors.

(d) The central gold reserves of the rest of the sterling area (a half-billion dollars).

Further, although the memorandum justifiably does not include the gold, dollar balances and American investments of Canada and France, it may be noted that these amounted to over 4.5 billion dollars and constitute a fund which in some measure undoubtedly will be available, directly or indirectly for the needs of the British Government in a protracted war.

These inquiries and comments are put forward in our endeavor to appraise whether the "total capital assets of Great Britain" may not lie somewhere above the 2,735 million dollars cited in the Ambassador's memorandum.

II

Estimated Balance of Payments between the "sterling area" and the United States

(1) It is the estimate of the memorandum that, omitting the sale of newly mined gold, the "sterling area" will have a negative balance of payments with the United States

- 3 -

States for the first year of the war (September 1939 - August 1940) of 117 million pounds sterling or 470 million dollars. Considerations of caution would obviously indicate the wisdom of making such an estimate on a most conservative basis. However, it would appear that, even on a conservative basis, the net result presented by this estimate may overestimate the prospective net adverse British balance - perhaps by as much as 100 to 150 million dollars. Without entering into detailed discussion, it would seem pertinent to inquire:

(a) Whether it is justifiable to assume that American imports from the United Kingdom will be as low as in 1934 or the exceptional year of 1938, as is done in the British estimate.

(b) Whether the dollar value of American imports from the rest of the sterling area is not likely to be substantially in excess of the 1939 value, which is the value assumed in the British estimate.

(c) On what basis the British Treasury has reduced the "net balance of invisible exports" to the United States to 5 million pounds (20 million dollars) when, according to our estimates, the "service" items in the balance of payments between the two countries has varied between 66 and 134 million dollars annually in the past six years (always in favor of the United Kingdom).

(2)

- 4 -

(2) It would be useful to have more information on the state of the adverse balance of the sterling area (as defined) other than the United Kingdom for which the newly mined gold will be required.

Since most of this newly mined gold will undoubtedly be sold, directly or indirectly, to the United States Government, it is pertinent to inquire why the dollar exchange proceeds cannot be spent for American agricultural products instead of diverting the British purchases of the same products to other countries, paying therefor with the proceeds of American purchases of newly mined gold (assuming of course that American prices are competitive world prices).

III

The Situation in Agricultural Products

The American Government is aware of the gravity of the British foreign exchange problem and fully understands that the British Government has strong reasons for reducing imports of non-essential products in order to conserve its resources for the procurement of commodities essential to Great Britain in time of war. With respect to any particular product, the urgency of the British position is such as to command the sympathetic understanding of the American Government. Unfortunately the cumulative effects of British

measures

- 5 -

measures for the control of trade bring direct loss and curtailment to American agriculture, which has a long-standing interest in the maintenance of foreign markets, while fostering an ephemeral trade in certain products directly related to the prosecution of the war, and for which the demand will largely cease with the end of the war. Hence, although fully understanding the position of the British Government, this Government cannot avoid concern over the loss of export outlets for its agricultural products in the United Kingdom. This loss would furthermore appear to be in considerable part the result not of reduced total British imports and consumption of such products, but of policies of diversion from American to other sources of supply. The United States is faced with the danger that its agricultural products may be shut out of their normal market in Great Britain because the United States is in a position to supply other products which are of the utmost importance to the British Government.

Approximately 35 percent of American agricultural exports (about 50 percent, excluding cotton) normally have gone to the United Kingdom, and a considerably higher percentage in the case of a number of individual products. For example

-5-

example, almost half of the total of American tobacco exports and about 85 percent of our ham exports are normally sent to the United Kingdom. It appears that various measures adopted by the British Government have completely closed the British market for American products which in recent years have accounted for almost half of our agricultural exports to the United Kingdom, that the trade in a number of other products has been severely curtailed, and that the outlook for the other agricultural products is far from reassuring.

The Department is currently giving attention to the various individual agricultural and forest products discussed in the Ambassador's memorandum. It would not appear to serve any useful purpose to enter into discussion of the details of the Embassy's comments, pending the more complete and, it is to be hoped, definitive talks which will be held upon the arrival of Mr. Ashton-Gwatkin. It may be remarked in general, however, on the basis of such incomplete information as the Department has been able to obtain from London and other sources, that the outlook for American agricultural exports to the United Kingdom (with the possible exception of cotton) is decidedly uncertain, particularly with respect to tobacco, fresh fruits and pork products.

Finally

-7-

Finally, note may be taken of the Ambassador's statements that "... cash purchases of non-essential American agricultural products and even of those now regarded as essential, must be reduced to a minimum" (page 16), that "imperative political considerations ... may necessitate the diversion of purchases of some agricultural products from the United States to other countries" (page 17), and that diversion of trade from the United States to other countries "is imposed on us by war necessity and by the 'cash' and 'carry' requirements placed on Great Britain for the conduct of its wartime trade with the United States" (page 17).

It is true that loans to belligerent governments are prohibited. But it may be observed that it is unjustified to conclude that this imposes trade diversion upon Great Britain and the British Empire.

(a) The memorandum claims that the sterling area has large adverse balances elsewhere for which it has to reserve the equivalent of its new gold production. Since these balances are not settled by credits or even by bilateral barter, there can be no economic reason (even of a wartime character) for diverting trade in agricultural products from the United States to these other countries. In either case the balance has to be
not

set out of British resources.

(b) It is stated that Great Britain is making loans for "imperative political considerations" to third countries and diverting trade from us in order to be repaid.

(c) It is stated that Great Britain is buying in other countries to keep them out of the German orbit or to keep goods from getting to Germany.

Actions (b) and (c) may be understandable enough for a nation at war. However, it cannot be maintained that the diversion is due to American legislation. Even if American loans were legal and American investors were willing to extend such credits, it would appear that the British Government would still be motivated by the same political and strategic considerations and would still be trying to divert trade in important products away from the United States. And such diversion may or may not "come to an end when the war is over". The experience of countries which have embarked upon bilateral arrangements and trade diversion under the plea of emergency needs bears witness to the fact that such systems of trade tend to create their own justification for continuance and although the "emergency" may change in nature, it seldom passes.

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AIR MAIL

NO. 59

AMERICAN CONSULATE GENERAL

American Foreign Service, Hanoi, Indochina, March 2, 1940.

SUBJECT: Closing of the Caobang Road.

The Honorable

The Secretary of State,

Washington.

Sir:

I have the honor to refer to my despatch no. 49 of January 30, 1940, in regard to the then prevailing opinion as to the usefulness of the Caobang road as a route of transportation to China via Indochina, and to report that recent developments have confirmed that unfavorable opinion. The Department will recall that the Caobang road was closed for a period of a week or more during early February, because of a number of small landslides, and I have now to report that the road is again closed, perhaps for an indefinite period.

Within the last week, representatives of the various oil companies and of other organizations interested in transportation to China, have individually expressed to me their profound scepticism in the future of the Caobang road, at least until the rainy season in Kwangsi is well past. Upon the basis of the reports of these observers, most of whom have vainly endeavored to enter China by this road, I venture to reiterate the previously expressed belief that any optimistic statements by the Chinese or by advisers to the Chinese National Government as to the immediate value of the road must be discounted as publicity

intended

intended to create optimism where no optimism exists.

During a recent trip to the frontier, involving unbelievable hardships, a representative of an American firm saw 60 trucks almost hopelessly mired down in the stretch between Tran Khan Fu and the frontier (about 24 kilometers), 3 completely wrecked trucks, and a number of others in various stages of collapse as a result of road conditions and bad driving. He was informed by the Indochina Customs officials at Tran Khan Fu that the Indochina section of the road would not be ready for sustained traffic under two months, these officials expressing at the same time their belief that the Chinese section of the road, between Pingma and Hochi, was in even worse condition.

I have had reports from other sources that the Chinese section between Pingma and Hochi is in terrible condition and that a number of bridges have been washed away by floods. If such adverse conditions obtain at the present time, before the onset of the rainy season, it is difficult to visualize the Caobang road functioning to any great extent within some months.

Respectfully yours,

For the Consul at Saigon,

CHARLES S. REED II,
American Consul

In duplicate to the Department (Original by air mail)
Copies to the Embassy, Chungking and Peiping
Copies to the Consulates General, Hongkong and Shanghai
Copies to Consulates, Kunming and Saigon

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RE OPEN MARKET

March 3, 1940.
10:40 a.m.

Present: Mr. Gaston
Mr. Bell
Mr. Haas
Mr. Murphy
Mr. Hadley
Mr. Lindow

H.M. Jr: Mr. Bell, how does the financing look to you today, as of the close of the market?

Bell: Well, I think the last two days the bonds that we have been talking about, the $2\frac{1}{2}\%$ has been extended as much as a half year and it is just a question in our minds as to whether that isn't getting out a little too far at this time and you might like to consider a $2-1/8$, which looks now as though it might be on the face of a 12, a $14\frac{1}{2}$ year, or you might even go back to a 2% coupon, which would be a $10-3/4$ to a $12-3/4$ year.

H.M. Jr: Supposing I say what I have in my mind, which may help these fellows. I read Haas' two memoranda. I was impressed with two facts. One, that doing a $3-3/8 - 3-5/8$, isn't it? $3/8$ note and a $1\frac{1}{2} - 3-3/8$ bond and a $1\frac{1}{2}\%$ note, you have got to do something which wouldn't necessarily - you wouldn't necessarily do if you had just one or the other. You have got two different pieces of merchandise which are quite different and of course the second suggestion that you fellows made, that in order to overcome the desire on the part of the people to give up that interest for three months, you might have to pay the $3-3/8$ until the 15th of June. Still you have got a difficult piece of merchandise there.

Gaston: $3-3/8$?

Bell: Yes, that is the coupon on the balance.

Haas: They are calling before maturity, Herbert.

Murphy: People have the legal right to get their full interest.

- 2 -

Gaston: Oh, that is the present coupon?

Haas: Yes.

H.M.Jr: It is calling two things, you see.

Gaston: Oh, yes.

H.M.Jr: I am impressed with the other thing, that there really is a shortage of three to five-year paper on the market. It isn't very much, but you people planned that out. It has been getting less. We have been forcing the banks into a long discount. Therefore, I would like to put on the table the thought that we only do the note and the possibility of doing a five-year note at $3/4$ of a percent, which is damned attractive and then pick up the $3-3/8$ bond any time and the longer you wait, the more you could tailor it. Then you could tailor the thing just for that. You wouldn't have to be trying to do - as far as I know, I don't think I have ever done a note and a bond at the same time, refunding.

Sell: Oh, I think you must have.

Gaston: I think so. We have offered a bond for a bond and a note for a note.

H.M.Jr: We have called the bond and given them the choice of a note or a bond, but we have never called a bond and a note and then tried to offer two different things at the same time.

Gaston: I thought we had.

Murphy: It would be as far back as the middle of '35, because we haven't called any bonds since October, '35.

H.M.Jr: You take 738 million dollars worth of notes and offer them a $5-3/4\%$ note and you would do about 700 million. I think that I am right that that would fall at a good time.

- 3 -

- Hadley: Yes.
- H.M.Jr: I mean March 15, '45. There is nothing there?
- Hadley: No, there are no others.
- H.M.Jr: What the hell is the matter with that? You can shoot.
- Hadley: Well, in the first place, the market is expecting this 3-3/8 to come through and they feel since you have made no announcement about financing, you may have something that you know about the European situation which, if you hold this 3-3/8 back, they will say, "Well, you are only doing a five-year note and it is about the shortest issue you have put out, even including the September crisis," and they will say, "We were expecting something longer," and if the short one comes out and no bond, they will say, "Well, maybe there is something coming up that we don't know about," and it will unsettle the market.
- H.M.Jr: Well, O. K. If you don't mind, it is an argument but not an awfully heavy one. I mean, it is not an awfully heavy argument.
- Bell: In September, '35, we offered a 12-year, 2 $\frac{1}{2}$ % bond and a 1 $\frac{1}{2}$ %, 3 and 6-year notes and gave them their choice. In addition, we had 500 million dollar notes for cash.
- H.M.Jr: That was five years ago.
- Bell: It was quite a ways back.
- H.M.Jr: But I mean, is there some unusual excuse for not doing it?
- Hadley: The market has got both those issues tied together and they don't put the weight on that interest adjustment that some might consider they would.
- H.M.Jr: Well, it is worth 9/32nds, and if my memory

is correct, that interest for three months --

Murphy: On the coupon in the new security that you put out, it would be worth 9/32nds.

Bell: It would be worth more than that at three-quarters and that pushes your rights way down.

Murphy: Of course, we proposed that the interest adjustment be made only on the exchange of bonds for bonds.

H.M.Jr: I know, but - well, aside from the fact that the market would be disappointed, we would be borrowing 700 million dollars at three-quarters of a cent, which we have already done once before. What would happen to the bonds if we did that to the bond market?

Hadley: Your right values would go down. Your short bonds would drop off. It wouldn't affect your longer bonds much except for the fact that they might tie it in to something coming that they don't - can't see and they think you see, unless you explain why you are doing it.

H.M.Jr: Well, the explanation is that it is very difficult to find something which is suitable both to the holders of the bond and the holders of the note and 735 million is still a lot of money.

Hadley: I don't think the market would accept the argument there, because they have it pretty well figured out about what type of issue would go.

H.M.Jr: What do they think?

Bell: Then we have had so many financings larger than this, I think they would put a question mark after it. That is what worries me.

Hadley: The market's first preference is a reopening of the '48-'50s, and second, reopening of '51-'53s,

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or something in the early fifties, 2-1/8, 2-1/4.

H.M.Jr: You fellows are recommending a 2% --

Hadley: As far as the possibilities, the preferable one right now is a 2-1/8, 12-1/4 - 14.

H.M.Jr: Well, unless - I want to talk to Gaston and Haas and Bell, so if you men have got anything you want to say, you three, would you say it now and then I will ask you to wait outside.

Henry?

Murphy: I would merely like to add that if we put out a 3/4% note it will take about maybe 3/4 of a point off right values.

Bell: It will affect the 2 1/2-year price.

Murphy: Yes. It takes 3/4 of a point at present and that gradually decreases as you go into the future, but it might affect the securities - the effect might go out even beyond five years as it gradually decreases and while we know that this is a technical adjustment, from the standpoint of the non-technical reader it is merely a decline in the bond market and that decline, accompanied by the unexpected omission of a financing would naturally give rise to - tie the two things together and what would in fact be quite an illegitimate tie, but which would sound plausible and to the lay reader would sound more reasonable than a technical explanation.

H.M.Jr: Supposing for some reason we didn't do any financing at this time.

Murphy: I think it would not have this repercussion on right values. The technical adjustment in right values which hasn't anything to do really with the general level of the bond market or confidence in the future of money rates, can't be separated out. It is just a decline in Government bond prices and it seems to me while I feel that rights are too high, I don't - what

we are really doing is, we are taking a shot at them and we put them down sharply and it seems to me that it would be interpreted unfortunately.

Lindow: I agree with the sentiments both of Mr. Hadley and Mr. Murphy.

H.M.Jr: Supposing you three gentlemen - do you mind waiting outside in the room out there and make yourselves comfortable.

(Mr. Murphy, Mr. Hadley and Mr. Lindow retired from the conference)

H.M.Jr: You see, this is the thing that bothers me. You see, when I came back from Arizona I had a note from the President in which he said, "Don't do any financing, don't even talk to the bankers until I get back." Well, whereupon Bell and I sent him a cable recommending that we go ahead and refund both of these and he came back and he said, "No, I haven't got all the figures out here and what is so sacred about the Ides of March? Wait until I come back." But I have been worrying about it more and more and this Eccles-Lasser thing, I think, sort of shows which way the wind is blowing and then phoning around - I may be wrong, but my guess is that they are going to try to get me to take a million dollars worth of gold out of the stabilization fund to pay off these securities, you see, and that way change the debt limit and that is a signal to Congress that they can go ahead and spend money on agriculture or whatever they want. They put in the 45 billion, didn't they?

Bell: Yes.

H.M.Jr: I don't want to say how I arrived at it, but I have been doing a little snooping and I think I have hit it on the head. Now, I am supposed to see the President at 4:00. He will see me today or tomorrow. My thought is, I am in a much stronger position. That is what I want to discuss. If I go in and see

the President this afternoon and say, "Mr. President, here is the program that we have worked out in Treasury and I would like you to approve it," and he will say, "What is it?" Now, if I present him a program to refund 738 million dollars on the 1 1/2 notes at three-quarters of a cent, it is a damn sight harder for him to turn that down than if I'm talking about a billion one of two and two and an eighth percent bonds and something, and he will say, "What percent goes into bonds and what percent notes?" And I will have to honestly say about 75% will go in the bonds, so what I am thinking of is not to hell with the market and the rights and all the rest, what I am thinking is I want to put up a program which looks so attractive that it makes it almost impossible for the President to turn it down because I am paying too much and he then has got to say, "No, I don't want this, but I want something else." In other words, I want to be in a position I have been for years. I have always gone and said, "Mr. President," and said what I want and I would like his approval and I am not going to start in arguing and simply say, "What do you want, Mr. President?" "This is what the Treasury thinks the best and I would like to do it - like your okay to go ahead and do this thing next Thursday." Now, supposing it gets to the point that the President says, "No, you can't do it," and the thing is public, that he and I have had a break. What have we broken about? The President of the United States has said I can't borrow 738 million dollars at three-quarters of a percent for five years. He has refused to let me do it. I mean, where does it leave him?

Now, you fellows come back at me and that is why I thought this thing out and that is why I have changed. I want to make the program so reasonable that in his mind and in the minds of the public it makes it almost impossible for him to turn it down. If he goes to Eccles and says 2% bond, Eccles will say, "If he refuses to use gold or silver certificates, then make him use bills or notes,"

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but I want to meet the Eccles school more than half way and come to this and later on, this is what I have got in mind, in a month from now if we want to reopen that other note - you see, Dan? What is it, the December note?

Bell: No, it is the March, '44.

H.M.Jr: Then if we want to go back and reopen that note and refund the Junes into that, we are still all right.

Bell: You mean the bonds?

H.M.Jr: Yes. In two months from now or three months or one month from now, we want to reopen that - which is the one you recommended?

Bell: The March, '44.

H.M.Jr: Reopen the March, '44, we can always do that before these 3-3/8ths.

Bell: 350 million.

Haas: Here is an argument that occurs to me.

H.M.Jr: Do you get the picture, Herbert?

Gaston: Yes, I get it.

H.M.Jr: Go ahead, gentlemen.

Haas: What if he says to you then, "No, I don't want that. I want you to get all these obligations to use the silver." It seems to me that a very important thing from his standpoint, even if he made up his mind to do it, that to use - to retire these obligations in silver would have this disadvantageous effect on the bond market. It would eliminate these rights. In other words, by using a note when the market is expecting a bond, you would eliminate some of them, but using the silver you would more or less eliminate --

Bell: You would just hit them all at once.

Haas: Oh, you would hit the whole thing and with the business situation as it is, you don't want to disturb the Government bond market that way. Even if he has made up his mind to spend the silver, that technically is not the way to do it. The way is to use it in new money or if you must retire the Government debt, retire that part of the debt which does not disturb the bond market, which is bills.

H.M.Jr: Granted, but we are going to do that normally anyway.

Haas: Well, there is a billion three in bills out and there is how much of the new money?

Bell: Well, there is only 500 million in new money outside of Savings bonds.

H.M.Jr: You are suggesting we let the bills run off --

Haas: You don't hit the Government bond market that way.

H.M.Jr: And issue more certificates.

Haas: For the new money.

Bell: If you are going to use the gold or silver seigniorage, first use it to meet current expenditures. That puts it back in the hands of the public and the people want this money in the hands of the public. If he doesn't want to do that, he wants to show a debt retirement, then this retiring bills, rather than retiring something that has a value in the market and you disturb your whole bond market which is largely tied in with your private financing, which has been going good in the last two months. I am afraid you will disturb that whole thing.

Haas: Even if I believed and if you believed that you wanted to get the silver out, then you would ask yourself the question, "How, technically, is the best way to do it?"

H.M.Jr: You see the point, that I don't want to be a party to it. I can't object if the President of the United States says, "Due to the unemployment situation I want to spend another billion dollars worth of money for unemployment and I am going to Congress or send them a message," and then Congress debates it and approves or disapproves it. Then it is up to me to raise the money.

Bell: It is up to them to raise the debt limit.

H.M.Jr: It is up to them to raise the debt limit, but this thing that I see is, some person has said to him, "Now, by using the silver certificates instead of gold, what it amounts to, you increase the debt limit by a billion dollars." Isn't that what it amounts to?

Bell: Yes, if you use this to retire it you would increase it about a billion one.

H.M.Jr: And that is the signal to Congress to go ahead and spend another billion dollars. I think Congress will be just sore. The budget message is only two months old and I become a part of the trick of another white rabbit and that is what I object to. He won't say to me that this is what he has in mind, but I have smelt this thing. They tried to keep it from me and I am almost sure that I am right, but I have done a lot of work in the last 24 hours and then by giving them another billion dollars worth of public debt, that is the signal to Congress to give agriculture what it wants or this person or the unemployed, and so forth, and everybody will say, "Well, Morgenthau is just part of the trick."

Haas: Well, when you --

H.M.Jr: And I don't want to be part of any tricks.

Gaston: It makes the budget message dishonest, of course.

Haas: Aren't you a little better off, Mr. Secretary,

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personally, if you suggest to him the bond or the note, because if he goes just the note, you are sort of half - well, a little half way, sir.

Gaston: They want a billion dollars. If you take three-quarters of a billion dollars away from them, that sort of gums up the scheme.

Haas: Yes.

Bell: You don't suppose that they would permit you to go on with this refunding, which is already in the market, in the minds of the people in the market, and then take these funds and retire the December notes, 738 million dollars also?

H.M.Jr: I have that in mind, but I don't want to say anything about it because they haven't done their job, because Harold Smith hasn't gone after that 700 million from Farm Credit and RFC. If they go after that, we are all right. The thing gets down to the point, if we get the 700 million the President mentioned in the budget message, that is the leeway. It is down so close you might say there is no leeway, lacking that. Is that right, Dan?

Bell: That is right. It is awfully close.

H.M.Jr: And there is another 700 million worth of bonds coming due in December, as Dan says, but if I was the President, I would certainly want - between now and the time Congress adjourns, I would want to give them a review of where the public debt stands and just where the whole business stands and I just feel this way. If I give an inch at this time on silver certificates, gold in the stabilization fund or any one of these devices, well, I might just as well hand over the Treasury to Eccles and Lasser and be done with it. I might just as well. I mean --

Bell: Well, it isn't going to stop at the billion if you give in.

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- Gaston: No, it is going to be both silver certificates and gold.
- Bell: Three billion three is going out, that is all, silver certificates and the gold.
- Gaston: And all the gold.
- Bell: That is right.
- Gaston: And you just can't consent to taking that gold in view of what you have said to the Congressional committees without going to Congress.
- H.M.Jr: I can't? Remind me of what I have said.
- Gaston: You told them that they identified - I don't know the exact language - they identified the two billion dollar gold reserve with the stabilization fund. You told them that resource was not going to be touched for any purpose except stabilizing the value of the dollar, if any such proposal was made, that you personally would come up to Congress and ask them for permission to do it, and it seems to me that in this jugglery of using the gold, which is the real resource, without making it a charge against the stabilization fund on the books, they would regard as a trick, which means nothing, which is just a shabby device. Don't you think so, Dan?
- Bell: Well, I think there might be that intimation, but I don't think the Secretary went quite as far as you seem to think he did. I think he was talking about loans to foreign governments, and so forth, and said that he wouldn't make any loans to foreign governments without first consulting Congress and then they raised the question about using this gold for some purpose of that kind. The Secretary said he wouldn't use it in case of a war unless he came to the Committee.
- H.M.Jr: Well, but I made the plea that this thing should be used as a first line of defense against

depreciation of currency going on somewhere in the world and this isn't using it for that purpose. Now, I feel in my own mind that I would be breaking - I consider myself sole trustee of this fund. I made the fight. The President didn't lift a little finger to help get this thing through.

Bell: I think you pointed out in that letter to the President --

Gaston: Lasser said something like that, that the only reason he would consent to the continuation of this stabilization fund was because that locked it up so they couldn't spend it for running expenses.

H.M.Jr: Well, looking on it from the other side, does anybody think I should exceed that?

Bell: Well, not unless you have --

H.M.Jr: I don't have to do anything, Dan, that I don't think is right. After all, Congress gave this to me. They didn't give it to - I am the trustee. That is the way I consider myself.

Bell: You have got a very great responsibility in the matter. I think you will be criticized if you are a party to it.

Gaston: I would think this, that as to the gold in the stabilization fund reserve gold, no, until Congress gives it consent. As to the silver certificates, I should think in view of what you said about if Congress didn't raise the debt limit you would just be forced to use silver certificates, I think the time to use silver certificates is when you are up against it and you haven't got any other resources, but not now when you have got resources.

H.M.Jr: As to gold, you say what, Herbert?

Gaston: I would say no. I would stand against any use of the gold without the specific consent of Congress. As to the silver certificates, I

wouldn't use them until you are up against it and have got to use them to maintain the Government credit and pay its bills.

H.M.Jr: Now, I've spoiled Mrs. Morgenthau's week-end. Supposing they sent for me up in Congress. She said, "What would you say if they asked you if you used the gold?" I said, "I would say no."

Gaston: I haven't had just the same idea about the gold. I felt that it is an extra resource to protect and in view of all the assaults on the Treasury, but that there were some pretty good arguments for using it now to retire the debt or part of it at least, but I don't think you can do that without getting a release from Congress.

H.M.Jr: Let me explain that that thing, if you don't mind my saying so, is a specious argument, because if you retire a billion dollars worth of these bonds now with the deficit running, you have just got to get out a billion dollars of something else in place of it.

Gaston: Well --

H.M.Jr: Silver certificates are something. You have just got to replace it as you spend the money with something else.

Bell: In other words, you are just using it to increase your present borrowing power.

Gaston: My objection to using it, I think, is along the same line as yours. My objection to using it is at a time when it just gives an excuse to increase the expenditures beyond they point where they wouldn't increase. If it wasn't so, then I think it would be good policy to use a billion and a half or more for current running expenses, but I am morally certain if you did use it now or make known your intention to use it now, you would just result at this time in shooting up your appropriations and therefore I say, don't do it. But theoretically --

H.M.Jr: There is another thing, Herbert. Look at what the French do. The French wait until they are in the war. They are in the war three months and now they are beginning to use their gold.

Gaston: Yes.

H.M.Jr: Believe me, the President doesn't know how lucky he was in September that I was 90 days ahead of my financing.

Bell: He certainly was.

H.M.Jr: And that is another argument, to say that the - he says, "Well, we won't argue now. We will delay it." Today, I am going to say, "No, Mr. President, I am not going to delay because supposing this spring drive materializes and one of these big cities in Europe are laid waste, I can't finance. Then I am a failure. I have got this gain of 90 days. The market is in beautiful shape and now is the time to take it." He certainly was in a damn lucky position last September, entirely due to my foresight.

Gaston: That is why I say wait until you are up against it in all these devices.

Bell: That is the position you took in your letter, that you may need these funds in a critical time.

H.M.Jr: I wonder if we could get a copy of that letter.

Bell: It is in my files some place.

Haas: I am afraid, Mr. Secretary, his mind may be running somewhat like this, like it was in the spring of '38. If business is going down, it needs some kind of help. In '38 he used the monetary thing plus - now, spending may be difficult to get because of Congress unless he works along the lines of the Secretary's suggestions, but you see we have got these things.

Why not use them now? Business is going down. We have got to get business to turn up and we will give it the monetary stimulus and therefore use them. That may be the pattern that his mind may be running to, just like it was in the spring of '38.

Gaston: Some economists right now are worrying about a runaway inflation, due to war orders. If you superimpose this, you will get a good push for runaway inflation that would cause an awful lot of hardship.

H.M.Jr: Private financing is going along - it was 140 million last week, wasn't it?

Haas: I have forgotten. It was a big issue.

H.M.Jr: Ask Henry if that issue went well.

Haas: It went all right. Do you recall the date it went? Shall I ask him?

H.M.Jr: Ask him, to make sure.

Gaston: What I think might be a strong argument is that, "You presented the budget message only two months ago with a picture which has been accepted by the country. Now, why kick it apart now?"

Haas: On that Bethlehem, it went slow at the beginning of the day but he says that it was just fair. They closed the books and so on, the underwriters, but there is a good deal of it still hanging around and the Kentucky one is a low-grade bond and that went not as well as the Bethlehem.

H.M.Jr: Did you find it?

Bell: The cases are locked and I can't find the keys. I could get it if you wanted it this afternoon.

H.M.Jr: No, I think not.

Haas: Mr. Secretary, if you get this thing, do it more or less normally, irrespective of what you have

done afterwards, I think it is - it would help out the business picture by keeping the Government bond market in good shape. It seems to me that ought to be quite an argument.

H.M.Jr: No, this thing - I may be wrong - would upset people terribly. It would upset them the way it upset me.

Haas: But if you pay off these issues, Mr. Secretary, there is a mechanical upsetting due to this right thing which is in addition to the psychological thing.

Bell: Haven't you got to sort of see how the trend of the conversations go and then try to meet it by what he advances, because he may have an entirely different --

H.M.Jr: Yes, that is what I have been trying to do for the last two days is think of every argument.

Bell: Don't give up the whole refunding until you see which way the trend goes.

H.M.Jr: You stick to the whole one and then say, "I want to go ahead with my refunding."

Bell: Yes, and you might bring in the other picture, how about the notes. There would be no argument against that.

H.M.Jr: You mean not give up the two right away?

Haas: That is what I would do.

H.M.Jr: Fine. All right, than, you.

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Rio de Janeiro

NO.: 82

DATE: March 3, 1940.

Reference is made to my telegram no. 79 of March 1.

Aranha tells me that upon making a closer check he finds that under his last offer holders of dollar bonds, who hold only 34.4 percent of the total debt, would receive 38.9 percent of the proposed payment; comparable figures for the other holders would be as follows: holders of sterling bonds, 60.8 percent and 58.4 percent; holders of franc bonds, 3.4 percent and 2.4 percent; holders of florin bonds, .4 percent and .3 percent.

CAFFERY

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