

DIARY

Book 70

May 25 - May 31, 1937

	Book	Page
Bankruptcy		
Sabath bill: "An Act to establish a uniform system of bankruptcy throughout the United States"		
a) HMJr-Sabath telephone conversation - 5/26/37.....	LIX	84
Business Conditions		
Conference on Government purchases of textiles; present: Peoples, Collins, Taylor, Lubin, and Miss Michener - 5/26/37.....		66-A

Chamberlain, Neville		
On leaving post as Chancellor of Exchequer to become Prime Minister, conveys to HMJr, through British Embassy, sincere appreciation of spirit of cordial collaboration now in existence between two Treasuries - 5/31/37.....		298
China		
For resumé of conversations between HMJr and Chinese delegation, see Book LXXVIII, page 190		
Central News Agency, Shanghai, reports that Kung plans to confer with American authorities regarding the Sino-American silver agreement during proposed visit to United States in June - 5/27/37.....		152

Financing, Government		
Governor Young reports on favorable reaction to a five-year note; some banks favor ten-year; some go as far as twenty-year - 5/25/37.....		1
HMJr and Bell-Burgess telephone conversation - 5/26/37....		86
Conference concerning relationship between Federal Reserve Board and Treasury with regard to financing; present: HMJr, Bell, Taylor, Lochhead, and White - 5/27/37.....		124
Governor Schaller re-surveys situation in Chicago, et cetera - 5/27/37.....		170
Seltzer memorandum: "Desirable volume and maturities of Treasury bills" - 5/27/37.....		176
Foreign Capital: Restriction of Inflow		
See also Taxation		
Conference concerning "hot money" and gold; present: Bell, Upham, White, Lochhead, Miss Michener, Oliphant, Gaston, Seltzer, Taylor, and Magill - 5/26/37.....		69
France		
See Stabilisation		

	Book	Page
Gold		
See also U.S.S.R.		
Sterilization: Taylor summary of program 12/23/36 to 5/27/37 (page 150), together with conference thereon; present: HMJr, Bell, Taylor, Lochhead, and White - 5/27/37.....	LXX	124
Government Bond Market		
Harris memorandum: Following Supreme Court decision upholding constitutionality of certain contested provisions, bond market becomes strong and fairly active; and at close of day, substantial gains have been recorded - 5/28/37.....		230

"Hot Money"		
See Foreign Capital: Restriction of Inflow		
Housing		
Memorandum with regard to Ihlder bill (first rough draft) 5/30/37.....		295
Conference at HMJr's home; present: HMJr, Mrs. Morgenthau, McReynolds, Oppen, Ihlder, Dager, Lindow, Patterson (Budget), West, Gray, Foley, and Krooth - 5/31/37.....		300
Hungary		
Fels asks HMJr concerning representation of American holders of Hungarian defaulted bonds at a meeting to be held in London - 5/27/37.....		168
Conference; present: HMJr, Fels, Livesey, White, and Lochhead - 5/27/37.....		174

Investigations, Treasury Personnel		
Yellowley-Igce case:		
Keenan tells Oliphant that Evans has persuaded Wilkinson to postpone entire matter indefinitely - 5/27/37.....		147

Japan		
Butterworth (American Embassy, London) reports that Bank of Japan has arranged to ship three lots of gold to United States, each amounting to approximately \$15 million; first two lots have arrived - portion of third is on the seas; Araki (Bank of Japan's New York agent) reports that proceeds of first lot were retained by Japanese Government in order to pay service on bonds held abroad, to pay foreign expenses of Government, et cetera; proceeds of second lot, and probably third, are gradually to be sold to Yokohama Specie Bank for use in exchange operations to support Japanese currency - 5/27/37.....		67

- J - (Continued)

	Book	Page
Japan (Continued)		
Gold transactions discussed by HMJr, Lochhead, and Taylor with Mallet and Trentham (British Embassy) - 5/28/37.....	LXX	208
British Treasury reaction to Japanese position reported by Butterworth - 5/28/37.....		223
Proposed cable to Butterworth, as drawn up by Taylor and transmitted to Feis, concerning revision of import exchange licensing system established on 1/8/37 - 5/29/37.....		289

- N -

Narcotics		
Report on case of Joseph Aveta, alias "Jo-Jo" - 5/26/37..		66-I

- P -

Platinum		
See U.S.S.R.		

- R -

Russia		
See Stabilization		
" U.S.S.R.		

- S -

Shafroth, Morrison		
See Tax Evasion		
Silver		
See China		
Simon, Sir John		
Butterworth (British Embassy) reports acceptance of Chancery of the Exchequer in Chamberlain's Government - 5/28/37.....		225
Social Security Act		
Harris memorandum: Following Supreme Court decision upholding constitutionality of certain contested provisions, bond market becomes strong and fairly active; and at close of day, substantial gains have been recorded - 5/28/37.....		230

	Book	Page
Stabilization		
Stock market resumed by Cochran and Butterworth - 5/25/37 and 5/27/37.....	LXI	44,199,202 64
Knoke-Cariguel conversation - 5/26/37.....		
a) Amount of Russian balances in Paris market discussed; Knoke asks whether their presence has created a problem; Cariguel replies, "Not yet; they may some day"		
HMJr discusses with Cochran recent transactions of Swiss National Bank - 5/28/37.....		211
Cochran reports daily losses of foreign exchange by Bank of France every day for the past ten business days at the rate of approximately 50 million francs per day; French Stabilization Fund now has on hand slightly over 3 billion francs in foreign exchange and gold; to meet end-of-month requirements, Treasury will probably exhaust its balance with Bank of France and will be obliged to draw upon its credit - 5/28/37.....		218,221
Cochran visit to Switzerland authorized by State Department - 5/28/37.....		228
Knoke and HMJr discuss gold scare which has again broken out over week-end - 5/29/37.....		253
Switzerland		
See Stabilization		

Tax Evasion		
HMJr tells Magill of conversation with FDR - 5/26/37...		92
a) FDR had conferred with Harrison and Doughton for an hour; couldn't get them stirred up and so finally told Pat Harrison at least ten million votes were involved in this matter		
b) Harrison and Doughton want Magill; FDR sends word to Magill not to let this preference go to his head		
c) FDR outlines procedure: letter to be sent; then publicity; then appointment of a Joint Committee of Investigation giving the money to the Secretary of the Treasury to conduct investigation over which Magill will have control		
Following visit to FDR, HMJr signs letter transmitting report on recent investigation of income tax returns for 1936, together with letters of transmittal (for FDR's signature) to Harrison and Doughton - 5/26/37...		93
HMJr and Magill confer with FDR for 1½ hours; a memorandum which was discussed, attached - 5/27/37.....		154
Gaston tells HMJr about Shafroth speech before Tax Committee of American Bar Association - 5/28/37.....		236

	Book	Page
Tax Evasion (Continued)		
HMJr and Magill call to White House; confer with Oliphant, Gaston, and Helvering before going over - 5/28/37.....	LIX	236
a) Copy of memorandum marked "OK" after 3 P.M. conference at White House.....		270
HMJr talks to Doughton and Harrison about future plans - 5/29/37.....		248,250
a) Conference at 10:15 A.M., Saturday, 5/29/37; present: HMJr, Harrison, Doughton, Magill, and Gaston.....		264
Taxation		
Magill memorandum on possibility of taxing purchases and sales of American securities of non-resident aliens - 5/25/37.....		8
Conference in re proposal for new withholding tax on foreign capital; present: Magill, Oliphant, Gaston, Oppen, Taylor, Viner, White, Upham, Lochhead, and Bell - 5/25/37.....		10
Viner memorandum in re withholding tax - 5/25/37.....		42
Textile Industry		
See Business Conditions		

U.S.S.R.

See also Stabilization

White memorandum with regard to points raised in conversation between HMJr and Oumansky concerning Russian gold production - 5/26/37.....		108
Conference; present: HMJr, Taylor, Troyanovsky, and Oumansky - 5/26/37.....		110
a) HMJr remarks that he felt when Litvinoff was here, real confidence was established between the two of them; since then, the Governments are not getting any closer together		
b) Charts attached on production and price of platinum		
Harrison (Federal Reserve Bank of New York) reports to HMJr formal request for the opening of Russian account; certain information necessary before this can be done - 5/28/37....		231

Fin
1

May 25, 1937.
9:24 a.m.

H.M.Jr: Hello

Operator: Governor Young. Go ahead.

H.M.Jr: Hello

Young: Young speaking.

H.M.Jr: Governor Young - hello

Young: Hello

H.M.Jr: Governor Young

Operator: I think there is someone else on the line.

Young: Well I guess you'll get it all right now.

H.M.Jr: Yes, hello

Y: I tried to locate you yesterday as.....

H.M.Jr: I know - I

Y:per your request. I'm afraid that the information I have now is a little bit late in view of the (some other conversation going on in the middle of this) the statement that came out yesterday.....

H.M.Jr: Ah-ha.

Y:but - ah - there's no question about a five year note.....

H.M.Jr: You mean.....

Y:and most of the banks seem to think that you can put a 10-year out.

H.M.Jr: Really?

Y: Some of them - ah - even go so far asttwenty but I'm skeptical about the twenty myself. (Interrupted again by someone constantly saying "Operator")

H.M.Jr: Governor Young, we've got a bad wire - do you mind waiting a minute.

Y: Yes.

H.M.Jr: Just let me clear it.
(Conversation going on by another party)

Operator: Hello.

H.M.Jr: Why can't you get me a decent wire.

Operator: Just a minute.
(Pause)

H.M.Jr: Hello

Operator: Governor Young. Go ahead.

H.M.Jr: Hello

Y: Hello

H.M.Jr: Morgenthau.

Y: Yes.

H.M.Jr: Now I can hear you.

Y: Why - ah - between the 5-year and the 10-year there's quite a spread.....

H.M.Jr: Yes.

Y:and when you call that to the attention of the banks they're inclined to think that the 10-year might go.

H.M.Jr: Ah-ha.

Y: Now when I say 10-years or 5-years I really meant 8-9-10-11 or 12 years or I mean 4 or 5 years.

H.M.Jr: I see.

Y: Those would all have to be worked out according to the market at the time.

H.M.Jr: Yes.

Y: Now it is my own personal opinion.....

H.M.Jr: Please.

Y:that - ah - the long time issues, that is, up to 10-years is not offered then it will be interpreted as a position of weakness on the part of the Treasury.

H.M.Jr: Ah-ha.

Y: And yesterday, before this decision came out, I thought that you might again offer an additional amount of the 2-7/8's or the 2-3/4's due in - in '51 - or 48-51.....

H.M.Jr: I see.

Y: But, of course, this market - ah - looks as if it's going up a little bit and looks as if both of those issues are sweetened too much.

H.M.Jr: Ah-ha.

Y: Now it may be that the 2-3/4's on 51-54.....

H.M.Jr: Ah-ha.

Y:which closed last night at 31/32's offered.

H.M.Jr: Yes.

Y: Take it up to a point where they're sweetened a little bit.....

H.M.Jr: Ah-ha.

Y:and some of those could be offered.

Y: Now I've been groping around in the dark a little bit because I don't know what your requirements are.....

H.M.Jr: Yes.

Y:and I don't know what your receipts are going to be.

H.M.Jr: Ah-ha.

Y: This decision yesterday I assume strengthens your position a whole lot.

H.M.Jr: Ah-ha.

Y: At least one of your worries is out of the way.

H.M.Jr: Yes.

Y: And I'll keep at that and talk with you again if you want me to.

H.M.Jr: Oh very much. Well I don't mind telling you, in confidence, I think we'll need somewhere around 800 million dollars - gross.

Y: Yes.

H.M.Jr: See?

Y: Well I should say 500 of the 5-year and 300 of the other; I don't think you'd have any difficulty in that.

H.M.Jr: That means 300 of bonds.

Y: I think it's policy for you to offer some long time bonds and in an amount that they'll go.

H.M.Jr: Yes.

Y: Otherwise if you don't offer long time everybody knowing that there's some 800 millions coming in September.....

H.M.Jr: Yes.

Y:it might be construed as - ah - ah - an act of hesitancy on the part of the Treasury; a little lack of confidence in the whole situation.

H.M.Jr: Well I haven't talked to anybody; you're the first person I've talked to since that decision but before that decision everybody said I've got to give them a short note - 3 years.

- 5 -

- Y: Well now I've talked with - ah - let's see - three, six, eight, nine, ten, eleven, twelve, thirteen, fourteen, fifteen, sixteen - I've talked with 21 people.....
- H.M.Jr: For Heaven's sakes.
- Y:and my man talked ~~talked~~ with about 14 or 15.
- H.M.Jr: Yes.
- Y: Now I find that the best advice comes from the dealers.
- H.M.Jr: Yes.
- Y: Ah - the advice from the bankers - even the large bankers is some - is somewhat selfish.
- H.M.Jr: Yes.
- Y: For instance, they - the bankers say, "Well if you put on a 10-year bond at 3% he won't have any difficulty.
- H.M.Jr: Ah-ha.
- Y: Well of course you put out a 10-year at 3% you knock the 2-1/2% down; they don't stop to think that you're kicking the tail out of the portfolio when they make a suggestion like that.
- H.M.Jr: Well that's just crazy.
- Y: And - ah - but the dealers are the fellows that you've got to sell on the idea, I think, because that's where it comes from.....
- H.M.Jr: Yes.
- Y:and I don't think there's much opportunity of support from New York City, particularly the banks of New York City.....
- H.M.Jr: Yes.
- Y:because their excess reserves are only a little over 200 millions of dollars.....
- H.M.Jr: Yes.

- 7 -

Y:and, under those conditions, they don't dare to step out anything beyond the - ah - the bills and properly so too because New York City is pretty vulnerable.

H.M.Jr: Yes.

Y: Take the bank balances in the country here there's something well over six billions of dollars; that's - ah - over 300% over normal.....

H.M.Jr: Yes.

Y:and regardless of where the drawing is throughout the country it eventually centers in New York and they've got to be in a position to take care of it.

H.M.Jr: Well I've kept away from the dealers because I thought it would be time enough to talk to them next week.

Y: Well I - I didn't understand that; I talked with - with two dealers.

H.M.Jr: Well that's all right. I'm glad you did but I mean I haven't.

Y: Yes.

H.M.Jr: No, I'm delighted that you have.

Y: Well I told them there was no significance in my inquiries at all; that I had no authority to talk about anything and just wanted to get their ideas.

H.M.Jr: Well now Governor Young could you check again and call me Friday morning?

Y: I'd be very glad to do that.

H.M.Jr: Because it's very useful because what you're giving me is - is - is - is fresh and it's different from what I'm getting from New York and that's what I want.

Y: Yes. Well now anytime that you think I can be helpful either here or in Washington don't hesitate to command me.

H.M.Jr: Well you're being helpful right now and if you could call me again Friday forenoon I'd appreciate it.

Y: All right.

- 8 -

H.M.Jr: And if you'd check again, you see.

Y: I will.

H.M.Jr: This is very useful what you're giving me.

Y: Yes.

H.M.Jr: And Quite different from what I'm getting from New York.

Y: Well -

H.M.Jr: I mean because I haven't talked - up to yesterday they all said, "Give them a 3-year note" and they all said, "Don't give them a a long note" and I said, "What do you mean by a long note" - 5 years, see?

Y: Yes.

H.M.Jr: Now they may feel better to-day.

Y: Well, of course, I don't know whether you noticed it or not but in this recent slump in the government bond market.....

H.M.Jr: Yes.

Y: New England is the one particular section of the country that has increased its government holdings, at least as far as the banks are concerned.

H.M.Jr: Good. Well what you've told me is very useful and if you would call me Friday forenoon I'd appreciate it.

Y: Yes, all right.

H.M.Jr: Thank you very much.

MEMORANDUM OF THE DAY'S ACTIVITIES

8

May 25, 1937

To: Secretary Morgenthau
From: Mr. Magill

1. Taxation of non-resident aliens

Following the general conference this morning I discussed with Mr. White the possibility of taxing non-resident aliens upon the purchases and sales of American securities, by means of some form of excise tax on the proceeds of such transfers. There are numerous difficulties and I think it is doubtful if they can be ironed out in time for legislation to be proposed during the next few weeks. We have a longer memorandum on the subject of transfer taxes on non-resident aliens from Mr. Bryan, tax assistant to Mr. Eccles. I, therefore, asked Mr. White to discuss the practicality of the proposed taxes with Mr. Kent and Mr. Zucker, taking Mr. Bryan's proposals into account.

At the suggestion of Mr. Lochhead, I inquired from Dr. Herbert Feis whether the State Department would oppose the proposal to fix a minimum rate of 10 percent upon non-resident aliens, the idea being to eliminate the necessity for making refunds to a large number of taxpayers with incomes of less than \$25,000 from American sources. Dr. Feis said he would direct an inquiry to Secretary Hull, who is absent from the city; but that he (Feis) felt that the suggestion would be unacceptable since the great merit of the original proposal from the point of view of the State Department is that it is intended to bring about equality in the taxation of non-resident aliens as compared to American citizens. I told Dr. Feis that we proposed to eliminate personal exemption in the case of non-resident aliens and he indicated no objection to that proposal. He will give us Secretary Hull's conclusions in a few days.

Dr. Viner has sent me a memorandum recommending an exhaustive study of the entire proposal by the Division of Research and Statistics and the Income Tax Unit. The study could not be made short of several weeks and Dr. Viner apparently contemplates that it is advisable to postpone action on the proposal until the proposed investigation is completed. The points he makes are elaborations of his discussion this morning. I will be glad to discuss them with you in detail if you so desire.

2. Undistributed profits tax

Judge Fletcher, counsel for the Association of American Railroads, asked me whether the Treasury would devote any real attention to a statement of specific instances in which the undistributed profits tax is operating unsatisfactorily. I told him that we would be glad to get a specific statement and that we would give it careful attention. He said he would have the necessary information prepared and submitted to us about July 1st.

- 2 -

3. Leonard S. Gans, 285 Madison Avenue, New York City

Commissioner Helvering has sent over a two-page memorandum concerning the collect telegram which was sent to Mr. Gans about his income tax for 1933. The essence of the statement is that the Conference Division of the Income Tax Unit is attempting to procure settlements of additional tax liabilities, and to collect the amounts due before June 30th. There had been previous negotiations with Mr. Gans regarding a deficiency in tax for 1933 of \$1,087. I still do not see why the telegram was sent collect and I am going to ask Mr. Helvering about it.

Rm

MEETING RE PROPOSAL FOR NEW WITHHOLDING
TAX ON FOREIGN CAPITAL

May 25, 1937
10 A.M.

- Present:
- Mr. Magill
 - Mr. Oliphant
 - Mr. Gaston
 - Mr. Opper
 - Mr. Taylor
 - Dr. Viner
 - Mr. White
 - Mr. Upham
 - Mr. Lochhead
 - Mr. Bell

H.M.Jr.: I changed my schedule around because the gentlemen I was going to see at 9:30 were sick; I saved from 9:30 to 11. So I'm going to have this meeting now and I've got an hour. I want to talk at you and be talked at, because it seems as though we've got..... I walked down with Dr. Viner and it seems as though we ought to have a meeting of the minds; different people are doing different things, and I want to take time to correlate it. Now let's just go around, let's just see where we're at. Because I don't want to move on this - talk first on this tax on aliens - if everybody isn't satisfied.

Now, as I say, walking down with Jake - I mean he raised some questions, and let's take the time to get together while he's still here. At four o'clock if there are any doubts in his mind - why, let's give him a chance. That's why it's so good to - sometimes I get a little angry, but his main job is to raise questions.

Now, on this question - let's just talk a minute about hot money, see? I mean there are two divisions; the tax division is yours (Magill) and the financial, fiscal one is Taylor's. Now, on the tax one, walking down and talking with Viner, he said that he wasn't sure that placing this flat tax of 35 percent on aliens would yield us as much as the present ten percent withholding tax.

Now, if there is any question about it - I mean, to give you the background, the way I feel, I'm not nervous about the hot money thing, see? And to give you what everybody tells me, if you don't mind my

-2-

quoting different people who talk at me - now, White, on the other hand, has told me last week that if I didn't make some move on it, to do something between now and the first of January, that it wouldn't wait until the first of January; I had to do something - gold! - that I had to make some move. If I made the move, curtailed the hot money thing, then you (White) felt I had time enough to turn around and think; and do something between now and the first of January. Is that quoting you right?

White: Yes

H.M.Jr: But I had to move some way and somehow between now and the first of January.

White: Was very wise to do so.

H.M.Jr: Is that quoting you right?

White: Yes

H.M.Jr: Now, on the other hand, I don't feel nervous about gold; I don't feel nervous about the gold coming this way. The President doesn't feel nervous about it. Now, if there is any question in anybody's mind that the 35 percent tax isn't going to produce as much revenue as the present tax, then I - I'd much rather wait until next fall and then recommend something in January. See what I mean? And I want to take this hour to talk at you people and let you talk at me.

And look - I mean after all, while we're talking about hot money, it's all part of the picture of gold moving this way, and I can't get excited about it.

Now, for instance, the thing that happened yesterday, I think, is very interesting. Yesterday morning Archie comes to me, upset about the way the Swiss are "delousing" their gold and de-earmarking. At four o'clock he comes in - "The Swiss bought five million dollars worth of our bills." I mean things happen so fast around here that you've got to sort of - I mean you just can't keep your finger on the thing, and I want to take a big broad look at this thing.

And then I'll - and I just would like to have

you (Magill) take the ball from here for a minute and, if you don't mind, discuss - let's discuss this 35 percent tax and give these monetary people, or tax experts, like Viner, a shot at it. Now, if anybody's got a question in this room about the effect of this move, I say let's drop it. So would you mind taking the ball on this thing?

Magill: Well now, what we've got is this. The Division of Research and Statistics has given me an estimate that this proposal will give us - I think it is approximately five million dollars more than we are now getting from non-resident aliens. Now, that Division raised the question as to whether or not this proposal was sufficiently good, in view of the fact that it didn't necessarily affect capital gains, unless the particular alien had income from interest and dividends in this country.

However, I notice, on going over their own tabulations, that the bulk of the alien money in this country is listed as long-term investments, in a tune of about six and a half billions, as compared to about one and a half billion in short-term investments; so that if that were true, it would seem that we are hitting the major part of the problem, even though we are not hitting it all. And they do estimate, as I say, that we will get more money out of this proposal than we are now getting.

Well now, further, as far as the hot money aspect is concerned, the way this would operate would be that the 35 percent gets withheld one year and then the alien files his claim for refund and some time in God's providence he gets his refund. We have assured the State Department that we will do what we can to speed up the granting of refunds, but it's a pretty long process; so that for a considerable period the alien is going to have better than a third of his income taken away from him and rest on the pious hope that some day the Treasury will give him back any excess over the tax which is normally due. From my own point of view, that would be an extremely discouraging factor to me, and I should think it would be to the alien.

H.M. Jr: You mean discouraging because he has to wait so long?

Magill: Yes.

H.M.Jr: But would you discourage him from the standpoint of reinvesting?

Magill: Well, to the same degree, it conceivably might induce him to make short-term investments, or something of that description, rather than long-term. But I should think it would have quite a strong effect toward inducing him to take his money home, because the disadvantages of this procedure are considerable.

Well now, looking at it again from the academic or theoretical aspect, the question on the yield resolves itself into how many of these people there are who have incomes of less than \$25,000 as compared to those who have incomes in excess of that amount; and on that the statistics are almost completely unreliable, as I see them. They are old and not much good. The reason for those figures is, as you know, that the ten percent flat rate is the rate which is applicable to our citizens at about \$25,000, so that in the case of persons with incomes of less than that amount we will in the end get less money under this proposal than we do at present; in the case of persons with incomes more than that amount, we will get more income under this proposal than at present.

Viner: That's incomes of that amount from American sources.

Magill: From American sources, that's right.

H.M.Jr: But the net gain to the Treasury might be five million dollars?

Magill: That's my rec- - I haven't looked at that figure recently, but that is my recollection of the figure which the Division of Research and Statistics gave me. I know there is a net gain and it is about that amount. That doesn't sound like much, but the fact is there isn't much income from these sources anyway. I think the last two or three years we've been getting only two and a half or three million dollars from non-resident aliens - very small figure.

H.M.Jr: Well, let me put it this way....

-5-

- Viner: That doesn't include bonds - the tax withheld at the source on bonds, does it? On bonds' interest?
- H.M.Jr: No.
- Viner: You'll be getting that, you see, from non-resident aliens.
- H.M.Jr: No, this wouldn't affect - our Governments would still be exempt.
- Viner: No, I don't mean Government bonds.
- H.M.Jr: Well, Government bonds are still exempt.
- Magill: I don't know; I assume that it does, Jake, but I don't know.
- H.M.Jr: May I just interrupt a minute? I'm going to do more talking than I have in some time. Now let's say we do this and it works; I mean they file returns and all that. I can't see myself that this gets at the source as to why funds move this way. I mean it isn't going to make the fellow who does it from fright change his mind, the fellow who wants to get his money away from the airplane bombs; it isn't going to make the fellow change who needs dollars; and also the fellow who is motivated by profit.
- Magill: I think that's true. Frankly,....
- H.M.Jr: I mean I'm arguing - I'm just going to argue against the thing.
- Magill: In addition to what I've said, one main reason that moved me toward this kind of conclusion is this: This proposal does do these two things. There is no doubt in my mind, from my factual study of how the 1936 provisions got in the law, that they were lobbied in there for the benefit of wealthy non-resident aliens, and the present provisions are simply a gift to the wealthy non-resident aliens in this country, of which there are plenty. You take Dorothy Whitney Straight* with \$300,000 American income; her tax gets reduced from \$155,000 to \$30,000. What more could you ask, at the time when American tax rates are going up?

*Dorothy Whitney Elmhurst, Straight Securities Holding Foundation

-6-

- H.M.Jr: Well, Ros, then if that were the motive, then this thing would become a part of the eight or nine methods of evading our taxes, rather than the hot money.
- Magill: Yes, it's closely connected with that.
- H.M.Jr: What? I mean then it would be just as much - this would be just as much a part of your program as - let's call it the Bahamas device of incorporating for Americans.
- Magill: Right! Right!
- H.M.Jr: What? Right?
- Magill: And you recall, in this same letter that we sent to the President, and which he may transmit, we put in the foreign personal holding companies as one part of the whole thing.
- H.M.Jr: Well then, the thing gets down, does it belong in the eight or nine devices that people use, both American citizens and aliens, to send their money abroad, to evade taxes, or become foreign citizens to evade our taxes?
- Magill: It certainly does so far as the foreign personal holding company goes.
- H.M.Jr: Or the American who becomes a Canadian citizen to avoid our tax.
- Magill: We've had that right along.
- H.M.Jr: I'm going to look up Jake's investments.
- Viner: I reversed it, became an American to escape taxes - on nonexistent income.
- H.M.Jr: That's just a little fun.
- Oliphant: On nonexistent income.
- H.M.Jr: I got that.
- Magill: We've got a lot of cases pending before the Board and in the courts which involve a device commonly used in 1929. If you wanted to sell securities, you organ-

-7-

ized a Canadian corporation to do the selling and another Canadian corporation which bought for whoever was taking the securities; or you could have Canada and Panama or Newfoundland, whatever you wished. Now, the books are full of those.

H.M.Jr: Well now, let's put it up to Dr. Viner on the basis of a part of eight or nine devices and not as a hot money proposition. How do you feel about it?

Viner: Well, there are a number of factual questions that I don't feel....

H.M.Jr: Would you mind raising them?

Viner: Well, one of them is just, first, the nationality of these recipients of income from American sources, and what do the tax laws in that country do with respect to credits paid here.

Magill: Honestly, I think you're too much influenced by your own situation.

Viner: Oh no.

Magill: I thought I had you sold yesterday afternoon on what seems to me a thoroughly sound theoretical proposition; that is, that what the country of nationality does with these people is none of our business; his personal situation and his surtaxes and personal exemptions are up to them and not up to us. And I don't see that it makes a damn bit of difference, as far as our tax laws are concerned, whether Great Britain taxes these people one way or taxes them another.

Viner: That isn't what I have in mind at all. But the question of tax exemption - for instance, Dorothy Whitney Straight is allowed to deduct from her total income tax to England any tax she pays in this country. Does it necessarily make any difference to her whether she pays us \$300,000 or \$10,000 a year?

Magill: Yes, it does, because the rates of the two countries are not the same. Now, we, for instance, allow as far as our own people are concerned - we allow a credit for foreign taxes only to the extent that those foreign taxes do not exceed our own; that's the way

-8-

it works out; so that one of our own citizens investing in England may very well not get a credit for the actual amount of taxes paid.

- Viner: Yes, but the question I asked is, what does England do? Unless we know what England does, we don't know that this would be a deterrent to Dorothy Whitney Straight.
- Magill: I still don't see why we need to know that. The fact is that the United States is more generous in the treatment of our people with incomes abroad than any other country is with its people with incomes abroad.
- Viner: I haven't made myself clear. If this is intended as a deterrent to foreign capital coming here.....
- H.M.Jr: No, no, we're going to leave that and say we're not going to do it for that reason.
- Viner: You mean we're not - we're talking simply as evasion of taxes. Well, I withhold any comments. I'm not at the moment enough interested, haven't thought of it from that angle. I'm thinking of it now simply - but we're doing the loopholes in the tax thing?
- H.M.Jr: Pardon me?
- Viner: Loopholes in the tax laws.
- White: I think Mr. Magill is over-modest in his claims in that respect, because I do feel that it is some deterrent to some foreign investors here to....
- H.M.Jr: Now wait a minute. I'm coming back. Wait a minute, I want to get him (Viner) first. I'm just having a little mental gymnastics. I'm just - I want to tackle him first on loopholes; then if I can sell him on that, we'll - then we'll come back to the hot money.
- Viner: Well, I'll talk on loopholes. I still say I'd like to see a picture of the amounts coming from countries where this would be - would lead to action on their part. If we want this in order to get revenue, then the question is, are we going to lose the revenue because it forces them to withdraw their funds? So

-9-

I say again - I go back to my idea that it affects you on the revenue. So I have you either way.

- Magill: A Mexican jumping bean is what you are, Jake.
- H.M.Jr: Well, you ought to - you can't let a Chicago boy take us over the jumps.
- Viner: He's a Chicago boy too.
- Magill: Well, so far as that part, the answer to that is that I think the people from whom we're going to collect the large sums of money are people who can't very well withdraw their investments. For instance, one of the largest cases I discovered was the case of a woman who withdraws her \$155,000 from the Guaranty Trust Company. And the run of these big cases are cases of trusts which were established for our wealthy American girls who married foreigners, nobility and what not, abroad. Now, that money can't be taken out of here, and it is from them - it is them that I am aiming at primarily, and it is from them that we will get our money.
- H.M.Jr: You - he doesn't like American gals. Well look, I really wish you'd keep at it. I'd like to settle this thing this morning. I mean even try to answer your (Viner) objections on the hot money, any basis at all. I mean I'd like to - I mean whatever your....
- Magill: You see, if you take your own proposition, you have answered yourself in this way. You have said that, assuming that this thing does plug the loophole, why, then maybe these people would withdraw their money. Well, as I understand, nobody's going to weep over that. Your own argument, I think, is one of the best reasons to do it.
- Viner: I say I'd like to explore it just to see what are the probable consequences. And part of the picture I'd want to see is, for how much of this income derived from American sources would this be a serious burden? And then see, what are they likely to do under the circumstances?
- H.M.Jr: Well, let me put it this way, Jake. If we got this bill through, can you see any chances of any more money coming here?

-10-

- Viner: You mean new money coming in?
- H.M.Jr: Yes.
- Viner: Would it act as a deterrent to new funds?
- H.M.Jr: No, would it encourage new funds?
- Viner: Oh, would it encourage new funds. Well, if they - the question is whether the funds come in in - typically whether the bulk of the funds come in in less than \$25,000 per individual chunks. If they do, then Magill tells me that we are lowering the tax rather than raising it, therefore encouraging its coming in in those small amounts. Is that right?
- Magill: Yes, in so far as your taxpayer has less than \$25,000 income from this country, he can get a lower rate. Now, obviously, you can modify this proposal if you want to by putting a ten percent bottom on it, in which event you'd be perfectly sure to get just as much as you are getting now; you'd also have Herbert Feis on your neck. You can weigh those considerations to suit yourself.
- Viner: Now, that doesn't apply to corporations, does it?
- Magill: Yes
- Viner: I mean the \$25,000 figure is corporations, anything?
- Magill: Well, I perhaps didn't understand you. The general proposal which we are making - talking about, would also apply some form of withholding rate to foreign corporations, to try to drive them to file returns of their capital gains.
- Viner: But the rates wouldn't be the same as this rate you are talking about.
- Magill: I've asked Economics and Statistics to give me a rate.
- Viner: Well, on the individuals - may I confine myself to individuals?
- Magill: Well now, bear in mind one further thing on this, that this proposal, unlike any other that's been

-11-

Blank page by mistake.

-12-

before us, has one other possible advantage, and that is that you do exercise a rather severe compulsion on the non-resident alien to report his capital gains, and we have never put him under any such compulsion before.

Viner: Also to deduct his capital losses.

Magill: Yes, up to \$2,000.

Viner: Which means this, in the past: you can't expect much revenue from that.

Magill: No, that isn't true. You see, we have slapped him on the wrist up till 1936 and told him he should report his capital gains and take off a deduction for his capital losses. The fact is he didn't do anything.

Viner: I mean domestically, the capital gains tax has not been used much as a source of revenue, has it?

Magill: Oh yes. What you been doing, reading the Chicago Tribune?

Viner: No, I'm not informed.

Magill: Oh yes, we get hundreds of millions of dollars out of it, over the years.

Oliphant: Do we?

Magill: Yes, we do.

Viner: Oh, I know - yes. The question that is in doubt is as to whether the capital gains have increased the net productivity of the income tax as a whole. That's the matter in doubt.

Magill: The two problems there are these, so far as the way the tax law has been actually formulated. We have made a great deal of money out of having the capital gains provision. Now, the qualifications are as follows: For the last several years, we have had severe limitations on the deduction of capital losses. If we had given people deductions of capital losses

-13-

against their ordinary income, why, then the losses might very well have wiped out gains which we have taxed in the past; but we haven't given them such losses.

Taylor: Ros, as I understand it, you're combining this proposal with a request to make foreigners subject to capital gains at this time?

Magill: We don't request, we simply say, "We're going to withhold 35 percent of your periodical income. Now, if you want to come in and file a return and show us what your American income is, including capital gains, and subject yourself to tax at the rates applicable to our own citizens, we'll give you back any excess of what we have collected from you over what your return shows."

Taylor: It is my understanding that your foreign resident is not subject to capital gains tax at the present time, so that you would have to, in order to make him subject to it - in other words, there's no reason for his coming in and filing a capital gains return because he isn't subject to the tax.

Magill: That's true; we need to amend that provision of the law.

Taylor: That's right. You would combine this with a request to amend that provision of the law so that he would be subject to it.

Magill: That's right.

Oliphant: He would do it, presumably, only when he could make a tax saving.

Taylor: You'd have to amend the law to require him to file a capital gains.

Oliphant: But do they have this privilege now on the ten percent tax?

Magill: No. You can lose on any taxpayer with less than \$25,000 income.

-14-

- H.M.Jr: As I understand it, what we are proposing to do on individuals is to withhold 35 percent of his revenue.
- Gaston: Less capital gains.
- H.M.Jr: No, wait a minute.
- Gaston: Isn't that right?
- Viner: On what we catch, on what we find.
- H.M.Jr: If he wants to file a return, then he is subject to all the taxes, including capital gains, that an American citizen is; but if he accepts the 35 percent, then he is not subject to capital gains.
- Taylor: In other words, you give him an option, but you have to change the law in order to give him an option.
- H.M.Jr: Clear that up, Ros, will you?
- Magill: Well, I don't see your point. You have to change the law to do any of this.
- Taylor: Yes, but as far as the capital gains thing, you have to change the law in order to give him the option, don't you?
- Magill: Well, yes. But I still don't see the materiality of it. At the present time the law is this: that if a non-resident alien, under the 1936 Act - it was not before 1936 this way, but in 1936 it was changed to the effect that a non-resident alien not having an office or place of business in this country is subject to a ten percent withholding tax on what I will call periodical income; that is, interest, dividends, royalties, etc.; but he is not subject to any tax at all on his capital gains at the present time. Now, prior to 1936 he was, but the provision could not be made effective because whether he filed a return or not was really a matter of his own option; there was no real compulsion to do so.
- Taylor: Now you make him subject to capital gains, all aliens subject to that.

-15-

- H.M.Jr: Only if he elects to be.
- Oliphant: Practically, if he elects to be, because we have no compulsion.
- Taylor: I think you have to make them all subject to it, because otherwise how do you give them an option?
- Gaston: Isn't it this, Ros: that you are proposing to increase the withholding rate from ten percent to 35 percent on the same income on which he is now taxed ten percent....
- Magill: Right.
- Gaston: ...but if he wishes, he may elect, in lieu of that, to subject himself on his income from American sources to the same rates and system of taxation as an American citizen would be subject to on that same income.
- Magill: Right, that's exactly right.
- Oliphant: And he will never do it except to decrease our revenue.
- H.M.Jr: That's right.
- Viner: Would that carry with it the right to audit his private books? Could we establish a corps in Internal Revenue in Canada and England, etc., to examine their books?
- Magill: You see your answer to your own question.
- Viner: No, I don't. Treasury does it on tariff.
- White: Tries to.
- Lochhead: But in this case we have the money; they have to come down and produce any evidence they can.
- Viner: Well, there's some easy outs; they'll set up six different members of the family to break it down into small chunks.

-16-

- Magill: I don't think you want to go into all the administrative machinery; we've discussed that somewhat. One thing that I contemplate requiring that he should do would be to file a statement under oath as to any American brokers with whom he's operated, or any British brokers with whom he's operated who in turn have accounts with American brokers, give us transcripts of his brokerage statements, etc. That is, we are certainly going to make him prove as conclusively as we can what his American income actually was before we'll give him any money back.
- H.M. Jr: The burden of proof is on the foreigner.
- Magill: The burden of proof is on the foreigner. That's why I said earlier in the discussion that I think this increase is going to have a severe discouraging effect at least upon new investments by non-resident aliens here.
- Viner: Well, you see, with Feis's point of view, say, in mind, if you expect to force him to get his refund by going through a very painful administrative process..... Will you force him to bring his books here?
- Magill: No more painful than our own citizens are subject to.
- Viner: Well then he's got easy evasion.
- Oliphant: Well, is this right: that the capital gains provision will deter new capital coming here only to the extent of 35 percent of his income, because we don't reach his capital gains unless by his paying on his capital gains he saves taxes.
- White: Why don't you make it possible for them to evade - why not make it evasion instead of avoidance, and say they have to file a return? Then, even though they're getting more than a capital gains so high that they would save money by not reporting it, they would be evading the tax and not avoiding it. And then you might get some additional capital gains and you would get additional returns.
- Oliphant: Well, that is that old picture we had before 1936.

-17-

H.M.Jr: How you going to make Mr. X, Y, Z file a return?

White: Except that when it is evasion instead of avoidance, it is some deterrent; he is breaking the law instead of not breaking it.

H.M.Jr: Well, if you don't mind, I'd like to stick to the formula, unless someone has got a better one so far.

White: Yes, I think that's better. It's not important.

H.M.Jr: You think it's better.

White: It's not important enough to take up time.

Viner: I'd say the only deterrent there to making fraudulent claims for refunds would be the requirement of making an oath.

H.M.Jr: Well now, Jake, let's ^{go} back to this thing.

Viner: That may be an important one.

Oliphant: Our access to brokers' accounts would be effective.

Viner: But you can deal with it by having six accounts with the broker under six different names of members of your family.

Lochhead: You don't trust six members of your own family.

(Hearty laughter)

H.M.Jr: Marvelous!

Magill: You can beat the present law. There is nothing in the world to prevent a non-resident alien at present from having his interest and dividends payable to an American with no income or very slight income, or having it payable to eighteen Americans with slight incomes and ask these fellows to go on and pay the tax at the rate for that amount of income and then transmit it to him. Now, unquestionably that is being done. Don't think that this present ten percent rate is any model of perfection. It's got holes in it like a Swiss cheese.

-18-

- Viner: I'm not saying anything for the ten percent; I'm just asking questions bearing on the possibility of having a reasonably good administration of this new proposal. I say if it's going to be evaded 80 percent or 60 percent, then you better not have it.
- Magill: I would think it is perfectly clear that it is not; it might be evaded five percent or ten percent; I think it is very unlikely to be evaded any more.
- Viner: It applies to persons who - they've got to reduce their individual incomes to below \$25,000 in order to have a saving by applying for a refund.
- Oliphant: From American sources.
- Viner: Yes, I know, from American sources. Now, in the first case, I suspect, as far as individuals are concerned, there are not more than a hundred individuals in the world who derive \$25,000 a year from American sources.
- Magill: You're wrong, on the statistics we have.
- Viner: I mean who have more than \$25,000 a year American income?
- Magill: (Nods yes)
- Viner: What is it, 150?
- Magill: I've got the figures. I don't remember precisely how many you have. There are not very many non-resident aliens paying us anything anyway. My recollection of - the last figures I got, as I say, are so incomplete that you can't do much with them. But they - well, as I recall it, there are not quite half of them above \$25,000 and about half of them below.
- Viner: Half of the persons who derive income from the United States only are below \$25,000? Why, there must be fifteen thousand people in Canada alone who....
- Magill: No, no - I mean that we have the knowledge of. No, I don't think.....
- Viner: Oh, you mean....

-19-

- Magill: Well, how can we tell how many non-resident aliens there are having income from the United States? I don't know when they file returns.
- Viner: There are tens of thousands in Canada. I can tell you where you can find one source and you can get a rough estimate. In the Province of Quebec, in the probate records, they publish each year a public volume containing records of all persons holding securities. It was over 150,000 in 1913, and 45 percent of them held American securities. That has undoubtedly gone up to 80 percent now, with the change.
- Magill: Well, see, one trouble you have had at present - one thing we are also eliminating, which will give us some more revenue: we have heretofore given your brethren up in Canada the same exemptions that we have given our own people, which means that you could have these people holding large amounts of American securities and still pay us no taxes. See, you can hold a hundred thousand dollars of American securities and the tax would be negligible.
- Viner: Everybody who holds securities in Canada has American securities.
- Magill: That unquestionably would yield some more money. I don't see why we should give the non-resident aliens any personal exemption at all, so we are recommending that that be abolished. Well, that undoubtedly will give us quite a bit of additional revenue.
- Viner: You already withhold on bond interest, don't you, at the source?
- Magill: Well, not effectively. I never can get correct exactly what they do do, because they've got this tax free covenant bond mix-up in there too; but generally speaking, the withholding provisions were not at all effective until 1936.
- Viner: But they withhold on bonds for everybody, including Americans, don't they?
- Magill: No, no. No, they don't really withhold for Americans at all.

-20-

H.M.Jr: What do you propose to do about aliens buying American Governments?

Magill: I haven't made any special provision.

H.M.Jr: You going to continue to let them be tax-exempt?

Oliphant: You mean new issues.

Magill: I haven't made any special proposal on that at all. I should think it would be essentially up to you and Taylor.

H.M.Jr: Well, will you make a note of that, Wayne? I mean whether an alien shall continue to buy United States Government securities the income of which is tax-exempt to him.

And you want to go any further, Jake?

Viner: (Nods no)

H.M.Jr: Where do you stand?

Viner: Oh, I think that so far I doubt very much whether it could be 20 percent effective under the present set-up.

Magill: In terms of....

Viner: You see, if there are no exemptions of a thousand dollars or.....

Magill: 20 percent effective as to what?

Viner: As to the amount....

Magill: Of evasion?

Viner:of evasion of persons applying. I mean that there will be an almost.....

Magill: Well, where do you get it? Where do you get the 20? Why don't you say 10 or 50?

Viner: Well, I'd say very substantially over 50 percent would make fraudulent claims on that basis.

-21-

- Magill: We don't have to approve them, do we?
- Viner: You can't prove they're fraudulent.
- Magill: Well, they have to prove that they are not.
- Viner: Then you're going to have an unreasonably severe administrative policy.
- Magill: No, we're not. No, I think you defeat yourself. You say here that we have to allow a fraudulent claim, but we don't; the burden of proof is on the alien.
- Viner: What will you accept as reasonable proof?
- Magill: We investigate these things with care, because there are not many of them.
- Viner: Oh, there will be thousands of them.
- Magill: No, there won't.
- Viner: Well, if you don't allow the thousand dollar exemptions, you've got thousands of cases in Canada, let alone the English, maybe another 50,000, who hold American securities.
- Lochhead: Well, Ros, the main danger I see there is eliminating the ten percent; I mean people being able to come back and claim the small refunds on small holdings, the average small investor that used to have five shares of this stock and that. He's getting 10 percent taken off now and he's not bothering much about it, but if he has a right to come back and claim below that ten percent, then you'll have all that small stuff. Isn't it feasible to continue your minimum? You say that Feis is going to object, but on what ground would the State Department object to keeping the minimum ten percent? I mean they might object, but we've already got ten percent and it's established; as long as we've got the ten percent, I don't see where the State Department could object very seriously.
- Magill: Well, as far as I'm concerned, I'd be glad....
- Lochhead: I think if you had the ten percent, you'd eliminate an awful lot of nuisance.

-22-

- Taylor: Don't you think you could be up against this, Archie? The presentation of each claim for refund is rather an expensive thing. I mean you've got to prepare the papers, you've got to get somebody to help you, and as I recall it, why, those boys charge you something, and you make affidavits, etc. And you are up against what the relative cost is.
- Lochhead: There's no doubt of that.
- Taylor: Ninety percent of these people that you're talking about, Jake - they'll find out what the cost is to be able to claim that refund and won't do it.
- Viner: Then divide into two groups. One group, it pays them to make a careful report and careful claims and to split up their returns among different members of the family and to evade it. The other group gets hit with a 35 percent tax, which is an unreasonable tax on persons with small income.
- Taylor: It's only the income which they derive from this country.
- White: Why the solicitousness for people who get income from this country on holdings of stocks and bonds? Is it because only widows and orphans select America as the country to pay them their income?
- Viner: Yes. I attach less importance to the bonds than you, and I say what is unfair to an American on this side is unfair to a person living on the other side.
- White: There are other things involved which necessitate certain policies.
- Viner: On the question of deterrents - on the hot money - that's not in the picture at the minute.
- White: If it wasn't in the picture, we wouldn't be talking about it.
- Viner: In any case, I'm not saying "yes" or "no." I'm simply thinking of possible difficulties.
- Magill: You say one minute that it isn't fair and then the next minute you say it won't work. Well now, it can't be both.

-23-

- Viner: It may work for some and not be fair for them and not work for others and be too generous to them. They may divide into two groups.
- Magill: It is essentially fairer than the present system, as far as that is concerned. Now then, so far as the matter of evasion is concerned, that is simply up to the Legal Division. We'll put the burden of proof squarely on the foreigner; and, as Wayne has said, he's got to hire himself a lawyer, make out this proof, get it in here, and satisfy us; and, believe me, we'll be strict. We're strict now, and refunds are just not being made.
- H.M.Jr: May I interrupt this a minute? I don't get - I'd like to just get the answer to Lochhead's proposal, the minimum of ten.
- Taylor: Our own citizens aren't on the same basis, you see.
- H.M.Jr: Oh, that's why the State Department wants this new scheme.
- Taylor: Because we're putting them on the same basis as our own citizens, and the foreign countries can't object on that basis.
- Lochhead: My answer to that is that the foreign countries are not on the same basis.
- Oliphant: What's the British rate?
- Viner: 22½. Foreigners can apply for a refund.
- Oliphant: I don't think foreigners.
- Viner: The English withhold income foreigners obtain from English sources; then you have to apply for a refund if you think you're entitled to it, just as the Englishman. Your proposal is very much like the English procedure, if I'm not mistaken.
- Oliphant: I don't think the English permit the foreigners to apply for a refund.
- Viner: I've applied for a refund.

-24-

- H.M.Jr: If you don't mind my saying so, there is nothing here that you (Viner) have said that influences me - I mean let's be honest - that, looking at this thing from every possible angle, shakes me sufficiently to say not to go ahead with it; because I don't care what the tax method is, there will always be something the matter with it. The only thing that would shake me would be if you say this is going to encourage funds to come here.
- Lochhead: That's why I still stick for this ten percent, because.....
- H.M.Jr: No, Archie, you can't.....
- Viner: Magill would say I'm shifting again, but I'd say as far as the ten percent, the necessity of going through that severe rigmarole on refunds would be equivalent to a ten percent withholding in severity.
- H.M.Jr: No, Archie, you can't get by with the State Department on that. The only reason I want this proposal to stay as is - I don't want to raise the thing again. The State Department says, "We're willing to face the various embassies and representatives of foreign countries because on this basis they can't object, because you're going to treat them the same as you treat your American citizens. No embassy could object." The entire State Department is satisfied. They weren't before. Now, if they are satisfied - certainly they're always worrying about the foreigner - why should we worry?
- Lochhead: I wasn't worrying about the foreigners. I was worrying about our tax group that is going to have to pass on those refunds.
- H.M.Jr: Well, the fellow who gets \$50 to \$100 worth of dividends a year, see - he's stuck for 35 percent. He isn't going to go to the trouble of making - going through this rigmarole; the paper work would be too much. He's stuck. And he's got to sit down and figure out whether it is worth while, his selling his Santa Fe Railroads.....
- Taylor: Going some where else - go home.
- H.M.Jr: ... and buying French railways.

-25-

- Oliphant: There is just the other side of the picture, which I think ought to be considered a moment before the thing is passed. Suppose the thing were unexpectedly drastic and effective in stopping - changing the flow, and, coupled with other events that upset things, should start a rush away from the dollar, etc. I say "unexpectedly" - I put it that way.
- Lochhead: Of course, we are faced with one billion dollars sterilized gold right now, plus two billion in the fund; I mean you've got plenty of leeway. I'm not worrying.
- White: What he's worrying about is the stock market, not gold. Security prices is what you had in mind.
- Oliphant: Grain prices - what have you - the whole deflationary effect of an unexpected sudden move, that's all.
- White: A possibility, but it's so slim, because any attempt to sell in any large quantities would soon remove the advantage or disadvantage which is caused by the additional tax, so as to give pause to it. It's too slow an acting matter to give rise to the difficulty which you mention.
- Oliphant: Well, I'm merely taking this occasion to point out that the last time the matter was discussed, it seemed there was no reason why the thing shouldn't be flexible in case of unexpected danger, and we conceded the advantages of its being flexible.
- H.M.Jr: Well, and we couldn't get away with it with the State Department.
- Oliphant: They objected to that, did they?
- H.M.Jr: Sure. The only reason I get it that they like this thing is because somebody sold it to them - I guess Magill did, or Taylor, I don't know who - on the theory that all we're suggesting in this method is to tax the foreigner the same rate we are taxing our own. Now, they won't go along with the flexible thing, and we have no flexible tax method here; and I suppose that since we discussed it last time, the thing Archie points out has made the danger lessen.

The other thing, when the President discussed this

-26-

thing last November - I haven't got the security chart but I remember the Dow-Jones figure was up to 190; since then they've gotten it down to 167 and it's recovered to 175; wheat was \$1.50 and now it is \$1.20. And also, just as soon as it's recommended - take three, four weeks to go through and if the publicity on it should be too severe, we'd always have a month to catch it. But I - I don't think that.....

Oliphant: That's one of the advantages of making it one of your eight, from that standpoint; make the publicity less severe.

Viner: But the big fellows would pick it up at once and notice.... In the interval, while the bill is under way, if you have holdings, say, of a million dollars American securities that you have held since 1934 or 1935, and of which three or four hundred thousand dollars is capital gain, you've got a tremendous incentive to draw that out before the law becomes effective.

White: Well, that is intended to - it was suggested in one of the other memoranda that the date at which this becomes effective be put sufficiently far ahead so that there is no immediate pressure to sell.

Oliphant: Or you could do it the other way, make it the calendar year '37.

H.M.Jr: I want it for the calendar year '37, Ros.

Magill: Oh yes, sure.

H.M.Jr: Well, I'm glad to have had this talk. I swear - I mean so far - I mean I don't think anything is going to be perfect, but I want to be frank with my own group and if you encourage it as a move in the direction of controlling hot money, I'd be more than pleased. Unless somebody has got something else.....

Viner: Even though it meant a sudden and voluminous sale, unloading of American securities?

H.M.Jr: I'll underwrite that that won't happen.

-27-

- White: They're going to have the date for the capital gains as of 1937.
- Viner: You mean December 31, 1937.
- Oliphant: No, it starts January 1, 1937.
- White: Any capital gains made up to that time.
- Viner: So you collect on the market value of the securities as of December 31, 1936, and apply the capital gain.
- H.M.Jr: I want it to apply to the calendar year 1937.
- Viner: Well, that's the same. Let me point out that you create for yourself another problem like this March 31, 1913, valuation.
- Magill: Why don't we use cost?
- Viner: Cost. Well then, they must sell out - you see, they must sell out now in order to realize on their capital gains so as to escape this 35 percent tax.
- Oliphant: But they don't escape if they do.
- Viner: They're out; you have no tax. They'll sell between the introduction of the bill and its passage.
- Oliphant: I think....
- Viner: They can stay in the country, switch from one security to the other. They realize on the ones that they have.
- White: You can arrange the effective dates to avoid that.
- Viner: I don't think you can.
- Oliphant: I think we can enact a retroactive duty on brokers, something like the silver tax.
- H.M.Jr: Well, we have Dr. Viner; do you want to ask him - does anybody want to ask him anything?
- White: I'd like to ask him one question. All this, do you feel - this is a leading question - is of secondary importance - not of no importance, but of secondary importance - with respect to stopping the flow that

-28-

is coming in?

- Viner: I don't know. It depends on the question I raise as to its effectiveness. I could see a 35 percent tax, including capital gains, would lead to - to anybody who has any funds coming here, it would be a strong incentive to change the form of his assets.
- Oliphant: Don't say 35 percent including capital gains. You report your capital gains only if you can lower it from 35 percent.
- Viner: You mean we don't reach the capital gains - we reach them only by voluntary reporting.
- Oliphant: So 35 percent is the top.
- Viner: I'd say then you'd realize your capital gains before the act becomes effective and then apply for the refund on the ground that your income is less than 35 percent.
- Oliphant: I think we can do something about making that retroactive.
- Viner: Well, you know what sort of an outburst would occur if you make it retroactive - that it wasn't a reasonable....
- Oliphant: Well, we've done that regularly in taxation. The 1936 Act was passed when?
- Magill: June 22.
- Oliphant: And it was retroactive from January 1, 1936. Regular procedure.
- Taylor: Almost have to give them January 1, 1937, as a deadline date, just the way you give 1913, because you had it off, now you're putting it back on, and that's a pretty good date.
- Viner: And you'd count the capital gains no matter when they acquired the property, even if they acquired it in 1913.
- Oliphant: That's right, if they realize it in '37. And the only problem is the problem of whether or not we

-29-

could enact a retroactive act placing the burden on the brokers to withhold, and I think we ought to do some work on that.

H.M.Jr: Are you all right now?

Viner: I don't say that....

H.M.Jr: But is what we are trying to do - is it clear to you what we are trying to do?

Viner: I think so. I see serious problems.

H.M.Jr: So do I.

Viner: I'd like to see now the thing worked out in detail and have a look at it that way.

H.M.Jr: Well, the President has given us three weeks to work out this legislation, see, so you've got time, Jake. He's given us three weeks to work this out. What? now if - wait a minute, does anybody else want to ask Dr. Viner a question, because I want... All right.

Now Taylor, are you ready at this time or would you want to do it some other time, to talk about the non-tax methods of trying to control foreign investments - financial methods, bank balances.

Taylor: I can tell you some of the more or less fundamental questions involved, if that would interest you. But I think it is probably better to prepare a memorandum which will discuss the subject and then throw that into discussion, because it would be a rather rambling presentation that I'd have to make at the present time.

H.M.Jr: Well, whatever you want to do would go to Banking and Currency, so it wouldn't go in this letter to Pat Harrison anyway. When will you be ready, if you want something? When will you be ready?

Taylor: I think I can be ready in a week, ten days, something like that.

H.M.Jr: Would you like to....

-30-

- Taylor: That will be a discussion of the subject rather than a recommendation.
- H.M.Jr: Well, let's put it this way: if you want something this session, don't wait too damn long.
- Taylor: That's right.
- H.M.Jr: See?
- Taylor: I think it is a different type of problem from the one that we're discussing.
- H.M.Jr: Well, this is one - what I wanted to clear was this. Magill's going to give me a letter tomorrow, which is going to be a letter to go to Harrison and Doughton on the methods of aliens and United States citizens avoiding taxes - both aliens and United States - either taking their funds out of this country or in; but that's what it affects. Now, is there anything else that should go into this letter which would go to Harrison and Doughton?
- White: I think there is one - don't know that it would go in that, but it is tied up with anything that you do about bank balances.
- H.M.Jr: Excuse me. (Has short conversation on White House phone)
- It's a great life. I told them yesterday I was just going to concentrate on financing. Your (Taylor) friend Sumner Welles at 2:15.
- Taylor: Ros, it would seem to me on this question of Government securities that if you put... Oh, did you (White) finish?
- White: No, I didn't. It's all right. I was going to say that anything we might do with balances, if you find it desirable to do anything with balances, would run immediately into the problem that there will be a movement out of balances into Government bills and other short-term securities, and if you wanted to check that you might find it highly desirable to have a tax measure very different from the kind which has been suggested. And therefore, if you are considering all tax measures now and if you further want to

-31-

consider the problem of hot money later, then it seems to me you have to consider that tax - the time to consider that tax in relation to balances is now, because if you wait it may be too late to do anything effective with balances unless you have a tax measure supplementing it other than the tax measure now presented.

H.M.Jr: When could you (Magill) see him? I mean you want to - you talk to Magill on that.

White: I think probably Mr. Magill has considered it; I don't know.

Magill: It's that transfer tax. I can see you right after this meeting, I guess. I wanted to talk to you (H.M.Jr) about the - with respect to the form of these letters, so I can get my people at work on them.

H.M.Jr: Well, he (Magill) says he'll see you afterwards - right after.

White: As long as it's given consideration before it's too late.

H.M.Jr: Well, the time to do it is now, today.

White: It's all right with me.

H.M.Jr: What?

White: All right with me.

Taylor: Government securities, Ros - it would appear to me that - no withholding, but that the income from Government securities held by foreigners should be on the same basis as our own nationals when applying, if they apply for a refund.

Magill: Sure, sure. That would automatically work out, I think, under this proposal.

Taylor: But you'd have to change the law to make that effective.

H.M.Jr: Anybody got anything else?

-32-

Taylor: That sound like sense?

Magill: Sure.

Lochhead: If it is not withheld, you'll never catch it.

Viner: But you catch something else; then they report their whole income.

Taylor: You don't attempt to catch it unless they apply for a refund.

Lochhead: But if a man invested all his money in Governments, then you wouldn't catch him.

Taylor: Then you wouldn't catch him.

H.M.Jr: All right. Well, let's - if there is nothing else, we'll.... Thank you, Jake, for your assistance.

May 25, 1927

To: Under Secretary Magill

From: Jacob Viner.

Re: Withholding Tax.

1. I would recommend that the Research and Statistics Division be asked to prepare a study of the proposal in all its angles.

2. I would ask for estimates of the amount of evasion under the present provision, and of the amount probable under the new proposal, based on Anna Taylor's estimates of the income denied by nonresidents from American sources. If the present estimate of the percent evaded is 95 percent and the estimate for the new proposal is 90 percent, I would regard that not as a case for the new proposal, but as a case against both the old and the new.

3. I would have a survey made of provisions in foreign tax laws granting to or withholding from their resident nationals credits for taxes paid to the United States. This information is needed, not, or not primarily, for an appraisal of the fairness of the American legislation, but as a basis for inference as to the extent to which foreigners would have a strong incentive to evade or minimize their American tax burden. If for instance an Englishman subject to a 35 percent tax at home could deduct from his English tax the amount of tax paid to the United States, he would have no incentive to apply for a refund from an American 35 percent tax withheld at the source.

4. I would have a survey made of the returns made by nonresidents under the present, and under past revenue laws, with a view to ascertaining, if possible, what classes of persons or corporations, (including a regional classification) are most likely to resort to evasion, and what devices are from past experience most conducive to reporting. It might perhaps be discovered, for instance, that the bulk of the voluntary reporting in the past has come from countries allowing full or generous credits against their own taxes for taxes paid to us, so that there was no cogent reason for not reporting.

5. Unless there was general confidence that the new proposal would really be substantially effective in checking evasion and would produce substantial revenues, I would contemplate with equanimity the postponement of introduction of the measure until some period when any adverse affect on markets could safely be disregarded or until it could be introduced as part of a carefully planned and coordinated legislative program to cope with the capital movements problem, or both. I don't think this summer is at all appropriate in either connection.

MEMORANDUM

May 25, 1937

To: Secretary Morgenthau
From: Dr. Burgess

Treasury bond market was quiet today and price changes in the course of the session were small. A somewhat easier tone developed in the afternoon and prices for the long bonds declined slightly, this group closing unchanged to 3/32 off from yesterday. The intermediates were irregular and short bonds were 1/32 to 4/32 better. Trading on the board was fairly active in the last half hour and Treasury bond turnover for the day totaled \$1,092,000. Changes in the government guaranteed group were rather mixed. Treasury notes were dull and slightly easier toward the close, the five longest issues finishing 1/32 down on the day.

There was fairly active trading in the high grade domestic bond market in the first hour and prices advanced fractionally. Prices lost some of their gains thereafter in quiet trading but closed small fractions better on the day. Second grades were dull and steady most of the day, easing small fractions in the latter part of the session.

Foreigns were quiet and steady except for German issues which sold down fractionally to about 1 point.

No purchases for Treasury today.

BC

Gray

Paris

Dated May 25, 1937

Received 1:07 PM

Secretary of State,
Washington.

678 May 25, 4 p.m. (section one)

FROM COCHRAN.

Francis losing this afternoon the gains of yesterday evening and of this morning. French control yielded some sterling today at 110.30, 32 and 45. Market thin and trading light. French rentes weaker. Immediate cause of downward turn in franc is said to be attack launched shortly after noon today in Chamber by Flandin against Auriol and his Treasury policies. No detailed account yet available. Furthermore market is pessimistic as a result of French port strike and complaints of textile manufacturers that their costs of production are not only stopping their export trade but are making it impossible for them to compete on the French market against imported goods. Arguments in favor of higher tariffs rather than freer trade are thus being renewed.

AGENCE ECONOMIQUE attributes to London rumors (1) that American Treasury has asked Bank of England

BULLITT

Regraded Unclassified

RB

GRAY

Paris

Dated May 25, 1937

Rec'd 1:50 p. m.

Secretary of State
Washington.

678, May 25, 4 p. m. (SECTION TWO)

to use its influence toward obtaining from South African Government a temporary letup in gold production, and (2) that there is an agreement between Washington and London for latter to sterilize more gold which otherwise would move to United States.

French press remarks upon improvement in United States Treasury bonds and in outlook for June financing following Court decision on Social Security Act.

Press reports that while Banking Committee of Riksdag has unanimously approved proposal of Swedish Minister of Finance to be taken against inflation, including the use of 70,000,000 crowns of the Central Bank's foreign exchange and gold reserve for purchases abroad, the idea of eventually lowering the sterling rate if Swedish prices continue to rise should not be considered as discarded.

Frere

RB

-2-#678 May 25, 4 p. m. from Paris

Frere visited Bern on his return trip from Rome to Brussels and is said to plan next to go to Praha and Warsaw. (END SECTION TWO)

BULLITT

KLP

RECEIVED
MAY 25 1957
TREASURY DEPARTMENT
Office of the Director
Financial and Economic Research

PARAPHRASE OF SECTION THREE OF TELEGRAM NO. 678
of May 25, 1937, from the American Embassy, Paris

Yesterday the Bank of France invoiced for shipment on the NORMANDIE 81,795,000 francs gold to the Federal Reserve Bank of New York for account of the BIS.

This morning I had a talk with Cariguel, who was not familiar with the exact nature of the BIS transaction just mentioned. The Dutch control, he said, is still buying gold importantly at London, where dehoarding is still going on. Cariguel said that last night he was able to sell a few francs in New York.

The French Treasury, according to gossip on the market is seeking one and a half billion francs for June, and has asked the French railways to try to get this amount. It is reported the railways contended that it was not possible to do this, and that they failed to obtain any satisfaction, when at the insistence of the Treasury they sent a committee to London to seek funds against their rolling stock.

I am told by Pennachio that Governor Azzolini of the Bank of Italy that the Governor has postponed from June until July his personal visit upon Labeyrie since while he is here he hopes to see the Bank of France Governor.

END MESSAGE.

EA:LWW

BULLITT.

RB

GRAY

London

Dated May 25, 1937

Rec'd 2:22 p. m.

Secretary of State

Washington.

308, May 25, 6 p. m.

FOR TREASURY FROM BUTTERWORTH.

London stock market declined today after examining the changes as embodied in the Financial Bill in the proposal for a national defense contribution tax. City in general takes the view that Chamberlain's concessions, although numerous, fail to eliminate the inequalities and it objects to the complicated character of the tax and the difficulty of arriving at assessments in individual cases. Such newspapers as the TIMES and DAILY TELEGRAPH whose policy it is to support the Government emphasize that "a genuine endeavor to meet the most serious criticisms has been made". On the other hand, the liberal NEWS CHRONICLE emphasizes that "Even after the concessions the tax is still an unfair one" and the independent FINANCIAL NEWS says "Chamberlain has obstinately declined to revise his tax scheme beyond giving relatively trivial concessions and he has made no serious

RB

-2-#308, May 25, 6 p. m. from London

serious attempt to remove the injustices". The labor DAILY HERALD finds that the tax has been whittled away to such an extent that it hardly seems to justify such formidable complications.

Little business is being done in the foreign exchange market. The price of gold in the Indian market which has recently over-sold has returned to its London parity.

BINGHAM

KLP

WWC

RECEIVED

MAY 25 1946

RECEIVED
MAY 25 1946
U.S. DEPARTMENT OF STATE

BC

Gray

Paris

Dated May 26, 1937.

Received 1:30 PM

Secretary of State,
Washington.

682 May 26, 4 p.m. (Section one)

FROM COCHRAN.

Paris exchange market has been slightly upset as a result of yesterday's Chamber debate on French Treasury policies. French control lost considerable sterling checking rate at 110.65. One broker is said to have taken 250,000 pounds and one Paris American bank 100,000 pounds. Control also yielded some dollars at 22.385 with Lazard taking 250,000. Forward franc more offered. Rentes opened considerably down but closed practically unchanged. Defense bonds 1937 at new low of 91.90. Banks losing deposits and worried over country's financial outlook. Market observers understand that as and to the extent "Auriol" bonds are being used for paying inheritance taxes the Treasury is issuing replace bonds.

Presentation to Parliament yesterday of "April collectif" which concerns supplementary credits and cancellation of credits arising from application

BULLITT

HPD

Regraded Unclassified

RR

GRAY

Paris

Dated May 26, 1937

Received 1:40 p. m.

Secretary of State,
Washington.

682, May 26, 4 p. m. (SECTION TWO)

the Finance law for 1936 led to important debate in the Chamber on the situation of the Treasury.

Deputy Gaston Gerard contended that the advance account at the Bank of France authorized by the law of June 23, 1936, was no longer available to the Treasury for the reason that after that date a new law was necessary for its extension. Furthermore, he contended that while in his estimate of requirements before the Parliamentary Finance Committees on April 28 and 29 the Minister of Finance had claimed with some optimism that he would only need to borrow 20,250,000,000 francs during the rest of the year the 1937 budgetary deficit was obviously underestimated; that there existed serious doubts that the economies envisaged of about six billion francs in the special armament budget could be effected and that the amount required for reimbursement in October next of the 1934 bonds had been greatly underestimated.

Furthermore,

682, May 26, 4 p. m. from Paris

-2-

Furthermore, repayment of the British forty million pounds credit had been overlooked as well as the railway deficit of about eight billion francs. If the Treasury now had four billion francs available as the Finance Minister had claimed this would be exhausted in one month

(END SECTION TWO)

HPD

BULLITT

RR

GRAY

Paris

Dated May 26, 1937

Received 1:45 p. m.

Secretary of State,
Washington.

682, May 26, 4 p. m. (SECTION THREE)

as outgoing payments totaled about 900,000,000 francs weekly.

The outstanding feature of the discussion was the intervention of Flandin who methodically analyzed the financial situation. Flandin expressed astonishment at the optimism shown by the Minister of Finance before the Finance Committees on April 28 and 29. He drew attention to the recent report of Treasury operations for the first quarter of 1937 which revealed that only 821,000,000 francs had been paid out on the special armament and public works budget of approximately 14,000,000,000 and insisted that under these circumstances it was apparent that substantial payments would have to be made in the near future.

Turning to the possibility of drawing on the Bank of France, Flandin emphasized the danger to the currency of resulting inflation especially at the moment when the three months forward rate for the pound and dollar exceeded the minimum limit of the parity of the franc.

He

682 May 26, 4 p. m. (SECTION THREE) from Paris

-2-

He agreed that the Government possessed ample authorization to issue loans but observed that the short term Treasury bills for the

(END SECTION THREE)

HPD

BULLITT

RB

GRAY

Paris

Dated May 26, 1937

Rec'd 3:08 p. m.

Secretary of State
Washington.

682, May 26, 4 p. m. (SECTION FOUR)

pension fund opened for subscription three weeks ago had not even been successful and that under present circumstances if the Government attempted to issue the balance of the recent national defense loan it would find no takers. The low level of rentes he continued was evidence of the present position of the country's credit. He doubted that any short term issue would meet with success for the reason that investors could easily find opportunity on the Paris market for 8% returns, and also because funds were scarce on the short term money market.

Flandin also drew attention to the failure of the Government and of public bodies to pay bills long overdue and pointed out that as French industry was now occupied almost entirely in filling orders for armament and public works, the failure of the Government to pay its bills raised

RB

-2-#682, May 26, 4 p. m. from
Paris Section Four

raised serious problems. Repeating his previous observations that since the beginning of the year only 821,000,000 francs had been paid out for armament and public works contracts, expressed the hope especially as concerns armament that the Government would not claim that orders to that

BULLITT

CSB

NPL

GRAY

Paris
Dated
May 26, 1937

Rec'd 5:00 p.m.

Secretary of State,
Washington.

682, May 26, 4 p.m. (SECTION FIVE).

amount only had been passed.

Flandin then gravely warned the Government that unless it took new measures to restore confidence before the end of June it could not pay its bills. He proceeded somewhat ironically to describe possible dangerous expedients which he said he was sure of in spite of rumors the Government could not possibly envisage. Specifically he advised the Chamber, it was rumored that (A) in order not to hold up payments due to its debt the Government intended to introduce a system whereby the Bank of France would undertake the discounting of Government work bills; (B) the various public financial agencies such as the Caisse des Depots would be asked to rediscount at the Bank of France large blocks of Government securities held by them so as to permit them to subscribe to new Treasury bills and, (C) it proposed to reduce to a variable limit between 46 and 43 milligrams the spread between the two extreme points of the gold parity of the franc in order to procure a supplementary revaluation of three milligrams.

NPL---2 --- No. 682, May 26, 4 p.m. from Paris.

milligrams. Such a step, Flandin remarked, would require the authorization of Parliament because even
(END SECTION FIVE).

CSB

BULLITT

RB

GRAY

Paris

Dated May 26, 1937

Rec'd 3:28 p. m.

Secretary of State

Washington. .

682, May 26, 4 p. m. (SECTION SIX)

if the Government could proceed to fix the gold rate of the franc within the limits now authorized it did not possess authority to utilize proceeds of devaluation of the gold reserves without the previous assent of Parliament.

Flandin assured the Chamber that the object of his declarations and his reference to "hypothetical projects" attributed to the Government was to reassure public opinion and to make sure that the menace of such expedients did not exist and that the Government had never seriously envisaged such measures.

In reply Auriol referred with some sarcasm to the obvious desire of Flandin to place the public credit in a good light and protested that he had already on many occasions loyally explained the financial situation to the public, to Parliament and to finance committees.

While

RB

-2-#682, May 26, 4 p. m. from Paris
SECTION SIX

While it was exact he said that only about 800,000,000 francs had been paid out during the first quarter of 1937 on account of the special armament budget. 2,200,000,000 had been paid out on account of the 1936 budget during that period. He admitted that the Treasury problem was indeed a difficult one but contended that it was not the fault

BULLITT

RR

NPL

GRAY

Paris
Dated
May 26, 1937

Rec'd 5:13 p.m.

Secretary of State,
Washington.

682, May 26, 4 p.m. (SECTION SEVEN).

of the Popular Front Government. He was at pains to assure the Chamber that the necessity to support the railways and to make advances to the Departments and Communes was a heavy burden on the Treasury. He emphasized, however, that the burden of armaments was chiefly responsible for the Government's financial difficulties. He formally denied that the Government had any intention of asking Parliament to approve the measures which had been outlined by Flandin. Flandin replied that he was grateful to have this advance assurance.

Incidentally Auriol indicated that the recent Treasury loan for the pension fund had so far produced 423,000,000 francs. However, he did not provide any clear information with respect to the Government's financial plans for the future except to repeat that the railways and other public bodies must be placed in a position where they would cease to burden the Treasury.

Finally

NPL--2-- No. 682, May 26, 4 p.m. from Paris.

Finally he insisted that the Treasury possessed more effective resources than had been the case with many administrations at various times.

Schacht arrived in Paris yesterday afternoon, attended German Embassy dinner last night and inaugurated

BULLITT

CSB

NPL

GRAY

Paris

Dated May 26, 1937

Rec'd 5:15 p.m.

Secretary of State,
Washington.

682, May 26, 4 p.m. (SECTION EIGHT)

German pavilion at Exposition today. In press interview yesterday he is reported to have denied that he was here on any political mission but merely to observe the building. He was seeking no loan. He voiced German desire to cooperate with France and to realize the Franco-German commercial treaty now under somewhat difficult negotiation. He argued that if interest rates were reduced on Dawes and Young bonds Germany would be in better position to buy foreign goods other than simply raw materials. He appeared skeptical in regard to Van Zeeland's inquiries leading soon to a world conference.

END OF MESSAGE

BULLITT

RECEIVED
MAY 26 1937
U.S. DEPARTMENT OF STATE
WASHINGTON, D.C.

FEDERAL RESERVE BANK
OF NEW YORK

all which
27

OFFICE CORRESPONDENCE

DATE May 20, 1937.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH

L. W. Knoks

BANK OF FRANCE.

I called Mr. Cariguel at 10:25 this morning. He told me that he had planned to call me before the day was over because he wanted some information about the present rate for United States Treasury bills, three and six months maturities. I replied that I had information before me on four and nine months bills which had been tendered for on Monday to yield an average of .45% and .62% approximately. Cariguel replied that that was all he needed to know at the moment. I added that we had recently had orders from Europe for September maturities to yield .40% and gave him some details about the latest tenders such as high and low rate, amounts applied for and amounts allotted.

Cariguel then referred to their own position and stated that they had had a very quiet day yesterday and also last Monday. Today, he said, was very bad and, as things were looking at the moment, they would probably lose about £1,000,000 worth of sterling before the day was over. This compared with a loss yesterday of about £450,000, all of which was sold between 2:15 p. m. and closing to meet a ^{sudden} demand which he attributed to the political debate then going on in the Chamber. Last Monday, when the franc suddenly turned strong, he had been able to do very little because the market had been too narrow. I asked whether, generally speaking, the Fund had been able to hold its own since the Committee was set up early in March and he replied "Oh, yes, quite easily." He was well satisfied with the way the Committee was working; whether its efforts would eventually be successful, he didn't know because

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE May 28, 1937.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH

L. W. Knoke

BANK OF FRANCE.

- 2 -

what was happening in France was purely a political matter and was beyond the reach of the Committee.

I inquired as to the amount of Russian balances in the Paris market and whether their presence had in any way bothered them. He said "Not yet," but added "They might some day." He referred to the recent purchase of gold which the French had made of the Russians, the condition agreed upon at the time, that the Russians should not take the proceeds away, and the fact that in spite of this agreement the Russians had converted them into sterling. He added that he was under the impression that Governor Labeyrie had agreed to buy another £3,000,000 worth of gold on the same conditions as before. Whether or not the Russians would live up to their agreement any better than they had done in the first instance was an open question. Personally, he said, he was not getting any closer to them. The Russians had inquired whether the Bank of France would invest their balances in the Paris market (about 150,000,000 francs) the same as it made investments for other central banks, and Governor Labeyrie had agreed. I thanked Mr. Cariguel for all this information which, I said, was of interest to us because we might, before long, be called upon to open an account for the Russian State Bank on our books.

I then discussed the recent transactions of the Swiss National Bank and asked whether he knew what its policy was with regard to its gold holdings. Cariguel replied that he did not know but had a suspicion, which was shared by Bolton, with whom he had

FEDERAL RESERVE BANK
OF NEW YORK

LD
66

OFFICE CORRESPONDENCE

DATE May 28, 1937.

TO CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH

FROM L. W. Knobe

BANK OF FRANCE.

- 3 -

discussed this matter, that the Swiss were selling some of their gold, ^{this} which, in his opinion, was not in accordance with the spirit of the Tripartite Agreement. Dr. Bachmann, who had been present in Basle at the recent meeting, had not told anybody what his bank was doing nor what his government's policy was. I told Mr. Cariguel very confidentially that his and Bolton's suspicions were borne out by the Swiss bank's operation in this market, as a result of which its gold holdings here had been very substantially cut down. I regretted the fact that I knew nobody at the Swiss bank whom I could call up for a friendly chat and discuss their and our operations. Should he, Cariguel, learn anything ~~more~~ about the Swiss plans, would he therefore bear me in mind and call me up over the telephone. This, Cariguel promised to do.


LWE:KMG

May 26, 1937

3:30 pm

Present:

Admiral Peoples
Mr. Taylor
Dr. Lubin
Capt. Collins
Miss Michener

Dr. Lubin: I have a picture of what happens in the cotton industry in normal times -- mill consumption of cotton. Here's a historical picture for 15 years which gives you a pretty good picture of operation of mills. (Photostats of charts used by Dr. Lubin and Admiral Peoples at this conference are attached.)

HM, Jr: Are valleys the same every year?

Dr. Lubin: Almost so. What I have done is taken them year by year on this chart of Seasonal Variations. You will notice the valleys took place almost identically the same time of the year, in 1923, 1925 and 1928.

HM, Jr: July and August.

Dr. Lubin: It starts back in May. Now I took the whole history of the cotton industry as shown by those 13 years to show how the peaks and valleys have averaged. It shows a lag of about six weeks between employment and cotton consumption. Now in '36 it was sort of up, both in consumption and employment. '37 has already begun; has not quite shown up; it will show up next month in employment.

Admiral Peoples: How does volume, from year to year, compare, we will say, with 1935?

Dr. Lubin: These are all on the same basis, so the volume of consumption in 1936 reached the peak there of about 125 or 124, the highest level ever reached in the industry. That's the calendar year. It surpassed even the peak year of 1933 after NRA went in. Higher than anything we had before the

depression.

HM, Jr: Now, where are the Government buying orders?

Dr. Lubin: I will say this: somebody has to do something for the industry in the next four or five months.

Admiral Peoples: We have a pretty good line on this. We estimate 77,879,021 yards of cotton (referring to table attached hereto) with a value of about \$8,700,000. That's from June 1 to December 31. Woolens, almost 10,000,000 yards with a value of about \$21,000,000.

HM, Jr: That's what they anticipate buying?

Admiral Peoples: Yes. That's the estimate of what they will do between now and the end of the calendar year. Of course, that may be affected somewhat by the condition of the Relief Bill when it gets out of Congress.

HM, Jr: If you take Procurement and the War Department, you have 95% of the picture. You have Procurement buying 52,000,000 yards and War Department 23,000,000; that's 75,000,000 yards right there. Well, now, would the War Department cooperate on the placing of those, as to when they should be placed?

Admiral Peoples: I think they would. Depends upon what their bids may be.

Capt. Collins: Almost depends upon enrollment of CCC men -- 300,000 next year.

HM, Jr: Why does he want us to hold back?

Dr. Lubin: Because the industry, even though it has started rising, is operating now at capacity with prices abnormally high, and if we could get a shake-down so the level would get down to the high point of 1936, which would be about on a level of the better years of 1925-1928, put your orders in then to start the ball going up-hill again.

Admiral Peoples: The difficulty is the War Department requirements include the CCC boys, 300,000 of them. Now those bids depend upon when they are going to be enrolled.

66C
~~JIF~~

When there was enrollment, the War Department has been able to take care of them. The Procurement part, which is handling for WPA, that depends entirely upon sewing rooms that WPA is going to maintain.

HM, Jr: Yes. But supposing we said to you: Procurement, you are going to place your orders between now and the first of July.

Capt. Collins: The answer is we will place 18 proposals -- going out now -- which will aggregate about \$8,500,000.

HM, Jr: How many days before the bids come in?

Capt. Collins: We usually give them 10 days or 2 weeks.

HM, Jr: If you are not pleased with the price, you can reject the bids?

Admiral Peoples: You can delay it all along the line.

Dr. Lubin: Have we any evidence of inventories in CCC? Just how much they actually need at a given moment?

Admiral Peoples: Not much stock carried in CCC. Most of it carried in the Corps Area.

HM, Jr: How about delivery?

Admiral Peoples: Come 10 days; some 5 weeks. The Navy is usually in better position to delay orders than the other Departments because they have a Revolving Fund out of which they can buy whenever they wish to and their stocks usually run up to 6 or 8 months' on hand.

HM, Jr: But this \$20,000,000 for textiles for the War Department, what is that?

Capt. Collins: That's different kind of cloth, both cotton and woolen: any cotton: cloth, denim, cotton duck; shirtings, which comes under woolens, uniform cloth, and that's mostly on account of 300,000 CCC.

HM, Jr: Could you not go back and find out -- under the two things, both cotton and textiles is as good a thing to experiment with as any -- go back to the Army and find out

-4-

how soon they need those things?

Admiral Peoples: We can.

HM, JR: And how they place their orders?

Admiral Peoples: As I understand it, the purpose to be accomplished is this: is to delay placing orders for a while in view of reduction of business later on.

Dr. Lubin: In view of the fact you will have unemployment in industry.

HM, Jr: That is, can the Government by placing its orders stabilize employment on some of these things where there are peaks and valleys on seasons. Can we use Government orders to stabilize employment in some of these industries.

Dr. Lubin: Which means more than delaying, but also means hastening. It may mean orders placed next October can be placed in June or July.

HM, Jr: We need more information.

Admiral Peoples: Suppose we do this. Suppose we call a conference; meet down in the Procurement Division; ask Dr. Lubin and representatives of all these Departments with a schedule of their requirements, and then lay down to them what the purpose is to be accomplished and see how far they can go, hastening in some respects, delaying in others.

Capt. Collins: I think we could confine that to two agencies: ourselves and the War Department.

HM, Jr: Can you keep it from getting out?

Admiral Peoples: Oh, yes!

Dr. Lubin: What are the total purchases by Navy for shoes? If they have this Revolving Fund it would be helpful....

Capt. Collins: Navy is only getting 45,000 pairs.

HM, Jr: Dr. Lubin and I know what we have in our mind. Why don't you drop back in Wayne Taylor's room and talk this thing

-5-

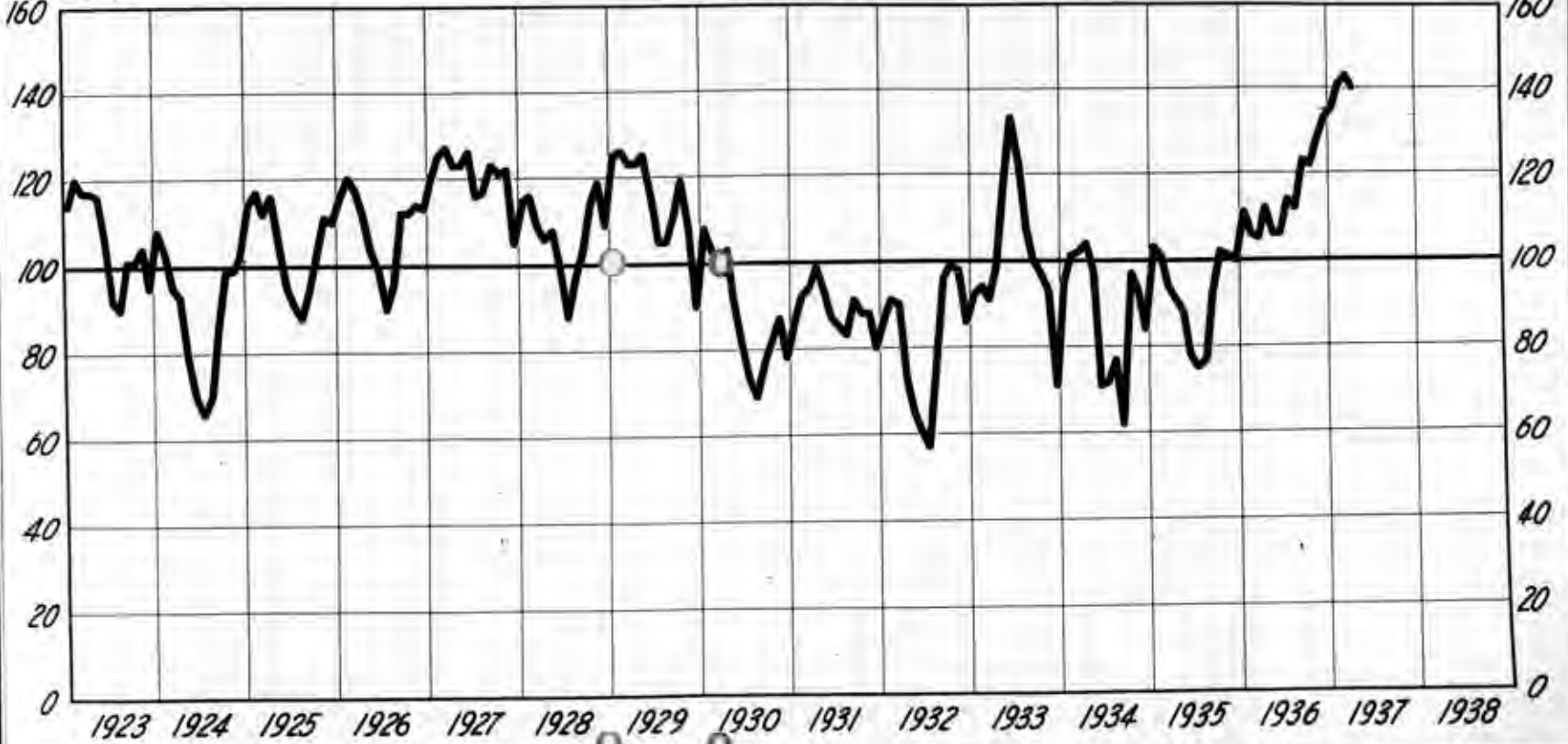
over. Before we finally do this, when we finally get the thing where we think we can do it, put it on one piece of paper and I will ask the President, Would you like us to do it? but I don't think its worth while showing it to him until we know. The main thing is can we through accelerating or retarding Government orders level out unemployment. Just like the President sold the idea to Walter Chrysler that he should start selling his new models in November instead of January and it has been a great success. Surprising how many business men -- I had a business man at the house last night (textiles) and he's going to prove that managed economy of the New Deal is wrong because while labor and the farmer has increased wages, the housewife and the person with fixed income -- the teacher, the trained nurse, their income has not gone up and therefore they can't buy cotton goods at the increased prices and it's going to be a test of the New Deal. If we can buy it cheap and at the same time give people more employment, then the Treasury is interested because we have to pay out less for unemployment. That's where I come in.

000-000

MILL CONSUMPTION OF COTTON UNITED STATES 1923-25=100

Index Numbers
160

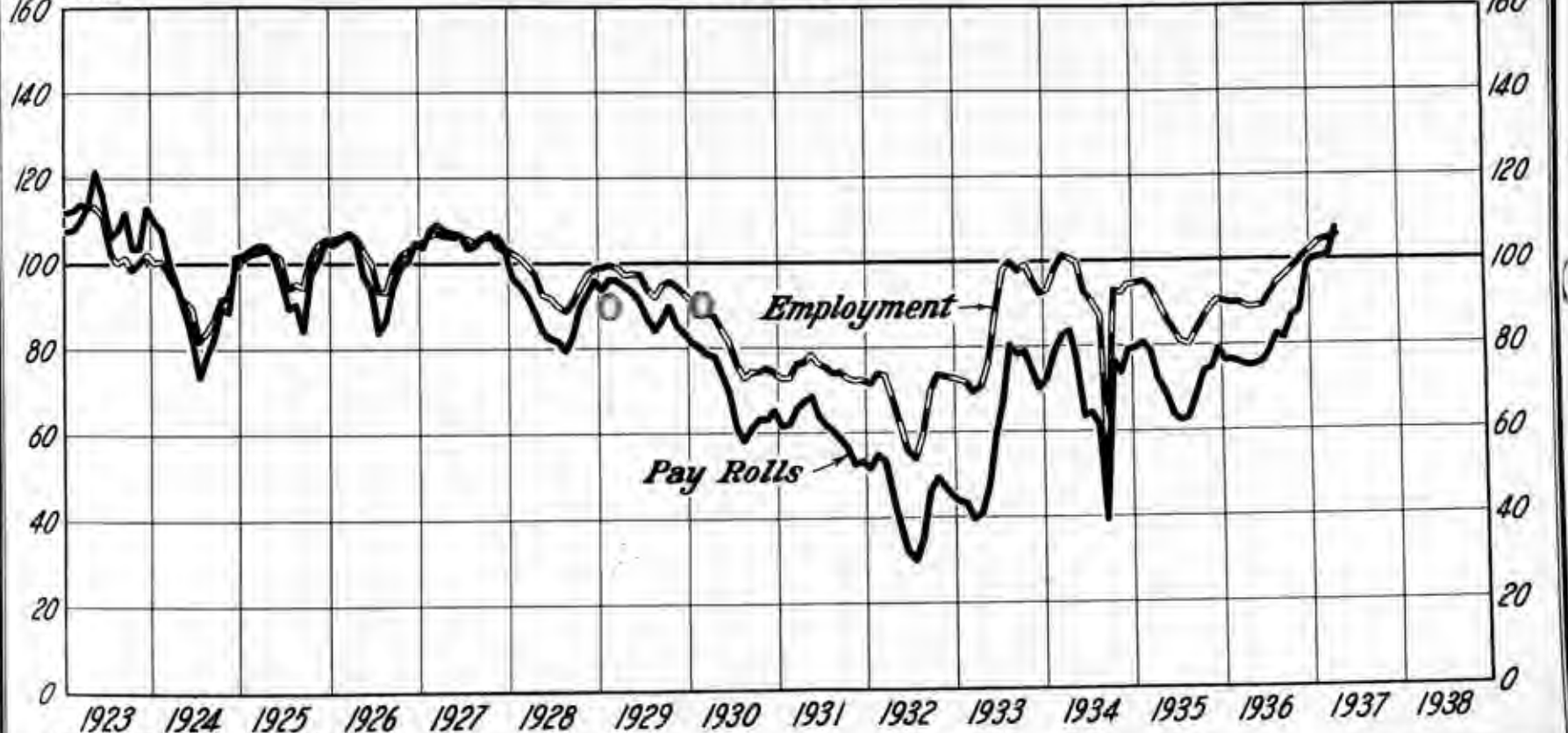
Index Numbers
160



EMPLOYMENT & PAY ROLLS COTTON GOODS 1923-25=100

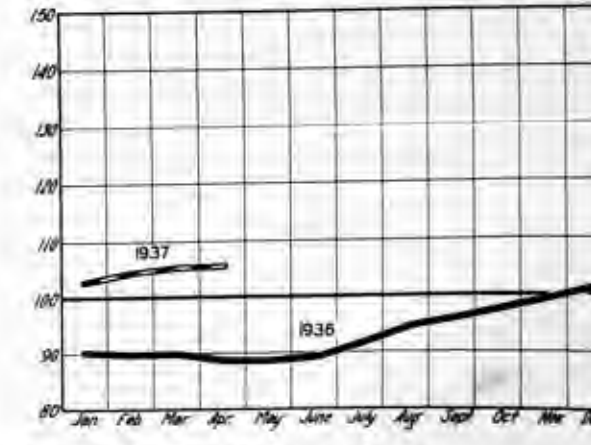
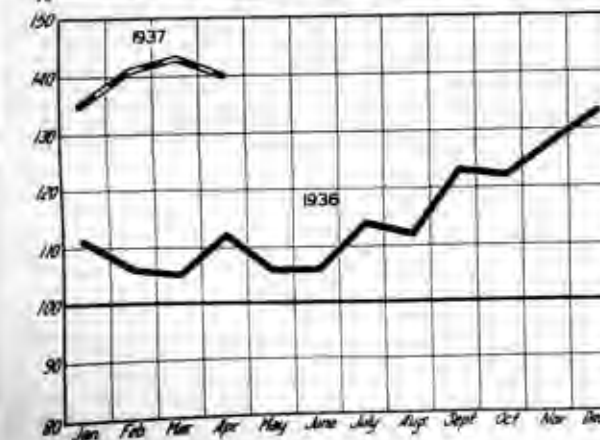
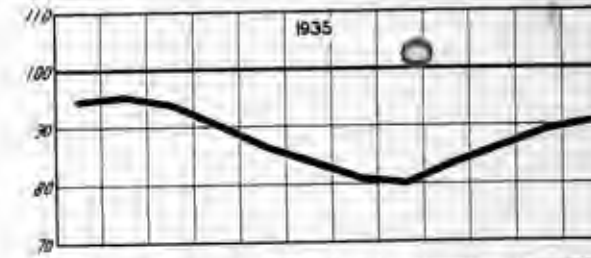
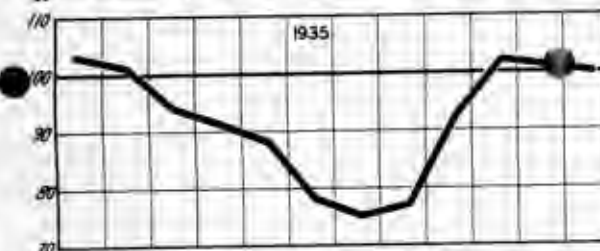
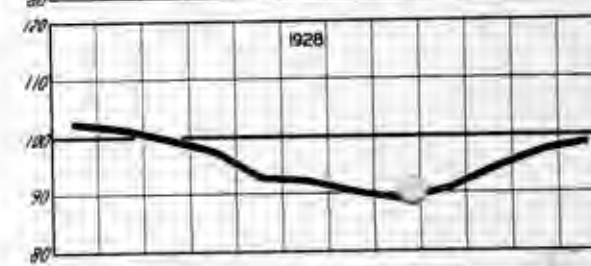
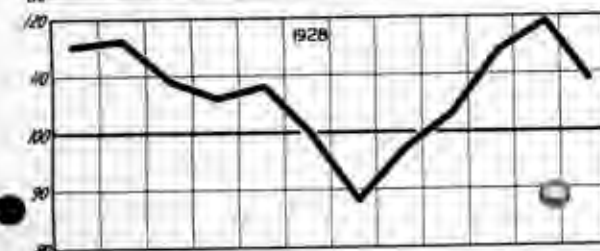
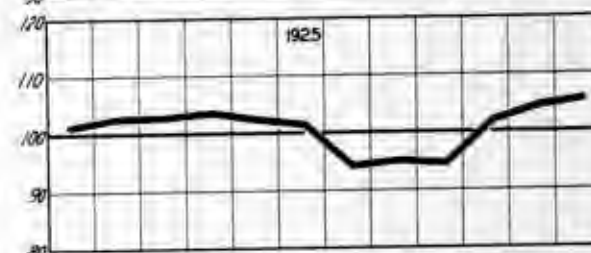
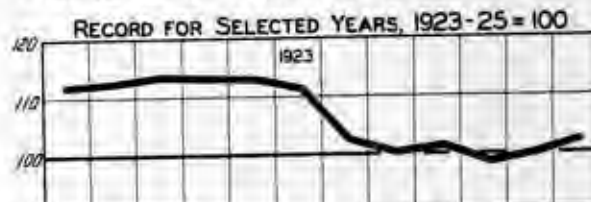
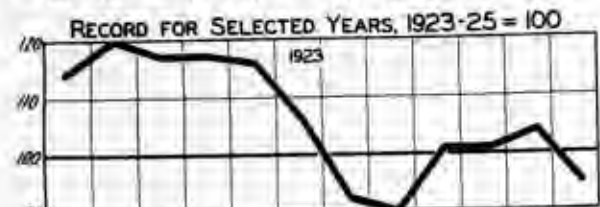
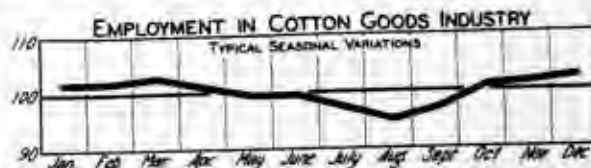
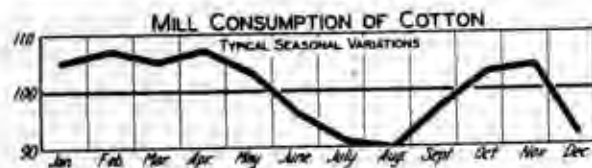
Index Numbers

Index Numbers



UNITED STATES BUREAU OF LABOR STATISTICS

SEASONAL VARIATIONS IN COTTON MANUFACTURING



SOURCE: INDEXES OF MILL CONSUMPTION OF COTTON AND SEASONAL VARIATIONS, FEDERAL RESERVE BOARD. INDEXES OF EMPLOYMENT, U.S. BUREAU OF LABOR STATISTICS.
PREPARED BY: CENTRAL STATISTICAL BOARD.

65-538

ESTIMATED QUANTITIES
 TEXTILES, SHOES, AND SHIRTS
 JUNE 1 - DECEMBER 31, 1957

Department	Cotton		Woolen		Linen		Blankets		Shirts & Drawers, Cotton		Shirts & Drawers, Woolen	
	Yards	Value	Yards	Value	Yards	Value	Woolen Blank	Value	Shirts & Drawers, Cotton	Value	Shirts & Drawers, Woolen	Value
Interior Department	419,958	\$ 52,845.00	1,698	\$ 1,000.00	86,508	\$43,250.00	4,000	\$ 26,000.00				
Justice Department	1,070,000	127,700.00	75,000	225,000.00					15,000	\$ 153,000.00	60,000	\$ 16,800.00
Marine Corps	300,000	34,000.00	62,000	136,000.00								
Army Department	360,450	54,255.00	80,700	205,543.00			7,150	49,370.00				
Procurement Division	51,977,000	5,132,579.00					10,187	30,279.00				
Vietnam Administration	99,000	12,375.00							2,550,797	8,325,789.00	4,533,789	1,106,705.00
Air Department	25,352,613	3,265,721.00	9,713,598	20,467,449.00								
Post Office Department	300,000	15,000.00							2,585,797	8,478,789.00	4,995,789	1,123,905.00
TOTALS	77,879,021	\$8,721,879.00	9,952,956	\$21,035,198.00	86,508	\$43,250.00	17,337	\$13,619.00	2,585,797	\$8,478,789.00	4,995,789	\$1,123,905.00

TOTAL MONEY VALUE
 \$ 8,721,879.00
 21,035,198.00
 43,250.00
 13,619.00
 8,478,789.00
 1,123,905.00
 1,027,116.00
 \$20,763,209.00



OFFICE OF DEPUTY COMMISSIONER
INVESTIGATIVE UNIT

TREASURY DEPARTMENT

BUREAU OF CUSTOMS

WASHINGTON

May 26, 1937

MEMORANDUM FOR MR. GRAVES

FROM DEPUTY COMMISSIONER GORMAN:

Re Joseph Aveta, alias "Jo-Jo"

As stated in my recent memorandum to you Aveta was arrested by customs agents at New York on Sunday, May 23, on the orders of the United States Attorney for the Southern District of New York, as a co-defendant in connection with the defendants Olson and Stadens, two longshoremen who were convicted in connection with the smuggling of two suit-cases containing gum opium, which were landed from the S/S MANHATTAN at New York in November, 1936; and also as a co-defendant with Nils Arnessen, et al., in connection with the seizure of forty pounds of gum opium, a part of which was landed from, and a part of which was seized on the S/S PRESIDENT HARDING about a month ago.

Aveta has been long known to be an important factor in the narcotic traffic in New York. Many years ago he was a seaman employed on vessels of the United States Lines, which company operates the MANHATTAN and the PRESIDENT HARDING. Apparently he was smuggling narcotics at the time he was a seaman, and acquired enough money to go into the business on a large scale. From information available to us it would appear that Aveta has many seamen who purchase narcotic drugs in Europe, particularly gum opium, morphine base, and heroin, which they in turn smuggle into the United States and sell to Aveta, who thereafter distributes same in the market.

Aveta had been in hiding practically since the arrest of Olson and Stadens in November, 1936, as the gum opium seized at that time, which was in fact brought into the United States by Henry Dominick, quartermaster on the MANHATTAN, was to be sold and delivered to Aveta.

It was known that John Tivus, a carpenter employed on the CITY OF HAVRE, of the Baltimore Mail Line, which arrives at Baltimore, was one of Aveta's carriers. Tivus has been

under observation for the last four months by customs agents at Baltimore and New York, and has been shadowed upon his successive arrivals. He last arrived at Baltimore on Saturday, May 22. He was placed under surveillance by Baltimore customs agents, who telephoned the New York office that he had left on the afternoon train. He was picked up at the Pennsylvania Station in New York, and shadowed to his residence in Brooklyn by customs border patrolmen. His house was kept under surveillance as had been done for the last three trips, and on Sunday Joseph Aveta was seen leaving the apartment house where Tivus was living, and was followed from a short distance from the house and placed under arrest. He is now held in default of bail in the amount of \$50,000. The United States Attorney is of the opinion that we are in possession of sufficient evidence to convict Aveta, both in connection with the MANHATTAN seizure and the seizure on the PRESIDENT HARDING.

Aveta has been under investigation also by the office of the District Supervisor of the Bureau of Narcotics at New York, as will be noted from the attached memorandum received by me from District Supervisor Williams bearing on the subject.

W. J. Gorman



OFFICE OF DEPUTY COMMISSIONER
INVESTIGATIVE UNIT

TREASURY DEPARTMENT

BUREAU OF CUSTOMS

WASHINGTON

May 26, 1957

Memorandum for Mr. Gorman:

Re: Joseph Aveta, alias "Jo-Jo"

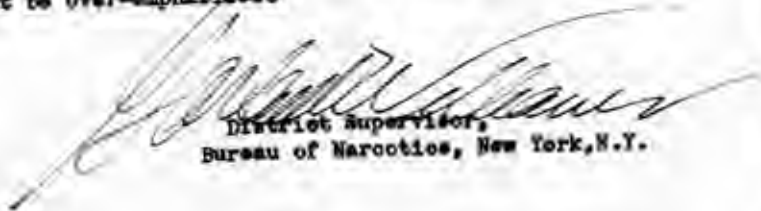
Regarding the importance of this man in the narcotic traffic in New York City, the New York office of the Bureau of Narcotics has long known him as a principal source of supply in the city for narcotics, and has also known that he is the smuggling source for narcotics sold by his organization.

Within the past three months we developed an informer named Willie Richardson, who was a fairly good-sized dealer himself, and who purchased his narcotics from Joseph Aveta, and this man stated that Joseph Aveta regularly secured his narcotics through his employees working on French Line boats.

On one occasion within the past year Willie Richardson accompanied Joseph Aveta in his automobile to the French Line docks and a man who was apparently a steward on the boat that had just arrived delivered to Joseph Aveta's car a package about eighteen inches square, for which Joseph Aveta paid him \$3000. This amount of money, however, was not sufficient, and Joseph Aveta drove the man to his home to secure additional funds to pay for the narcotics. Richardson stated that this was heroin.

This information was submitted to the Supervising Customs Agent at the time, and efforts were made to develop a case against Joseph Aveta through this informer. However, in the development of the case we secured evidence against Louis D'Ercole, who is supposed to be Joseph Aveta's younger brother.

The importance of Joseph Aveta in the narcotic traffic in New York can not be over-emphasized.


District Supervisor,
Bureau of Narcotics, New York, N.Y.

PARAPHRASE OF TELEGRAM SENT

TO: American Embassy, London, England

DATE: May 27, 1937, 11 a.m.

NO.: 201

FROM SECRETARY MORGENTHAU FOR BUTTERWORTH.

Your cable of May 21.

Information came to Treasury that the Bank of Japan has arranged to ship three lots of gold to the United States, each amounting to approximately fifteen million dollars. The first two lots have already arrived, and a portion of the third lot is on the seas now. According to Araki, the Bank of Japan's New York Agent, the proceeds of the first lot were retained by the Japanese Government in order to pay service on bonds held abroad, to pay foreign expenses of the Government, and so on. The second lot proceeds, and probably the third lot also, are gradually to be sold to Yokohama Specie Bank for use in exchange operations to support the Japanese currency. Araki thought that since this procedure takes funds out of the Japanese market, it would place some limit on the amount of Japanese gold which could be used in this way, particularly since the Japanese Government is interested in seeing that on their market money continues relatively easy.

The first half of the calendar year, Araki said, is the time of heavy imports, and during the second half of the year it may not be necessary to sell gold in order to obtain

PARAPHRASE OF TELEGRAM SENT

TO: American Embassy, London, England

DATE: May 27, 1937, 11 a.m.

NO.: 201

FROM SECRETARY MORGENTHAU FOR BUTTERWORTH.

Your cable of May 21.

Information came to Treasury that the Bank of Japan has arranged to ship three lots of gold to the United States, each amounting to approximately fifteen million dollars. The first two lots have already arrived, and a portion of the third lot is on the seas now. According to Araki, the Bank of Japan's New York Agent, the proceeds of the first lot were retained by the Japanese Government in order to pay service on bonds held abroad, to pay foreign expenses of the Government, and so on. The second lot proceeds, and probably the third lot also, are gradually to be sold to Yokohama Specie Bank for use in exchange operations to support the Japanese currency. Araki thought that since this procedure takes funds out of the Japanese market, it would place some limit on the amount of Japanese gold which could be used in this way, particularly since the Japanese Government is interested in seeing that on their market money continues relatively easy.

The first half of the calendar year, Araki said, is the time of heavy imports, and during the second half of the year it may not be necessary to sell gold in order to obtain

- 2 -

obtain foreign exchange since during the second half the trade balance is more nearly adjusted. Japanese bank balances (for your information) were overdrawn here the early part of the year and only upon receipt of the proceeds of the second lot of gold did they go on the credit side.

WELLES

ACTING.

EA:LWW

RECEIVED

MAY 20 1937

TREASURY DEPARTMENT
Office of the Director
U.S. DEPARTMENT OF THE TREASURY

MEETING RE HOT MONEY AND GOLD

May 26, 1937
9:30 A.M.

Present: Mrs Klotz
Mr. Bell
Mr. Upham
Mr. White
Mr. Lochhead
Miss Michener
Mr. Gaston
Mr. Oliphant
Mr. Seltzer
Mr. Taylor
Mr. Magill

H.M.Jr: Now on the hot money stuff, you people who were responsible for this have just got to be getting places. Now, the Treasury is not in the leadership on this thing; we're not in the leadership on the hot money, we're not in the leadership on the gold business. And I just can't sit around here and wait much longer. I mean either the thing in the Treasury has got to break or I've got to go outside and get it.

Now, on this thing, for instance - you (Mrs Klotz) just take one or two notes - do we know, of the short-term balances, which roughly run to one billion two, which countries?

White: Certainly.

H.M.Jr: All right, never been given to me. Never had it.

White: Been in several memoranda. Give it to you as quickly as you want it.

H.M.Jr: Well, you show it to me in any memoranda. How much of it is central bank money?

White: We can tell you that too.

H.M.Jr: So that if we decide to move it from the general banks into Federal Reserve - I mean how much - in other words, if I want to say to the Bank of England, "I'd like you to move your money into the Federal Reserve of New York," I'd like to know how much there is.

White: We always have the total. We never had the breakdown, because that information isn't available to us. We

-2-

have asked - a letter went through here several days ago to ask for that information weekly; have to get permission, which you would have to request from the Board of Governors. But we always had the total.

H.M.Jr: What I want is this. I want a list - this is - I gave it to you (Taylor) - of the various possible devices that we can use to handle this so-called hot money proposition, using that as an all-inclusive term. Now, the question of hundred percent reserves for foreign balances and this whole business, which - I mean I want the whole thing, so that I can sit down and study the thing one by one and decide how much of this thing we can do. But there is no use trying to do this thing in a piecemeal manner. But I can't wait much longer, Wayne.

Taylor: O.K.

H.M.Jr: At least I want a list, see?

And then the other thing that I want - on this question of sterilization I want to know how much we are over- or under-sterilized. Now by that I mean the 670 million...

Bell: 720 million.

H.M.Jr: What?

Bell: 720 - 750 million.

H.M.Jr: All right, whatever it is - now, the 700-odd million which showed up in the inactive gold fund; have we borrowed the full amount or haven't we? And by drawing down our balances with the Federal Reserve, how much have we offset that? So that if we took a cut-off line as of the end of this month, where do I stand on sterilization of gold? Have I double-sterilized it? When the money goes into the Federal Reserve Bank instead of the central bank.... Where are we on this sterilization? I've never gotten a memorandum on that. No one's ever given me one on that.

White: No, you haven't....

-3-

- H.M.Jr: No, I mean what is the position on this sterilization? I mean have I sterilized too much? Have I double-sterilized? The money goes in the banks, the money goes in the Federal Reserve? Every fellow gives me a little piece, everybody gives me a bit, but nobody ties it up together.
- White: I could answer that, but it's all right.
- H.M.Jr: Well, go ahead, you can answer anything, I don't care; anybody can hit just as hard as he wants.
- White: Well, the answer - the two-fold one - is that all the memoranda that are prepared don't get to you; secondly, there are some problems which may seem acute to you that may not be acute, there are some problems which have a very simple answer and all you need to do is ask one of those and you can have the answer.
- H.M.Jr: But my dear White, why should I sit here in ignorance?
- White: You shouldn't.
- H.M.Jr: Certainly the Research Division - why should they always wait for me to push them? Why shouldn't I have a weekly statement? Why shouldn't somebody have the brain power back there to think and draw to my attention - "You either have over-sterilized or under-sterilized."

Now, why am I interested now, why am I raising this hell? Because Bell and I have got to sit down and decide how much money we've got to borrow between now and next fall. Why do I want to know what the summer condition is? And I haven't got a decent memorandum out of the Research Division. Why? Because, should I over-borrow in June because I think we're going to have a good summer or a bad summer, or should I just take a little money in June and take the risk? But I haven't got a first-class memorandum from Research on the business conditions this summer. I mean I haven't got a first-class memorandum and I'm getting all of this stuff piece-meal.

Now, if, for example, we have sterilized two or three

-4-

hundred million dollars too much, then Dan and I don't have to borrow 800 million dollars; maybe we only have to borrow five or six hundred million dollars and we release this thing. If we're going to have a bad summer, maybe we want to release some gold anyway. I mean if Jake Viner's right and we're going to have a very bad summer, maybe we want to figure we're going to release it. What effect does it have on sterilization? What's our excuse going to be?

White: Is there provision for any memoranda that are prepared to come to your attention, or only those memoranda that you ask for? That's been an important question here for some time. Would you see memoranda that are sent in here?

H.M.Jr: Well, we'll call a spade a spade. Now, Edna Lonigan writes memoranda too and Edna Lonigan gets her stuff to me, and the fact that she gets her stuff to me makes her unpopular in that Division. If she gets an idea, she sits down and writes it and tells me what she thinks, and it gets to me. Now, it's too bad, if somebody has an idea, that they don't do the same thing. The reason they don't like her is because she fights like hell. And I told her any time she couldn't get it to me to walk in. But the girl thinks, and that's one of the reasons they don't like her. That's true. They don't like her because she sends me a memorandum - original stuff. We don't always agree, but she's thinking along original lines on unemployment; she writes a memorandum about how the stuff should be handled, entirely different from what it is being handled. And that's why I keep her back there. Does that answer your question?

White: Certainly does.

H.M.Jr: I mean anybody that works back there ought to be able to write anything that he wants, whether it's in agreement with what the Treasury thinks or not, and it ought to be forwarded to me.

White: The first has always been true.

H.M.Jr: What?

-5-

- White: That they have always been able to write anything they want - no restrictions there. The second has not been true.
- H.M.Jr: I'm sorry George isn't here. I sent him away because he is sick. Miss Michener has got to take it as Haas's representative; she can take it.
- White: And it hasn't been true because, in complete justice to George, there is a desire to save you from reading what anybody wishes to write; I mean that's the principle behind it.
- H.M.Jr: But now this responsibility is Taylor's, and I want an all-inclusive memorandum giving me the list of the various devices that may or may not be used on hot money and gold and the whole question. And I want particularly tomorrow morning, and I don't care what - how it's gotten, but I want tomorrow morning a memorandum telling me where we stand on this sterilization, so that Bell and I can sit down and decide whether we are over-sterilized or under-sterilized, and where we are at. Now, I want that - 24 hours - I mean I want that, and take in the picture. You give me a little, Jake Viner gives me a little. I said to Jake last night - you gave him the stuff that the money that goes directly in the Federal Reserve shouldn't be sterilized; I said, "What about the general fund pulling down the balances, increasing excess reserves?" "Well, I hadn't thought of that."
- Lochhead: We discussed about two weeks ago those three different methods I suggested.
- H.M.Jr: I know, but you give me a little, Jake Viner gives me a little; I want the whole thing. I gave it to Taylor, it's his responsibility, and he should take it and tie it up into a bouquet and walk in here. If you've got something you can walk into his room. You've never tried to see me that you can't see me, have you?
- White: Very true.
- H.M.Jr: But I can't sit here - I mean I'm ashamed when I see a man like Walter Stewart last night and hear that fellow talk and hear the way he's thinking, and I had

all I could do to cover up my ignorance.

White: Well, in my own defense, and I am speaking possibly for the others....

H.M.Jr: Now, I didn't let anybody in the Treasury down. Don't worry about Walter Stewart; he didn't know I didn't have this stuff.

White: The fact that you may not know it doesn't mean that we don't know it, but that we have not talked about it. I want to make that distinction clear. We have failed possibly in bringing it to your attention; but I don't want you to feel that Walter Stewart knows anything that we don't know.

H.M.Jr: Don't be so sure.

White: Well, I'm pretty sure about it.

H.M.Jr: Well, George Haas sits here every morning at 9:30, Taylor sits here every morning at 9:30, Archie sits here every morning at 9:30, Bell sits here. There's four people. You could go say to one - knock on the door, say, "For God's sake, the Secretary ought to have this information; see that he gets it." If there is something the matter back there, it's just too bad.

White: No, it will be rectified.

H.M.Jr: You can fight, but don't take it out on me; take it out in your own shop, raise hell back there. If you've got the stuff, can't you see Taylor, can't you see Haas?

White: Oh yes, oh yes.

H.M.Jr: But the thing I want particularly tomorrow morning - I want the answer, where do we stand on sterilization, and its relation to the question of our drawing down our balances with the Federal Reserve. Where is this thing? Where are we at? Have we over-sterilized? In Bell's estimates for handling the gold the next three months, he's estimating to handle the thing the same way; he has no other information. You haven't got any more than I've got, have you, Dan?

-7-

- Bell: No, except I do know this problem exists, and what we are doing is following out exactly what we agreed upon with the Federal Reserve Board. Now, I think we have discussed from time to time that maybe our policy is a little too inflexible.
- White: And it is a policy which we are pursuing which the Division did not recommend, defending the Division from that definite point of view.
- H.M.Jr: I think we're doing little pieces that I pick up. I'll wait until tomorrow morning. My own position is I think we are way over-sterilized and we're going way beyond our agreement with the Federal Reserve.
- Bell: I think our agreement was we'd sterilize all gold coming in. At the time we discussed it we knew we were sterilizing the reserve of 26 percent, which could very well be let go into the System.
- H.M.Jr: Well, I frankly - I don't remember anybody raising it at the time.
- White: Oh, yes, 'it was raised.
- H.M.Jr: In this room?
- Taylor: I think so.
- White: But we came in with the recommendation that not all gold should be sterilized, but there should be - from time to time reconsideration should be given to the amount; sometime between that and the announcement, something else happened and word was given that we'd sterilize all gold.
- H.M.Jr: I can't do this job and remember every detail. The fact I remember as much as I do - I think it is damn good. Now, this thing took place last November.
- Bell: December.
- H.M.Jr: And I've got to sit here and raise hell this morning because - let's say that you have raised everything you did in my presence; I can't remember, I won't question it; that's your particular field. I say since then, and now, in view of the thing - in view

-8-

of our estimates and in view of what we're going to do, and in view of the question of what kind of money - all that stuff - what about this sterilization, how much money, and all that stuff.....

White: Oh, I think you're quite justified. It's cleared the air about some points and I don't think the difficulty will arise again as acutely in the future.

H.M.Jr: Oh, it isn't acute; if it were, I'd really be in bad humor. But I don't like to get this stuff piecemeal; I don't like to get it at all hours of the morning, noon, and night, and not be able to tie it up in a bouquet.

Now, as I say - I come back to Wayne; have you got any complaints that you can't get these fellows to work with you?

Taylor: (Nods no)

H.M.Jr: Well now, will you take this thing, please, and tie this thing up, and particularly let me know tomorrow morning, looking forward after the first of July - I mean whether we have to continue for the rest of the year the same program; and what have we done since - you can do it the first of January, you can take any day I mean how much have we over- or under-sterilized? I mean have we kept our bargain or haven't we, see? That's what I want to know. And if we wanted to change it, what explanation would we make to the public, see?

Then the other particular thing that I'd like you (Seltzer) to do in connection with the financing is that, more and more, these people tell me the need of New York for more bills, because with the less reserves and this calling on New York for funds, they need a three months bill, which is the same as cash, so that if the interior calls on New York, which it always does, they will have - they can handle three months bills with their cash, so that the thing is more flexible. And they say there isn't any other piece of paper that the banks can get.

Seltzer: That's right.

H.M.Jr: And that with this cutting down reserves the situation is different than it ever was before; that selling the securities into a tax date does not answer the purpose, that the nine months doesn't answer the purpose. And the people I've been talking to seem to think in terms of the possibility of a three months and a nine months; but they say that from now on New York will need a three months very badly; that the New York financiers won't admit it, but as we go into crop season and the interior banks call more on the New York banks, that if they can put their money into a three months it would help the money market considerably. I wish you'd look into that and talk to Goldenweiser about it. I mean just don't keep it here. Because Eccles is thinking in terms of a three, six, and nine months bill, with an understanding that the Federal Reserve System will offer to buy those at par at any time; and he's trying to find out whether they have the legislation, the authority to do that. Now, that's the idea he's working on, that the Federal Reserve System will offer to cash....

Seltzer: Not at par, but at the market. See, the bills are discount bills.

Bell: He'd get them all.

H.M.Jr: Anyway, I want you to know what he's thinking; he's got Goldenweiser thinking about it. So don't just keep it in here. He feels that's the way to popularize the thing; he didn't talk in terms of the New York market needs. But as I have seen these important bankers, each one keeps talking, "If we had a three months bill, it would help us out considerably."

Bell: Of course, they've got plenty of bills maturing all the way from a week to 9 months.

H.M.Jr: They say they haven't got enough.

Bell: Two billion four isn't enough? I thought they wanted to cut them down here.

H.M.Jr: Take people like Walter Stewart; he recommended to me formally to cut it down. He said he's changed, that there's not enough commercial paper to go around.

-10-

Taylor: Not only absorb more bills, but it's good for us and it's good for the System to have more bills out.

H.M.Jr: He said the whole situation, due to the change in excess reserves, has changed, and he says New York is tight due to the lack of enough bills; they haven't got enough bills. He says he recommended differently before, but he said the thing has changed, and he said, "The New York bankers won't admit it; they don't like it."

Seltzer: That's what we got in New York, that the Bankers Trust and Irving wanted another billion bills out.

H.M.Jr: Well, give me something on that tomorrow morning. I mean what I was thinking about - I haven't had a chance to think it through - is the possibility of - this 350 million is closed now; that ends that - that when we start again, instead of selling them into December, that we start a new series of three months bills. Dan, see? I mean I want to explore that.

Bell: Carry them into September.

H.M.Jr: Pardon me?

Bell: That would carry them into September, where you have already 350 million.

H.M.Jr: No, wait - not begin until after we got by the 15th; I mean not start the thing until - what would it be, the 15th of....

Bell: August?

H.M.Jr: No, after the 15th of June. We can start any time after the 15th of June.

Bell: That would still throw them in September.

H.M.Jr: Well, I - no, I wouldn't start - start the 20th of June; then it could come after that.

Bell: It's all right; you can have a hundred million a week maturing.

-11-

H.M.Jr: Hundred million of what?

Bell: Bills.

Seltzer: You'd have to issue more of the three months bills.

Bell: No, 50 million dollars a week of three months bills would just throw a hundred million dollars maturing in that period, a hundred million maturing instead of 50 - no harm in that.

H.M.Jr: No, but stop the selling to the tax dates.

Bell: Yes.

H.M.Jr: But if we got out 50 million a week, I figured - see if I figured correctly - that's 600 million, isn't it?

Seltzer: 50 million a week, three months bills?

H.M.Jr: Is that right?

Bell: You'd have 12; yes, that's right; 12 weeks, if you go the whole period.

H.M.Jr: Is 600 million. And if we continued the nine months, is it a billion eight or billion eight fifty?

Seltzer: A billion nine fifty.

H.M.Jr: Is that what it is?

Bell: About that.

H.M.Jr: Well, that's two and a half billion. That isn't too much.

Taylor: Add another half to that.

H.M.Jr: Why?

Taylor: Add another half billion to that.

H.M.Jr: Why? I mean you can't do it if you have just nine...

Taylor: I'm not talking about just when to do it.

-12-

H.M.Jr: I mean if you get the nine months and the three months, it would give you abot two and a half billion.

You (Bell) want to add anything?

Bell: No, that suits me.

H.M.Jr: I'm not saying I'm doing - I'm not saying I'm going to do it; I'm just raising the point; I don't know.

Seltzer: No doubt your three months bills would be very popular.

H.M.Jr: It's good for us, it's good for the banking system. As I say, I'd like - I wish you'd talk to Goldenweiser about that.

Wayne, have I been unnecessarily hard?

Taylor: (Nods no)

H.M.Jr: What?

Taylor: No, no.

H.M.Jr: Now, anybody can shoot at me that wants to. I can take it. Anybody got anything? Any criticism?

White: Well, I have, as usual.

H.M.Jr: Speak up, go ahead, please.

White: I expressed myself this morning to Wayne before I came in here that I think this matter of hot money has not been properly handled in the sense that one person wasn't made responsible for it and your insistance that he push the thing through and stay with it until final recommendations are made. We picked that thing up, spent a lot of time on it; we've dropped it, and picked it up at spare moments, this person and that person. There's been a lot of work done, but there's been nobody who, to my knowledge - that was - took or was given or accepted the responsibility to push that thing through until a concensus of opinion of all the best methods was presented to you in wuch a way that you could go over them and go through them. And that's my general criticism.

-13-

H.M.Jr: When did you say this?

Taylor: Before we came in this morning.

H.M.Jr: Well, we're in agreement.

White: Well, I meant to imply a certain criticism. I mean + think somebody should have been given the responsibility and somebody wasn't.

H.M.Jr: Well, somebody was (nods at Taylor).

White: On all angles of it, everything? Taxes, everything?

H.M.Jr: No, we divided it. The tax angle is Magill's and the fiscal end is Taylor's.

White: Well, I - may I suggest that in this particular problem, though it obviously has those two aspects, they are sufficiently merged so that one person should have been in charge of the whole thing, because a good deal of the problem....

H.M.Jr: Well, originally, if you want to go back, Haas represented me on this thing, and - I mean he.....

White: Well, we started off in great fashion, did a great deal of work, and got a long way - not toward the solution, but we made a lot of progress in a brief time. Then the thing was dropped - whether at your request or what I don't know.

H.M.Jr: Because they couldn't get together.

White: No, I don't think so.

Oliphant: Well, Eccles lost interest.

H.M.Jr: No, I lost interest, because I couldn't get a report from Haas - sorry Haas isn't here, but I got a distinct feeling that they couldn't get together.

White: Well, I'll defend Haas; if he had thought your interest was either maintained or you thought it was important for a decision to be given, I think he would have pushed it.

-14-

- H.M.Jr: It's hard to say - I mean he isn't here and I'm not going to criticize him.
- White: Well, I mean my criticism to be constructive; it's a little impertinent. But I think if problems - when problems are important, if one person was given the responsibility to push that thing and deliver something within one or two or three weeks, whatever you think is reasonable, I think you'd get results, the kind you want.
- H.M.Jr: Well, perfectly frankly, on some of these things I've got tired of pushing, and I didn't get results. I mean I'm pushed out; I've pushed and pushed, and I just don't get any answer.
- White: Well then, what we need is to be bawled out a little more.
- H.M.Jr: I think now that I've asked Taylor - I think he'll go to it; I'm sure he will. And will you - just let's get all the things down, one, two, three, whatever they are, and let me take a look at them.
- Now, unfortunately, I've got this lousy thing on housing, and I've given McReynolds Saturday and Sunday afternoon, and Monday afternoon; if I can do that and get it out of the way - and I'm not going to touch it after that; we either hit it or don't hit it. But I'm giving him Sunday afternoon and Monday, because next week I just can't be bothered with anything but financing. But I would like this.
- Anything else, White?
- White: No, that's - I think I've said more than....
- H.M.Jr: No, it's all right.
- Miss Michener, want to stand up for your Division?
- Michener: No, I'm afraid I'm not in a position at the moment to say anything about it.
- H.M.Jr: White doesn't.... You know him by now, don't you?
- White: No, no, we get along splendidly.

-15-

H.M.Jr: All right. Well now, tomorrow morning, Wayne, I get something on....

Taylor: Sterilization.

H.M.Jr: And within a very reasonable time, something on Tuesday morning at the latest - something on the list of the devices on hot money. And on this thing I have absolutely no objection - be delighted if you talk it over either with Eccles or Goldenweiser.

All right, thank you all very much.

May 26, 1937.
11:16 a.m.

Operator: Go ahead.

H.M.Jr: Hello

Sabath Hello

H.M.Jr: Yes, Mr. Sabath

S: Mr. Secretary.

H.M.Jr: Yes.

S: I've seen the letter that sent to the
Judiciary Committee as well as to the Interstate
and Foreign Commerce Committee.

H.M.Jr: Yes.

S: Now in the letter to Mr. Sumner he states that the
Chandler Bill will - ah - do what - ah - eliminate
the abuses-to make it short-that he refers to and
also to - ah - in the - ah - but
unfortunately - ah - there is nothing done in
that - ah - there's nothing in the Chandler Bill;
it's merely a codification of the Bankruptcy Act
and does not take care of matters that we are to
reach. Now my bill contains everything that the
bill as well as the Chandler Bill.

H.M.Jr: Now Mr. Sabath, would you mind if I had Mr. Landis
get in touch with you.

S: Well all right, I think I talked to Mr. Landis and
is he the man to talk to or is it Professor.....

H.M.Jr: Well I think Landis. Supposing I call up Landis
and ask him to call you.

S: Now there - there - I think the President has
been misinformed. I tell you honestly they -
the bill that Chandler introduced is the Commercial
which is composed of the Bankruptcy
Committee of the National Bar and the
Association and Association; it's the
same gang, same clique that has
and these will never wide open
I'm trying to eliminate the damned abuse and At least

- 2 -

and at the same time it will make it applicable to - ah - smaller corporations as well those over 5 million dollars. There's more abuse in those small issues even than in the big.

H.M.Jr: Well.....

S: Now I'll appreciate it if you'll talk to Mr. Landis. He and I are all right.

H.M.Jr: Well I'll - I'll talk to him at once and ask him to get in touch with you and see if.....

S: Will you please?

H.M.Jr: At once.

S: I'll appreciate it very much. You see I worked like a slave on this thing here and, of course, the lawyers there in the Judiciary Committee like to kill everything and this thing here may kill the legislation and while I was hearing thinks my bill was reported out when the word came from the White House.

H.M.Jr: Yes, well let me get in touch with him right away.

S: All right, thank you very much.

H.M.Jr: Thank you.

May 26, 1937.
12:06 p.m.

H.M.Jr: Hello

Operator: Dr. Burgess will be back from lunch in an hour.

H.M.Jr: I'll call later.

O: Right.

2:14 p.m.

H.M.Jr: Hello

O: Dr. Burgess.

Burgess: Oh hello, sir.

H.M.Jr: How are you?

B: I'm pretty well thanks, and you?

H.M.Jr: Ah - oh I'm all right. Dan and I are sitting here just talking.

B: Yes.

H.M.Jr: Got nothing to do.

B: (Laughs) That's swell.

H.M.Jr: And we wondered what you knew about government financing.

B: Well I don't know very much about it but it looks to me as though you could - ah - it would probably be wise not to do anything over five years.

H.M.Jr: Ah-ha.

B: I've been playing with the idea of whether you could do an intermediate bond issue but - ah - the way the thing looks now I think it might not be wise.

H.M.Jr: Ah-ha.

- 2 -

B: Ah - I think you could do a five year note; I think it might perhaps be wiser on the present look out to split it between a five year note and, say a 2-1/4 or a 3-1/4.

H.M.Jr: Ah-ha.

B: And have about half of each.

H.M.Jr: You know that little wrinkle - did I make that suggestion to you?

B: No, what is that?

H.M.Jr: Well let's say for argument we want 800 million, see?

B: Yes.

H.M.Jr: And we'd have two notes.

B: Yes.

H.M.Jr: And let the investor decide which one they want.

B: Ah - Henry, I have a little doubt about that.

H.M.Jr: Ah-ha.

B: Because they like to know what quantities of each is going to be put out.....

H.M.Jr: Yes.

B:because it affects the value.

H.M.Jr: Yes.

B: I think we have done that once.....

H.M.Jr: Yes, we've done it twice.

B:or twice but I think on the whole it's - ah - it's less desirable than indicating how much you take of each.

- 3 -

- H.M.Jr: But you - ah - you don't find anything but what everybody tells you, don't they, if the price is right it will go.
- B: I think that's right, yes. They're - some of them are a little hesitant about the five years.
- H.M.Jr: Yes.
- B: And I don't take them very seriously.
- H.M.Jr: Yes.
- B: I think that these fellows have got to have a lot of governments to earn their living in these banks and they've got to have something that yields something.....
- H.M.Jr: Yes.
- B:so I'm pretty sure they'll take a five year note.
- H.M.Jr: Ah-ha.
- B: Now they're very keen on more short stuff.
- H.M.Jr: Yes.
- B: Of course, the way the Treasury bills have been going indicates that.
- H.M.Jr: Yes.
- B: So that a two or three year note would go very well; would go even better than a five. So just to make it certain if - when we're doing it right now I'd split it between the two.
- H.M.Jr: Yes, well now this week I've seen a lot of bankers, see?
- B: Yes.
- H.M.Jr: And next week I'd like to see the government dealers.....
- B: Yes.

- 4 -

H.M.Jr:and I'll let you fix that up.

B: All right.

H.M.Jr: And I thought we might start Wednesday afternoon - take a peek on Wednesday afternoon - Wednesday evening maybe.

B: Wednesday evening.

H.M.Jr: And then just - rest up Thursday.

B: Yes.

H.M.Jr: So you might be thinking about it and we could make the appointment say on Tuesday - you let me know.

B: Yes.

H.M.Jr: I'll let you make those arrangements.

B: All right, now you see Discount, First Boston.....

H.M.Jr: Might as well see all five, hadn't I?

B: Ah -

H.M.Jr: I could see two on Wednesday and three on Thursday, if you want me to.

B: Yes, all right, well let me go over that pretty carefully.....

H.M.Jr: Yes and let me know.

B:and see who just the fellows are.

H.M.Jr: Yes, I've seen all the bankers I want to by the time I get through this week.

B: They've had a clean-up over in Childs; they've got a new lay-out there now.....

H.M.Jr: Ah-ha.

B:and it's much more satisfactory than the old.

- 5 -

H.M.Jr: Well Childs brought his New York Manager down here and introduced him to me.

B: Is that Swyhart?

H.M.Jr: Yes.

B: He's a very nice fellow.

H.M.Jr: How do you pronounce his name?

B: Swyhart.

H.M.JrL Yes.

B: S-w-y-h-a-r-t.

H.M.Jr: Yes.

B: Yes, he's a very nice fellow.

H.M.Jr: Yes.

B: And we're very well satisfied that he's made a change.

H.M.Jr: Yes.

B: In fact we had something to do with it, you know.

H.M.Jr: You did. Well you - ah - I'll talk to you again this week but you let me know Tuesday.

B: Ah- what banks have you seen, Henry?

H.M.Jr: I've seen the Central Hanover.

B: Ah - Davidson?

H.M.Jr: Yes. Potter of the Guaranty.

B: Yes.

H.M.Jr: And - ah - I'm going to see Rentschler of the City.

B: Yes.

H.M.Jr: That's all.

- 6 -

B: Well you got about the same stories from them, didn't you?

H.M.Jr: No, they - ah - about - but they don't - ah.....

B: They're a little afraid of five years, aren't they?

H.M.Jr: Yes.

B: Well I thought that was so.

H.M.Jr: Yes.

B: I - ah - looking at it from a little perspective which I think I got from being away - I - I don't see that.

H.M.Jr: Yes.

B: And I think this decision Monday changes the tone of things a little bit.

H.M.Jr: Oh yes.

B: So that you've got a little firmer basis to walk on.

H.M.Jr: Yes.

B: It doesn't change quotations much but it feels a little better.

H.M.Jr: Good. Well take care of yourself.

B: All right, fine.

H.M.Jr: Goodbye.

B: Goodbye.

May 26, 1937

The following was related to Magill after the Secretary came back from the White House at 2:30.

"I walked over uninvited to see the President and told him I had come to call on my friend to see how he was feeling. And the man over there had said, Don't stay more than three or four minutes because he wasn't supposed to see anybody.

"I went in and the President said, Sit down. I will tell you all about it. He told me, I had Harrison and Doughton here for an hour this morning and told them all about these terrible people and he said I could not get them stirred up until finally I said to Pat Harrison, 'How many votes do you think is in this? At least 10,000,000.' Harrison thought and said, I guess that's right. I said, Mr. President, how did you arrive at the 10,000,000 figure. He said, I don't know, but it sounded good!

"So he says, Now they want Magill. They love Magill, but tell Magill not to let their love to to his head because next year they will hate him! So I said, I told you that when I wanted to bring him down.

"So he said, Send the letter over now and let me study it and then you and Magill come over at half past ten or eleven tomorrow. And he said, This is the way it will go -- I send the letter, then the publicity, then the appointment of a Joint Committee of Investigation, giving the money to the Secretary of the Treasury to conduct the investigation and have Magill do it. Everything settled!

"I got up three times to go out because they told me he should be sleeping now. He said, Where's the letter? I said, I did not bring it. I didn't come to talk business; I didn't come to see the President of the United States.

May 26, 1937

Following his visit to the President today, The Secretary signed the attached letter to the President transmitting the report on the recent investigation of income tax returns for 1936 and letters of transmittal, for the President's signature, of letters to Senator Harrison and Congressman Doughton.

May 26, 1937.

My dear Mr. President:

Complying with your request I am sending you herewith, by hand, a report on our recent investigation of income tax returns for 1936 and letters of transmittal for your signature to Senator Harrison and Congressman Doughton.

Mr. Magill and I will be pleased to call on you any time tomorrow morning as convenient for you.

Faithfully yours,

The President,

The White House.

May 26, 1937.

My dear Mr. President:

Complying with your request I am sending you herewith, by hand, a report on our recent investigation of income tax returns for 1936 and letters of transmittal for your signature to Senator Harrison and Congressman Doughton.

Mr. Magill and I will be pleased to call on you any time tomorrow morning as convenient for you.

Faithfully yours,

The President,

The White House.

My dear Mr. Chairman:

The Secretary of the Treasury has transmitted to me a report indicating the principal methods of tax avoidance which the preliminary investigation of the individual income tax returns for 1936 has disclosed. I am enclosing a copy of this report for your consideration. The Treasury Department will be glad to supply you, at your convenience, with the details of the various transactions which are summarized in the report, as well as with any other information which you or your Committee may wish to have.

Sincerely,

The Honorable Pat Harrison,
Chairman, Committee on Finance,
United States Senate.

W:cc

My dear Mr. Chairman:

The Secretary of the Treasury has transmitted to me a report indicating the principal methods of tax avoidance which the preliminary investigation of the individual income tax returns for 1936 has disclosed. I am enclosing a copy of this report for your consideration. The Treasury Department will be glad to supply you, at your convenience, with the details of the various transactions which are summarized in the report, as well as with any other information which you or your Committee may wish to have.

Sincerely,

The Honorable Robert L. Doughton,
Chairman, Ways and Means Committee,
House of Representatives.

RD:cc

MEMORANDUM TO THE PRESIDENT:

As soon as the returns of 1936 incomes were filed, the Bureau of Internal Revenue undertook an immediate investigation and audit of typical tax returns showing large amounts of income, in order to determine whether the Revenue Act of 1936 was operating effectively and fairly. Since most of the returns of large manufacturing corporations have not yet been filed it is not possible as yet to present any conclusions with respect to the operation of the 1936 law as to them. The investigation to date has disclosed that taxpayers have utilized existing devices for tax avoidance to an increasing extent, and that the loss of revenue occasioned thereby is becoming more and more serious.

The principal devices which are now being employed by taxpayers with large incomes for the purpose of defeating the income taxes which would normally be payable by them, are the following:

1. Foreign personal holding corporations organized in the Bahamas, Panama, and Newfoundland, where taxes are low and corporation LAW TAX

Americans have formed 64 such companies in the Bahamas alone in 1935 and 1936, and 22 more were organized by Americans in the Bahamas during the past six weeks. Panama and Newfoundland seem to be even more fertile territory since their corporation laws make it more difficult to ascertain who the actual stockholders are. Moreover, the stock-

- 2 -

holders have resorted to all manner of devices to prevent the acquisition of information regarding their companies. Thus, one wealthy woman originally organized her personal holding company in the Island of Guernsey, and then moved it to Panama. She keeps the corporate books in Newfoundland. Another individual has a \$3 million Bahamas corporation and in an attempt to prevent the Bureau of Internal Revenue from catching up with him, moves his home address from one small hamlet in Canada to another in the United States each year. Another individual believes that he has been so successful in removing his assets from the United States to the Bahamas that he is defying the Treasury to collect a tax upon a \$250,000 fee he has received; and by way of insult, he has offered to compromise his admitted tax liability of \$33,000 for past years by a payment of \$1700.

Still another individual showed a large net loss on his personal return for 1936. In considerable part, the loss was due to the large deduction he claims for interest on a loan made to him by his personal holding company. But the man in question is no object of charity, for his personal holding company, organized in Canada, had an income of over \$1,500,000 from American dividends in 1936, though it has not yet filed a return.

Perhaps the most flagrant case of this character is that of a retired American Army officer with valuable American securities which he desires to sell. To insulate himself from our tax laws, he suddenly became a naturalized British subject, and six days later organized four

- 3 -

Bahamas corporations to hold his securities. He and his lawyers think that he can now sell his securities free from American taxes on his profits.

2. Foreign insurance companies

Two New York insurance agents have caused the organization of insurance companies in the Bahamas with a view to enabling taxpayers to secure fake deductions for interest through an ingenious scheme for the issuance of life insurance policies. Americans who went into the scheme purported to pay a large single premium for their policies, but immediately borrowed back practically the entire sum. Under the plan the so-called policyholders sought to obtain a large deduction for interests on this loan, although the fact was that no interest was really paid. By this means five Americans sought to evade nearly \$550,000 in income taxes in the years 1932 to 1936. This fraud was discovered by the Treasury's investigators and all of the taxpayers have now submitted offers to pay the full amount of taxes evaded, plus interest.

3. Domestic personal holding companies

The rates of tax applicable to personal holding companies were reduced in 1936 and are not now sufficiently high to discourage the use of such companies as a means of avoiding the surtaxes. The personal holding companies whose returns have been examined by the Treasury would have paid 51.7 percent more in taxes on their 1936 returns if the applicable tax rates had not previously been reduced. Thus, one large personal holding company distributed none of its income in 1936; and its sole

- 4 -

stockholder saved \$322,958 in taxes. In another case, a man and his wife saved \$791,000 through the use of personal holding companies in 1936. In a third case, the personal holding company reported over \$500,000 of net income but the total taxes paid by the two stockholders were less than \$60,000, due principally to credits for payments on indebtedness the holding company prudently incurred in accumulating properties for its owners.

Another favorite device is to organize a considerable number of personal holding companies, not only for the sake of reducing the tax but of increasing the Treasury's difficulties in auditing transactions between companies. At last accounts one man was interested in some 96 companies scattered all over the country; two other individuals were utilizing 23 personal holding companies.

4. Deductions for personal expenses

Our income tax laws expressly deny any deduction for personal expenses or living expenses in computing taxable net incomes. If this were not true, the principle of taxation in accordance with ability to pay could readily be defeated. Yet many wealthy taxpayers today are dodging these express provisions of the law by incorporating their yachts or their country places, along with securities yielding an income sufficient to pay the entire expenses of operation. Hundreds of thousands of dollars in income taxes are annually saved in this way. One wealthy woman has improved on the general plan by causing her personal holding company, which owns her country place, to employ her husband at a salary to manage it. She can thereby supply him with pocket money, and in effect secure

- 5 -

a deduction for the expense of maintaining him. In a similar category are the deductions some individual taxpayers are taking for interest on loans to them by their personal holding companies, and for interest on loans to them by their family trusts.

5. The creation of multiple trusts for relatives and dependents

Splitting income two ways, between husband and wife, reduces income taxes and leaves the family income intact. Splitting the family income many ways by means of many trusts, all for the same beneficiaries, may effect a much greater saving, while leaving the money actually in the same hands. For the creator of the trust often constitutes himself or his wife as trustee, and thus retains full control over the investment and disposition of the fund itself and of its income. One thrifty taxpayer has formed 64 trusts for the benefit of four members of his immediate family, and thereby claims to have saved them over \$485,000 in one year in taxes. Another thrifty pair have constituted 40 trusts for their relatives, and a prominent lawyer and his wife utilize 16 trusts for the same purpose. Numbered brokerage accounts are maintained, and only at the end of the year are the beneficial owners identified. In this way innumerable transactions are carried on, often between accounts, which do not actually affect the beneficial interests of their owners, but which are designed solely to reduce tax liability.

6. Percentage depletion

This is perhaps the most glaring loophole in our present revenue laws. Since 1926, the large oil and mining corporations have been entitled to deduct from 5 to 27½ percent of their gross income as an allowance

for the depletion of their mines or wells, and the deductions may be taken even though the cost of the property has been completely recovered. Thus, in 1936, one mining company deducted nearly \$3 million under this provision, although it had already completely recovered the cost of its property. The amount of the deduction was a sheer gift from the United States to this taxpayer and its stockholders and the revenue that we lost thereby was \$318,517. Similar annual losses of revenue in the cases of a few other typical companies are \$564,000; \$557,000; \$512,000; \$272,000; \$267,000; \$202,000; and \$152,000. The estimated annual loss of revenue due to this source is about \$75,000,000. The Secretary of the Treasury recommended in 1934 that this provision be eliminated but nothing was done, presumably because of the heavy pressure from the large oil and mining companies which are profiting immensely at the expense of other taxpayers.

7. The division of income between husband and wife, particularly in the 8 community property states

This is another major cause of revenue loss, which is particularly unjustifiable because obtained at the expense of taxpayers in the 40 states which do not have community property laws. A New York resident with a salary of \$100,000 pays about \$32,525 Federal income tax; a Californian with the same salary may cause one half to be reported by his wife and the Federal income taxes payable by the two will be only \$18,626. The total loss of revenue due to this unjustifiable discrimination against the residents of 40 states runs into the millions.

Such legalized avoidance breeds outright evasion. Recently professional men in other states have attempted to secure a similar tax

- 7 -

saving by taking wives and minor children into partnerships. Thus, the Treasury has unearthed the case of a New York brokerage firm which late in 1935 admitted into partnership the four minor children of one of the partners, two boys and two girls.

5. Increasing purchases of tax-exempt bonds by wealthy citizens

The last statistics which we have show enormous holdings of tax-exempt state and municipal bonds by our wealthiest citizens. Our records are very incomplete since these individuals do not report fully what their actual holdings are. Such returns as we have checked for 1936 indicate a gradual increase in these holdings. Until the United States is empowered to tax the interest on state and municipal bonds like other forms of income, the higher surtax rates cannot be made effective.

* * *

In conclusion, I have two observations to make from the evidence before me. In the first place, the instances I have given above are disclosed by a quick check of comparatively few individual returns. Most of the large corporation returns have not yet been filed. The general audit of 1936 returns is just beginning. Nevertheless, it is likely that the cases I have digested above are symptomatic of a large number of others, which will be disclosed by a careful audit. In the second place, the ordinary salaried man and the small merchant does not resort to these or similar devices. The great bulk of our 5,500,000 returns are honestly made. Legalized avoidance or evasion by the so-called leaders of the business community is not only demoralizing to the revenues; it is demoralizing to those who practice it as well. It throws an addi-

- 5 -

tional burden of taxation upon the other members of the community who are less able to bear it, and who are already cheerfully bearing their fair share. The success of our revenue system depends equally upon fair administration by the Treasury, and upon completely honest returns by the taxpayers. We have a right to expect higher standards of morality in high places than the 1936 returns disclose.

MEMORANDUM ON SPECIAL LETTER TO THE PRESIDENT

The special letter which was signed by Secretary Morgenthau to the President was turned over to Chief Wilson at 3:10 and in my presence he turned it over to Bowen and I asked Bowen to let me know what Agent would take it over. He made a telephone call and told me Agent John Brooks would deliver it to Mr. Muir personally, as per my notation on the envelope. Mr. Bowen is to report back to me when the envelope has been delivered to Mr. Muir. Delivered to Mr. Muir personally at approximately 3:20 this afternoon.

McH

May 26/37

May 26, 1937

Excerpt from Mr. Magill's memo to the Secretary dated May 26, 1937, entitled, "Memorandum of the Day's Activities":

2. Taxation of non-resident aliens

I have discussed the practical questions involved in increasing the rate of tax upon wealthy non-resident aliens with Messrs. Kent, L. H. Parker, and Zucker. Mr. Kent is considering administrative machinery to prevent evasion. Mr. Zucker is collecting the answers to Dr. Viner's questions.

Mr. Tarleau, my assistant, suggested as a revision of my original idea the following plan: Continue the present withholding provisions and 10 percent rate, but provide that any non-resident alien receiving more than \$25,000 of American income, including capital gains, shall file a return and pay the additional tax shown to be due, at the rates applicable to American citizens. The 10 percent tax already withheld would be a credit against the tax shown to be due on this return. The merit of this proposal is that we are assured of as much revenue as we will receive under the present law, plus the higher rates of tax which we collected under prior laws from wealthy non-resident aliens receiving income from American trusts, etc. I proposed this plan to Dr. Herbert Feis over the telephone and he thought the State Department would have no objection to it. He will advise me tomorrow what Secretary Hull thinks.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE May 26, 1937.

TO Secretary Morgenthau

FROM Mr. White

Subject: Question re. Russian gold production in conversation between Secretary and Mr. Oumansky.

1. Did the Secretary ask Mr. Oumansky how much gold U.S.S.R. has and how much she is producing?

No, not directly. Almost all of the discussion was concerned with (a) the reason for U.S.S.R. gold sales here; (b) information as to the reason for the selection of that particular channel of sales; (c) the definitely expressed suggestion that cooperation between Russia and the United States with respect to gold would be beneficial to both countries.

2. Did the Secretary ask for information on Russian gold production and holdings indirectly?

In a way, yes. The one statement in the whole interview which comes closest to a direct question is as follows: (Quoted from pages 5 and 6 of the transcription.)

"HM, Jr: But where your Government has such a tremendous stake -- you understand what I mean?

Mr. Oumansky: Yes. Yes.

HM, Jr: in this present medium of exchange in the world -- gold -- then it is to your interest to cooperate and make gold valuable and not to do everything possible

Mr. Oumansky: To depreciate it.

HM, Jr: Yes. That's the whole story.

Mr. Oumansky: You express the idea perfectly,
Mr. Secretary.

Secretary Morgenthau - 5/26/37 - 2.

HM, Jr: Well, you can say, 'If you don't want to buy it, all right,' and so forth and so on. 'How much gold we have is our business. How much gold production there is, is our business.' That's all right; if that's the position of your Government, all right. But it seems to me that the contrary should be the answer.

Mr. Oumansky: I understand perfectly."

3. Can we reasonably expect the U.S.S.R. to tell us what their production and gold holdings are on the basis of what has already been asked?

I don't think so. The statement marked with red above might legitimately be treated by Oumansky as not being the important question emerging from the interview. It is even possible that Mr. Oumansky lost sight of that question and concentrated on the specific questions asked him.

4. Ought we to ask the question specifically?

I think it is important that we ask the U.S.S.R. the specific question:

(a) "What has been your annual production of gold and what do you expect your annual production of gold to be in 1937?" I believe this question should be asked as soon as feasible. Once in the possession of that information, we would be in a better position to proceed, if necessary.

(b) It would also be helpful if we could find out how much gold they have now. They might object to answering that question on the grounds that their gold is a "war chest". Yet I think the question should be asked.

May 26, 1937

3 p. m.

Present:

- Ambassador Troyanovsky
- Mr. Oumansky
- Mr. Taylor

Ambassador: I represent Mr. Oumansky! He knows better the financial program.

HM, Jr: He and Mr. Taylor can help us both out.

Mr. Oumansky: I just took two lessons from Mr. Taylor!

HM, Jr: We can all learn.

Ambassador: Yes, we could.

HM, Jr: Mr. Ambassador, the reason I asked you to come down was this. Since our last talk I have been doing a lot of thinking, about this question of relationship between your Government and ours, and I think that when Mr. Latvinoff was here, in the small part I played in the preliminaries I think at that time he had confidence in what I was trying to do.

Ambassador: Yes.

HM, Jr: And I think -- I know, I had confidence in him. Now, I am going to talk very frankly -- the two Governments are not getting any closer together.

Ambassador: Uh-huh.

HM, Jr: And what I would like to do, if your Government will encourage me, is to attempt through this discussion of finances to see if we can't come to a general understanding. Now, I don't start something like this unless I first talk to our President.

Ambassador: Uh-huh.

HM, Jr: And he is more than pleased to have me do this and I am only interested in the financial end, the monetary end. I am not interested in trade treaties or anything like that. I am just interested

-2-

Ambassador: . . . in the finances.

HM, Jr: In the finances. If you have troubles on coal, that's another Department.

Ambassador: It's connected with your Department too.

HM, Jr: It's the State Department's responsibility. I am quite interested. I am not going to make it more difficult for you. But I am just using that as an example. I know they are talking to you about coal, but I want to confine myself, just as I have in the contacts with the English, the French, and Chinese and Mexican and the Canadians, Belgium, Holland and Switzerland -- it's always been just on money. And the State Department, it's entirely agreeable to them. Now, naturally, you will want to talk to your Government and find out if they want . . .

Ambassador: . . . to do something.

HM, Jr: To do something. Now, what am I trying to do? We talked about gold -- foreign exchange. Just as a matter of interest, you pick up -- here are two English papers. Here's the London Financial Times. I mean, if you look at those papers, they are just full of Russian gold.

Ambassador: Yes.

HM, Jr: Here's one of the 18th. Gold. If you go through the thing . . .

Ambassador: It is always gold.

HM, Jr: Gold. Russian gold. It's just -- I believe this is the leading financial paper in London.

Mr. Oumansky: Oh, yes!

HM, Jr: Take them, if you would like to take them.

Ambassador: Yes?

HM, Jr: It's an unknown quantity. Now, for this conversation, I took a look at platinum, of which you are a big producer.

Ambassador: Yes.

-3-

HM, Jr: And in 1924 (I went back 10 years) platinum was worth \$120.00 an ounce, and then it got down to \$30.00 an ounce in 1933 and today it's \$43.00.

Ambassador: Yes.

HM, Jr: But the man did not know why I wanted it. From here on, 1927, Russian production (indicated by gestures.)

Ambassador: We stopped our exportation.

HM, Jr: But no one knows what your production is. The thing that worries people is they don't know. Now, gold, platinum, silver, particularly gold, is used for payment of balances and you are supposed to be the second biggest producer, but nobody knows. And, as I told Mr. Oumansky, if gold is going to be continued to be used as a method of paying for goods, you don't want and we don't want people to lose their interest in gold; lose their taste for it. I mean, there is all this talk all the time about we are not going to be as interested in gold because they can't see it; they don't feel it; they don't know what it is.

Ambassador: It's in our cellars.

HM, Jr: It's in our cellars. And we are like squirrels -- we take it out of one hole and put it in another. Well, there's some truth in that.

But what I am leading up to is this: if we could have a free exchange of information, the way our Bureau of Mines publishes all these statistics, and we could work out together mutual problems on this thing -- what are we going to do about gold? -- looking towards the future, I should think it would be most useful to both Governments.

Ambassador: I don't know. At present time nobody knows what production of gold we have. Maybe if it is published fact, maybe it will be published with some disturbance.

HM, Jr: No. The worst thing is the lack of knowledge. I don't care how big your production of metals is, it's the unknown factor that worries the people. I mean -- I want to make myself -- I feel that we can, to use a poker term, can sit in this game as long as anybody.

Ambassador: Uh-huh.

-4-

HM, Jr: We have our Stabilization Fund of \$2,000,000,000 intact. We are going along well. We have, I think, less worries than most Governments, in relation to other Governments, by comparison.

Ambassador: Yes.

HM, Jr: And I am not doing this because I have any immediate worry, but I am looking to the future and I can see a great deal of good might come out of it from both Governments gaining sufficient confidence. At the beginning we might just exchange information. After all, your Government is so constituted that you can keep things secret and the United States Treasury is so situated that we can keep it secret. The fact that we could keep

Ambassador: You mean only for mutual information? Not for outside?

HM, Jr: At the beginning, only for the information of myself and the President. At the beginning. So that if you had it and said, Now, Mr. Morgenthau, here's the picture

Ambassador: But maybe you don't know. We have four aces. You have interest in the game. But once you know

HM, Jr: I don't know that you have four aces, but I don't know how many chips you have got. I don't know how many chips you have got and what your chips are made of. I don't know whether they are ten-cent chips or dollar-chips. And this is finance. It's the biggest game in the world. And up to now England has always played it alone and London has always dictated. I mean the idea that we should make the price of silver here instead of London was unheard of. These four men get together every morning and make the price of silver. They said, You tell us how much silver you have to sell and we will make you a price. And I said no. No, we will do it the other way round. You give us the price first. We have never done business that way. And for three days we did no business. I said, I am not going to let you take it and juggle it and then give us a price afterwards.

Whether this thing fits into the picture looking four or five years ahead, your Government knows. I don't. But frankly, talking for myself, it seems that we are less close today than we were before we had recognition. There have been some misunderstandings.

-5-

Ambassador: I don't say. I can't tell, because the atmosphere is more favorable generally now than before. We can talk. We can look for a solution of certain problems.

HM, Jr: Maybe that's too strong a statement. When I say that I mean I ought to limit that to myself. But I don't feel that we are getting any closer.

Ambassador: Of course, I think that something must be done in order to make our relations closer, but of course I am not able to say, not entitled to say, anything positive at the present moment.

HM, Jr: I would not expect it. But I am making it much stronger than when I talked with Mr. Oumansky because I did not have authority to go as far as I have now. But I have been thinking about this for months now and it seems the more I think about it, looking at it selfishly, it's good for us and I can't see why it isn't good for you, that you would not have just as much to gain as we would, and therefore it looks as though it ought to be good. I have tried to see why wouldn't it be good for the Russian Government and I can't see any reason why it should not.

Ambassador: You are talking about reserves and it's more advantageous for you, of course.

HM, Jr: You produce more gold than we do.

Ambassador: Oh, yes!

HM, Jr: At least we think you do. We don't know. We have more, but we think you produce more.

Ambassador: Yes, I think so.

HM, Jr: We think you are second to the British Empire.

Ambassador: Maybe we will be the first.

HM, Jr: Maybe. And the only use gold can be to you is to buy things in the world's market.

Ambassador: Yes. Of course. Production of gold without use of it, it is not profitable business.

HM, Jr: Maybe you would like to ask me something. I have been doing a lot of talking.

-6-

Ambassador: I wish to know if our Government accept your suggestion and give you information, but really would it be kept in secret?

HM, Jr: Could it be kept in secret here? Absolutely! Absolutely!

Ambassador: You will pledge that?

HM, Jr: Yes. If that's the way you want it, it could be absolutely secret. We have kept other secrets. We can do it here. I can make the flat statement that we could do it.

Ambassador: Of course, our Government has already showed its willingness to cooperate with this gold business, but if it will even go so far as to give you this information, I don't know.

HM, Jr: It just isn't that I want information. It's the idea -- here, if you take the British Empire, the Soviet Republic and ourselves, we pretty well could control

Ambassador: Uh-huh.

HM, Jr: Now, you have done business with the British and you know how they do business. I have done business with them. I think, I believe your people are interested in peace.

Ambassador: Yes.

HM, Jr: We are interested in peace. The reason they didn't have a war in Europe last Fall, in my belief, was because we saved France. All of our Navy people all thought there would be war last September. I don't know what your people thought, so much so it has been overlooked, but for the first time in years the President re-created the European Fleet; sent four battleships to Europe to be ready to take American refugees out of France. That's how serious we thought it would be. We had four battleships off Plymouth to take American refugees out of France. It was the monetary thing that saved France. And I look at it as an instrument of peace.

Ambassador: Certainly it's most important. I will convey your suggestion to my Government in the hope that it will be

-7-

some step in the way of certain contact.

HM, Jr: It just isn't that I want to know how many ounces. After all, go a step further. Take a look at China. Look at the chances I took with China when we made those loans and gave them that assistance. The Chinese tell us we saved them. And they are getting stronger every day.

Ambassador: Yes, but our Army contributed a little bit.

HM, Jr: I mean from a monetary sense. A weak China in the Pacific, you and yourselves would both have had trouble. Right?

Ambassador: Certainly. Certainly.

HM, Jr: It may be I am overstating. But a weak China and we would both have had trouble.

Ambassador: Certainly.

HM, Jr: And with China growing stronger assures Russia and the United States of peace in the Pacific. Right?

Ambassador: Yes.

HM, Jr: So we have a common interest there.

Ambassador: Yes; that's true.

HM, Jr: And everywhere I look -- as one naval officer put it, Russia and ourselves have the same common enemies.

Ambassador: Yes; more or less true.

HM, Jr: Looking all around the world.

Ambassador: The same situation in Europe, almost.

HM, Jr: Now, if we can just work this thing and keep -- all I am responsible for is finance.

Ambassador: But finance is a part of general politics, of course.

HM, Jr: And if we can keep this thing growing steadily, why

-8-

the chances for war will be less.

Ambassador: Will be less.

HM, Jr: Because the fact these people can't borrow here, the fact that they owe us money here, is good because they can't borrow; can't borrow to make war. But I wanted to take a little time to explain. It's not that I want a lot of statistics.

Ambassador: Along general lines, I should say.

HM, Jr: Yes.

Mr. Oumensky: The first answer was probably satisfactory. The reaction of our Government to your first suggestion?

HM, Jr: Fine! I think we have made steps. I reported that back to the President. I said, Now, we have gone this far; I feel the Russian Government wishes to

Ambassador: Of course our Government is ...

HM, Jr: I said I would like to go much further. He said all right. Just as you said, I think our conversations were so helpful that I felt encouraged. I want to go further and I may not always say a thing very diplomatically, but my objective is, through finance, is world peace.

Ambassador: Yes. Of course, if you can cooperate; have some contact, it will be helpful for world peace and can better the general situation.

HM, Jr: When I am talking about this, I don't want to trade on anything else. You understand?

Ambassador: Yes.

HM, Jr: Any more than when we went in with the Chinese Government. It was purely financial and we got no concessions; did not ask for anything; don't want anything. I don't mix with this anything else. Anything the State Department may have is entirely separate from what I have. From all I know, I hope while I am talking about this --they may do something which would seem we are working in the opposite direction.

Ambassador: Of course, we are in strong position in the

-9-

world affairs, but still we are ready to cooperate.

HM, Jr: You are in a very strong position and I think you will get stronger as time goes on and I recognize that. I think it would be stupid not to recognize that.

Ambassador: All right. I will convey the message and maybe something come out.

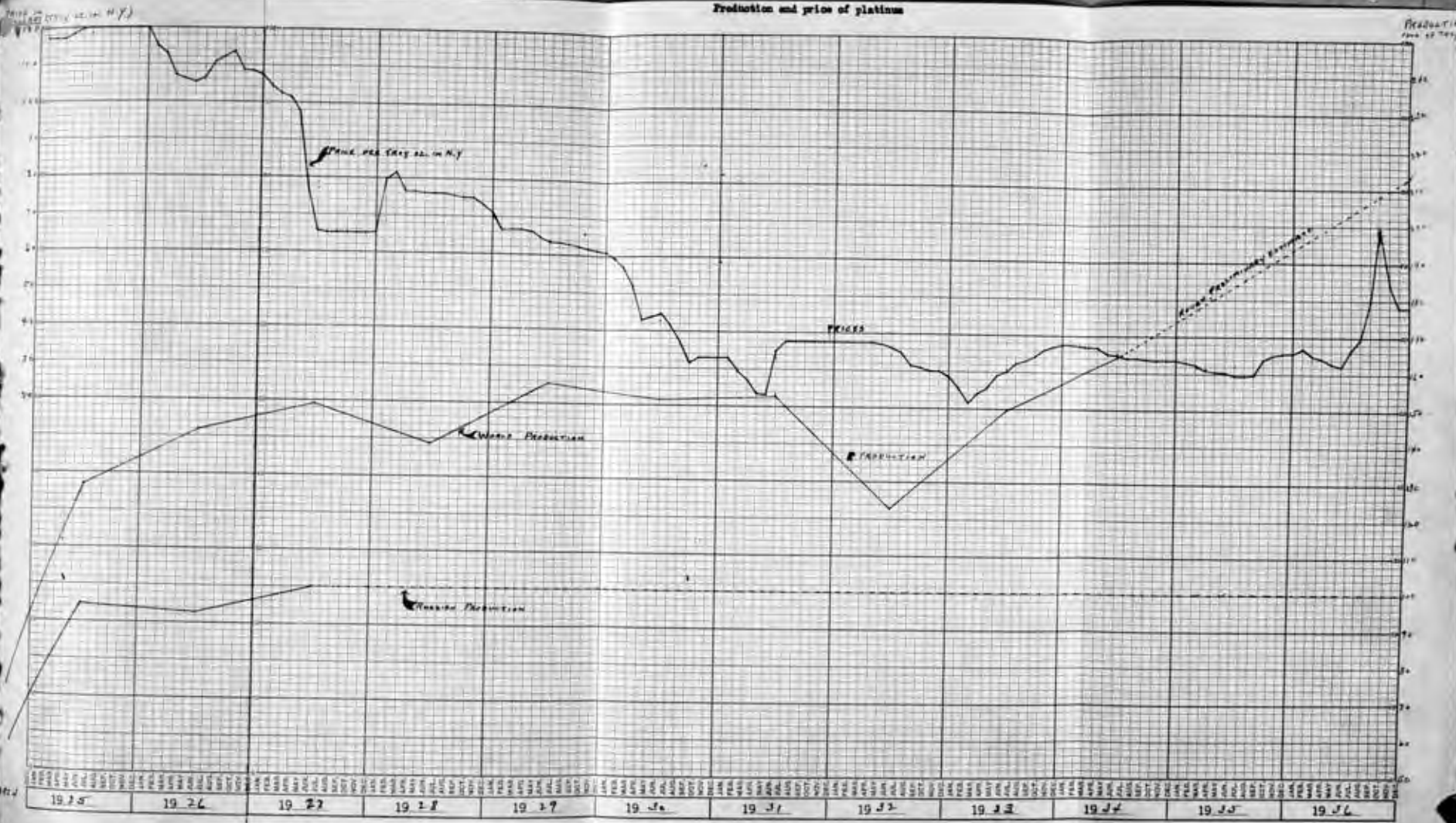
HM, Jr: And I will leave it this way: when you hear, you give me a telephone call and if you have anything -- well, just let it go that way.

Ambassador: I leave probably for vacation the end of June.

HM, Jr: I am here until the end of July.

oOo-oOo

Production and price of platinum



19 25	19 26	19 27	19 28	19 29	19 30	19 31	19 32	19 33	19 34	19 35	19 36
-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------

Platinum Prices in New York
(In dollars per troy ounce)

	1924	1925	1926	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937
January	122	117	115	104	79	66	59	33	37	26	37	33	36	50
February	125	117	113	102	82	66	57	29	37	22	37	32	35	64
March	122	117	107	102	77	66	52	27	37	24	37	31	34	58
April	116	118	106	97	76	66	43	23	37	26	37	30	32	58
May	116	120	105	77	76	65	44	23	37	29	35	30	32	
June	116	120	106	66	76	63	44	35	36	30	35	29	36	
July	118	120	111	66	76	63	41	37	35	32	34	29	39	
August	120	120	112	66	76	63	37	37	31	33	34	30	49	
September	119	120	114	65	75	62	32	37	31	34	34	34	68	
October	118	120	109	65	75	62	33	37	30	36	34	35	54	
November	118	120	108	65	73	61	33	37	30	37	34	35	48	
December	117	120	107	66	71	61	33	37	28	37	34	35	48	
Average	119	119	109	78	76	64	42	33	34	30	35	32	43	

Treasury Department, Division of Research and Statistics.

May 26, 1937.

Price taken to nearest dollar.

Estimate of
World and Russian Production of Crude Platinum

	<u>World production</u> (in ounces)	<u>Russian production</u> (in ounces)
1924	72,615	56,900
1925	126,597	94,800
1926	141,958	92,700
1927	149,275	100,000
1928	138,613	*
1929	155,482	*
1930	151,796	*
1931	152,829	*
1932	123,147	*
1933	149,815	*
1934	164,107	*
1935	176,200 (Preliminary)	*
1936	195,000 (Preliminary)	*

* No authentic statistics of production of platinum in the U.S.S.R. are available. However, it is generally estimated that an annual output of 100,000 ounces of crude platinum has been maintained, according to the Minerals Yearbook. But there is every reason to believe that Russia has greatly increased her production of platinum (a) because her methods of production of the precious metals is greatly improved, and (b) because there has been a very extensive and intensive exploitation of all mineral resources in U.S.S.R.

May 26, 1937.
3:32 P.M.

H.M.Jr: Hello.
O: Senator Wagner can't talk to you for five minutes.
H.M.Jr: All right.
O: I'll call you.

3:35 p.m.

H.M.Jr: Hello
O: Senator Wagner - go ahead.
H.M.Jr: Hello
Wagner: Yes, hello Henry.
H.M.Jr: How are you Bob?
W: I'm all right, if you'd leave my Housing Bill alone.
H.M.Jr: I'd leave it alone?
W: Yes (laughs) no, I'm not so hot yet; I'm coming back but it's a little slow; I'm still a little weak now and then, don't you know.
H.M.Jr: Oh I'm sorry.
W: But I'm quite better than I was - very much than I was.
H.M.Jr: Well the reason I'm calling you is this. Ah - by Tuesday I'll be ready and I'd like very much to have a chance to see you.
W: All right.
H.M.Jr: See?
W: Ah - Tuesday - that's the day after Decoration Day.
H.M.Jr: That's right.

- 2 -

W: Will you surely be back - ah - and sober.

H.M.Jr: Well I'll be back; I don't know whether I'll be sober.

W: Well I'm - because I'm going to New York.....

H.M.Jr: Yes.

W:and I was hoping you could make it - could you make it in the afternoon?

H.M.Jr: Anytime that suits you.

B: On Tuesday - say we make it - ah - about 3 o'clock.

H.M.Jr: 3 o'clock - where.....

W: Well I'll drop over in your office.

H.M.Jr: That would be very nice.

W: And I'll - I'll bring my young and brilliant Secretary along with me whose got some of the detailed figures I may not have.

H.M.Jr: Fine.

W: There's no objection to that.

H.M.Jr: Anybody you want, Bob.

W: Well that's all.

H.M.Jr: Thank you.

W: Thank you very much.

H.M.Jr: Thank you, Bob, take care of yourself.

W: Thank you.

MEETING RE GOLD STERILIZATION AND FINANCING

May 27, 1937
9:35 A.M.

Present: Mr. Bell
Mr. Taylor
Mr. Lochhead
Mr. White

H.M.Jr: That first sentence is "fightin' words," isn't it?
(Referring to Summary on sterilization dated
May 27, 1937, attached) (p.150)

White: I'm sorry, Wayne didn't have a chance to change
much.

H.M.Jr: The way I read - "The program of sterilization has
been carried out."

Taylor: He had quite a few more in there that I was able to
eliminate in a short period.

White: But he didn't have long enough - my fault really.

(H.M.Jr reads Summary)

Bell: I don't think 2a is worth very much.

H.M.Jr: What?

Bell: I don't think 2a is worth very much as a statement of
fact.

White: 2a?

Bell: Yes

White: No, I left out the details; I've got it in another
sheet.

H.M.Jr: Now, what about "\$130 million was frozen"? I always
had a figure in my mind of 185 or 180.

White: Well, it really is 170, but Dan said 130. It doesn't
affect the net results, so I didn't....

Bell: What do you mean?

White: The gold in the working balance on December 23.

-2-

Lochhead: The gold in the working balance shows up about 190.

Bell: 175, but 104 million of it was national bank gold, 71 million was free gold. Now, about 30-some million has been switched from national bank gold to the general fund free gold. As national bank notes come in, we switch that gold from earmarked national bank to free gold general fund.

H.M.Jr: Well now, the free gold now is 131 million.

Bell: That's right, yes, sir.

H.M.Jr: Now, "held to retire national bank notes, 163" - that's sacred. "Increment resulting from reduction of gold dollar, 140" - what's that?

Bell: That's the 140 held in the Treasury to advance to Federal Reserve banks for loans to industry, and 23 million for redemption of bank notes.

H.M.Jr: I get you. Then the only free gold we could spend, if we want, is the 131.

Bell: That's right.

H.M.Jr: What?

Bell: That's right, we could spend 131.

H.M.Jr: What?

Bell: Yes, sir.

H.M.Jr: Well now, taking this fighting memorandum at its face value, as this new money came in if we permitted the excess reserves to fall through increasing our deposits with the System, then what? Is it your (Bell) idea to keep our deposits after we get this new money - to keep it with the Federal Reserve - to keep it between 75 and 125, to keep it just about that?

Bell: That's what I contemplated doing right along, regardless of this policy.

H.M.Jr: Keep it about on an even..... ?

-3-

Bell: Yes, sir.

H.M.Jr: And then the money we borrow - let's say we borrow 800 million dollars. Well now, that we borrow under what is called war loan?

Bell: We'll give the banks the privilege of paying for their subscriptions by crediting the war loan account. But I - but you can't control what they pay in cash. Now, our balances may at that time go above the 125 million.

H.M.Jr: What they pay with cash goes into the Federal Reserve....

Bell: ...banks to the credit of the Treasury account.

H.M.Jr: When that goes in, that brings the excess reserves down.

Bell: Yes, sir.

Taylor: But you draw down on that practically immediately, don't you?

H.M.Jr: Well, from reading this I would say that we had done about as good a job as we could have done. We can't hit it closer than 66 million.

White: We made no attempt to hit it identically.

H.M.Jr: Just good luck.

White: No.

H.M.Jr: Well, we knew approximately.

White: Well yes, that's right - the reduction of the balances.

H.M.Jr: Nobody ever had the thing. I mean the knowledge that you must have worked out in your office - didn't you all learn a little?

Taylor: Some.

White: That isn't the whole story.

- Lochhead: But we realized we didn't know a lot of things; I don't know how much we learned.
- Taylor: There are all sorts of minor differences which you could go into, and which you have to estimate the amount of: the amount of notes - or bills, rather - which were actually taken by the banks; the amount of savings bonds which were taken by the banks, etc. Now, this figure that is given you is a pretty good figure. It's about as - I think it's about as good a one as you could have. Now, you can argue ten million or even 20 million one way or the other.
- H.M.Jr: For this purpose it doesn't make.....
- White: There is an accompanying memorandum that explains each one of these items.
- H.M.Jr: For the purposes here - I mean for my purposes, what I was trying in connection with the financing, I am willing to take this at face value, as long as you four fellows are together.
- Taylor: We can debate quite a bit, but you won't get anywhere.
- H.M.Jr: I'll put it this way: 50 million or 75 million, it makes very little difference.
- White: That's the range.
- H.M.Jr: I mean whether it's 50 or 75 million - it's very little difference.
- White: No, it's a difference of interpretation as to certain items.
- Taylor: Interpretation and the assumptions which we have been given.
- Bell: You could argue 10 or 15 percent and you wouldn't know which was right.
- H.M.Jr: Now, one of you take the argument, or I'll put the proposition: supposing I'd want to put up to the Federal Reserve, say, "The first of July I'd like to spend a hundred million dollars worth of this 130

-5-

million dollars worth of gold." Now, anybody can argue for or against that. I'll give you my reasons for wanting to do it. I have to borrow a hundred million less; that's Number One. Number Two, if the people are right and there is going to be a little slump in the summer, why, a hundred million dollars of gold into excess reserves isn't going to hurt anything. I don't feel very strongly about it. But I want it in my estimates; see what I mean? I mean it's a hundred million you can't just overlook, you know. I'll take either side.

- Taylor: Where would you put it, directly in the Fed?
- Lochhead: Have to be spent first.
- Bell: At the time you needed it, without calling on the banks.
- H.M.Jr: Well, I would spend it first. I mean I'd use it up first. I mean it would be the first money that I'd use.
- Taylor: So that there would be a slight lag before it did get into the System.
- Bell: Might take a month.
- White: There are two reasons that I should support that, in addition to those that you gave - why I think that should be done and why it can be done reasonably without violating any understanding or implication. One is that at the time this arrangement was made, nothing was said of that working balance in the discussion; it was merely new gold that was talked about. You merely had this other gold in the balance, and you now decide to let it out; therefore, you are not violating any understanding or implication.
- In addition, the second reason is that I should like to see some action be taken to show that there is flexibility and that there is adjustment. The situation calls for it; no reason why it shouldn't be done.
- H.M.Jr: Of course, in connection with that, it would be very

-6-

interesting if you took this up. It so happens that the Fed has increased its portfolio by a hundred million. Now, I think the thing - I'm going to ask you (Taylor) to conduct these negotiations, if you would, with the Federal Reserve; you might go to them and say, "Now, what is your policy going to be about your hundred million after the 15th of June? Are you going - supposing we have a good bond market, are you going to sell them? Now, if you're going to sell them, we'd like to know, because we feel (I mean if we are in agreement) that the present excess reserves are the minimum." Are the minimum!

White: There is one further argument. It is not a good one, but it might frequently be made. The objection might be made that on the one hand you have the Federal Reserve Board adding to its portfolio and you are selling bills and they're buying bills; you're just sort of washing out the sale.

H.M.Jr: You're a little fast there.

White: Well, the Federal Reserve has added to its portfolio. You, on the other hand, have borrowed to sterilize gold. So at least if you do a hundred million, you can say, "They added to their portfolio by a hundred million, so we sell that gold." It's kind of a weak argument, but....

H.M.Jr: The thing that - I purposely didn't say 130; I don't think we should do 130. Make it a round figure, do a hundred, you know. No sense of doing 130, just do a hundred. But I think that the thing is a little close. Why keep a hundred million dollars worth of that gold there? Why not let it go?

Lochhead: Nobody's taking the Federal Reserve Board's side. I was just wondering what kind of argument they would bring up. First of all, they might say, "Well, we had an understanding that you were going to freeze any additions to gold so that we could control - take care of the excess reserves. If you are starting in to alter this figure, it may be the only way to alter the whole program of sterilizing gold, and if you do alter that program we no longer have control."

- H.M.Jr: May I answer you? Eccles has two or three times himself asked us to put in an extra 180, which they claim we didn't let them know about.
- Lochhead: But that 180, they will claim, is a figure set by them, that they feel should go in. In other words, the Federal Reserve Bank feel that they should dictate or say how much gold should or should not go in.
- H.M.Jr: Well, what I am saying - I'm just saying to Taylor I don't want to bring this up until after the eighth, because I don't want to - I mean I'd like to have the arguments in our shop, but beginning with the eighth of June I'd like you - that's a Tuesday; if we have lunch with Eccles on that date, why, we could start negotiations with him. First, what is his policy going to be about letting his bonds run off? Second, that - this answers your (Lochhead) question - this doesn't change the policy at all. It just means the hundred million dollars - there's no particular sense in sterilizing it; it's got nothing to do with gold coming from Europe. Then we have to borrow that much less and we feel it is, from a Treasury standpoint - I wouldn't say anything about excess reserves - from a Treasury standpoint we think there is every reason to do it, and "what about it?"
- Bell: I hate to see it put on the basis that it will give the Treasury that much more money. After all, if there's a good excuse for the hundred, there's a good excuse for the 750. I don't like the argument that we sterilized more than we agreed to, because as a matter of fact the excess reserves are 300 million dollars now over the estimates of what they thought they would be; so I don't think that argument holds.
- I like the argument that there may be a slump in the summer and this hundred million gold going in might help the excess reserve situation. And I also like the other argument that you put up - slipped my mind now; what was it?
- H.M.Jr: About their selling their bonds?
- Bell: Yes, sets that off.

-8-

- Taylor: The hundred million increase in portfolio - it is only if they sell it that you would neutralize it. If they don't sell it....
- Bell: The flexibility - that's what I mean.
- White: You're being inconsistent, but you don't mind, I presume.
- H.M.Jr: Well now, I can go around the other way and say to do nothing but use that as a club. "Now listen, fellows, if you're going to draw down your excess reserves by reducing your portfolio, why, then we feel that we'll have to put that hundred million in."
- Lochhead: I wouldn't like to use a club that way, because I think it would be a good idea if there is a strong bond market and if they want to let out a few bonds; I'd like to let them feel they are free in the System to do that, as long as we are free to counteract it if we want to. But I wouldn't say it on that basis. In other words, we are absolutely independent. If they want to let out a few bonds, all right, but that doesn't stop us from freedom of action in using our own devices.
- White: In other words, there is always a bigger club in the background - calling attention to that.
- Taylor: Here's what we said, which you probably remember.
- H.M.Jr: Not too well.
- Taylor: "The Secretary of the Treasury, after conferring with the Board of Governors of the Federal Reserve System, announces that he proposes, whenever it is deemed advisable and in the public interest to do so, to take appropriate action with respect to net additional acquisitions or releases of gold by the Treasury Department."
- White: And we fought about every word there.
- Taylor: "This will be accomplished by the sale of additional public debt obligations, proceeds of which will be used for the purchase of gold, and by the purchase or redemption of outstanding obligations in the case of movements in the reverse direction."

At your press conference, and at various other times when we have been asked questions about it, why, you have made the statement that, inasmuch as this first action was done in agreement with and in consultation with the Board of Governors of the Federal Reserve System, that any alteration would also be done.....

- White: Did you say "in agreement"? Was it "agreement" or just "consultation"?
- Taylor: "Consultation," but the "agreement" was very much - the "agreement" part was not only given to the public but also in conversations.
- H.M.Jr: After I think it all over, you might say, "Why fuss with a hundred million to upset the thing? It isn't - it's just a stab. If you're going to really change it..... "
- White: Well, a hundred million is a hundred million.
- Taylor: A hundred is a hundred million, but....
- Bell: It's just an indication that you do have flexibility.
- Lochhead: I'd rather have - I mean rather than to tie up on the hundred million that that is the only thing you can use and then you'd say that's the only thing - I'd rather say, "If we decide it is necessary, we'll let out some gold, or, on the other hand, probably cease sterilizing."
- H.M.Jr: No.
- Taylor: "Take appropriate action with respect to net additional acquisitions."
- H.M.Jr: What I would suggest is this: that we all of us think about it and then take it up again on June 8, see?
- Bell: I'd like to see some scheme worked out whereby the Federal Reserve Board could write the Treasury a letter and ask them to put it in.
- Lochhead: Well, they would probably write the letter on the

-10-

180, but I don't want them to get down to calling for a particular amount.

Bell: That's right, and then you tie it up to that one point, and what you going to do in the future?

White: That's a direct violation of the statement that the Secretary, when he deems it in the public interest, shall take such action. Why should he wait for them to ask?

H.M.Jr: I agree with Harry.

Taylor: I don't think you need any letters, but you should follow the plan of consulting them.

White: Yes, "consultation."

H.M.Jr: If I did it again, I'd have Eccles here.

Taylor: Oh yes, that's the only way you do it.

White: No one's on the other side; I think there is agreement that you should do that.

H.M.Jr: I'd have Eccles here again. Now let me just talk. This is a good memorandum, a good job; I'm pleased, Wayne.

Taylor: Well, it was ... (points to White) Some arguments.

H.M.Jr: But I directed the criticisms to you, so I also direct the compliments to you, and you can split them wherever you want to.

Now let me just say this a minute. In talking to George Davison yesterday, of the Central Hanover, I sounded him out on this question of three months bills, and he is crazy about them. I said, "Well, do you think the Federal Reserve would have to make some agreement to buy them?" He says, "You don't have to buy three months bills." He says, "There will be a market for them - after you've had them two or three weeks, be used to them, always be a market. We don't need the Federal Reserve. We'll agree to buy anything."

-11-

So I said, "Well, am I right in thinking if I got out a six months that the six months would sell almost the same as the nine?" He said it would. "But you can continue to sell nine," he says, "they'll go." And then I said, "If some time we had too much money, we'd temporarily stop selling nine." He said, "Oh, that would be marvelous; have a wonderful effect." "But right now," he said, "you can get out a three months bill - would help tremendously, because that would give us what we need in flexibility as between New York and the rest of the country, and we need it very badly." He said it would be received extremely well.

Now, I got Rentschler coming for supper tonight and I'm going to ask him the same thing on that. I want to give you (Bell) the same thought; if we started in, we could add right away 600 million dollars, and the reason I want to tell it to you is so that you can think about it over the weekend. Now, you only counted on selling - between the first of July and the first of September, you only counted on three hundred, see? So that there is an extra three hundred.

Bell: 250, as I recall, not three.

H.M.Jr.: Yes, 250, so there is 350 more than you count on; so if we don't want to sell so much in June, we don't have to sell so much.

Bell: That's right, you could cut it down to five hundred.

H.M.Jr.: If I wanted to.

Bell: Yes, sir.

H.M.Jr.: On the other hand - I mean if we could get away with it, I'd like that extra 350 to make me feel comfortable. But I mean if the thing doesn't look right and the boys don't talk right.... Now, I talked to - were you (Bell) in the room when we talked to Burgess?

Bell: Once.

H.M.Jr.: Well, that's the only time I talked. Well, Burgess is talking in terms of a five-year note. He said,

-12-

"Don't let these fellows frighten you." Isn't that what he said?

Bell: Uh-huh.

H.M.Jr: What? It's ten; let me talk to Burgess again.

(On phone) Dr. Burgess, N.Y.

And Burgess and Young of Boston - Young is very bullish. He wants us to sell at least 300 million dollars worth of bonds.

Taylor: Nuts.

H.M.Jr: Well, he talked a 21-year. Jeff Coolidge was in yesterday and said, "You got nothing to worry about."

Bell: Well, 300 million dollars in bonds wouldn't be a very good issue.

H.M.Jr: Pick up a good issue. Well, I'm just telling you.
Hello (On phone; conversation with Burgess follows:)

May 27, 1937.
9:57 a.m.

H.M.Jr: Hello

O: Dr. Burgess. Go ahead.

H.M.Jr: Hello - hello

Burgess: Hello, sir.

H.M.Jr: How is the tonsil-less man?

B: What's that?

H.M.Jr: How is the tonsil-less man?

B: (Laughs) I got working tonsils.

H.M.Jr: You've got working tonsils.

B: I've got plenty of tonsils still left.

H.M.Jr: Yes, well what do you know to-day?

B: Well I don't know much. The market isn't doing anything at all to-day.

H.M.Jr: I haven't seen it.

B: Ah - I'm - I've got a question mark on my desk about a 5-year note but I'm still - I haven't given it up yet.

H.M.Jr: You have not given it up.

B: Not yet, no, although I may have to. (Laughs).

H.M.Jr: Well -

B: I don't get encouragement from anybody much.

H.M.Jr: What?

B: I don't get encouragement from much of anybody.

H.M.Jr: Of course, we could go back you know - make it four years and 9 months if they don't like five years.

- 2 -

B: Yes. Well, that'd be about the same thing, I think.

H.M.Jr: No, lot of these fellows - they can't think in terms of five years. They might...

B: That's right, yes.

H.M.Jr: ...they might think in terms of four years...

B: Yes

H.M.Jr: ...and nine months.

B: Well, I think it may look a lot different a week from today.

H.M.Jr: Yes, they're going to have a three-day holiday.

B: That'll help them. That'll improve their digestion a bit.

H.M.Jr: What?

B: That'll improve their digestion.

H.M.Jr: Uh-huh.

B: That always helps the market.

H.M.Jr: Nothing will happen much the rest of the week, will it?

B: I don't think so; I think it'll be very quiet. You notice the stock exchange - they voted a holiday for Saturday.

H.M.Jr: I noticed that.

B: Good idea.

H.M.Jr: Yes. Well - ah - then I guess we'll let everything slide now till next week?

B: I think that's the way to do it, yes. I'm keeping on talking to fellows, getting all the ideas I can.

H.M.Jr: Uh-huh.

B: But I think there's nothing to do before next week.

-3-

H.M.Jr: But you're still hanging on to five years.

B: Well, I'm trying to.

H.M.Jr: Uh-huh. What - one and three-quarters?

B: Yes.

H.M.Jr: Uh-huh.

B: I wouldn't do it for more than half the amount, though.

H.M.Jr: Uh-huh. Well, things may look better or worse next week, we don't know.

B: No, I think they'll look better, but no - nobody knows.

H.M.Jr: All right. Goodbye.

B: Goodbye.

-13-

- H.M.Jr: So that's that. That's all right. They'll always go backwards. If you can talk five years and slip back - as I see it, I've been talking five years; keep talking five years.
- Taylor: Go ahead, have some fun out of it.
- H.M.Jr: We have done more difficult things than that. But - I mean I'm not going to "bull" it, you know.
- Taylor: Well, there's no serious problem, God knows. But the one thing that I think would be good for the market is to give it exactly what it wants this time, and then have this accumulation of funds, which are going to be quite heavy this year, going to become somewhat more impressive than they are at the present time - have them go into the outstanding market, which is where they'll go, so that all your funds which might have gone into a new bond goes right into the market; then your September show is a cinch, all other things being equal. The difference between being able to sell 300 million bonds and having that buying power going into the market will be a very important one. It isn't as if you had a big job to do again.
- H.M.Jr: You know, we got a funny thing here in September, which I notice; my boat gets back to San Francisco on September 2, just looking this thing up. Have you (Bell) looked this up?
- Bell: No, I know about when you said.
- H.M.Jr: And Labor Day is the sixth, which is a Monday. I figured you'd want to do it on about a Wednesday and a Thursday. The 15th of September is the following Wednesday. Why couldn't we do our financing - you told me we have done it before on a Wednesday or Thursday.
- Bell: Oh sure, we could do it.
- H.M.Jr: I mean you certainly wouldn't do it on Tuesday the seventh, the day after Labor Day, because they'll close down again, do just what they're doing now, and you'll have a three-day holiday. So we'd all be back here on the seventh, take a look at the market, most likely announce it Thursday the ninth.

-14-

- Bell: You can do it that way. We'd have to get all of our material out here Tuesday night.
- H.M.Jr: But wouldn't you most likely do it on Thursday? I mean whether I came back or not, if I was in the country, it wouldn't make a bit of difference; you wouldn't announce your plans on Monday.
- Bell: No, you'd announce it on Tuesday if you're going over the holiday.
- H.M.Jr: But we wouldn't take the chance of doing it over a three-day holiday. I wouldn't.
- Bell: If you're going over the holiday, then Thursday is the day.
- H.M.Jr: I mean I wouldn't want to price it on Friday the third any more than I'd want to price it this Friday for the following Tuesday. I mean I'm just arguing if - if anybody thinks I'm wrong..... And I think you ought to sell it on the ninth, that it will be plenty of time. If you raise enough money in June and go ahead with your Treasury bills, you can cut out your cash financing almost in September.
- Taylor: Oughtn't to need any cash.
- H.M.Jr: Just have a refund.
- Bell: That's right, because you'll be raising more money with bills right after the September financing.
- H.M.Jr: I hadn't thought of that; be just a turnover.
- Bell: Might do that very well.
- H.M.Jr: But I mean my being here or not - it looks to me as though the logical day would be Thursday. Have they in days gone by priced the thing ahead of a three-day holiday, then come out on a Tuesday?
- Bell: I don't know; I'd have to look back and see. But they don't always declare a market holiday before.
- H.M.Jr: Yes, but you take, for instance, right now the market is dead.

-15-

- Lochhead; They started in this morning with very little doing; and there's no interest in the stock market.
- H.M.Jr: Now, you try to price the thing today for next Tuesday; I wouldn't want to do it. I mean if you men think I'm wrong I'll change my whole plans, but I don't think I'm wrong.
- Bell: The only thing is that we're getting close to the time, that's all; that's the big item.
- H.M.Jr: You mean that - I mean it would give us a day after Labor Day to size up the market, then you shoot the works.
- Bell: No, I'm not thinking of shooting the works; I'm thinking on the other end - six days in which to refund and get all of your paper work done, particularly if you have a cash offering.
- H.M.Jr: But supposing it's just a refund.
- Bell: Then that simplifies it.
- H.M.Jr: Well, you see, all these people - they're already talking now about - "Look at September, 11 hundred million dollars." Well, if we can get a hundred million dollars in the bill market, then we won't have to raise any new money.
- Bell: Particularly if you get your bills and a hundred million gold.
- H.M.Jr: See how I'm thinking?
- Bell: It's all right.
- White: That would be a good thing - might be suggested ahead of time somewhere along.....
- Taylor: Well, you got this bill program, which is - can - let's say, starts after the 15th of June, if you want to go into it. That will be before you have gone. It ought to be going along in nice shape there. It's just crying to be done.

-16-

H.M.Jr: Well, I think, Dan, I would start the bill thing on the first of July, which is a Thursday.

Bell: That's all right.

H.M.Jr: No, I mean I'd start it on Monday, June 28; Monday, June 28.

Bell: You want to.....

H.M.Jr: I mean we'd sell on Monday, June 28. Huh?

Bell: What is Wednesday, the next Wednesday? July 1?

H.M.Jr: No, the next Wednesday is June 30. We don't sell on...

Bell: Yes, Wednesday is the day of payment.

H.M.Jr: It would be June 30.

Bell: That's right. It would be either June 30 or July 7.

H.M.Jr: What?

Bell: Either June 30 or July 7. But Wednesday's the payment date.

H.M.Jr: My thought was to start June 28, Monday.

Taylor: You announce them Thursday.

Bell: Yes, go out Thursday night. The bid goes out here on Friday, June 25, the bids are opened on June 28, and the payment is made on June 30. The next would be July 7 - payment date.

H.M.Jr: Well, I don't think I'd want to.....

Bell: In case you'd announce it on the second, bids open the fourth.

H.M.Jr: I thought I'd start it right the 28th, because we'd know a little bit better about our balances - or my thought was to start it either the 21st of June or the 28th, both of them Mondays.

Taylor: Well, right after your June financing is out of the way, why then you go into your bill program, and it's going to have a pretty good - very material effect on what your September program will be.

-17-

- H.M.Jr: Sure; well, that's why I don't want to wait too long.
- Taylor: I wouldn't. I'd do it as soon as I could after the June financing.
- H.M.Jr: You see, the 15th is a Tuesday - 16 - 17 - 18th is a Friday - Saturday. By that time all of that - that's the week that the readjustment of balances will take place. Announce it June 21 and those fellows don't pay until June 23.
- Bell: That's right.
- H.M.Jr: They pay on June 23, and by that - and you're - you're out of that bad week.
- Taylor: Yes.
- Bell: The income taxes will be pretty well in by that time. Of course, if we have large balances, you can allow this to be paid by credit.
- H.M.Jr: And - but I'd still keep my nine months.
- Taylor: Plus the three.
- H.M.Jr: Oh yes. Do them both.
- Bell: Yes. Your nine months is nothing more than a refund.
- H.M.Jr: But you see, I'm not doing what Harrison suggested, cut my nine to six.
- Taylor: I don't care very much one way or the other.
- H.M.Jr: But these fellows say I can get a nine months bill for practically the same as six.
- Lochhead: I think so, because if you get it down to six, you get the same people bidding and you get - I don't think there would be five points' difference by the time you put out two issues.
- Taylor: As you know, I've been talking for a long time about the total volume of bills; as long as you get the volume out there and the right maturities, I think the three months is unquestionably the right thing. I think you get very nice answers out of that.

-18-

- H.M.Jr: Well, I'm going to try that on Rentschler tonight, and I consider him one of the ablest. I've seen some smart boys this week. I've seen Potter. I've seen Davison; he was a little combative yesterday; he's seen too much of George Harrison. I mean I've seen about three as able bankers as there are, I think. And next week I'm going to see Governor Schaller, and Fred Ecker's coming in.
- Bell: Who's he?
- H.M.Jr: Chairman of the Metropolitan Life.
- Lochhead: The nine months bill should be popular because there are not enough bankers' acceptances to go around; the volume of bankers' acceptances is very small now.
- H.M.Jr: I think if we could fool these boys and just have a refund in September - and then if they want anything, they've just got to go in the Government bond market and buy; and I think we'll see a very nice situation.
- Taylor: Best thing you could possibly do is to have them go in the market, and I think you can work it around so that it will happen that way.
- H.M.Jr: Now, one of these people surprised me by saying they thought that all indications were that private concerns would again be borrowing money at $3\frac{1}{2}$ percent; said that, contrary to what everybody said, he said that good concerns will again be able to borrow long-term money at $3\frac{1}{2}$ percent. He used as an example - I don't know private bonds - Texas corporation, some other ones. He spoke of them as Texas - I suppose they're Texas. They were gradually working their way back on a three and a half percent basis. Well, if they can refund on three and a half, why, that isn't bad, is it, Wayne?
- Taylor: (Nods no)
- H.M.Jr: Well, I'm beginning to feel kind of easy now. Now, the next thing you fellows are going to do is give me a list of the various things we can do in connection with handling gold - hot money - hot potatoes. Is

-19-

that right? When we going to get that?

Taylor: You asked for it for Tuesday.

H.M.Jr: Yes, sir; going to get it?

Taylor: You'll get it on Tuesday.

H.M.Jr: And it will be just as snappy as this?

Lochhead: No, he can't crowd that all in.

H.M.Jr: Tuesday I'm getting housing; I'll give you till Wednesday.

Taylor: Then I can ask you some questions.

H.M.Jr: When? Going to ask me some questions? Swell. I'll give you till Wednesday, because I'm doing housing Sunday afternoon, Monday afternoon, Tuesday at three o'clock Senator Wagner, and by that time I'll be in such bad humor that you get what's left for Wednesday.

Lochhead: Do you know Monday's a holiday?

H.M.Jr: I know; I'm working Sunday and Monday.

Lochhead: I was just - that's why I asked.

H.M.Jr: But none of you are in that group; Mac's taking it. I think when Wagner is here - would you (Bell) like to sit in on that?

Bell: (Nods yes) I'll go over it before then.

H.M.Jr: Don't you think you'd like to?

Bell: My man is sitting in on most of the stuff. I'll get a picture from him.

H.M.Jr: No, I'm not asking you boys. You (Taylor) going down to Yorktown?

Taylor: No, I'm staying right here.

H.M.Jr: So am I, unfortunately. All right?

Taylor: I'm all right.

-20-

White: There is just this (another memo). I don't know whether you wanted to look at it now.

Taylor: I was planning quite a lot of night work over this.

H.M.Jr: I'd like to talk to you (Bell) just a second.

Mr. McHugh says that copy of this conversation
was turned over to Miss McGuire. 6/10/37 mas

147

May 27, 1937
10:53 A.M.

Joseph B. Keenan: I called up last night Evans.

Oliphant: Yes. Again?

K: And I just got a call from him now.

O: Yes.

K: And he told me confidentially that he went - he went confidentially to Evans and got Ev- - to Wilkinson and got Wilkinson, of his own motion, to put the whole thing over indefinitely.

O: Indefinitely?

K: Yes

O: Yes. What does that mean, you suppose?

K: Well, I think it may blow - the whole thing might - may blow over now without any hearing.

O: All right, Joe. Why.....

K: I thought you'd like to hear that.

O: Yes, I was waiting to hear that so we'd know what the plans for Graves and so forth were.

K: Yes

O: Now, Maguire is over with - ah - Morrie and they're going over that whole picture.

K: Well, it won't do any harm now to go over the picture.

O: Well, I do - now, Joe -

K: Yes

O: Don't - don't mind my saying this, but God almighty, somebody in your shop has got to really acquaint themselves with the details now.

K: Well, that's what they're doing right now.

-2-

O: What?

K: Yes, that's - he's the man to do it.

O: Will you do that, Joe?

K: Yes

O: And I think Maguire's good stuff.

K: Yes, well he's the - he's all right. But the main thing is that we got this thing - I don't think there ever will be a hearing out there now.

O: Yes. Well now, Joe, you remember what I said to the A.G.

K: Yes

O: That it was enough to clean this thing up if - if ten days and nothing - something else was going to break up - break -

K: Yes

O: Break now - I'll.....

K: Well, I tell you, here's the reaction we'll get. Of course, Igoe will know now that the case is not going to be heard Friday.

O: Yes

K: And he - he'll either be sensible about it or he'll storm around.

O: Yes

K: And if he storms - starts to storm around, he's going to storm into us.

O: Yes

K: That's - it's inevitable, and of course the burden's going to be on me when we get through, because I took this action of my own accord.....

O: Yes

-3-

K:as you know.
O: Yes, I know you did. All right, Joe.
K: But I think that's the proper thing to do. We can't be hurried into it.
O: No
K: And if this big thing itself will blow over.....
O: Right.
K: ...it's a good thing to save the good name of all the departments and stop the foolishness.
O: All right.
K: All right.
O: Much obliged, Joe.

* * * * *

H.M.Jr: Hello.
Operator: Hello.
H.M.Jr: I just want to talk into this record a minute.
Operator: All right.
H.M.Jr: This is a conversation between Mr. Oliphant and Mr. Keenan, and a copy of this conversation is for Mr. Oliphant. 10:55.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE May 27, 1937.

TO Secretary Morgenthau
FROM Mr. Taylor

Summary

1. The program of sterilization has been carried out.
 - (a) From December 23, 1936, to May 27, 1937:

Gold added to our monetary stock, about \$732,000,000
Gold placed in the Inactive Account about 730,000,000
 - (b) In addition to the \$730,000,000 gold placed in the Inactive Account, the gold in the working balance, about \$130 million, was frozen, i.e., was not to be used.
2. Modification of the program was urged by the Division of Research (and by some others in the Treasury) on two occasions, but no change was finally made.
 - (a) When the policy was being formulated.
 - (b) When interest rates were rising.
3. The program as finally formulated was designed to remove the effect of additions of gold either from abroad or at home from the decisions the Federal Reserve Board would have to make.
4. It is not now, and never was, designed specifically to neutralize all the effects of:
 - (a) Treasury fiscal operations;
 - (b) Gold purchases.

Secretary Morgenthau, 5/27/37 - 2.

5. If the policy had been to neutralize Treasury fiscal operations, and gold acquisitions, the Treasury should have placed \$66,000,000 (approximately) more in the Inactive Account, as follows:

Reduction in Treasury balances in the Federal Reserve Bank increased excess reserves by	\$216,000,000
Borrowing by Treasury decreased excess reserves by	<u>150,000,000</u>
Net increase in reserves about	\$ 66,000,000



DEPARTMENT OF STATE
WASHINGTON

In reply refer to
FE 893.515/1232

May 27, 1937

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. 219 of May 26, 11 a.m., from the American Embassy at Nanking, in regard to a report from the semi-official Central News Agency at Shanghai under date May 25 to the effect that Dr. H. H. Kung, Chinese Minister of Finance, plans to "confer with the American authorities regarding the Sino-American silver agreement" during his proposed visit to the United States in June of this year.

Enclosure:
From Embassy Nanking
No. 219, May 26, 11 a.m.

Handwritten initials

Department of State

BUREAU
DIVISION

FE

ENCLOSURE

TO

Letter drafted

ADDRESSED TO

Treasury.

JR

Nanking via N R

Dated May 26, 1937

Rec'd 8:45 a.m.

Secretary of State,
Washington.

219. May 26, 11 a.m.

Semi-official Central News Agency Shanghai, May 25, reports that Kung telephoned from London to the two Vice Ministers of Finance, May 24, and stated among other things that during his projected visit to the United States late in June he would "avail himself of the opportunity to confer with the American authorities regarding the Sino-American silver agreement".

Sent to the Department; by mail to Peiping and Shanghai.

PECK

RECEIVED
MAY 28 1937
DEPARTMENT OF STATE
WASHINGTON, D. C.

May 27, 1937

Magill and I saw the President at 11:15 today and we were with him for an hour and a half. This is what we discussed with him.

My dear Mr. Pres.

MEMORANDUM TO THE PRESIDENT

As soon as the returns of 1936 incomes were filed, the Bureau of Internal Revenue undertook an immediate investigation and audit of typical tax returns showing large amounts of income, in order to determine whether the Revenue Act of 1936 was operating effectively and fairly. Since most of the returns of large manufacturing corporations have not yet been filed it is not possible as yet to present any conclusions with respect to the operation of the 1936 law as to them. The investigation to date has disclosed that taxpayers have utilized existing devices for tax avoidance to an increasing extent, and that the loss of revenue occasioned thereby is becoming more and more serious.

The principal devices which are now being employed by taxpayers with large incomes for the purpose of defeating the income taxes which would normally be payable by them, are the following:

1. Foreign personal holding corporations organized in the Bahamas, Panama, and Newfoundland, where taxes are low and corporation laws lax

Americans have formed 64 such companies in the Bahamas alone in 1935 and 1936, and 22 more were organized by Americans in the Bahamas during the past six weeks. Panama and Newfoundland seem to be even more fertile territory since their corporation laws make it more difficult to ascertain who the actual stockholders are. Moreover, the stock-

FILE COPY

holders have resorted to all manner of devices to prevent the acquisition of information regarding their companies. Thus, one wealthy woman originally organized her personal holding company in the Island of Guernsey, and then moved it to Panama. She keeps the corporate books in Newfoundland. Another individual has a \$3 million Bahamas corporation and in an attempt to prevent the Bureau of Internal Revenue from catching up with him, moves his home address from one small hamlet in Canada to another in the United States each year. Another individual believes that he has been so successful in removing his assets from the United States to the Bahamas that he is defying the Treasury to collect a tax upon a \$250,000 fee he has received; and by way of insult, he has offered to compromise his admitted tax liability of \$33,000 for past years by a payment of \$1700.

Still another individual showed a large net loss on his personal return for 1936. In considerable part, the loss was due to the large deduction he claims for interest on a loan made to him by his personal holding company. But the man in question is no object of charity, for his personal holding company, organized in Canada, had an income of over \$1,500,000 from American dividends in 1936, though it has not yet filed a return.

Perhaps the most flagrant case of this character is that of a retired American Army officer with valuable American securities which he desires to sell. To insulate himself from our tax laws, he suddenly became a naturalized British subject, and six days later organized four

FILE COPY

Bahamas corporations to hold his securities. He and his lawyers think that he can now sell his securities free from American taxes on his profits.

2. Foreign insurance companies

Two New York insurance agents have caused the organization of insurance companies in the Bahamas with a view to enabling taxpayers to secure fake deductions for interest through an ingenious scheme for the issuance of life insurance policies. Americans who went into the scheme purported to pay a large single premium for their policies, but immediately borrowed back practically the entire sum. Under the plan the so-called policyholders sought to obtain a large deduction for interests on this loan, although the fact was that no interest was really paid. By this means five Americans sought to evade nearly \$550,000 in income taxes in the years 1932 to 1936. This fraud was discovered by the Treasury's investigators and all of the taxpayers have now submitted offers to pay the full amount of taxes evaded, plus interest.

3. Domestic personal holding companies

The rates of tax applicable to personal holding companies were reduced in 1936 and are not now sufficiently high to discourage the use of such companies as a means of avoiding the surtaxes. The personal holding companies whose returns have been examined by the Treasury would have paid 51.7 percent more in taxes on their 1936 returns if the applicable tax rates had not previously been reduced. Thus, one large personal holding company distributed none of its income in 1936; and its sole

FILE COPY

stockholder saved \$322,958 in taxes. In another case, a man and his wife saved \$791,000 through the use of personal holding companies in 1936. In a third case, the personal holding company reported over \$500,000 of net income but the total taxes paid by the two stockholders were less than \$60,000, due principally to credits for payments on indebtedness the holding company prudently incurred in accumulating properties for its owners.

Another favorite device is to organize a considerable number of personal holding companies, not only for the sake of reducing the tax but of increasing the Treasury's difficulties in auditing transactions between companies. At last accounts one man was interested in some 96 companies scattered all over the country; two other individuals were utilizing 23 personal holding companies.

4. Deductions for personal expenses

Our income tax laws expressly deny any deduction for personal expenses or living expenses in computing taxable net incomes. If this were not true, the principle of taxation in accordance with ability to pay could readily be defeated. Yet many wealthy taxpayers today are dodging these express provisions of the law by incorporating their yachts or their country places, along with securities yielding an income sufficient to pay the entire expenses of operation. Hundreds of thousands of dollars in income taxes are annually saved in this way. One wealthy woman has improved on the general plan by causing her personal holding company, which owns her country place, to employ her husband at a salary to manage it. She can thereby supply him with pocket money, and in effect secure

FILE COPY

- 5 -

a deduction for the expense of maintaining him. In a similar category are the deductions some individual taxpayers are taking for interest on loans to them by their personal holding companies, and for interest on loans to them by their family trusts.

5. The creation of multiple trusts for relatives and dependents

Splitting income two ways, between husband and wife, reduces income taxes and leaves the family income intact. Splitting the family income many ways by means of many trusts, all for the same beneficiaries, may effect a much greater saving, while leaving the money actually in the same hands. For the creator of the trust often constitutes himself or his wife as trustee, and thus retains full control over the investment and disposition of the fund itself and of its income. One thrifty taxpayer has formed 64 trusts for the benefit of four members of his immediate family, and thereby claims to have saved them over \$485,000 in one year in taxes. Another thrifty pair have constituted 40 trusts for their relatives, and a prominent lawyer and his wife utilize 16 trusts for the same purpose. Numbered brokerage accounts are maintained, and only at the end of the year are the beneficial owners identified. In this way innumerable transactions are carried on, often between accounts, which do not actually affect the beneficial interests of their owners, but which are designed solely to reduce tax liability.

6. Percentage depletion

This is perhaps the most glaring loophole in our present revenue laws. Since 1926, the large oil and mining corporations have been entitled to deduct from 5 to 27½ percent of their gross income as an allowance

FILE COPY

for the depletion of their mines or wells, and the deductions may be taken even though the cost of the property has been completely recovered. Thus, in 1936, one mining company deducted nearly \$3 million under this provision, although it had already completely recovered the cost of its property. The amount of the deduction was a sheer gift from the United States to this taxpayer and its stockholders and the revenue that we lost thereby was \$818,517. Similar annual losses of revenue in the cases of a few other typical companies are \$584,000; \$557,000; \$512,000; \$272,000; \$267,000; \$202,000; and \$152,000. The estimated annual loss of revenue due to this source is about \$75,000,000. The Secretary of the Treasury recommended in 1934 that this provision be eliminated but nothing was done, presumably because of the heavy pressure from the large oil and mining companies which are profiting immensely at the expense of other taxpayers.

7. The division of income between husband and wife, particularly in the 8 community property states

This is another major cause of revenue loss, which is particularly unjustifiable because obtained at the expense of taxpayers in the 40 states which do not have community property laws. A New York resident with a salary of \$100,000 pays about \$32,525 Federal income tax; a Californian with the same salary may cause one half to be reported by his wife and the Federal income taxes payable by the two will be only \$18,626. The total loss of revenue due to this unjustifiable discrimination against the residents of 40 states runs into the millions.

Such legalized avoidance breeds outright evasion. Recently professional men in other states have attempted to secure a similar tax

FILE COPY

saving by taking wives and minor children into partnerships. Thus, the Treasury has unearthed the case of a New York brokerage firm which late in 1935 admitted into partnership the four minor children of one of the partners, two boys and two girls.

8. Increasing purchases of tax-exempt bonds by wealthy citizens

The last statistics which we have show enormous holdings of tax-exempt state and municipal bonds by our wealthiest citizens. Our records are very incomplete since these individuals do not report fully what their actual holdings are. Such returns as we have checked for 1936 indicate a gradual increase in these holdings. Until the United States is empowered to tax the interest on state and municipal bonds like other forms of income, the higher surtax rates cannot be made effective.

9. Taxation of non-resident aliens

The 1936 Act eliminated the requirement that a non-resident alien, (without United States office or business) should file a return; fixed the withholding rate for individuals at 10 percent; and freed the non-resident alien from taxation on American capital gains. Since the total Federal tax upon a citizen or resident amounts to 10 percent of his total net income at about \$25,000. (in the case of a married individual with no dependents), the withholding rate is too low as applied to non-resident alien individuals with American incomes of more than \$25,000. There are a number of cases of non-resident aliens with large incomes from American trusts or with large American investments whose taxes have been cut to one-third or one-fifth of what they paid under the prior act. Thus, one American woman who married an Englishman had an income from this country in 1935

FILE COPY

- 5 -

of nearly \$300,000. Her tax for 1936 will, therefore, be approximately \$30,000 as against over \$160,000 under the prior law. Another American woman who married a Frenchman has an income of over \$150,000 from American trusts, on which she paid a tax of about \$55,000 in 1935. Her tax is reduced to about \$15,000 by the 1936 law. Although the tightening of the withholding provisions in 1936 will tend to insure more revenue from non-resident aliens in the lower income brackets, the present taxing provisions are not satisfactory as applied to non-resident aliens with income in the higher brackets.

* * *

In conclusion, I have two observations to make from the evidence before me. In the first place, the instances I have given above are disclosed by a quick check of comparatively few individual returns. Most of the large corporation returns have not yet been filed. The general audit of 1936 returns is just beginning. Nevertheless, it is likely that the cases I have digested above are symptomatic of a large number of others, which will be disclosed by a careful audit. In the second place, the ordinary salaried man and the small merchant does not resort to these or similar devices. The great bulk of our 5,500,000 returns are honestly made. Legalized avoidance or evasion by the so-called leaders of the business community is not only demoralizing to the revenues; it is demoralizing to those who practice it as well. It throws an additional burden of taxation upon the other members of the community who are less able to bear it, and who are already cheerfully bearing their fair share. The success of our revenue system depends equally upon fair administration by the Treasury, and upon completely honest returns by the taxpayers.

May 27, 1937
2:57 P.M.

H.M.Jr: Hello.

Operator: Mr. Kennedy. Go ahead.

H.M.Jr: Hello.

Joseph P. Kennedy: Don't you pay any attention to your social life?

H.M.Jr: Do I?

K: Yes.

H.M.Jr: I haven't today.

K: (Laughs) You were going to call me up.

H.M.Jr: What?

K: You were going to call me up and tell me what night you were going to come out to the house.

H.M.Jr: Yes. I - I know I was.

K: And you forgot it, I suppose.

H.M.Jr: No, I did not.

K: Didn't you?

H.M.Jr: No, because it's a nice invitation, and here's what my situation is.

K: Yes.

H.M.Jr: My Mrs. tells me she's going up to New York to get the country house ready.....

K: Oh yes.

H.M.Jr: ...on either the first or the second.

K: Yes.

H.M.Jr: The following week I - let's see, where am I? Ah - hello?

K: Yes.

H.M.Jr: What I'd like to do, if it was agreeable to you, would be the week of the 14th - that's the week from the 14th to 15th.

K: Swell.

H.M.Jr: Now - ah - let's just see.

K: Well wait till she goes back because I don't have to.....

H.M.Jr: She isn't coming back.

K: She what?

H.M.Jr: She's not coming back - that's just the point.

K: She's not coming back at all.

H.M.Jr: Not - ah - for the summer, I mean - she's getting ready to go.

K: Oh and she.....

H.M.Jr: And I'll be here alone.

K: Oh well that.....

H.M.Jr: I'll be here alone beginning with the week of the 14th.

K: Oh well then all right.

H.M.Jr: Any night that you'd like me that week.

K: Well that's very good. I'll get you a girl.

H.M.Jr: Ah (laughs) no. I'll tell you what I'd like to do if you don't feel it's a wasted evening.

K: Yes sir.

H.M.Jr: I'd like to spend it with you alone.

K: All right, Mr. Morgenthau, you and I will have dinner and we'll look at the - ah

H.M.Jr: I'll tell you right now. Do you want to make it the 15th?

K: Yes.

H.M.Jr: What?

K: Make it any night you like.

H.M.Jr: Well let's make it the 15th.....

K: Jesus, I never knew I was so social before where I made dates three weeks ahead. Wait till I put that down.

H.M.Jr: And if you want to break it or if something comes.....

K: The hell - I don't have anything to do.

H.M.Jr: Well I'll be - I'll be all alone then. Elinor's going away either Monday or Tuesday and then - the other thing - well I'll give you my whole story.

K: Yes.

H.M.Jr: Then I'm - my son, Bob, graduates on the 8th and the 9th and so that kills that week.

K: Certainly, well this is fine, Henry. We'll - we'll do that and then after that when your wife is away why then we can spend some cool evenings out there.

H.M.Jr: But if you'll have me on the night of the 15th alone and don't feel it's wasted I'd be more than pleased.

K: It's a pleasure my boy. How is the battle of the century going?

H.M.Jr: Oh I'm all out of breath.

K: (Laughs) What the hell have you been doing? Did you see the boss to-day?

H.M.Jr: Yes.

K: Is he feeling any better than he was yesterday? I was over there yesterday and.....

H.M.Jr: He's too good.

K: Is he really?

- 4 -

H.M.Jr: (Laughs) He's all full of ideas again.

K: Holy Jesus, I thought he'd be sick to-day and it would be too hot.

H.M.Jr: No (laughs) he's going a mile a minute and he's just - he just put me through the keyhole.

K: Well you - you've given him a lot of ideas to raise hell with..

H.M.Jr: Yes, I know.

K: You'll be sorry boy after he gives the market another kick in the what's is tomorrow.....

H.M.Jr: I know.

K:and you'll be gaping again.....

H.M.Jr: Yes, I know.

K:wondering what the hell's the matter with your bond market.

H.M.Jr: I know - you don't tell me.

K: Yes.

H.M.Jr: And he knows it too.

K: Yes, well he doesn't care because he loves this idea of catching all these bastards that have been stealing out on taxes.

H.M.Jr: But - ah.....

K: Well how is the market to-day? Is it as lousy as usual?

H.M.Jr: The bond market was a trifle better.

K: Yes, well that's all you're interested in.

H.M.Jr: And -

K: How was the stock market?

H.M.Jr: Up a half of point, that is, industrials.

K: Yes.

-5-

H.M.Jr: Railroads - off 37.
K: Yes.
H.M.Jr: Utilities up .02.
K: Yes.
H.M.Jr: And commodities - ah - up .41.
K: Yes.
H.M.Jr: Price for silver 45¢ - to you.
K: (Laughs) Yes, much as I want to buy. All right, Henry.
H.M.Jr: Ah - no, that's - I mean, as I say, next week Eleanor leaves....
K: Yes, well, that's.....
H.M.Jr: And I'm going up to see Bob graduate for two days. But if you still want me, I'm.....
K: Oh swell, that's great, Henry. We'll talk about it.
H.M.Jr: What picture will you show me?
K: That'll be lovely. What?
H.M.Jr: What picture will you show me? Well, we don't know.
K: Well, we'll see what's good then.
H.M.Jr: O.K.
K: All right, boy.
H.M.Jr: Thank you.
K: Goodbye, Henry.

May 27, 1937
3:05 p.m.

H.M.Jr: Hello, Herbert.
Herbert Feis: Hello, Henry?
H.M.Jr: Yes.
F: We have a question of the representation of American holders of Hungarian

H.M.Jr: A little louder.
F: American holders - we have the question of representation -
H.M.Jr: - of American holders of Hungarian defaulted bonds in a meeting that is to take place in London.
H.M.Jr: Monday?
F: In London.
H.M.Jr: Oh.
F: Next week. It also ties up with the fact that the American Government has an interest in the situation.
H.M.Jr: How come?
F: We have a million 800 thousand of relief bonds which may very well rank ahead of some of the private loans that are to be discussed.
H.M.Jr: Yes.
F: We suspended our priority in order to permit Hungary to issue the one big league loan. Now, we're worked out a possible plan by which Butterworth might be able to serve.
H.M.Jr: Yes.
F: The Secretary asked me if I would please discuss it with you. It would take five or ten minutes to explain and I think if you could find the time to let me come over, it would save your time.
H.M.Jr: I see. How about 3:30?

F: I'll be there at 3:30.
H.M.Jr: All right - thank you.
F: All right - thank you, Henry.

F 170

May 27, 1937
3:20 p.m.

H.M. Jr: Hello?

Operator: Governor Schaller. Go ahead.

H.M. Jr: Hello?

Schaller: Hello, Mr. Secretary.

H.M. Jr: How are you?

S: Pretty well, thank you.

H.M. Jr: Well, how is Chicago on our Government financing?

S: Well, I've canvassed the whole situation again. There isn't very much change from what I reported to you a week ago.

H.M. Jr: I see.

S: They're most all of them centered on about a - well, they'd like a 3-year, about 1-5/8s. I think that might go up to 5 years.

H.M. Jr: I see.

S: No one, Mr. Secretary, thinks that we should put out any bonds.

H.M. Jr: Ah-ha.

S: Excepting - well, there's just one smaller bank probably might, but they feel that it's very - it will be very essential to make a success of it -

H.M. Jr: Ah-ha.

S: - and that rather than take any chances on it -

H.M. Jr: Ah-ha.

S: - it would be well to stay within the 5 years at least and better to stay with 3 years.

H.M. Jr: I see.

S: Of course, in the smaller banks, there is possibly

-2-

a seasonal decline in deposits - that keeps them out of it.

H.M.Jr: Yes.

S: And the larger banks, they - they want the short-term.

H.M.Jr: Ah-ha.

S: So I don't know if there is very much more that I can add to that, but there is very little change from a week ago.

H.M.Jr: I see.

S: I - some of them mentioned whether or not we would permit a deposit in the war loan account -

H.M.Jr: Yes.

S: They thought that might be helpful.

H.M.Jr: Yes, we will.

S: Yes. They thought that might help some.

H.M.Jr: Now, what I'd like you to do. Do you think you could give me another ring, say, next - a week from today? Next Thursday?

S: If you want it, sure.

H.M.Jr: I do very much.

S: Yes.

H.M.Jr: Give me another check a week from today.

S: I'll check a week from today and call you again.

H.M.Jr: If you don't mind.

S: Yes, sure. I'll do that.

H.M.Jr: What do you hear about business this summer?

S: What do I think about it?

H.M.Jr: Yes.

- S: Well, of course, we've got several things. A large part of our district is dependent upon crops and crop prospects. Another part is this labor trouble is throwing a sort of a monkey wrench into the machinery a little out here.
- H.M.Jr: Ah-ha.
- S: Depending upon what proportions that grows to.
- H.M.Jr: Yes.
- S: And those are the things - outside of that, of course, the rising costs, I think, has kind of - especially in building and so on - has put a damper in the - in the prospects we had a few - six, eight weeks ago.
- H.M.Jr: Yes.
- S: I think that kind of slowed things up.
- H.M.Jr: You do.
- S: Yes. I - I think it has.
- H.M.Jr: Ah-ha.
- S: As I told you last week, if there's anything that the President can do toward indicating a drift toward a balanced budget, I think it would be very helpful...
- H.M.Jr: Yes.
- S: I think we're very critical out here of the - of the - of the relief work.
- H.M.Jr: Ah-ha.
- S: That's getting lots of criticism out here.
- H.M.Jr: It is?
- S: Yes.
- H.M.Jr: Ah-ha.
- S: If that could be - if that could be quick healed, -

H.M.Jr: Ah-ha.

S: I think it would all go to sort of re-establishment of public confidence.

H.M.Jr: Ah-ha. Well, now if you could call me a week from today, I'd appreciate it.

S: Well, I'll - I'll be back. I'm going away for a couple of days over Memorial Day but I'll be back and I'll arrange to call you a week from today.

H.M.Jr: Thank you very much.

S: Yes. All right.

H.M.Jr: Goodbye.

MEETING HELD IN SECRETARY'S OFFICE - May 27, 1937 - 3:30 P.M.

PRESENT: Secretary Morgenthau
Mr. Feis
Mr. Livesey
Mr. White
Mr. Lochhead

Mr. Feis called to inform the Secretary that negotiations were at present in progress regarding means of repayment of the Hungarian external debt. The State Department had been notified today that negotiations were to take place in Budapest and the question had arisen as to whether or not the United States should have a representative at these negotiations. There are several loans owing by Hungary to United States under the following classifications:

- (1) Bankers' loans to Hungary
- (2) Bonds floated in the United States to private investors by Hungary
- (3) Loan due to the United States Government by Hungary
- (4) League loans to Hungary

Mr. Feis claimed that the bankers had recovered the greater portion of their loans to Hungary and that certain payments were being made on the League loan. It now seemed possible that arrangements might be made for further payments by Hungary and Mr. Feis thought that the United States should have a representative at the conferences to see that the interests of the American bondholders were protected, and also to make sure that the United States Government loan would receive equitable treatment. He therefore asked the Secretary's permission to dispatch Butterworth from the London Embassy to attend these conferences.

The Secretary informed Mr. Feis that as long as the State Department had designated Cochran and Butterworth for use of the Treasury Department, he did not wish either one of them to be used in connection with attempted collection

-2-

of foreign debts as this would undoubtedly lessen their usefulness to the Treasury in the monetary arrangements which the Treasury is endeavoring to promote.

Mr. Feis agreed, and then asked the Secretary if he thought the State Department should send someone to attend these negotiations.

The Secretary felt that he should not express any opinion on this subject as this would be a question of setting a policy in the collection of war debts, and he did not feel that the Secretary of the Treasury was to intervene in this subject, basing his decision on the advice he had received from the President. Secretary Morgenthau felt that this was a question for the State Department itself to decide without expecting the decision to be made by the Treasury Department.

Mr. Feis then admitted that he was endeavoring to form a policy, and further intimated that he had been unable to obtain any clear declaration of policy in his own Department and for this reason was very anxious to have the Secretary of the Treasury express an opinion so as to help formulate a policy.

The Secretary again repeated that he did not feel that the Treasury should take any part in forming a policy on debt settlements unless he was requested to do so by the President.

In the course of the conversation Mr. Livesey remarked that the State Department had collected 3 or 400 thousand dollars from Greece on debts which had only been possible by having representations made by the State Department. He admitted, however, that the State Department had made no attempt to either contact or obtain the Treasury's approval before consulting with the Greek financial authorities.

Prepared by: Lawrence H. Seltzer,
Assistant Director of
Research and Statistics;
Assisted by: Henry G. Murphy and
Sidney G. Tickton.

Research File
Statistical
176

May 27, 1937

For: Secretary Morgenthau
Prepared by: Mr. Seltzer *SHS*
Subject: Desirable Volume and Maturities of Treasury Bills

Conclusions

The following analysis of each of a number of factors bearing upon the aggregate volume of Treasury bill issues that may be prudent or desirable indicates that an increase of at least \$500 millions in such volume could well be justified, if needed; and good reasons exist for substituting 6-months bills in whole or in part for the present series of 9-months bills; although final determination on this point may well await decision by the Federal Reserve authorities on Mr. Eccles' proposal, which is to be presented to them next week, for the establishment of Federal Reserve buying rates for Treasury bills.

I. The Banking System's Demand for Treasury Bills

Prior to the depression, commercial banks carried substantial quantities of bankers' acceptances and open-market commercial paper that could be readily purchased from and sold to dealers. Bankers' acceptances, moreover, could be sold at any time and in any quantity to the Reserve banks at posted rates which were changed from time to time in accordance with changing conditions. In addition, member banks held substantial amounts of customers' commercial loans which could be rediscounted with the Federal Reserve banks.

Today, the situation is very drastically changed. With the Federal Reserve Board index of industrial production not far below 1929 levels, the average monthly volume of bankers' acceptances and open-market commercial paper outstanding in 1936 was only \$530 millions, as compared with \$1,960 millions in 1930, and \$1,620 millions in 1929 (see Table I). The aggregate volume of "other loans" of all member banks at the end of 1936 was \$6,172 millions, as compared with \$11,515 millions at the end of 1929.

These changes have enormously increased the need of our commercial banking system for a short-term readily marketable investment. Treasury bills are now supplying this need in important measure for New York and a few other banks. British Treasury bills are performing a comparable service in the English money market. Mr. Shields of the Irving Trust Company and Mr. Riddle of the Bankers Trust Company have expressed the opinion that the volume of our Treasury bills should be increased to further meet this banking need; and this opinion has likewise been expressed by Mr. Eccles.

Secretary Morgenthau - 5/27/37 - 2

II. Mr. Eccles' Proposal

In order to enlarge the important banking function now served by Treasury bills, Mr. Eccles informed me that he intends to propose next week to the Board of Governors of the Federal Reserve System, the presidents of the Federal Reserve banks, and the Open-Market Committee, that the Federal Reserve banks establish published buying rates for Treasury bills, just as they now do for bankers' acceptances. At these buying rates, the Federal Reserve banks would hold themselves ready to purchase unlimited quantities of Treasury bills.

The buying rates would be different for bills having 6 to 9 months to run before maturity than for those having 3 to 6 months, and these in turn would be less than for those having less than 3 months to run. The rates would be so fixed, at least initially, as to prevent subscriptions to Treasury bills for the sole purpose of reselling them to the Federal Reserve banks at an immediate profit. On the other hand, the buying rates would not be so fixed as to impose a severe penalty upon banks or others that sell them to the Federal Reserve banks. Mr. Eccles suggested that at this time, the buying rate for bills having 6 to 9 months to run could properly be fixed at $3/4$ of 1 percent; for those having 3 to 6 months to run, at $5/8$ of 1 percent; and for those having less than 3 months to run, at $3/8$ or $1/2$ of 1 percent.

The resulting ability of any bank to turn its Treasury bills into cash at will would have the effect of greatly increasing the attractiveness of Treasury bills to interior banks which now carry considerable balances, on which they earn no interest, with correspondents. Another result of the adoption of this policy would be to diminish the prejudice against 9-months bills, and, for the present, at any rate, to remove much of the argument for 3-months bills. A bank could purchase a 9-months bill with far greater assurance than it has now that this bill could be liquidated at the end of 3 months at a trifling cost, if any; and with the probability that it will have earned a large part, or all, of the full interest for the period during which it held the bill. The case would be similar with a 6-months bill. In a word, Treasury bills would become as liquid as the most liquid of existing banking paper.

Another effect of the adoption of this proposal would be to make the Federal Reserve's buying rate the ceiling for the yield on Treasury bills. So long as the Reserve banks continued ready to buy all bills offered at the prices posted, the market yields could go no higher than these posted rates. It should be noted, however, that actual additions

Secretary Morgenthau - 5/27/37 - 3

of bills to the holdings of the Federal Reserve banks, unless offset by corresponding reductions in other parts of their portfolios, would increase the volume of member bank reserves; and this, of course, by rendering the bills more attractive to banks, would tend to reduce the offering of bills to the Reserve banks.

At this time, of course, the Reserve banks would be reluctant to create any important additions to the volume of member bank reserves. On the other hand, the sale of long-term Governments by the Reserve banks to offset additions to their bill portfolio could create very unfavorable conditions in the Government bond market. Mr. Scoles contemplates, however, that the Reserve banks will not normally be called upon to make any substantial net additions to their portfolio of Treasury bills by reason of their posted buying rates. His thought is that, under ordinary circumstances, pressure upon some banks means only a shifting of balances to other banks; and, hence, the bills purchased by the Reserve banks from institutions experiencing an outflow of cash could be resold — though seldom directly — by the Reserve banks to other institutions receiving this cash. This is a function now performed in part, and mainly for large banks, by dealers; but the Reserve banks, through this plan, could add very substantially to the effectiveness of this process. Moreover, the mere ability of banks to sell Treasury bills to the Reserve banks at any time, if at little or no net penalty, would make the bills a kind of quasi-cash, and would permit member banks and others who purchased the bills to maintain much smaller idle cash balances than otherwise.

Apart from these advantages of the plan from the standpoint of the normal operations of the banking system, there can be little doubt that the plan would greatly strengthen and make more flexible the Reserve System's present instruments of control over the money markets. Even prior to the depression, American banks possessed considerable prejudice, based upon long tradition, against going into debt. The rediscount rate — the rate at which the Federal Reserve banks were willing to discount eligible paper for their members — could only be effective when the member banks were forced to borrow. Today, as a result of the banking crisis of 1933, American banks are more than ever prejudiced against borrowing. Hence, the Federal Reserve System's power to raise or lower discount rates is mainly of potential rather than actual importance. Their present practice of establishing and changing posted rates for the buying of bankers' bills is analogous to the type of control exercised by the Bank of England, but its effectiveness in this country is at present severely limited by the scarcity of bankers' bills already alluded to. The establishment of buying rates for Treasury bills would enormously augment the Reserve System's scope for this type of control, particularly if the volume of Treasury bills were adequately large and the bills were fairly widely distributed. Under these conditions, an increase or decrease in the buying rates would not only serve notice of the Board's desire to restrict or encourage credit expansion, but this desire could more easily be translated into action having these effects.

Secretary Morgenthau - 5/27/37 - 4

By the same token, the market for Treasury obligations would be made somewhat more susceptible to Reserve Board policy. Increases in the buying rates for Treasury bills, if not too arbitrary, could stiffen interest rates on short-term Treasury obligations and on Treasury obligations generally. This power will be far from absolute, however. Although the buying rates for Treasury bills would provide a ceiling above which the yields on Treasury bills could not rise, they would not, unless other considerations favored, provide a floor below which such yields could not fall. If money market conditions are extremely easy, the yields on Treasury bills could remain substantially below the Reserve buying rates, and for considerable periods. Such a situation existed with respect to bank acceptances between October 20, 1933 and April 1937. The buying rate of the Federal Reserve Bank of New York for 90-day bankers' acceptances remained unchanged at 1/2 of 1 percent throughout this period. Yet for more than three years during this period, the market rates on 90-day bankers' acceptances ranged from only .13 to .19 percent. It was not until April of this year that the market rate caught up with the Federal Reserve Bank's buying rate.

On the whole, I find no good reason for doubting that the increased control over the money markets that would be enjoyed by the Federal Reserve banks, were Mr. Eccles' proposal adopted, would be an altogether healthy development. While it is true that the Reserve System would increase its degree of control over the market for Treasury securities, I do not believe that this increased control would be at all decisive in the event of any serious conflict of policy between the Treasury and the Reserve Board. The existing weapons in the hands of both parties for such a conflict are of far greater basic importance, and, for the present at any rate, enormously favor the Treasury. In fact, I believe that this proposal would give the Reserve System far more power to benefit the Treasury than to harm it. It would permit the Reserve System not only to make Treasury bills equal to the very highest type of banking asset, but it would also permit the System better to support the Treasury bill market without limit in an emergency.

As previously indicated, to the extent that interior banks employed balances now carried with correspondents for the purchase of Treasury bills, the relative importance of the New York money market would be diminished. This would be in line with the original objective of the Federal Reserve System; and it would be in line with the policy of Congress as embodied in the prohibition against the payment of interest on demand deposits — one of the desired effects of this provision being to prevent an undue centralization of liquid funds in New York City.

Secretary Morgenthau - 5/27/37 - 5

This aspect of the proposal might well have to be emphasized because of political considerations. Many persons would be likely to interpret the proposed action of the Reserve System as a measure designed primarily to help the Treasury, rather than as one designed primarily to help the banking system. And Senator Glass might well take umbrage and declare that the action constitutes an indirect means of evading the provision that he succeeded in having incorporated in the Banking Act of 1935 — a prohibition against the purchase of Government securities by the Reserve banks from the Treasury. He might contend that, by establishing appropriate buying rates, the Reserve banks could insure that they would be the ultimate purchasers of all the Treasury bills issued.

Mr. Eccles did not appear to be concerned over this possibility when I mentioned it. And it is likely that an adequate exposition of the underlying aims of the proposal might succeed in overcoming objections of this sort on the part of most Members of Congress, though not necessarily on the part of Senator Glass.

It is conceivable that, despite their greatly increased value to bankers, Treasury bills would nevertheless continue to be largely neglected, under Mr. Eccles' proposal, by interior banks. Most such banks rarely participate in competitive bidding, and dealers have been unable to sell bills in profitable quantities to most interior banks. Short-term securities possessing a fixed interest coupon and publicly offered at par, such as Treasury certificates of indebtedness, have in the past been more attractive to interior banks. For this reason, if we should find it desirable to revive the use of Treasury certificates of indebtedness, it may also prove desirable to have the Reserve banks establish posted buying rates for such certificates as well as Treasury bills.

Secretary Morgenthau - 5/27/37 - 6

III. Short-Term Character of Immediate Financial Requirements

1. The Treasury's present financing requirements are seen in proper perspective when it is realized that our new money requirements are due altogether to the gold sterilization program.

(a) Were it not for the gold sterilization program, the Treasury's cash balance today would be approximately \$1,200 millions; and there would be no occasion for further new money borrowing, except for bill issues offered in anticipation of quarterly income-tax receipts.

(b) The revised budget estimates contained in the President's message to Congress of April 20, 1937, indicate that no public financing for the purpose of financing the deficit will be necessary during the remainder of the present fiscal year and during the fiscal year 1938. On the contrary, between May 1, 1937 and June 30, 1938, some \$1,300 millions net of cash will become available to retire Treasury bonds, notes, and bills now held by private investors, or to increase the working balance. This net excess of cash receipts will arise out of the non-cash character of the expenditures for the Government Life Insurance Fund and the Old-Age Reserve Account, and out of the receipts from sales of United States Savings bonds and Unemployment Trust Fund deposits. This is exclusive, however, of any financing undertaken to finance the gold sterilization program.

2. Apart from the gold sterilization program, the scheduled excess of cash receipts over cash disbursements during the next fourteen months is such as to make any new money requirements during this period of distinctly temporary character. Only one-half of the prospective excess of net cash receipts would be enough to raise our effective cash balance to approximately \$1,000 millions. The immediate financing for replenishing the cash balance may therefore be short-term in character.

3. The entire amount of funds scheduled to be made available for reductions in the privately held public debt, exclusive of United States Savings bonds, during the next fourteen months could very conceivably be exceeded by the requirements of the gold sterilization program. Between December 23 and May 24, net gold sterilizations amounted to \$731 millions, of which \$225 millions was received in April. Obviously, if gold acquisitions averaged \$125 millions per month during the next fourteen months, they would aggregate \$1,750 millions in that period.

Secretary Morgenthau - 5/27/37 - 7

On the other hand, however, our prospective net cash expenditures for gold acquisitions -- about \$462 millions between May 24 and December 31, 1937, by Mr. Bell's preliminary estimates -- are of very special character. If these acquisitions were regarded as permanent, it is extremely unlikely that we would finance them by interest-bearing obligations of any character. If they be regarded as temporary, they will obviously be best financed by short-term obligations.

4. It is apparent from the foregoing that the immediate needs of the Treasury could be properly provided by the sale of short-term obligations. This does not mean that it would be improper to offer longer-term securities, if the market appeared receptive to the latter. The large volume of near-term maturities now outstanding would provide ample scope for the use of excess cash receipts for debt retirement, even if the immediate short-term needs were met by the sale of longer-term obligations. Nevertheless, the purport of this analysis is that, taken by itself, the June 15 financing arises out of temporary, rather than longer-term, requirements; and, if otherwise desirable, could be properly financed in large part by Treasury bills.

Secretary Morgenthau - 5/27/37 - 8

IV. Market Factors

Treasury bills constitute, of course, our cheapest financing medium in absolute terms.

Apart from this general consideration, they possess a peculiar attractiveness, at this time, shared in lesser degree by Treasury notes and certificates of indebtedness, because of the condition of the bond market. The evidence seems reasonably clear that the banks as a whole are not disposed to add to their holdings of Government bonds for the present; whereas it is highly probable that they are still disposed to add to their holdings of Treasury bills and notes.

In addition to the psychological shock occasioned by the recent decline in the bond market, there are two other reasons for believing that banks would prefer short to longer-term maturities in the near-term future. One of these is the fact that the capital of banks has not been increasing in proportion to the increase in their deposit liabilities (see Table II). This fact discourages bank purchases of additional long-term bonds because the risk of market depreciation is concentrated on the slender capital equity of the banks. Such risk is present in much smaller degree in the case of Treasury notes, and in insignificant degree in the case of Treasury bills, precisely because of their short maturities.

The other reason is that banks acquire Treasury obligations mainly as a substitute for, and in the absence of, commercial loans. The rising trend of commercial loans during 1936 made many bankers concerned over the effect of additions to their long-term Treasury holdings upon the volume of their resources available for direct customer loans. Treasury bills and notes constitute a satisfactory investment for funds that bankers hope later to make available for commercial loans.

In previous years, the market for Treasury bills and certificates has by no means been confined to banks. Corporations and individuals formerly purchased Treasury certificates of indebtedness in substantial amounts, often against their quarterly income-tax liabilities, and this has also been true in some degree of Treasury bills. If, by reason of an increase in the volume of bill issues, or, for other reasons, Treasury bill rates rose, such rise would likely be tempered by renewed demand from these sources. There is attached hereto a chart showing the percentage distribution of Treasury certificates of indebtedness and bills outstanding on various dates between 1929 and 1936, classified by type of holder. This chart indicates the former popularity of certificates of indebtedness particularly, among non-banking investors.

Secretary Morgenthau - 5/27/37 - 9

Y. The Level of Receipts

The current and prospective level of Treasury receipts can support a much larger volume of short-term borrowing than the substantially lower level of Treasury receipts that have obtained during the past ten years. Total general, special, and trust fund receipts for the fiscal year beginning July 1, 1937 are estimated at \$7,706 millions, of which \$6,906 millions are general and special fund receipts, and some \$800 millions (excluding silver seigniorage) are trust fund receipts. Of the latter, the Unemployment Trust Fund will account for \$576.5 millions.

For many years past, Great Britain has maintained outstanding a volume of Treasury bills equal to a very large proportion of her annual receipts. In recent years this proportion has been particularly large. The volume of Great Britain's debt maturing within one year, outstanding on March 31, 1936, approximated her total revenues during the fiscal year ended March 31, 1937.

The comparative relationship between debt maturing within one year, at the beginning of each fiscal year, and Treasury receipts of Great Britain and the United States during their respective fiscal years is indicated, for recent years, in the table immediately following.

Debts Maturing Within One Year, at
the beginning of each Fiscal
Year, as percent of Treasury
Receipts ^{1/}

Fiscal year : Great Britain :	United States	
^{2/} :	^{3/} :	^{4/}
1934	111.6	100.8
1935	109.0	96.6
1936	103.9	85.4
1937	97.9	72.9

- ^{1/} Does not include securities called for payment within one year which otherwise would not have fallen due during that period. Receipts include net revenues of the Post Office in Great Britain. Trust accounts are included but silver seigniorage and increment resulting from the reduction in the weight of the gold dollar are excluded.
- ^{2/} Fiscal year ended March 31 for Great Britain; June 30 for the United States.
- ^{3/} Treasury bills and bonds; excludes National Savings Certificates, National Savings Bonds, Ways and Means Advances and maturing instalments on intergovernmental loans.
- ^{4/} Treasury bills and notes maturing within one year; excludes special issues, United States Savings Bonds, and Adjusted Service Bonds.

Secretary Morgenthau - 5/27/37 - 10

If the total United States debt maturing within one year were to approximate 75 percent of the aggregate receipts estimated for the fiscal year 1938, the figure would be about \$5,800 millions. Our actual note maturities during the fiscal year 1938, plus the present volume of Treasury bills outstanding, aggregate some \$4,500 millions. The level of our debt maturities within one year is about \$1,100 millions less than a level proportional to the situation obtaining June 30, 1936.

If the level of our debt maturities within one year were proportional to the British situation -- that is, about 100 percent of the aggregate receipts estimated for the coming year -- we would have outstanding a volume of obligations maturing within one year some \$3,200 millions greater than the present volume of such maturities. Great Britain, however, for many years, has regularly maintained a much larger volume of debt maturing within one year in relation to her prospective receipts for the ensuing fiscal year than the United States.

Income-tax receipts for the fiscal year beginning two months hence are estimated at \$2,955 millions. Income-tax receipts of not far from \$500 millions can be anticipated at each of the next three quarterly collection periods, and about \$900 millions in March 1938. To minimize the disturbance to the money markets incident to such large concentrated transfers of funds to the Treasury, bill maturities at such quarterly periods might well be increased or certificates of indebtedness of such maturities issued. Table III presents the relationship between the volume of Treasury obligations maturing within one year from the years 1921 to 1937 and aggregate Treasury receipts.

Secretary Morgenthau - 5/27/37 - 11

VI. Short-Term Debt in Relationship to the
Aggregate Volume of the Public Debt

In the United States, the proportion that all Treasury obligations maturing within one year has constituted of the total interest-bearing public debt* from 1920 to date, at the close of the fiscal years, has ranged from 5.9 percent (in 1927) to 20.9 percent (in 1932). As of March 31, 1937, the percentage was 11.7 percent. The detailed figures are presented in Table IV. For recent years, such maturities have been a larger proportion of the total debt in the United States than in Great Britain, as is shown in the table below:

Percentage of Interest-Bearing Public Debt
Outstanding Represented by Securities
Maturing within one year or less ^{1/}

Fiscal year	Great Britain	United States
^{2/}	^{3/}	^{4/}
1933	12.5	15.1
1934	11.7	14.9
1935	11.7	13.9
1936	11.7	13.4

- ^{1/} Does not include securities called for payment within one year which otherwise would not have fallen due during that period. Figures for Great Britain exclude external obligations.
- ^{2/} Fiscal year ended March 31 for Great Britain; June 30 for the United States.
- ^{3/} Includes Treasury bills and bonds but excludes National Savings Certificates, National Savings Bonds, Ways and Means Advances, and maturing instalments on intergovernmental loans.
- ^{4/} Includes Treasury bills and notes maturing within one year but excludes special issues, United States Savings Bonds, and Adjusted Service Bonds.

The case is different as respects bill volume alone. Since 1930 the volume of Treasury bills in Great Britain has constituted between 8.8 percent and 11.6 percent of the aggregate internal interest-bearing public debt outstanding at the end of the fiscal year. On March 31, 1937, the British Treasury bills constituted 9.8 percent of such debt.

* Exclusive of special issues, United States Savings Bonds, Adjusted Service Bonds, and War Savings Securities.

Secretary Morgenthau - 5/27/37 - 12

In the United States during the same period, Treasury bills have constituted between 1.0 percent and 7.6 percent of the outstanding interest-bearing public debt* at the end of the fiscal year. On March 31, 1937, Treasury bills constituted 6.9 percent of such debt.

It is important, in this connection, moreover, to recognize the changed situation respecting Federal financing that is now taking place. The main reason for the large volume of short-term debt now outstanding is the rapidity with which our total debt grew during the past few years and the unfavorable conditions obtaining during several of these years for longer-term financing. With a balanced budget in early prospect and substantial trust fund receipts likely to be available for reductions in the privately held public debt, it should be possible to refund into longer-term securities a considerable proportion of the notes maturing during the next several years. To the extent that this is done, we enlarge the scope for the use of Treasury bills and certificates of indebtedness.

* Exclusive of special issues, United States Savings Bonds, and Adjusted Service Bonds.

Secretary Morgenthau - 5/27/37 - 13

VII. Volume and Maturities of Weekly Issues

Since the beginning of April 1935, British Treasury bill offerings have not been less than £30 millions weekly, and have very frequently been £50 millions weekly — roughly from \$150 millions to \$250 millions weekly. During the same period, our own bill offerings have not exceeded \$100 millions at a time, although there have been a few occasions in previous years when our offerings ranged from \$125 millions to \$175 millions. Part of the reason for the heavier weekly issues of British bills is their shorter maturity — three months.

It is obvious that, barring increases due to new money requirements, the volume of our weekly bill issues must be a function of their maturities. Offerings of \$50 millions weekly of 9-months bills will maintain outstanding a bill volume of \$1,950 millions. To maintain the same volume with 6-months bills would require weekly issues of \$75 millions. To maintain the same volume with 3-months bills would require weekly issues of \$150 millions. It is also possible, of course, to use two or more issues weekly of different maturities.

From the market's standpoint, the argument in favor of Treasury bills of maturities shorter than 9 months is strong and convincing. The primary market for Treasury bills is provided by commercial banks, particularly those in the larger financial centers. A very much smaller market is provided by other corporations with temporarily idle funds. The need of both types of these bill purchasers is for a very short-term security. Nine months is a long time for which to tie up funds of the character that commonly go into such instruments. Bankers' bills constitute the most nearly comparable security to Treasury bills; and the great bulk of these are issued for 90-day maturities. A small proportion of these bills, usually arising out of the Far Eastern trade, run as long as 6 months.

When Treasury bills were inaugurated in December 1929, the first issue was for 90 days, and the succeeding issues, until February 7, 1934, were all for periods of 93 days or less. On the latter date, the Treasury inaugurated a series of 6-months bills, in addition to the 3-months bills, these two series being continued until May 23, 1934, when the 3-months series was discontinued. On February 27, 1935, the Treasury inaugurated the present series of 9-months bills, the series of 6-months bills being discontinued shortly thereafter. Since that time, the issue of 9-months bills has been occasionally supplemented by the issuance of bills of irregular shorter maturities.

It is to be noted that Treasury bills of 9-months maturity have been in existence only since February 1935; and most of this period has been characterized by an abnormally low volume of demand for bank credit. By reason of the latter factor, the long term of these bills

Secretary Morgenthau - 5/27/37 - 14

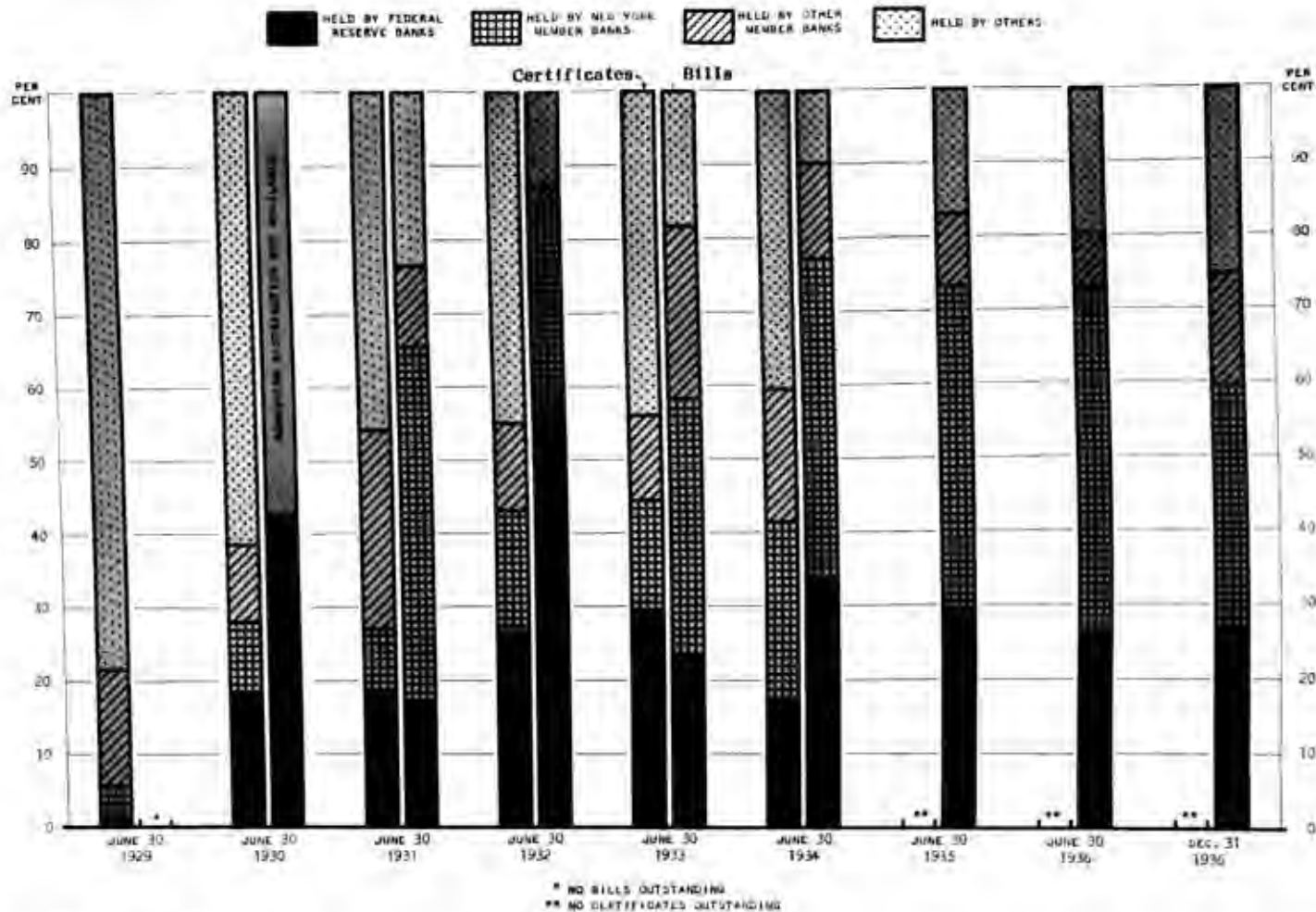
has not, until recently, occasioned any serious concern on the part of the principal purchasers. The recent increases in member bank reserve requirements, which led to substantial withdrawals from New York and Chicago banks by their correspondent banks, as well as a widespread belief among bankers that commercial loans will continue their substantial expansion of the past year, have caused banks to be more concerned than previously with the maturities of obligations in which they invest temporarily idle funds.

On this ground, justification exists for substituting 6-months maturities, in whole or in part, for our present series of 9-months bills. Although such substitution, taken by itself, would involve \$75 million offerings instead of \$50 millions weekly, I believe it probable that the influence of the shorter maturity upon the interest cost to the Treasury would more than offset the influence of the larger volume of weekly offerings. I believe that serious consideration may be given to this substitution after a decision has been reached by the Reserve System on Mr. Eccles' proposal to establish posted buying rates for Treasury bills.

I do not believe that the case is at all clear in favor of the introduction at this time of 3-months bills. Such a shortening of maturity, though it may become advisable in the future, especially if interest rates rise, does not appear to be particularly desirable at the moment. For one thing, even the partial re-introduction of 3-months bills immediately would constitute a very abrupt transition. If we are to use 3-months bills, it would appear to be more advisable to approach such use gradually, first going to a 6-months bill. Both Mr. Eccles and Mr. Goldenweiser concurred in this opinion during my conversation with them yesterday.

Attachments

PERCENTAGE DISTRIBUTION OF TREASURY CERTIFICATES OF INDEBTEDNESS AND BILLS
 OUTSTANDING ON VARIOUS DATES
 Classified by Type of Holder



* NO BILLS OUTSTANDING
 ** NO CERTIFICATES OUTSTANDING

Table I
Average Monthly Volume of Bankers' Acceptances
and Open-market Commercial Paper Outstanding
1925-1937

(In millions of dollars)

Total Outstanding

<u>Year</u>	<u>Average</u>
1925	1,440
1926	1,320
1927	1,433
1928	1,567
1929	1,620
1930	1,960
1931	1,517
1932	889
1933	807
1934	753
1935	568
1936	530
1937	667*

* First four months

Table II

Total Deposits and Total Capital Funds
All Member Banks

June 30	Total deposits	Total capital funds	Capital funds per dollar of deposits
	(Millions of dollars)		(Cents)
1920	25,372	3,853	15.2
1921	23,325	4,133	17.7
1922	25,517	4,214	16.5
1923	27,053	4,367	16.1
1924	29,530	4,486	15.2
1925	32,420	4,690	14.5
1926	33,724	4,832	14.3
1927	35,351	5,147	14.6
1928	36,060	5,625	15.6
1929	35,893	6,180	17.2
1930	38,139	6,543	17.2
1931	36,268	6,166	17.0
1932	27,864	5,317	19.1
1933	26,587	4,441	16.7
1934	31,012	4,731	15.3
1935	34,938	4,770	13.7
1936	40,706	4,904	12.1
(December 31) 1936	42,885	4,965	11.6

Table III

Comparison of Treasury Obligations Maturing within One Year
at the Beginning of each Fiscal Year, and aggregate
Treasury Receipts, 1921 to 1937

Fiscal year	Debt maturing within one year ^{1/}	Aggregate Treasury Receipts ^{2/}	Percent
1921	2,745	5,625	48.8
1922	2,666	4,109	64.9
1923	3,820	4,007	95.3
1924	1,342	4,012	33.5
1925	2,307	3,780	61.0
1926	1,495	3,963	37.7
1927	1,536	4,129	37.2
1928	1,042	4,042	25.8
1929	2,481	4,033	61.5
1930	1,640	4,178	39.3
1931	1,420	3,317	42.8
1932	2,247	2,121	105.9
1933	3,942	2,238	176.1
1934	3,306	3,278	100.8
1935	3,894	4,030	96.6
1936	3,735	4,374	85.4
1937	4,175	5,726	72.9

^{1/} At the beginning of the fiscal year; does not include securities called for payment within one year which otherwise would not have fallen due during that period. Excludes special issues to Government corporations and trust funds, United States Savings Bonds, Treasury and War Savings Securities, and Adjusted Service Bonds.

^{2/} Includes trust accounts but excludes silver seigniorage, the increment resulting from the reduction in the weight of the gold dollar, and postal revenues (except surplus receipts covered into the Treasury).

Table IV

**Interest-Bearing Public Debt Outstanding
and the Proportion thereof represented by Securities
maturing within one year or less**

June 30	: Total interest- : bearing debt : outstanding 1/	: Securities matur- : ing within 1 year : or less 1/ - 2/	: Percent
(Millions of dollars)			
1920	23,210	2,745	11.9
1921	23,010	2,666	11.6
1922	22,032	3,820	17.3
1923	21,670	1,342	6.2
1924	20,568	2,307	11.2
1925	19,730	1,495	7.6
1926	18,820	1,536	8.2
1927	17,583	1,042	5.9
1928	16,711	2,481	14.9
1929	16,019	1,640	10.2
1930	15,158	1,420	9.4
1931	16,229	2,247	13.9
1932	18,852	3,942	20.9
1933	21,834	3,306	15.1
1934	26,084	3,894	14.9
1935	26,950	3,735	13.9
1936	31,102	4,175	13.4
(March 31 1937	32,119	3,771	11.7

1/ Excluding special issues to Government corporations and trust funds; United States savings bonds and Treasury and war savings securities; and adjusted service bonds.

2/ Does not include securities called for payment within one year which otherwise would not have fallen due during that period.

PARAPHRASE OF TELEGRAM RECEIVED

NO. 687

FROM: American Embassy, Paris

DATE: May 27, 1937, 1 p.m.

This morning I had a conversation over the telephone with Mr. Trip, President of the Netherlands Bank at Amsterdam. He was pleased with the results of the election yesterday in the Netherlands. He felt that these results considerably strengthened the position of Premier Colijn and indicated to the world that the Netherlands was not leaning toward radicalism. I was informed by Trip that some question between Colijn and the Catholics might arise. He was sure, however, that a working majority supporting the Premier in Parliament would be found.

Mr. Trip informed me that as the weekly statement of his bank (to which the control was turning over its gold gains) showed, he was still having to take in a great deal of gold. Much sympathy with the United States was expressed by Trip in facing the gold problem. He was gratified at the good judgment and the coolness which had been demonstrated by our authorities. He was sorry that Great Britain had not done as much as possible toward
stabilization

-2-

stabilization of the situation by absorbing more of the gold offered on the market in London. It was his hope that a more cooperative attitude on the part of the British might be indicated by yesterday's purchases. He thought that the representatives of the Empire in London at the present time might have an influence on the Government which would be helpful to the world in general. He recalled to my mind the fact that when the British permitted sterling to appreciate, much pressure was brought to bear on Amsterdam and it had been necessary to change his dollar buying rate.

It is Trip's feeling that the analysis of the gold situation made by B.I.S. and set forth in the recent annual report, has been worth while since it has brought about world wide realization and discussion of the problem. He stated frankly that there is absolute conviction in Amsterdam that the present Government in France will not be able to overcome its financial difficulties and that it will fall in a few months--six months at the outside. He is not in agreement with the opinion of certain observers in his country whose belief it is that France will not need to devalue the franc further. It is his belief that the necessity for further devaluation would be obviated if there should come into office a Government
with

with leaders such as Reynaud and Chautemps who would take firm steps toward balancing the budget. Since the French situation is so questionable at the present time, Trip does not agree with the suggestions which have come from certain financial papers in Great Britain that it would be desirable to issue a tripartite declaration on gold policy now. Trip will not be able to attend the B.I.S. meeting on June 14, he told me, because he is chairman of the committee which is to receive the Dutch Royal Family from June 8 to 14 in Amsterdam.

END SECTIONS ONE AND TWO

PARAPHRASE OF SECTION THREE.

I received a telephone call this morning from the Paris Manager of the National City Bank. He made reference to rumors in this morning's British press, in particular the FINANCIAL TIMES, with respect to the provisional fixing of the gold price at from thirty-one to thirty-two dollars an ounce in America and at about six pounds, ten shillings in London with the understanding that Washington would then not oppose the New-York-London exchange rate appreciating against the pound to dollars 4.70 to 4.75. As a corollary, this story mentioned that the United States and British exchange funds would undertake to absorb fifty percent each of all gold coming on the world market, thus lightening the recent abnormal strain on the former. I was told by the Manager that his bank was being flooded with inquiries in regard to the American position and that such rumors as that above were causing much comment and apprehension on the Paris market.

END OF MESSAGE

BULLITT

EA:DJW

RB

GRAY

Paris

Dated May 27, 1937

Rec'd 4:24 p. m.

Secretary of State

Washington.

688, May 27, 4 p. m.

FROM COCHRAN.

Paris exchange market quiet. French control said to have yielded some sterling at from 110.60 to 64 and a few dollars around 22.39. Rentes opened lower but improved through supposedly official intervention. National defense bonds 1937 were brought up to 93.45. Bank of France statement as of May 20 showed no significant changes but decline in note circulation caused gain in coverage from 45.52 to 45.66. Talk of devaluation is gaining in market circles. French shipping strike reported settled. London rumor of change in American gold price to \$31 discredited here. Schacht's visit has no market influence.

In inaugurating the German pavillion at the Paris Exposition yesterday Doctor Schacht emphasized according to the press German aspirations for a Franco-German trade treaty which would do away with the unsatisfactory clearing arrangement. He stressed the fact that with

BULLITT

CSB

sms

GRAY

Paris

Dated May 27, 1937

Rec'd 5:42 p.m.

Secretary of State,
Washington.

688, May 27, 4 p.m. SECTION TWO

the exception of Switzerland which enjoyed an international guarantee Germany was the only nation in the world which did not possess either at home or abroad a source of foodstuffs sufficient to feed its population. He remarked that those who sought to keep up this state of things would never be able to eliminate the risks it causes. Those who contributed to its removal would guarantee the (*) of Europe and the world for generations. In the afternoon Dr. Schacht is reported to **have had** a long conversation with Bastid, Minister of Commerce.

Paris press has not received Schacht's remarks favorably. Germany's unilateral decisions of recent years in regard to reparations, rearmament and the Rhineland are recalled and skepticism as to Germany's desire now for friendly relations and as to her respect of contracts is indicated. (?) writers feel that Germany

is

sms 2 - No. 688, May 27 from Paris. Section Two
is trying to get something concrete from France in
return for merely a pledge of peace and that Germany
could not be trusted to keep this pledge.

END OF MESSAGE

BULLITT

(* Omission

csb

RECEIVED
MAY 28 1952
U.S. DEPARTMENT OF STATE
WASHINGTON, D.C.

RB

A portion of this telegram must be closely paraphrased before being communicated to anyone. (C)

London

Dated May 27, 1937

Rec'd 5:35 p. m.

Secretary of State

Washington.

313, May 27, 6 p. m. (GRAY)

FOR TREASURY FROM BUTTERWORTH.

Today's TIMES' leading article dealt with the Imperial Conference review of the gold situation which incidentally has become the all important question of the hour in London since the problems arising out of the increased quantity and value of gold are interpreted here as covering the more important aspects of current monetary and economic policy.

"It is expected that the gold question will come up for preliminary discussion at today's meeting of the principal Empire delegates. The South African Government are known to favor currency stabilization and the restoration of the gold standard, and, judging from the comments made by members of the Government before the departure of the South African Delegation for London, they would not oppose some reduction in the price of gold

if this

FILE COPY,
A. LOCHHEAD

RB

-2-#315, May 27, 6 p.m. from London

if this is considered necessary in return for stabilization. It remains to be seen whether the South African Delegates have considered all the implications of this policy. It is evident that the gold question can not usefully be discussed without reference to either the United States the most important buyer, or to Soviet Russia, the second most important producer. Currency stabilization is moreover of vital importance to all the countries forming part of the sterling area and to France whose social reforms necessitate some further use in the international level of prices if new financial difficulties are to be avoided. In the meantime, the uncertainties surrounding the gold question continue to have an unsettling effect on sentiment in the City where it is widely hoped that the Conference will find it possible to make some reassuring declaration without undue delay. While City opinion is far from unanimous on the question of gold policy it seems to be agreed that currency stabilization (by the adoption of an inflexible gold price) can hardly be contemplated for the moment. In 1932 the Ottawa Conference agreed that while 'stability of exchange rates over as wide an area as possible' was of great importance 'the complete solution' of the problem 'must await

RB

-3-#513, May 27, 6 p.m. from London

await the restoration of conditions for the satisfactory working of an international standard'. These conditions included 'a rise in the general level of commodity prices' and 'an adjustment of the factors, political, economic, financial and monetary which have caused the break down of the gold standard in many countries'. Though some of the conditions have been fulfilled it is felt that further progress towards economic appeasement will have to be made before the gold or any other international currency standard is restored. It seems to be felt that it would be most useful if in the meantime the principles of the tripartite currency agreement were reaffirmed and made more explicit so as to guarantee a stable price level with a slightly rising tendency while at the same time ensuring the maximum of stability among the chief currencies of the world".

If the above article be read in the light of the British Treasury conversations reported in my recent telegrams its cautioning character becomes apparent. Likewise I understand that the article on page 460 of the *ECONOMIST* of May 22 was written after consultation with Montagu Norman who it is said wishes to soothe but not to fool the market; that is, to dissipate the scare mentally but at the same time not to hide the fact that there are

RB

-4-#313, May 27, 6 p.m. from London

there are difficult problems to be faced.

Likewise in a luncheon conversation with Leith-Ross today he volunteered that in his opinion the British financial and industrial community was not yet prepared for de jure stabilization since they still somewhat associated the gold standard with high interest rates and deflation but that conception was waning. Feeling was becoming general that some further step implementing the tripartite monetary agreement would be welcome. He emphasized that the immediate gold problem was one of distribution and in particular stressed the fact that France having lost some 500,000,000 pounds of gold in the past four years an improvement in the French situation would bring an immediate alleviation in the gold position and in general his approach was not dissimilar to that revealed in the conversations with Philipps and Waley.

Leith-Ross also said that the eventual problem, namely, whether the world could absorb its current (repeat current) gold production could not now be ascertained or dealt with but if it was seen at some future date that the world could not absorb current production satisfactorily an agreement encompassing all the important trading countries would then have to be negotiated so that they

might

- 5 -

might simultaneously reduce the value of gold without disturbing their relative exchange rates.

It might be useful in this connection to summarize certain points brought out in various conversations with British Treasury and other officials:

First. The British, it would seem do not wish any precipitate action to be taken. They are by no means convinced that eventual gold price reduction will be absolutely necessary, although such action is regarded as inevitable by such individuals as Clay of the Bank of England and Hawtrey of the Treasury. The British authorities do feel, as remarked by one highly placed governmental official in a private conversation, that "the United States is holding the gold baby while England is merely supporting a leg". They are fully aware that at some point the United States may find it difficult to bear the double burden of paying interest on the bills for sterilizing gold while giving Russia and other countries (omission) thus building up bank balances in New York, and I O U in terms of gold on future American goods and services at such reduced prices. They want to indicate, at the same time, that they are taking a more active part in bearing a share of the burden of sterilization by increased purchases of the excess gold offered on the market. [Reference is made to my telegram No. 301 of May 21.]

Second.

- 6 -

Second. A continuance of the price rise, with 1929 the desideratum level, is favored by the British Treasury. [Reference is made to my telegram No. 265 of May 4.]

Third. Hope is still held out by the British Treasury that other countries besides those adhering to the tripartite monetary arrangement will increase their holdings. In this connection reference presumably to the remarks regarding Argentina, Brazil, and Japan in my telegram No. 301 of May 31.

Fourth. The hot money question they regard as having been absorbed in the more inclusive gold question about which they offered to undertake detailed discussions with the United States. [Reference is made to my telegram No. 222 of April 16, paragraph three.] The gold problem, they believe, is now receiving active attention in Washington, and the United States is in the process of formulating the policy it will follow. I might add, incidentally, that any action regarding hot money, such as an increase in the withholding tax if Washington took action without prior consultive discussions with Great Britain, would not in the given circumstances be understood in London. ~~||~~

END MESSAGE.

BINGHAM.

EA:LWW

May 28, 1937

11:35 a. m.

Present: Mr. Mallet
Mr. Trentham
Mr. Taylor
Mr. Lochhead

Mr. Trentham: Immediately after I saw you, last time, I was down for a month.

HM, Jr: That's too bad.

Mr. Mallet: We only came because you very kindly suggested to me the other night that you would like to have a talk.

HM, Jr: Well, I have nothing special. The only thing that might interest you, your people asked our people in London something about what the Japanese were doing over here in in the way of their gold and we sent that over to Butterworth.

Mr. Trentham: That's interesting, because I have heard nothing about Japan for weeks.

HM, Jr: Well, we sent that over to London to give to Phillips at the Treasury. You can have that. (Secretary gave Mr. Trentham a copy of cable #201 to Butterworth dated May 27, 11 a.m.)

Mr. Trentham: If this is a spare copy?

Mr. Mallet: It would be very nice.

HM, Jr: They have been very decent in that they have gone out of their way to explain, haven't they Wayne, about anything they are doing in gold?

Mr. Taylor: Almost embarrassing; because they keep writing these "love notes" about every little thing they do after complete silence for a long, long time.

HM, Jr: And that's something entirely new.

Mr. Lochhead: But the important point is their statements

-2-

have been borne out by the facts, because we keep a record of all foreign balances here and the Japanese balances have gone over-draft, so it was obviously necessary for them to replenish balances here.

Mr. Mallet: More gold coming in?

HM, Jr: From that source?

Mr. Lochhead: \$30,000,000 of the total \$45,000,000 has already arrived. The first two shipments have arrived and have gone into our System and the other \$15,000,000 is on the way now.

Mr. Trentham: Yes. That makes it, what? Nearly \$800,000,000?

Mr. Lochhead: About \$754,000,000 on the sheet today.

Mr. Trentham: London is helping, isn't it? London is buying gold to prevent the stream here?

HM, Jr: We don't really know.

Mr. Trentham: I don't know. I have heard nothing for a couple of weeks.

Mr. Lochhead: The Bank of England has stated to the Federal in conversations that they were buying gold and also Phillips mentioned to Butterworth once that they were buying gold. They don't give details, but they give the intimation they were intervening actively.

Mr. Trentham: By using the exchange position?

Mr. Lochhead: I suppose so.

HM, Jr: Do you have anything in particular? We have nothing at all.

Mr. Trentham: I was wondering a little -- I have had, as a matter of fact, short talks with Mr. Bonnet and Mr. Henry on the French situation. So far as I can make out, the French position looks serious and I was just wondering when the crisis, if there is to be a crisis, will come up. I guessed it late July. I don't base that on anything except conjecture, but

-3-

if it happens I hope it will be before you go to Hawaii.

HM, Jr: I hope it happens after!

Mr. Lochhead: Our experience is they drag along pretty well.

HM, Jr: I don't know when that railroad loan expires -- that \$400,000,000 they got in London.

Mr. Trentham: \$40,000,000. I think September.

Mr. Taylor: September, with that thing coming along and then their own refunding which they have to do.

Mr. Trentham: Have they a maturity then?

Mr. Mallet: The idea is the Exposition is going to help them.

HM, Jr: It is, when they get it started. It isn't ready yet.

Mr. Trentham: Well, we had our Coronation on time.

Mr. Mallet: We had that on time.

HM, Jr: Any time you have anything, drop in. There just does not happen to be anything now.

Mr. Mallet: I hope to be going in ten days' time, so we may not meet again until I get back.

HM, Jr: Why don't you drop in just before you go.

Mr. Mallet: Yes. I will be delighted. Probably about Monday week?

HM, Jr: Just call up.

Mr. Mallet: I will call up towards the end of next week.

HM, Jr: Just before you go, because I may have something on my mind.

oOo-oOo

May 28, 1937
12:00 n.

H.M.Jr: Mr. Cochran?
Cochran: Yes.
H.M.Jr: I'm calling up about what the Swiss National Bank has been doing recently, see?
C: About what?
H.M.Jr: The Swiss National Bank.
C: Yes.
H.M.Jr: Now, on May 10, they sold us about \$23,000,000 of gold - shipment May 10.
C: Yes.
H.M.Jr: That was gold that they had earmarked with the Federal.
C: Yes.
H.M.Jr: Hello?
C: Yes.
H.M.Jr: They had earmarked with the Federal about \$29,000,000.
C: Yes.
H.M.Jr: Since the tenth of May, they've sold us about 23 million -
C: Yes.
H.M.Jr: - which leaves about 5 million still earmarked with the Federal.
C: Yes.
H.M.Jr: They have in transit another 11 million.
C: Yes.
H.M.Jr: Now they've kept their dollar balances intact here so it looks as though they needed the money for some purpose.

C: I see.

H.M.Jr: Now, both Knoke talking with Cariguel - Cariguel has raised the question and so has Bolton, see?

C: And so has who?

H.M.Jr: Bolton.

C: Yes.

H.M.Jr: Now what are the Swiss trying to do?

C: Yes.

H.M.Jr: And they're all a little timid about asking them.

C: Yes.

H.M.Jr: But they don't any of them say that they're very close to Dr. Bachman.

C: I see.

H.M.Jr: And I wondered whether you felt close enough to sort of inquire in a very diplomatic way - what's it all about?

C: Well, they're -

H.M.Jr: What's that?

C: He's a very unsatisfactory person to talk with over the telephone.

H.M.Jr: What's that?

C: I say he is a rather unsatisfactory person to talk with over the telephone.

H.M.Jr: Well, how - how about going up to see him?

C: I'm quite happy to do that any time you say it.

H.M.Jr: Well, ah -

C: You see I'm close enough to him so that I can speak very frankly with him.

H.M.Jr: Well, I think I'd find out, and maybe between now and Tuesday - could you arrange it?

C: I certainly - you mean go up between now and Tuesday?

H.M.Jr: Yes.

C: Tomorrow is Saturday and I can't very well see him on a Sunday.

H.M.Jr: No, but could you see him Monday?

C: I'll certainly try. I could phone tomorrow and see about his appointments for Monday.

H.M.Jr: Yes.

C: I could do that.

H.M.Jr: When is the next BIS meeting?

C: On the 13th and 14th of June.

H.M.Jr: Well, that's too far off.

C: Too far?

H.M.Jr: Yes. I think I'd call him up and ask him if he could see you Monday or Tuesday.

C: All right, fine.

H.M.Jr: And, see if you can find out what they have in mind.

C: All right.

H.M.Jr: Do you see any objections to asking them?

C: None whatever.

H.M.Jr: Ah-ha.

C: And it's - it's in line with your idea that we might visit these people occasionally any way.

H.M.Jr: That's right. That's right. Well, everybody in the group seems to be a little bit worried about it.

C: Yes.

H.M.Jr: And if you could sort of clear it up, I think it would be helpful.

C: I - I shall be very glad to phone tomorrow -

H.M.Jr: Yes.

C: And see if I can have an appointment for Monday or Tuesday.

H.M.Jr: Yes. Now, just a moment.

C: All right.

(Pause)

H.M.Jr: Knoke says that you want to be sure that you don't imply that we are in any way worrying about it.

C: Surely.

H.M.Jr: It's just that what we'd like to know is - what is the policy that they have in mind.

C: Yes.

H.M.Jr: See?

C: Yes.

H.M.Jr: I mean the - the gold they're sending in relation to all the rest is not very big -

C: No.

H.M.Jr: But what we'd like to know is what have they got in mind - what is their objective.

C: Yes.

H.M.Jr: See?

C: Yes.

H.M.Jr: Because these other banks when they send us gold, like the Japanese, they go under a very elaborate explanation what they're sending it over here for and what they expect to use the money for.

C: Yes.

H.M.Jr: Now, we're very glad to have their money on the target but we're just a little curious.

C: Yes, yes.

H.M.Jr: See?

C: Yes.

H.M.Jr: You get the idea?

C: Hello?

H.M.Jr: I say, you get the idea?

C: I - I get it.

H.M.Jr: All right.

C: May I ask you one question?

H.M.Jr: Surely.

C: That 23 million has come since May 10 or on May 10?

H.M.Jr: No, since May 10.

C: Since May 10?

H.M.Jr: Yes.

C: I see. And you tell me this is gold which the Bank of France puts for the account of the BIS?

H.M.Jr: Yes.

C: That was not for Switzerland, too, was it?

H.M.Jr: Just a moment.

(Pause)

H.M.Jr: That's for the BIS account.

C: I see. I wondered if it was for some other central bank.

H.M.Jr: Well, we don't - all we know it's coming here and as rapidly as it arrives, the gold is being sold.

C: I see.

H.M.Jr: But if it's for anybody other than the BIS, we don't know it.

C: I see, because I asked at the Bank of France when I saw those two invoices the other day -

H.M.Jr: Yes.

C: And they didn't know any - any background at all.

H.M.Jr: Well, we don't either. We have no background on that.

C: I see.

H.M.Jr: No.

C: There's nothing you want me to do at Basle?

H.M.Jr: No.

C: Then I shan't stop there unless it be to change trains. Sometimes Bachman

H.M.Jr: Yes. No, I - I think it would be worth going up and having a little talk with him.

C: Yes.

H.M.Jr: Yes.

C: Will - will you send me an instruction?

H.M.Jr: Yes.

C: Is Feis there with you now?

H.M.Jr: No, No. I'll ask Taylor to call up Feis and tell him to ask you to go up to Switzerland.

C: Be sure and get the wire off tonight.

H.M.Jr: We'll get it off in five minutes.

C: Fine. Then I - I can be there. The office will be closed here on Sunday and Monday.

H.M.Jr: Yes, they'll get it off right away.

C: Fine.

H.M.Jr: All right.

C: I sent you two wires today. The situation's not so bright.

H.M.Jr: I see. All right.

C: Fine. Then I'll - I'll wire you as soon as I come back.

H.M.Jr: Thank you.

C: Fine.

H.M.Jr: Good-bye.

C: Good-bye.

PARAPHRASE OF SECTION ONE OF TELEGRAM RECEIVED
FROM: American Embassy, Paris, France.
DATE: May 28, 1937, 2 p.m.

NO.: 694

FROM COCHRAN.

STRICTLY CONFIDENTIAL.

This morning at the Bank of France I learned that the French control has lost foreign exchange every day the past ten business days at the rate of around 50,000,000 francs per day. The Maximum daily loss was around 100,000,000 and the minimum 25,000,000. Therefore today the French stabilization fund has on hand slightly over three billion francs in foreign exchange and in gold. To meet its end of the month requirements it is considered quite probable the Treasury will exhaust its balance with the Bank, which as of May 20 was one billion forty two million francs, and it will be obliged also to draw upon its credit with the Bank of France.

There have been discussions at the recent meeting of the Committee supervising the French control fund regarding steps which should be taken to right the French financial and monetary position. It is reported that Cariguel insisted that this is a matter beyond correction through any technical steps which the exchange control fund or the Bank of France could take themselves. The suggestion was made by Rueff, it is said, for an increase in railway rates, but this suggestion was discouraged when it was revealed that a rise of 10 percent would only bring in around 1,000,000,000 francs per year

PARAPHRASE OF SECTION TWO. Telegram No. 694 of May 28, 1937, from the American Embassy, Paris.

while approximately six billion francs is the railways' deficit. The fact is realized by the more practical members of the committee that the railway situation is so bad that administrative measures of reform would not be enough to put the railways on a sound basis, and that it will be necessary to take some decisive action. One expert has recommended a forced conversion of all Government and railway securities toward this end and to reduce the Government's heavy burden of carrying the national debt. Doubt was expressed by this expert that the Government would take such a step realizing that its downfall might very conceivably follow. It is reported that one of the measures most likely to be considered by the Government is that of increasing taxes from July 1 by approximately five billion francs per year. Baudoin has left Paris on a motor trip to Venice, and he is to be gone until the end of the month.

I have been told that when Schaecht, during his conversations here, demanded the reduction of interest rate on the Dawes and Young bonds as a condition to signing the Franco-German commercial treaty, Rueff insisted that
the

- 2 -

the terms of the loan contracts be met by Germany. It is reported that Schacht told Rueff he was talking like another Poincare. The response of Rueff is said to be that he was flattered to be compared with so illustrious a statesman, but he added that Schacht should realize it would be impossible for France to approve of a lower rate of interest on the two German loans than the French Treasury is now having to pay for its own loans.

END MESSAGE.

BULLITT.

EA:LWW

RECEIVED
JUL 23 1934
U.S. DEPARTMENT OF STATE
WASHINGTON, D. C.

RB

GRAY

PARIS

Dated May 28, 1937

Rec'd 4:05 p. m.

Secretary of State
Washington.

696, May 28, 5 p. m.
FROM COCHRAN.

Although exchange market is rather quiet this afternoon, observers believe French control lost considerable amount of sterling this forenoon between 110.66 and 70. Since noon franc sentiment is improved on report that on next Tuesday there will be launched a plan for increasing French stamp and some other taxes importantly, to relieve French budgetary situation. Swiss private banks were important buyers of dollars, one Paris American Bank selling them one million; Swiss franc is consequently weaker. French rentes unchanged to slightly up.

Customs Committee of Chamber has approved proposal for giving Government full power to modify customs tariffs but has amended the measure with a provision requiring that the Government shall not on any pretext establish exchange control without prior specific legislative authority.

RB

-2-#696, May 28, 5 p. m. from Paris

authority.

Chamber Committees of Foreign Affairs and Finance will meet together to discuss proposal for French Government to give its guarantee to conversion loans of Czechoslovakia which are being issued on Paris market this and next year.

BULLITT

CSB

London

Dated May 28, 1937

Received 2 PM

Secretary of State,
Washington.

Not Distributed

315 May 28, 6 p.m.

~~FOR TREASURY FROM BUTTERWORTH.~~

Appreciate receiving your telegram of yesterday, the substance of which I conveyed to the British Treasury at a meeting with Phillips, Waley and Bewley today. Phillips said that he was most interested to have this information, that whereas he must admit that he was not fully acquainted with the Japanese position, nevertheless, he could not help feeling that it was not as bad as they were inclined to make out.

Waley remarked that this meeting was most timely since Arakawa had without prior notice called to see him yesterday when he was out. He assumed that Arakawa now wished to take up the question of the possibility of Japan adhering to the tripartite monetary agreement (my 189 April 2, 5 p.m.) and in turn he did not wish to be particularly specific with Arakawa without prior consultation with us.

The question

FILE COPY
LOCHHEAD

Page 2 from London #315 May 28 6 pm

The question was if Arakawa asked whether Japan would be welcomed as a member of the tripartite agreement could one say "yes"? At this point Bewley interposed to say that he had understood from Arakawa that Arakawa had discussed this matter at the American Treasury in February and had received the impression that inasmuch as Japan had no equalization fund and had instituted a system of exchange controls she was inadmissible from the American point of view. Waley queried were there two aspects of the tripartite monetary arrangement, viz., the declaration of principles of September and the gold arrangements of October? Therefore was it not possible for Japan to adhere to the September declarations even though she had exchange control? He referred to the Rome-Berlin axis in much the same terms reported in my 189 of April 2, 5 p.m., and said that there was an added advantage since such an adherence might act as a deterrent toward further depreciation of the yen. On the other hand, the tripartite monetary agreement had helped to keep the French away from exchange control and the admission of a country with exchange control might have the disadvantageous effect of weakening the French position. In this connection Waley emphasized that America's position was somewhat different from Great Britain's because of

RB Page 3 from London #315 May 28, 6 p. m.

because of the free gold market here but at the same time there was no desire here to move except in concert.

I agreed to obtain information regarding the American attitude and I mentioned that inasmuch as Monday was a holiday it would be difficult to receive it before Tuesday. Pressed for my personal opinion I said that my instinct was to look upon the September and October arrangements as a unit and that aside from the disadvantage mentioned by Waley it hardly seemed an appropriate time to weaken the tripartite monetary arrangement especially as the benefits of Japanese adherence were completely intangible. Phillips expressed agreement with this view and said that if he were convinced that there is any serious danger of Japan's further depreciating the yen in the near future he "would be willing to consider doing almost anything that might stop it" but he could not feel that the danger was real at present and that he too felt that nothing should be done to weaken the tripartite monetary arrangement if it could be avoided. He concluded by saying that the weakness of the yen was fundamentally due to the weakness of the Japanese budgetary position which in turn was caused by excess armament expenditure.

Sir John Simon has assumed the Chancellorship of the Exchequer in Chamberlain's Government.

BINGHAM

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Tokyo, Japan

DATE: May 28, 1937, 6 p.m.

NO.: 138

FOR SECRETARY MORGENTHAU.

There is a prevailing impression that the import exchange licensing system established on January 8, 1937, under the foreign exchange control law will shortly be revised but not later than the thirty-first of July, on which date renewal of the system will be considered.

Revision of the system will probably provide for bringing the present limit of yen 30,000 for transactions not requiring official permits down to the lower figure, probably yen 1,000 in order to prevent evasion by importers using "straw men" to cover imports which would in the aggregate greatly exceed the system's present limit of yen 30,000.

Foreign bank representatives in Tokyo are of the opinion that the foreign exchange control law may be revised so as to incorporate more rigid control over remittances for other than essential import trade requirements, for the acquisition and withdrawal of Japanese securities issued abroad, and for the munitions and allied industries. It is said the Finance Ministry deems the measures contemplated necessary. The Finance Ministry is reportedly much concerned

- 2 -

cerned over the adverse visible trade balance exceeding 500,000,000 yen on the twentieth of May. The observers mentioned think that preparations are going on for other measures which are designed further to restrict imports to offset to as great an extent as possible the unfavorable trade balance which is inevitable, notwithstanding the heavy gold exports.

Since January gold exports have already reached approximately 150,000,000 yen. By December they are likely to be increased by an additional fifty millions, thus consuming estimated 1937 production.

GREW.

EA:LWW

RECEIVED
MAY 22 1937
INTERNATIONAL FINANCE
SECTION

PARAPHRASE OF TELEGRAM SENT

TO: American Embassy, Paris, France

DATE: May 28, 1937, 6 p.m.

NO.: 243

The Secretary of the Treasury asks that Cochran be authorized to go to Switzerland early next week on matters discussed on the telephone between him and Secretary Morgenthau. The Department of State is agreeable unless the Ambassador has objection.

WELLES, ACTING.

EA:LWW

MEMORANDUM

May 28, 1937

To: Secretary Morgenthau
From: Dr. Burgess

Treasury bond market was strong although not active today. Quotations tended higher during the session and closed at the highs of the day. The long bonds were unchanged to 6/32 better on the day. The intermediates were 3/32 to 7/32 better and the three short bonds were more or less unchanged. Guaranteeds also moved higher, F.F.M.C.'s closing 2/32 to 8/32 better and the H.O.L.C.'s 5/32 better. Turnover of Treasury and government guaranteed bonds on the board totaled \$755,000. Note market was dull and quotations tended slightly higher. The 1939 through 1941 maturities were generally 1/32 up from yesterday. The new 1 1/4s were 3/32 up on the bid side.

Domestic bonds were unusually quiet and there were only minor price changes. High grade bonds in general held firm at yesterday's closing levels; second grades were slightly off from yesterday.

Foreigns were more or less inactive, with no price changes of consequence.

No purchases for Treasury today.

The Government Security Market

Week ended May 28, 1937

- - * - -

Following the announcement of the Supreme Court's decisions upholding the constitutionality of certain contested provisions of the Social Security Act on Monday, the Treasury bond market became strong and fairly active and at the close of the day substantial gains had been recorded. However, during the next three days the market resumed a steady tone in quiet trading with the issues callable in the 5 to 10-year period making small gains, while the long and the three shortest issues moved irregularly with changes small. Activity again increased on Friday with the market moving higher under the leadership of the intermediate issues.

The average price of Treasury bonds consequently advanced about $1/2$ of a point to 104.78, which is about $1-3/4$ points above the year's low. Individual gains for those issues callable in the 5 to 10-year period ranged from about $1/2$ of a point to $7/8$ ths of a point and from 8 to $15/32$ nds for the long bonds. Guaranteed issues show an average gain of about $3/8$ ths of a point for the week.

A quiet and firm tone characterized the Treasury note market with practically all of the activity confined to the longer maturities. Small gains of 1 and $2/32$ nds were made on Monday and Friday, otherwise quotes remained about unchanged. The average yield on 1 to 5-year notes declined 0.02 per cent to 1.17 per cent, compared with the April high of 1.44 per cent.

M. H. Arvin

May 28, 1937
11:07 a.m.

H.M.Jr: Hello?

Operator: Governor Harrison. Go ahead.

H.M.Jr: Hello?

Harrison: Hello?

H.M.Jr: Hello?

H: Good morning, Henry.

H.M.Jr: Good morning, George.

H: Henry, I just wanted to keep you posted about this Russian thing.

H.M.Jr: Please.

H: I got a telegram yesterday -

H.M.Jr: Yes.

H: - in which they formally request the opening of an account.

H.M.Jr: I see.

H: And referring to the terms and conditions which we sent them a copy of.

H.M.Jr: Yes.

H: And they also say that they are mailing us the information which we asked them to send us.

H.M.Jr: Right.

H: Now pending the receipt of the information, there isn't anything that we can very well do.

H.M.Jr: I see.

H: However, we cabled them yesterday telling them - thanking them for their cable and saying that we would submit their request to our Board of Directors and so on as soon as we got the information and had a chance to study it. But I just want you to know that the thing is in the works.

H.M.Jr: Is that the customary way to handle it?

H: Yes, that - that is.

H.M.Jr: I mean you - you wait pending the information?

H: Yes, we've - we explained that in our first cable to them.

H.M.Jr: You did.

H: And indicated we didn't consider their first cable a formal request, but they're now making request and say they are sending the information.

H.M.Jr: Yes.

H: And I don't think they would expect us to answer their request -

H.M.Jr: No.

H: - until we got the information we had asked for.

H.M.Jr: And they also most likely wouldn't make a formal request unless they thought the information they are sending would be satisfactory.

H: Yes, that's quite right.

H.M.Jr: Yes.

H: I was rather surprised that they came through as quickly as they did about all the information because we asked them for a copy of their statement of condition, -

H.M.Jr: Ah-ha.

H: - which has never been published ever - not that I know of.

H.M.Jr: No, I don't think it has.

H:

H.M.Jr: Ah-ha.

H: I know what we better do - I think we'd be putting our necks out if we went any further than this now before we get their statement because then there would have been no point in asking for it.

-3-

H.M.Jr: No, I think it's all right. I - I appreciate your telling me.

H: But I just wanted to let you know where it rests.

H.M.Jr: Yes.

H: I understand we picked up some stuff out there that they're pretty tough customers to deal with.

H.M.Jr: Well, I saw some copies of the conversation Knoke had with Cariguel.

H: Yes.

H.M.Jr: That - on the gold.

H: Yes.

H.M.Jr: About the excesses. Of course, there's always two sides to every story.

H: Oh, surely.

H.M.Jr: And, naturally I haven't asked them what their side is.

H: No, no.

H.M.Jr: Because then they'd know that the French were talking to me.

H: Surely. I think that's better not to tell them.

H.M.Jr: Oh, I wouldn't dream of telling them.

H: No.

H.M.Jr: but what I am doing today if I can get hold of Cochran, I'm going to ask Cochran if he can talk to Bachman over there in Switzerland, and find out why they're sending all this gold over here.

H: Well, they're - they're just releasing gold that they've got earmarked, isn't that all?

H.M.Jr: No. Both the conversations that Knoke has had with Cariguel and Bolton - they all feel that the Swiss are doing a little - oh -

-4-

H: Oh, I agree. I think they ought to and I can't understand it.

H.M.Jr: No.

H: But I meant I thought that they were only - I didn't know that they were shipping us gold.

H.M.Jr: Well, there's - there's 11 million in transit.

H: From Switzerland.

H.M.Jr: Yes.

H: Ah-ha.

H.M.Jr: Swiss National Bank.

H: I see.

H.M.Jr: And the fact that both England and France don't understand what it's all about - I was going to put it up to Cochran whether he felt he could, very diplomatically, sort of question them, see?

H: Yes.

H.M.Jr: And especially when I got that memorandum from Knoke yesterday of his conversation with Cariguel, and since they don't understand it, I think it perfectly proper to ask information.

H: Yes.

H.M.Jr: Yes.

H: Yes.

H.M.Jr: But everybody tells me that the Swiss are a little - what shall you say - over-smart?

H: They're pretty smart. And way, I think Bachman really in one way is pretty stupid, too.

H.M.Jr: Well -

H: He's - he's stupid and he's shy, and he gets scared - he's skittish.

-5-

H.M.Jr: Well, I'm - I'm going to leave it there. Cochran is pretty good at this stuff.

H: Yes.

H.M.Jr: See what he can get. That's about all?

H: You know I don't forget this point that I didn't go abroad when I thought I was going to this spring.

H.M.Jr: (Laughs)

H:

H.M.Jr: Well, thank you -

H: They made all - all that trouble then.

H.M.Jr: They do.

H: Yes.

H.M.Jr: Yes.

H: All right, Henry.

H.M.Jr: Thank you.

H: All right.

MEETING RE TAX LOOPHOLES

May 28, 1937
9:30 A.M.

Present: Mr. Magill
Mr. Oliphant
Mr. Gaston
Mr. Helvering

Gaston:speech which Shafroth made before the Tax Committee of the American Bar Association on this subject of people who adopt - set up foreign corporations. He went over there and they called up from Shafroth's office and got Shwartz - I was out of the office - and wanted to know who this man Dickson was, and he told them that he was the representative of the Universal News Service organization. Well, Shafroth saw him and he had this speech with him and ask him some question about it. He said he understood that there were - this stuff is in the head here (referring to article in Washington Herald of May 28) - that a hundred American millionaires face fraud prosecution. Shafroth said he didn't know anything about that, about the number, but he admitted that he did make this speech about people - just repeated what he said in this speech. Then Dickson wanted to know something about what they did in the way of fraud prosecutions and Shafroth explained the routine of fraud prosecutions.

H.M.Jr: Well, Herbert.....

(White House phone buzzes)

Excuse me. (On White House phone) Hello. What! All right. I haven't even read it. O.K. Ten minutes.

President says you (Magill) and I should come in ten minutes.

Well listen, on Shafroth, just give him a nice little fatherly talk and let this be a lesson.

Gaston: I've done that.

H.M.Jr: All right.

Gaston: I have done that.

-2-

Magill: Want me to take that apart for you (referring to memo to President on tax loopholes)? Shall I give copies to these other men and let them pray silently?

H.M.Jr: I'm more than pleased to leave it in your (Gaston) hands, and I think everybody else is in the room, too. But I think let this be a lesson to Shafroth.

(All read memo on loopholes)

Magill: Now, you have seen all of these in one form or another.

H.M.Jr: Where is the difference?

Magill: Well, the first page is essentially the stuff that he dictated yesterday.

H.M.Jr: I see. And the rest is the same?

Magill: Well, the rest has got the modifications he made, and I put in one or two additional instances from place to place.

H.M.Jr: Well, let me take two minutes. I can read it as he goes along.

This is what the plan is, see? The President decided yesterday that this is to be a message to Congress, as I understand, Tuesday, see? And first it was to be a letter to Harrison; now it's going to be a message to Congress. And then the idea that we refer to Harrison and Doughton and they're going to appoint a subcommittee and take these questions up at this session, see, of Congress.

There are no names in this thing. Now, I still haven't had - I mean I'm suspicious how these names are going to get out. I've asked three times. Is it clear to you (Magill) yet?

Magill: Yes, I think that what he has in mind is that the Committee shall give out this evidence and shall give out what they are receiving.

H.M.Jr: Well, I - no, no, I think there is an in-between step which he doesn't want to tell me, which he's got up

-3-

his sleeve, how these names are going to get out; because after all I left him Oliphant's memorandum and I think the old boy knows - "What's the use of - what Henry doesn't know won't worry him."

Oliphant: And what he doesn't know doesn't bother him.

H.M.Jr: So I think there's something in between there which Harrison and Doughton are in on. The fact I wasn't invited to that meeting makes me a little suspicious.

Gaston: You saw this Turner Catlett story.

H.M.Jr: Yes.

Gaston: Of course, that's perfectly.....

Magill: Harrison called me up this morning before I came in. He wanted to know whether anything was coming up today and I said I didn't know.

H.M.Jr: My statement was, "We'll get something," and then they said, "What did you see the President about?" "About tax evasion," and that's all I said - about ten words. And that was what - and they called me twice to tell me to go out and see the reporters. I was ordered to go out.

I think we better walk over. I tell you what we do. You haven't got a copy. I think we - as soon as.... Let's leave it this way: as soon as we come back - if you don't mind, Guy, I'll ask you to come over again, because this is terribly important. If you've got any suggestions to make or Oliphant's got any suggestions to make, there's still time, because I don't think this thing is going to go up before Tuesday.

Magill: The thing we want to be sure of is that we are absolutely sure of all our facts and all our statements.

H.M.Jr: Well now, you haven't got enough copies to leave with Helvering and Oliphant.

Magill: Well, how many do I need to take over there?

-4-

H.M.Jr: Well, two, one for the President and one for me.

Magill: We'll get one more and we'll be all right.

H.M.Jr: What about that message stuff?

Magill: I've got one here.

H.M.Jr: Just take over two copies and you leave one for Oliphant and one for Helvering, so they'll be studying it.

Magill: Do you want to keep one, Herb?

H.M.Jr: He can give up his copy.

Magill: You want another copy or two of his message in which this is to be stuck, don't you?

H.M.Jr: If you could do it - just why don't you let Herbert fix it up and you and I go; and I take over an original and a copy and let Herbert fix each of these people up with an original and copy.

Magill: Well, there's no facts in the transmittal of the message.

H.M.Jr: I want you two men to have the whole thing, have a chance to look-see.

Magill: The President proposes to put on an introduction and conclusion to the message.

H.M.Jr: Stay here, Herbert, and get these two gentlemen fixed, will you, out in Magill's office; give them a copy of the message, a copy of my letter to the President, and explain it to them; sit down and tell what's happened since yesterday, and bring these people up-to-date.

Magill: I want to get one more copy of this. See you out in the hall.

H.M.Jr: I think we're all right.

Oliphant: Now, I gave him that joint resolution - been worked on

-5-

about a year, this Constitutional law question, the right.....

H.M.Jr: Excuse me?

Oliphant: - I mean done in a certain way because of a Constitutional law matter. I gave it to him, if there is any question about it.

H.M.Jr: Now, when I come back I'll report back exactly what happened, see? But it's up to you, Herbert, to see that these fellows get copies.

Helvering: You'll be there some time, I suppose, won't you?

H.M.Jr: Oh yes. But I'll let you know. But as far as Shafroth and that, that's a closed book. We got enough troubles. Thank you. Sorry to drag you over, Guy, but I really - it's coming so fast.

May 28, 1937
12:00 n.

H.M.Jr: Mr. Cochran?

Cochran: Yes.

H.M.Jr: I'm calling up about what the Swiss National Bank has been doing recently, see?

C: About what?

H.M.Jr: The Swiss National Bank.

C: Yes.

H.M.Jr: Now, on May 10, they sold us about \$23,000,000 of gold - shipment May 10.

C: Yes.

H.M.Jr: That was gold that they had earmarked with the Federal.

C: Yes.

H.M.Jr: Hello?

C: Yes.

H.M.Jr: They had earmarked with the Federal about \$29,000,000.

C: Yes.

H.M.Jr: Since the tenth of May, they've sold us about 23 million -

C: Yes.

H.M.Jr: - which leaves about 5 million still earmarked with the Federal.

C: Yes.

H.M.Jr: They have in transit another 11 million.

C: Yes.

H.M.Jr: Now they've kept their dollar balances intact here so it looks as though they needed the money for some purpose.

-2-

C: I see.

H.M.Jr: Now, both Knoke talking with Cariguel - Cariguel has raised the question and so has Bolton, see?

C: And so has who?

H.M.Jr: Bolton.

C: Yes

H.M.Jr: Now what are the Swiss trying to do?

C: Yes.

H.M.Jr: And they're all a little timid about asking them.

C: Yes.

H.M.Jr: But they don't any of them say that they're very close to Dr. Bachman.

C: I see.

H.M.Jr: And I wondered whether you felt close enough to sort of inquire in a very diplomatic way - what's it all about?

C: Well, they're -

H.M.Jr: What's that?

C: He's a very unsatisfactory person to talk with over the telephone.

H.M.Jr: What's that?

C: I say he is a rather unsatisfactory person to talk with over the telephone.

H.M.Jr: Well, how - how about going up to see him?

C: I'm quite happy to do that any time you say it.

H.M.Jr: Well, ah -

C: You see I'm close enough to him so that I can speak very frankly with him.

H.M.Jr: Well, I think I'd find out, and maybe between now and Tuesday - could you arrange it?

-3-

C: I certainly - you mean go up between now and Tuesday?

H.M.Jr: Yes.

C: Tomorrow is Saturday and I can't very well see him on a Sunday.

H.M.Jr: No, but could you see him Monday?

C: I'll certainly try. I could phone tomorrow and see about his appointments for Monday.

H.M.Jr: Yes.

C: I could do that.

H.M.Jr: When is the next BIS meeting?

C: On the 13th and 14th of June.

H.M.Jr: Well, that's too far off .

C: Too far?

H.M.Jr: Yes. I think I'd call him up and ask him if he could see you Monday or Tuesday.

C: All right, fine.

H.M.Jr: And, see if you can find out what they have in mind.

C: All right.

H.M.Jr: Do you see any objections to asking them?

C: None whatever.

H.M.Jr: Ah-ha.

C: And it's - it's in line with your idea that we might visit these people occasionally any way.

H.M.Jr: That's right. That's right. Well, everybody in the group seems to be a little bit worried about it.

C: Yes.

H.M.Jr: And if you could sort of clear it up, I think it would be helpful.

-4-

C: I - I shall be very glad to phone tomorrow -

H.M.Jr: Yes.

C: And see if I can have an appointment for Monday or Tuesday.

H.M.Jr: Yes. Now, just a moment.

C: All right.

(Pause)

H.M.Jr: Knoke says that you want to be sure that you don't imply that we are in any way worrying about it.

C: Surely.

H.M.Jr: It's just that what we'd like to know is - what is the policy that they have in mind.

C: Yes.

H.M.Jr: See?

C: Yes.

H.M.Jr: I mean the - the gold they're sending in relation to all the rest is not very big -

C: No.

H.M.Jr: But what we'd like to know is what have they got in mind - what is their objective.

C: Yes.

H.M.Jr: See?

C: Yes.

H.M.Jr: Because these other banks when they send us gold, like the Japanese, they go under a very elaborate explanation what they're sending it over here for and what they expect to use the money for.

C: Yes.

H.M.Jr: Now, we're very glad to have their money on the target but we're just a little curious.

-5-

C: Yes, yes.

H.M.Jr: See?

C: Yes.

H.M.Jr: You get the idea?

C: Hello?

H.M.Jr: I say, you get the idea?

C: I - I get it.

H.M.Jr: All right.

C: May I ask you one question?

H.M.Jr: Surely.

C: That 23 million has come since May 10 or on May 10?

H.M.Jr: No, since May 10.

C: Since May 10?

H.M.Jr: Yes.

C: I see. And you tell me this is gold which the Bank of France puts for the account of the BIS?

H.M.Jr: Yes.

C: That was not for Switzerland, too, was it?

H.M.Jr: Just a moment.

(Pause)

H.M.Jr: That's for the BIS account.

C: I see. I wondered if it was for some other central bank.

H.M.Jr: Well, we don't - all we know it's coming here and as rapidly as it arrives, the gold is being sold.

C: I see.

H.M.Jr: But if it's for anybody other than the BIS, we don't know it.

-6-

C: I see, because I asked at the Bank of France when I saw those two invoices the other day -

H.M.Jr: Yes.

C: And they didn't know any - any background at all.

H.M.Jr: Well, we don't either. We have no background on that.

C: I see.

H.M.Jr: No.

C: There's nothing you want me to do at Basle?

H.M.Jr: No.

C: Then I shan't stop there unless it be to change trains. Sometimes Bachman

H.M.Jr: Yes. No, I - I think it would be worth going up and having a little talk with him.

C: Yes.

H.M.Jr: Yes.

C: Will - will you send me an instruction?

H.M.Jr: Yes.

C: Is Feis there with you now?

H.M.Jr: No, no. I'll ask Taylor to call up Feis and tell him to ask you to go up to Switzerland.

C: Be sure and get the wire off tonight.

H.M.Jr: We'll get it off in five minutes.

C: Fine. Then I - I can be there. The office will be closed here on Sunday and Monday.

H.M.Jr: Yes, they'll get it off right away.

C: Fine.

H.M.Jr: All right.

-7-

C: I sent you two wires today. The situation's not so bright.

H.M.Jr: I see. All right.

C: Fine. Then I'll - I'll wire you as soon as I come back.

H.M.Jr: Thank you.

C: Fine.

H.M.Jr: Good-bye.

C: Good-bye.

May 29, 1937.
9:07 a.m.

H.M.Jr: Hello
Hello

H.M.Jr: Hello Mr. Doughton.

Doughton: Yes.

H.M.Jr: This is Morgenthau.

D: All right, Mr. Secretary.

H.M.Jr: Now - ah - I'm awfully glad you're in town and - ah - we expect to see the President shortly and - ah - sort of map out a campaign for Tuesday.

D: Yes.

H.M.Jr: Now are you going to be at your office this morning?

D: Yes, I'll be in as far as I know.

H.M.Jr: Well -

D: I'll be here anytime - I might drop out a little but I'll be here anytime anybody wants to see me.

H.M.Jr: Well if you don't mind because I - I'd like to just - ah - as soon as I can get at the President - they/he hasn't had his breakfast yet.
say

D: Yes.

H.M.Jr: Then - ah - we'll ask him what he'd like us to do, see?

D: That will be all right.

H.M.Jr: So if you don't mind.....

D: Then you'd probably like me to come down or would you probably like to come up here and see me yourself?

H.M.Jr: Well I don't know. I want to wait until I see the President.

- 2 -

D: Well I'll be right here awaiting your call.

H.M.Jr: Well if you don't mind - it will be sometime this morning.

D: All right.

H.M.Jr: Thank you very much.

D: You're very welcome. I want to cooperate any way I can.

H.M.Jr: Thank you.

D: . Goodbye.

May 29, 1937.
9:09 a.m.

H.M.Jr: Hello

O: Senator Harrison. Go ahead.

H.M.Jr: Hello

Senator Harrison: Hello Henry, how are you?

H.M.Jr: OH I'm fine. How are you?

H: I'm all right.

H.M.Jr: Now look. I'm awful glad you're in this morning because.....

H: You're what?

H.M.Jr: I'm glad you're at your office.....

H: Yes.

H.M.Jr:because I'm waiting to hear from the President as soon as he's had his breakfast.

H: Yes.

H.M.Jr: And then Bob Doughton's in town and I thought maybe we could get together and decide on our strategy for Tuesday.

H: Well I went over - ah - I - he - Doc came up yesterday.

H.M.Jr: Who?

H: Ah - Magill.

H.M.Jr: Yes.

H: And I had Doughton over here and we went over that whole proposition.....

H.M.Jr: Yes.

H:and when the message comes down, of course, it will be referred to the House Ways and Means Committee in the House and referred to the Finance Committee in the Senate.

H.M.Jr: Yes.

H: We're going to have a resolution immediately in order - ah - for the President of the Sen - Vice President of the Senate - Speaker of the House to appoint a sub-committee of so many people from the House and Senate - from the Ways and Means on the Finance Committee.....

H.M.Jr: Yes.

H:to take this message and to get all these facts, don't you see?

H.M.Jr: Yes.

H: Now that's all can be done immediately.

H.M.Jr: Well now have you got that resolution?

H: We'll have that all fixed and all prepared. I told Magill what we wanted and we'll get that up.

H.M.Jr: Ah-ha. Well now.....

H: I don't know anything else, Henry, that can be done except that.

H.M.Jr: Well I didn't know that you traveled that far.

H: Yes, we went over the whole thing yesterday and then after Magill left here Doughton wanted him to go over there and meet him and two fellows on his committee.....

H.M.Jr:and so he did.

H.M.Jr: Well now, Pat, in - where are you going to be from now till 12 o'clock, if I might ask?

H: I'm going - I have to go to the hospital about 11 but I'll be here in the office until about 11 anyhow.

H.M.Jr: Until 11.

H: Yes, I can come by there if you want me to.

H.M.Jr: Well I - I - I have nothing right now until I saw the President but he hasn't had his breakfast yet.

H: Yes.

H.M.Jr: See?

H: Yes.

H.M.Jr: But - ah

H: Well I'll be here at the office - ah - you can give me a call - I'm going down to the hospital but I'll keep in touch with the office if you want me to come by there I'll come by there.

H.M.Jr: Well thanks awfully. Thank you.

H: All right, Henry.

H.M.Jr: Thank you.

May 29, 1937.
9:55 a.m.

H.M.Jr: Mr. Knoke

Knoke: Good morning.

H.M.Jr: Good morning.

K: Ah - I thought I'd tell you this, that - ah - of course the scare - the gold scare is - has broken out again over the week-end; probably or very probably as a result of the fact that we have two holidays here.

H.M.Jr: Yes.

K: The supply in London that was offered at fixing was extraordinarily large for a Saturday - it was six million dollars.....

H.M.Jr: Yes.

K:and the price went down to 70½.

H.M.Jr: Yes.

K: The - ah - cable - the Bank of England's cable stated that they had to - that they had to take the full amount as there were no other buyers.

H.M.Jr: Yes.

K: Ah - the Bankers Trust Company just called me up to say that one of their clients - Lemberg, which is an Argentine firm - ah - and which is in international banking firm.....

H.M.Jr: How do you spell that?

K: L-e-m-b-e-r-g.

H.M.Jr: Yes.

K: Lemberg, an old - I understand an old Bavarian family that emigrated years ago. Active in Argentine financing which sold five million dollars worth of gold - ah - about three or four weeks ago through the Bankers in London....

H.M.Jr: Yes.

K:is planning to sell six million dollars on Monday.....

H.M.Jr: Yes.

K:and the Guaranty call... - the Guaranty London asked Guaranty New York whether they would make a bid and the Guaranty New York came in to talk to me and I told them all I could say is that I positively knew of no change - ah - ah - in the situation, in other words, if the Guaranty bought the - thought it was a good purchase three weeks ago it was a good purchase to-day; a better purchase probably because the price was a little lower

H.M.Jr: (Laughs)

K:but beyond that, of course, I couldn't go.

H.M.Jr: Yes.

K: Now they are cabling - they wanted to cable back that they didn't want to make a bid because it was a holiday I suggested, although it's none of my business, that if I were in their boots I wouldn't cable that but I'd simply say that they had ten million gold on the water, of which five million was coming in here over the week-end and on Tuesday they'd be willing to talk business again but ten million was the limit that their Executive Committee had set for them.

H.M.Jr: Yes.

K: That, I think, is the better answer.

H.M.Jr: Who took that six million to-day?

K: The Bank of England.

H.M.Jr: Ah-ha. Well I'm glad to have a couple of minutes to talk to you because - ah * I was talking the other day - ah - with Gordon Rentschler...

K: Yes.

H.M.Jr:and he raised the point, what would the effect be if we went in and bought aggressively, see?

K: Yes.

-3-

- H.M.Jr: Would that help the situation any? Well I think today demonstrated that if we bought aggressively it wouldn't help any because the fact that we've been handling it the way we have now for weeks - when they have a very bad day like to-day the English take it.....
- K: Yes.
- H.M.Jr:and if we bought aggressively, we'd get it all. Is that right?
- K: Ah -
- H.M.Jr: Supposing - supposing we put the price right up that we'll take everything offered at - at 3477 - then we'd get it all, wouldn't we?
- K: That's right. Of course, I don't think we should ever do that anyhow - ah -
- H.M.Jr: But I'm just raising the point. I - I - I.....
- K: Well at 34 - at 3477 we get all the gold - ah - ah - ah - until the world is satisfied that 3470 - that \$35. dollar level remains unchanged.
- H.M.Jr: Yes.
- K: Ah - at - then we are back where we were before when the gold inflow here was steady but not spectacular.
- H.M.Jr: Yes, well now - ah - the - ah - well, see if I get this thing - what the Guaranty will tell their London office is that they're closed till Tuesday?
- K: Pardon me - it's the Bankers, not the Guaranty.
- H.M.Jr: The Bankers.
- K: Yes, the Bankers will tell their office now that their Executive Committee has - has set a limit of ten million dollars for gold in transit.
- H.M.Jr: Yes.

- K: That - ah - they are - their limit is - is - ah - is full; that there are five million dollars arriving in New York over the week-end so that by Tuesday their line will be open again.....
- H.M.Jr: Yes.
- K:and on Tuesday the Bankers New York will talk turkey again.
- H.M.Jr: Why will their lines be open? Will they - some gold arrive?
- K: Yes, there is five million arriving to-day and on Tuesday.
- H.M.Jr: Oh I see - I see - I see.
- K: And the moment that gold is in their line, of course, automatically is reopened..
- H.M.Jr: Yes, well now just hold the wire a minute - I've got White and Taylor here - just a minute will you.
- K: Yes sir.
- H.M.Jr: Just hold the wire a minute. (Pause while conversation is had aside with the men in the Secretary's office)
- H.M.Jr: Hello
- K: Yes sir.
- H.M.Jr: Ah - after all - if Lemberg wants to sell Monday there are other people who can buy it besides the Bankers.
- K: Oh surely, the - ah (laughs) on Monday you will probably have a repetition of to-day. As the market - if the market doesn't step in it will be the Bank of England again.
- H.M.Jr: Well what I'm doing here is, we've had a lot of hints thrown out in the last three-four months in our cables from London from the Treasury there and I'm having them all written down to-day, see?
- K: Yes.

-5-

- H.M.Jr: And - one by one and look them over and then what I'm going to most likely do Tuesday is say, "Now look, you've got a new Secretary of the Treasury there, stop hinting - if you want us to do something or you want to talk - talk turkey but I can't understand all this hinting business, see?" In other words - ah.....
- K: Yes, that will - ah - ah.....
- H.M.Jr:there's a new man goes in there what is his position? Does he want to talk to us? But stop all this hinting - I don't understand it.
- K: Yes.
- H.M.Jr: And they've sent us three or four hints and we're putting them all down and to-day we're going to take a look at them - Monday or Tuesday and then I think I'll send for the representative here of the British Treasury and say, "Now this is what we received during the last two or three months. Do you fellows want something or are you just going to keep on hinting? What does the new Chancellor of the Exchequer have in mind?" See?
- K: Yes.
- H.M.Jr: But I got some more hints last night. I - I - I - I can't understand hints. If they want to talk let them talk.
- K: (Laughs) Yes
- H.M.Jr: What?
- K: Yes, well, of course, not knowing what the hints are it's difficult for me to.....
- H.M.Jr: Well I mean - it's - it's this stuff about gold and is gold in the tri-partite and that sort of stuff, you know.
- K: Yes.
- H.M.Jr: Incidentally, two things - they've sent us word do we want to take the Japanese into the tri-partite? The English want to know, see? And - ah - how would you feel about it?

K: Are you asking me?

H.M.Jr: I'm asking you.

K: The question is whether the Japs should be taken in?

H.M.Jr: Yes.

K: There is only one answer - "yes."

H.M.Jr: Really?

K: Well that's my feeling but, of course, assuming that the Japs will - will live up to the terms of the conditions as they exist between the other participants.

H.M.Jr: Yes.

K: Well I think the - ah - the more you can broaden out the tri-partite agreement among the leading nations, the better it is.

H.M.Jr: Ah-ha.

K: I don't think it hurts much Astonia in or Lithuanian but if you can get Japan to join I think that.....

H.M.Jr: Well hasn't she got exchange control?

K: I beg your pardon.

H.M.Jr: Hasn't she got exchange control?

K: Well that's - I said before if she agrees to live up to the terms that the others have laid down for themselves.....

H.M.Jr: Yes.

K: A....ah - I'm not sure that Japan will do it. (laughs)
But - ah.....

H.M.Jr: Well - but you'd encourage them?

K: Oh yes - yes - you don't feel differently, do you?

H.M.Jr: Not if they'll live up to their terms.

-7-

K: Well, I mean it all depends on that.

H.M.Jr: Now, the other thing for your own information only. I've asked Cochran to go to see Dr. Bachman in Switzerland Monday or Tuesday -

K: Fine.

H.M.Jr: - and ask him what all the shooting is for, see?

K: Fine.

H.M.Jr: He knows Bachman very well.

K: Yes.

H.M.Jr: And I've asked him to go there Monday or Tuesday.

K: Yes.

H.M.Jr: And find out what their policy is.

K: Frankly, I'm very much exercised over the way Bachman has acted. I think -

H.M.Jr: Yes - so I gathered, and I gathered that neither the English nor the French know.

K: Yes, that's positive - at least that's my positive information.

H.M.Jr: So, ah - Cochran will be there Monday or Tuesday.

K: And that ought to help.

H.M.Jr: Yes. Well, now as to this immediate situation, I think I'd let it ride and I - I - where will you be Monday?

K: I'll be home.

H.M.Jr: Well, I'll be home. You can call me. I mean I'll be in Washington.

K: Yes. I'm getting posted by the Guaranty Trust on Monday morning as to what's doing.

H.M.Jr: Yes. But the only thing that's happening on it is that the English are going to have to take a little

more gold today and most likely a little more Monday. What - what's the matter with that?

K: Oh, there's nothing - there's nothing the matter - I didn't - I'm not alarmed over the situation. I'm simply calling because I thought you would be interested.

H.M.Jr: I'm very much interested, and - and - they just went through another settlement day, didn't they?

K: Yes, and successfully. *

H.M.Jr: Now I got my bond chart in front of me, and my bonds are behaving very well, and that's my barometer.

K: Well, I think they're behaving too well. I tell you why - because we are again getting an order from the Swiss today to buy \$5,000,000 of Treasury bills at .40% and we can't get them any more.

H.M.Jr: Well, did they take any yesterday?

K: Oh, yes, they have taken - well, they took - I won't say yesterday - they - they - the last few days they've taken 10 million, as I told Lochhead, and today we have the third order for 5 million.

H.M.Jr: How will that - when you've finished this third order, how much will that make altogether that they have taken?

K: They will have taken \$15,000,000.

H.M.Jr: Well, well what's the matter with that?

K: Oh, nothing at all. That's splendid.

H.M.Jr: But I mean if they want to earmark their gold and buy our bills, what's the matter with that?

K: Nothing at all. I - I simply said that the prices are - are behaving too well so that I am afraid the yields will be so low that - that the Swiss won't take them any more after awhile.

H.M.Jr: Well, I mean they've - they've just been doing this for a week, and if that's their policy, what's the matter with that?

K: That policy is perfectly all right. There's no fault to find with that policy.

-9-

H.M.Jr: We'll give them some more bills. They can get some more. They can buy some of our stuff on the seventh if they want to.

K: Ah -

H.M.Jr: - of June, whatever we sell.

K: Sure, only I'm afraid that the rates will be - will be up again and they'll seem less attractive to the foreigners.

H.M.Jr: Well, it's better than leaving the money in the banks not earning anything.

K: True. They started - they wanted to buy bankers acceptances irregularly.

H.M.Jr: I see.

K: And we told them - they came in with an order of 5 million - we told them the supply was too small but we suggested that they might find the supply of Treasury bills broader.

H.M.Jr: Ah-ha.

K: And we indicated to them - oh, we got them a fair offer.

H.M.Jr: Ah-ha.

K: They cabled the following morning, and they accepted.

H.M.Jr: Yes.

K: Then the second order came in at the limit, and we told them we couldn't execute it - the limit was too low. We made them another fair offer, and they accepted it. Today is the third order.

H.M.Jr: I see. Well, this is the way I feel, Knoke. Gold selling in London at 34.70 - I can't see that it's harmful to the United States Government or United States businessmen. I don't see that it hurts either the Government or the United States businessman, do you?

-10-

K: Well, no, the fact that it does - it does not but, of course, the disturbing - the price is disturbing and may lead to further disturbance.

H.M.Jr: Yes, but it doesn't hurt us.

K: No, no. It doesn't hurt us in dollars and cents but I think it hurts us to the extent that we are primarily interested in the stability.

H.M.Jr: Well, look what Trip said. I don't know whether you saw that. Trip said - he was most complimentary the way the United States Government - the courage, the foresight and statesmanship that we showed in handling the gold thing, and he wished the English would do as much.

K: No, I didn't see that. That -

H.M.Jr: Well, that's been in about two days ago.

K: Oh, I see. Well, I haven't had it -

H.M.Jr: And that was what he said about the way the United States Treasury had handled this gold.

K: Well, I - I think that is - is very nicely expressed, but I'll say this - the way Trip himself has acted I think is very splendid.

H.M.Jr: What?

K: The way the Netherlands has stepped in and bought this gold is excellent.

H.M.Jr: Exactly.

Well, now if the English would do as well - fine. In the meantime, I've bought myself two pairs of extra pants so I could sit here long enough until the English wake up.

K: (Laughs)

H.M.Jr: Now, don't forget that. I've got two pairs of extra pants and I can sit here, and I've got a nice air-cooled room, and I can sit here until they're ready.

K: All right (Laughs).

-11-

H.M.Jr: And with gold selling at 34.70, and the South African there, it doesn't do them a bit of good. I should worry. What? Think it over. There's nothing to worry about for the United States Government, the United States businessman or the United States banks. The worrying is on the other side. If you get anything, call me up Monday, will you?

K: All right, sir.

H.M.Jr: Thank you.

K: All right.

H.M.Jr: Good-bye.

Saturday, May 29, 1937.

The Secretary called the White House shortly after nine o'clock and talked to Muir and Steve Early. Magill and Gaston were with him in his office at the time. He learned that the President would not be able to see the three of us until some time in the afternoon. Muir was to notify him of the hour. The Secretary then called Senator Harrison and Representative Doughton and arranged that they should meet with him in his office at 10:15 to discuss the strategy of handling the message on tax avoidance when it should reach the Hill.

At the conference at 10:15 there were present the Secretary, Chairman Pat Harrison of the Senate Finance Committee, and Representative Doughton, Chairman of the Ways and Means Committee, Under Secretary Magill and Mr. Gaston.

The Secretary, at the outset of the conference, said he thought it desirable that we should have some understanding about the method of handling the matter, whether an investigation should be conducted by separate committees or by a joint committee of the two houses. Senator Harrison thought that a joint committee would be the best method. The committee could issue subpoenas for the attendance of witnesses and it seemed to him that any investigation the Treasury pursued could be better conducted if they worked under the authority of a joint committee. There was a feeling of a certain amount of reluctance to give the Treasury broad powers for an independent investigation. Some of the work of actual hearings might be conducted by a sub-committee, but the

- 2 -

full committee could act in making representations to Congress.

Representative Doughton said that there was one question he thought needed to be settled before we could go ahead intelligently. Is it in the mind of the President that we take the facts that we have available now and pass legislation, or should we defer legislation until we make a more complete investigation? Senator Harrison said it was his judgment that the President wants the men who have participated in these practices of avoidance exposed and he has no doubt many will want to come in and answer. We can't very well legislate until we get the whole picture. The Secretary responded that it was clear in his mind what the President wants and he thinks the President has said so. As to such instances as that of incorporated houses and incorporated yachts, the President wants the thing cleared up so the men who are doing these things can't repeat the same thing in their returns for 1937. Senator Harrison commented that that doesn't present any complications. Representative Doughton commented that then the President didn't want to rely simply on publication of the facts - he wants some legislation now. The Secretary said definitely that is what he wants.

Senator Harrison remarked that of course we can't pass legislation until we get the facts. When we have the facts they can go to the Ways and Means Committee for the preparation of legislation. Representative Doughton said that he had always been a believer in the joint committee method but some of his men on the Ways and Means Committee are opposed to the joint committee method. Senator Harrison added that the President of course wants legislation, but the greatest

- 3 -

thing is to bring out the facts. This could best be done by a joint committee. The President thought so when Harrison discussed it with him and he, Harrison, thought so. Of course it is purely a revenue matter. The House will have to take up legislation first, but it would be foolish for the House and Senate committees to be working at the same time on the same facts. Secretary Morgenthau said he agreed to this. It was best to have a joint committee hear the evidence and then if legislation is desired, it will naturally be drawn up in the House.

Mr. Doughton said it was his understanding that the Treasury proposed to submit to the committee the facts that it had already gathered for such corrective legislation as would seem to be necessary; that the committee would consider just the facts that the Treasury had already gathered; that then the Treasury would go ahead with further studies with the object of making recommendations for additional legislation which could be considered by the next Congress. The Secretary replied that it was true that the Treasury had enough facts to show the need of legislation now.

Senator Harrison said that personally he would prefer that the whole matter be handled by the Ways and Means Committee, but he thought it was true that the hearing and consideration would be given greater weight publicly if it were conducted by a joint committee. The joint committee's report could then be referred in the House to the Ways and Means Committee for the preparation of legislation. He thought, therefore, that the joint committee was the best method, but if some of the

people in the House objected he personally did not care how it was handled. Mr. Doughton said that he agreed that it was probably better to have a joint committee deal with the matter. He thought that he could overcome objections that might be made by some of the members of his own committee, that is, the Ways and Means Committee.

Senator Harrison pointed out the difficulties which would ensue if two separate committees of the House and Senate should be holding hearings, going over the same grounds, and the Secretary agreed that this would present unnecessary difficulties. Senator Harrison said that his policy was to avoid hearings as much as possible.

In view of Mr. Doughton's agreement on the joint committee plan of handling the matter, there was discussion of the mechanics of preparing resolutions to that effect. Senator Harrison suggested that he could call Wood of the Legislative Drafting Section of the Senate to have him get to work on a draft of a resolution. The Secretary asked if it would be agreeable if Mr. Magill should work with the drafting experts. Representative Doughton said there would be no difficulty in having the House drafting experts work with Wood and Magill. He could get hold of O'Brien or Beeman. Senator Harrison said that would not be necessary, that he would call Wood and have him get in touch with Beeman or O'Brien and both he and Doughton agreed that they would be glad to have Magill work with these men.

Mr. Doughton remarked that he supposed Mr. Magill had already been working on a draft of a bill and asked if he would plan to cooperate with Parker in that work. Mr. Magill said he had not talked

to Parker yet because he did not think it proper to do so in view of the fact that the whole matter was still in the President's hands, but that of course he would be glad to work with Mr. Parker.

Mr. Doughton expressed the opinion that the seriousness of the evasion situation was something of a reflection on Parker and the others in the Joint Committee; that he thought these experts had not been working on this problem with the intensity that they ought to. They ought to have been staying up nights with this evasion problem; instead of that they have been spending a good deal of their time playing golf and other things. If they had worked as they should, we would not be in the situation we are in today. Both the Secretary and Senator Harrison dissented from this point of view. Harrison said he didn't think it was a reflection on Parker. The Secretary said we were calling attention in the report to the fact that the Joint Committee had done valuable work in closing up loopholes, but the fact was that the legal experts employed by taxpayers were constantly busy devising new schemes which couldn't very well be foreseen. Pointing to the difficulties he said he sent out thirty picked agents to check up on the 1936 returns and that they found out practically nothing. We didn't begin to get into the heart of the matter until Magill decided that he would have to go out and look at some of the returns himself, which he did and quickly found all this material that we are submitting to the President.

Senator Harrison remarked that of course the Republicans and the Republican newspapers were going to ask why we didn't discover these things before, but the answer is that whenever we do discover

- 6 -

something and stop it the taxpayers' experts discover some new loophole. He thought we ought to expose the whole damn thing. Mr. Doughton again said that the taxpayers' lawyers lie awake nights to cook up new schemes; that our men ought not to go to sleep.

Senator Harrison then went to the phone and called Wood and told him to get in touch with Beeman and for both of them to await a call from Mr. Magill. Senator Harrison said he was sure the Senate would work with all possible expedition. He said he planned to ask unanimous consent to take up the resolution. Mr. Doughton added that he hoped the Secretary would assist him in convincing the members of the committee that a joint committee is the right way to handle the thing. He said he planned to tell his members that the President thinks, and the Secretary thinks, that that is the right way to do it and he added "I will need your aid."

Immediately after Harrison and Doughton left Mr. Magill got in touch with the drafting experts and the three of them, Wood, Beeman and O'Brien, met with him in his office shortly after 11:30.

The Secretary went to his home at 11:30 and said he would call about 12:30 to give what information he could about the conference with the President during the afternoon.

-00-

(MK)

#5
5/28/37²⁷⁰
after 3 P.M.
Conference at
White House

May 29, 1937

My dear Mr. President:

As you know, the Treasury was surprised and disturbed by the failure of the receipts from the income tax on March 15th to measure up to the budget estimates. Therefore, we undertook an immediate investigation. Only a preliminary report can be made at this time because the complete investigation covering all the income tax returns filed will require the balance of this year. Furthermore, since many of the returns of large manufacturing corporations have not yet been filed, the present report is confined almost wholly to data disclosed by the individual tax returns.

But even this preliminary report discloses conditions so serious that immediate action is called for. More than the usual examination and audit by the Treasury is needed. It seems clear that if tax evasion and tax avoidance can be promptly stopped through legislation and regulations resulting from a special investigation a very large portion of the deficiency in revenues will be restored to the Treasury.

I herewith enumerate some of the principal devices now being employed by taxpayers with large incomes for the purpose of defeating the income taxes which would normally be payable by them. As we continue our preliminary examination, other devices are being disclosed.

- 2 -

1. The device of evading taxes by setting up foreign personal holding corporations in the Bahamas, Panama, Newfoundland, and other places where taxes are low and corporation laws lax.

Americans have formed 64 such companies in the Bahamas alone in 1935 and 1936, and 22 more were organized by Americans in the Bahamas during the past two months. Panama and Newfoundland seem to be even more fertile territory since their corporation laws make it more difficult to ascertain who the actual stockholders are. Moreover, the stockholders have resorted to all manner of devices to prevent the acquisition of information regarding their companies. The companies are frequently organized through foreign lawyers, with dummy incorporators and dummy directors, so that the names of the real parties in interest do not appear.

One American citizen with a \$3,000,000 Bahamas corporation has apparently attempted to prevent the Bureau of Internal Revenue from catching up with him by filing his individual tax returns in successive years from towns in New Brunswick, British Columbia, and Jamaica.

Another individual believes that he has been so successful in removing his assets from the United States to the Bahamas that he is defying the Treasury to collect a tax upon a \$250,000 fee he has received; and by way of insult, he has offered to compromise his admitted tax liability of \$33,000 for past years by a payment of \$1700.

Still another individual showed a large net loss on his personal return for 1936. In considerable part, the loss was due to the large deduction he claims for interest on a loan made to him by his personal holding company. But the man in question is no object of charity, for

- 3 -

his personal holding company, organized in Canada, had an income of over \$1,500,000 from American dividends in 1936, though it has not yet filed a return.

Perhaps the most flagrant case of this character is that of a retired American Army officer with a large income from valuable American securities which he desires to sell at a very large profit. To escape our income and inheritance tax laws, he used the device of becoming a naturalized Canadian citizen, and six days later organized four Bahama corporations to hold his securities. He and his lawyers apparently think that he can now sell his securities free from any taxes on his profits, since there are no income taxes in the Bahamas, and that he has adroitly escaped American taxes.

E. The device of foreign insurance companies.

Two New York insurance agents have caused the organization of insurance companies in the Bahamas with a view to enabling taxpayers to secure spurious deductions for interest through an ingenious scheme for the issuance of life insurance policies. Americans who went into the scheme purported to pay a large single premium for their policies, but immediately borrowed back practically the entire sum. Under the plan the so-called policyholders sought to obtain a large deduction for interest on this loan, although the fact was that no interest was really paid. By this means five prominent Americans sought to evade nearly \$350,000 in income taxes in the years 1932 to 1936. This fraud was discovered by the Treasury's investigators and all of the taxpayers have now submitted offers to pay the full amount of taxes evaded, plus interest. Until our investigation is completed we do not know how many similar companies may have been organized in other countries, and utilized by our citizens; nor do we yet know whether this newly invented type of fraud has other ramifications.

- 4 -

3. The device of domestic personal holding companies

The rates of tax applicable to personal holding companies were reduced in 1936 at the time of the enactment of the undistributed profits tax. It was believed at that time that the combined rates of the two taxes would be sufficient to insure the distribution of the entire incomes of these companies, and the consequent imposition of surtaxes upon their owners. This expectation has not been realized.

Thus, the single stockholder of one large personal holding company saved himself \$322,000 by causing his company to distribute none of its income to him.

In another case, a man and his wife saved \$791,000 through the use of personal holding companies in 1936.

In a third case, the personal holding company reported over \$500,000 of net income but the total taxes paid by the two stockholders, husband and wife, were less than \$40,000, due principally to credits for payments on indebtedness the holding company prudently incurred in accumulating properties for its owners. If the personal holding company had not been in existence, the stockholders would have paid over \$200,000 additional income taxes.

Another favorite device is to organize a considerable number of personal holding companies, not only for the sake of reducing the tax, but of increasing the Treasury's difficulties in auditing transactions between companies. At last accounts one man had caused to be set up some 96 companies scattered all over the country. Two other individuals were utilizing 23 personal holding companies.

4. The device of incorporating yachts and country estates

Many wealthy taxpayers today are dodging the express provisions of the law denying deductions for personal expenses by incorporating their yachts or their country estates, turning over to the yacht or to the estate securities yielding an income just sufficient to pay the entire expenses of operation. Hundreds of thousands of dollars in income taxes are annually avoided in this way.

Thus, one man's yacht is owned by his personal holding company, along with three million dollars in securities. He rents the yacht from his company for a sum far less than the cost of upkeep, and the company uses its income from the securities to pay the wages of the captain and crew, the expenses of operating the yacht, and an annual depreciation allowance. None of these items would be deductible if this individual owned the yacht personally.

A great many wealthy taxpayers are utilizing a similar arrangement for the operation of their country places and town houses.

One man has placed his five million dollar city residence in such a corporation; another his racing stable whose losses last year were nearly \$200,000. The tax savings he thus sought to obtain through the use of the holding company were \$140,000.

One wealthy woman has improved on the general plan of evasion by causing her personal holding company, which owns her country place, to employ her husband at a salary to manage it. She can thereby supply him with pocket money, and in effect claims a tax deduction for the expense of maintaining him.

5. The device of artificial deductions for interest, losses, etc.

Taxpayers are seeking greatly to reduce their personal income taxes by claiming deductions for interest on loans to them by their personal holding companies, or on loans to them by their family trusts. These transactions normally have no business purpose, but are merely an artificial means of shifting income from one member of the family subject to high surtax rates to another member of the family subject to lower rates.

Thus, one woman claims a large annual deduction for interest on a loan made to her by her husband as trustee of a trust which she created for their children. The mother thereby seeks to secure a deduction for her contribution to the children's support, and since the trust is revocable by her husband, the parents still have the desired control over the property and its income.

In the same category are losses deducted by taxpayers who claim that their racing stables or hobby farms were operated for profit, even though a profit is never realized. Thus, a prominent manufacturer seeks a deduction of over \$125,000 against his income from his business, on account of his losses in operating a chicken farm.

6. The device of the creation of multiple trusts for relatives and dependents

Splitting income two ways, between husband and wife, reduces income taxes and leaves the family income intact. Splitting the family income many ways by means of many trusts, all for the same beneficiaries, may effect a much greater saving, while leaving the money actually in the same hands. For the creator of the trust often constitutes himself or his wife as trustee, and thus retains full control over the investment and disposition of the fund itself and of its income.

- 7 -

One thrifty taxpayer has formed 64 trusts for the benefit of four members of his immediate family, and thereby claims to have saved them over \$485,000 in one year in taxes.

Another thrifty pair have constituted 40 trusts for their relatives, and a prominent lawyer and his wife utilize 16 trusts for the same purpose. The first pair maintains numbered brokerage accounts, and only at the end of the year are the beneficial owners identified. In this way innumerable transactions are carried on, often between accounts, which do not actually affect the beneficial interests of their owners, but which are designed solely to reduce tax liability.

7. The device of husband and wife or father and children partnerships

The purpose of these partnerships, like the multiple trusts, is to split the family income artificially into two parts; or, if the children are taken in, into still smaller fractions.

There are many instances of this kind; but to illustrate the point, it is sufficient to cite the case of a New York brokerage firm which late in 1935 admitted into partnership the four minor children, two boys and two girls, of one of the partners. The tax saving he sought thereby in 1936 amounted to over \$50,000.

8. The device of pension trusts

For 10 years the revenue acts have sought to encourage pension trusts for aged employees by providing corporations with a special deduction on account of contributions thereto, and exempting the trust itself from tax. Recently this exemption has been twisted into a means of tax avoidance by the creation of pension trusts which include as beneficiaries only small groups of officers and directors who are in the high

income brackets. In this fashion high salaried officers seek to provide²⁷⁷ themselves with generous retiring allowances, while at the same time the corporation claims a deduction therefor, in the hope that the fund may accumulate income free from tax.

Thus, in one case \$43,000 is annually appropriated by the corporation to a pension trust for the benefit of its two chief owners. One of the co-owners will retire at the age of 65 with a monthly pension of \$1725, and the other will retire at 60 with a monthly pension of \$1425.

These eight types of tax avoidance are sufficient to show that there is a well-defined purpose and practice on the part of some taxpayers to defeat the intent of Congress to tax incomes in accordance with ability to pay. In some cases, the Bureau of Internal Revenue under existing law can establish a liability or indeed proceed on the ground of fraud; but many of these cases fall in the category of a legal though highly immoral avoidance of the intent of the law. It seems, therefore, that legislation should be passed at this session of the Congress in order to eliminate these loopholes which our preliminary investigation has proved; and that as a result of the further investigation this summer and autumn the next session of the Congress should finally close any further loopholes which may be discovered.

• • •

In addition to these cases of moral fraud, there are three other major instances in which the law itself permits individuals and corporations to avoid their equitable share of the tax burden.

1. Percentage depletion

This is perhaps the most glaring loophole in our present revenue law. Since 1928 large oil and mining corporations have been entitled to deduct from 5 to 27½ percent of their gross income as an allowance for the depletion of their mines or wells, and the deduction may be taken

even though the cost of the property has been completely recovered. Thus, in 1936, one mining company deducted nearly \$3 million under this provision, although it had already completely recovered the cost of its property. The amount of the deduction was a sheer gift from the United States to this taxpayer and its stockholders, and the revenue that we lost thereby was \$618,000. Similar annual losses of revenue in the cases of a few other typical companies are \$584,000; \$557,000; \$512,000; \$272,000; \$267,000; \$202,000; and \$152,000. The estimated annual loss of revenue due to this source alone is about \$75,000,000. I recommended in 1933 that this provision be eliminated but nothing was done at that time; and it has since remained unchanged.

2. The division of income between husband and wife in the 6 community property states

This is another major cause of revenue loss, which is unjustifiable because obtained at the expense of taxpayers in the 40 states which do not have community property laws. A New York resident with a salary of \$100,000 pays about \$32,525 Federal income tax; a Californian with the same salary may cause one half to be reported by his wife and the Federal income taxes payable by the two will be only \$18,626. The total loss of revenue due to this unjustifiable discrimination against the residents of 40 states runs into the millions.

3. Taxation of non-resident aliens

The 1936 Act eliminated the requirement that a non-resident alien, (without United States office or business) should file a return; fixed the withholding rate for individuals at 10 percent; and freed the non-resident alien from taxation on American capital gains. Since the total Federal tax upon a citizen or resident amounts to 10 percent of his total net income

- 10 -

at about \$25,000, (in the case of a married individual with no dependents), the withholding rate has proved in practice to be too low as applied to wealthy non-resident alien individuals. There are a number of cases of non-resident aliens with large incomes from American trusts or with large American investments whose taxes have been cut to one-third or one-fifth of what they paid under the prior act.

Thus, one American woman who married an Englishman had an income from this country in 1935 of nearly \$300,000. Her tax for 1936 will, therefore, be approximately \$30,000 as against over \$160,000 under the prior law.

Another American woman who married a Frenchman has an income of over \$150,000 from American trusts, on which she paid a tax of about \$55,000 in 1935. Her tax is reduced to about \$15,000 by the 1936 law. Although the tightening of the withholding provisions in 1936 will tend to insure more revenue from non-resident aliens in the lower income brackets, the present taxing provisions are not satisfactory as applied to non-resident aliens with incomes in the higher brackets.

* * *

The problem of tax avoidance is not new. The Congress devoted particular attention to it in 1933 and 1934, and by legislation effectively put a stop to many evasive devices discovered then as having been in use. The practices outlined above can and should be stopped in the same way.

In conclusion, I have two observations to make from the evidence before me. In the first place, the instances I have given above are disclosed by a quick check of comparatively few individual returns. As I have said before, most of the large corporation returns have not yet

been filed. The general audit of 1936 returns is just beginning. Nevertheless, it is likely that the cases I have digested above are symptomatic of a large number of others, which will be disclosed by the usual careful audit.

In the second place, the ordinary salaried man and the small merchant does not resort to those or similar devices. The great bulk of our 5,500,000 returns are honestly made. Legalised avoidance or evasion by the so-called leaders of the business community is not only demoralizing to the revenues; it is demoralizing to those who practice it as well. It throws an additional burden of taxation upon the other members of the community who are less able to bear it, and who are already cheerfully bearing their fair share. The success of our revenue system depends equally upon fair administration by the Treasury, and upon completely honest returns by the taxpayer.

The disclosures are so serious that I recommend that authority be given to the Treasury Department with an adequate appropriation in order that a complete and immediate investigation may be conducted. The cost of such an investigation will be returned many times over to the Treasury of the United States.

Faithfully,

The President,

The White House.

In the House of Representatives

June _____, 1937.

Mr. _____ introduced the following joint resolution which was referred to the Committee on _____, and ordered to be printed.

JOINT RESOLUTION

To create a Joint Congressional Committee on Tax Evasion and Avoidance.

Received by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) there is hereby established a Joint Congressional Committee to be known as the Joint Committee on Tax Evasion and Avoidance (hereinafter referred to as the joint committee).

(b) The joint committee shall be composed of five members of the Senate who are members of the Committee on Finance, appointed by the President of the Senate, and five Members of the House of Representatives who are members of the Committee on Ways and Means, appointed by the Speaker of the House of Representatives. A vacancy in the joint committee shall not affect the power of the remaining members to execute the functions of the joint committee, and shall be filled in the same manner as the original selection.

Sec. 2. It shall be the duty of the joint committee to investigate the methods of evasion and avoidance of income, estate, and gift taxes, pointed out in the message of the President transmitted to Congress on June 1, 1937, and to report to the Senate and the House, at the earliest practicable date, and from time to time thereafter, its recommendations as to remedies for the evils disclosed by such investigation.

Sec. 3 (a). The joint committee, or any subcommittee thereof, shall have power to hold hearings and to sit and act at such places and times, to require by subpoena or otherwise the attendance of such witnesses and the production of such books, papers, and documents, to administer such oaths, to take such testimony, to have such printing and binding done, and to make such expenditures, as it deems advisable. Subpoenas shall be issued under the signature of the chairman of said joint committee, and shall be served by any person designated by him. Amounts appropriated for the expenses of the joint committee shall be disbursed one-half by the Secretary of the Senate and one-half by the Clerk of the House. The provisions of sections 101 and 102 of the Revised Statutes shall apply in cases of any failure of any witness to comply with any subpoena, or to testify when summoned, under authority of this joint resolution.

(b)(1) The Secretary of the Treasury and any officer or employee of the Treasury Department, upon request from the joint committee, shall furnish such committee with any data of any character contained in or shown by any return of income, estate, or gift tax.

(2) The joint committee shall have the right, acting directly as a committee, or by or through such examiners or agents as it may designate or appoint, to inspect any or all such returns at such times and in such manner as it may determine.

(3) The joint committee shall have the right to submit any relevant or useful information thus obtained to the Senate, the House of Representatives, the Committee on Ways and Means, or the Committee on Finance,

and shall have the right to make public, in such cases and to such extent as it may deem advisable, any such information or any such returns. The Committee on Ways and Means or the Committee on Finance may submit such information to the House or to the Senate, or to both the House and the Senate, as the case may be.

Sec. 4. The joint committee shall have power to employ and fix the compensation of such officers, experts, and employees as it deems necessary for the performance of its duties, but the compensation so fixed shall not exceed the compensation fixed under the Classification Act of 1923, as amended, for comparable duties. The joint committee is authorized to utilize the services, information, facilities, and personnel of the Department and agencies in the Executive branch of the Government and of the Joint Committee on Internal Revenue Taxation.

Sec. 5. The joint committee may authorize any one or more officers or employees of the Treasury Department to conduct any part of such investigation on behalf of the committee, and for such purpose may authorize such persons to hold such hearings and require by subpoena or otherwise the attendance of such witnesses and the production of such books, papers, and documents, to administer such oaths and to take such testimony as the committee may authorize. In any such case subpoenas shall be issued under the signature of the chairman of the joint committee and shall be served by any person designated by him.

TO THE CONGRESS:

A condition of such seriousness to the Nation has been developing during the past two months that the Congress and the people are entitled to information concerning it. The Secretary of the Treasury has given me a report of a preliminary study of income tax returns for the calendar year 1936. This report reveals efforts at avoidance and evasion of tax liability, so widespread and so amazing both in their boldness and their ingenuity, that further action without delay seems imperative.

It ^{is} ~~seems~~ obvious as we read this report that we ~~can~~ face a challenge to the power of the Government to collect, uniformly, fairly and without discrimination, taxes based on principles duly adopted by the Congress.

Methods of escape or intended escape from tax liability are many. Some are instances of avoidance which appear to have the color of legality; others are on the borderline of legality; others are plainly contrary to the law. All are definitely contrary to the spirit of the law. They are all alike in that they represent a determined effort on the part of those who employ them to dodge the payment of taxes which were based on ability to pay. They are all

alike in that failure to pay results in shifting the tax load to the shoulders of others less able to pay.

The three great branches of the Government have a joint concern in this situation. It is the duty of the Congress to remove unheard of loopholes devised by unscrupulous attorneys for clients willing to take an unethical advantage of society and their own Government. Second, it is the duty of the Executive branch of the Government fully to investigate all cases and to prosecute where wrong has been done. Third, it is the duty of the Courts to give full consideration to the intent of the Congress in passing tax laws and to give full consideration to all evidence which points to an objective of evasion on the part of the taxpayer.

I commend to your attention the following letter by the Secretary of the Treasury. (Quote letter)

A feeling of indignation on reading this letter will, I am confident, be yours, as it was mine.

What the facts set forth mean to me is that we have reached another crucial stage in the maintenance of the normal processes of our Government. We are seeking more greatly than ever before to protect the weak, curb avarice, to relieve suffering and want. Taxation necessary to these ends is the foundation of sound governmental finances. When

our legitimate revenues are attacked, the whole structure of our Government is attacked.

Very definitely, the issue immediately before us is the single one relating to the evasion or unethical avoidance of existing laws. That should be kept clearly in mind by the Congress and the public. Already efforts to befog this issue appear. Already publishers of a certain type of newspaper are seeking to make it appear - first, that if a citizen can devise unthought of methods to avoid taxes which the Congress intended him to pay, he is doing nothing unpatriotic or unethical; and, secondly, that because a citizen does not approve of high income tax brackets, or the undistributed earnings tax, or the capital gains tax, taxes such as these should be repealed or lowered as the first duty of the Congress. In other words, not one but many red herrings are in preparation.

It seems to me that the first duty of the Congress is to enable the Government to stop these evil practices, and that this duty should not be confused in legislation by any revision of ~~tax~~ tax schedules. That is a wholly different subject. In regard to that subject, I have already suggested to the Congress that at this session there should be no new taxes or no changes of rates. And I have indicated to the

Congress that the Treasury will be prepared by next November to present to the appropriate committees information on the basis of which more general revision of the tax structure may be undertaken. It is our duty to the Nation not to confuse the correction of this glaring evasion and avoidance problem with the whole separate problem of tax policy.

The decency of American morals is involved. The example of successful tax dodging by very rich citizens breeds efforts to dodge tax laws and other laws on the part of others. We hear too often the phrase "It is all right to do it if you can get away with it."

Taxpayers in the lower brackets have some justification for opposing any broadening of the tax base if they can point out that many in the upper brackets are escaping taxation they were intended to bear.

It is also a matter of deep regret to know that lawyers of high standing at the Bar have ~~advised~~ advised and are advising their clients to utilize devious tax avoidance devices. Many of them, indeed, are actively using these devices themselves.

I am confident that the Congress will wish to proceed in this grave matter; that it will give to the Treasury all authority necessary to expand and complete the present preliminary investigation, including, of course, full authority to summon witnesses and compel their testimony. The ramifications and the geographical extent of complete investigation are so large that it is necessary to include every power of Government.

I am confident also that the Congress will wish to enact legislation at this session specifically and exclusively aimed at making the present tax structure leak-proof.

With the development of a complete investigation, it will become possible for me to set forth the facts in full and to make recommendations to the next session of this Congress in January.

PARAPHRASE OF TELEGRAM SENT

TO: American Embassy, London, England

DATE: May 29, 1937, 1 p.m.

NO.; 205

FROM SECRETARY MORGENTHAU FOR BUTTERWORTH.

On May 28, 1937, the following telegram was received from the American Embassy, Tokyo, Japan:

[The paraphrase of telegram No. 138 of May 28 from Tokyo was herein quoted.]

I will try to send you a reply early next week to your cable No. 315.

WELLES, ACTING

EA:LWW

RECEIVED

MAY 29 1937

UNITED STATES DEPARTMENT OF STATE
WASHINGTON, D. C. 20520
OFFICE OF THE SECRETARY OF STATE

May 29, 1937

TO: Dr. Fels

FROM: Mr. Taylor

Will you please send the following cable to Buttersworth

in London:

Following telegram received from American Embassy, Tokyo, Japan May 28, 1937 (NOTE There is a prevailing impression that the import exchange licensing system established on January 8, 1937, under the foreign exchange control law will shortly be revised but not later than the thirty-first of July, on which date renewal of the system will be considered.

Revision of the system will probably provide for bringing the present limit of yen 30,000 for transactions not requiring official permits down to the lower figure, probably yen 1,000 in order to prevent evasion by importers using 'straw men' to cover imports which would in the aggregate greatly exceed the system's present limit of yen 30,000.

Foreign bank representatives in Tokyo are of the opinion that the foreign exchange control law may be revised so as to incorporate more rigid control over remittances for other than essential import trade requirements, for the acquisition and withdrawal of Japanese securities issued abroad, and for the munitions and allied industries. It is said the Finance Ministry deems the measures contemplated necessary. The Finance Ministry is reportedly much concerned over the adverse visible

- 2 -

trade balance exceeding 500,000,000 yen on the twentieth of May. The observers mentioned think that preparations are going on for other measures which are designed further to restrict imports to offset to as great an extent as possible the unfavorable trade balance which is inevitable, notwithstanding the heavy gold exports.

Since January gold exports have already reached approximately 150,000,000 yen. By December they are likely to be increased by an additional fifty millions, thus consuming estimated 1937 production UNQUOTE

With reference to your cable No. 315 I will endeavor to send you an answer early next week

MORGENTHAU

JR

GRAY

Paris

Dated May 29, 1937

Rec'd 9:20 a.m.

Secretary of State,
Washington.

699, May 29, 1 p.m. (SECTION ONE).

FROM COCHRAN.

Minister of Finance has announced that June 1st coupons of French Government 7 $\frac{1}{2}$ % 1921 and 7% 1924 bonds issued in the United States will be paid on basis of 25.52 francs to the dollar.

Minister of Finance has warned public against accepting press stories which pretend to anticipate Government's tax reforms which are now in course of preparation.

AGENCE ECONOMIQUE today carries following story of Franco-German trade negotiations:

"The conversations which have taken place between Dr. Schacht on the one hand and M. Bastid and Spinasse on the other hand have made possible the establishment of an agreement in principle on essential questions in suspense which had held up the conclusion of the Franco-German commercial agreement. Apparently another ten days will be necessary (end section one).

BULLET

CSB

JR

A portion of this telegram must be closely paraphrased before being communicated to anyone. (B)

Paris

Dated May 29, 1937

Rec'd 10:55 a.m.

Secretary of State,
Washington.

699, May 29, 1 p.m. (SECTION TWO) (GRAY).

for the drawing up of the new convention although the tourist provisions will come into force as from June 1st. Last evening M. Bastid made the following declaration to the press:

Following conversations which have taken place during the past few days the principle difficulties which had stood in the way of the realization of an economic arrangement between France and Germany have happily been removed. The two Governments consider with satisfaction that the negotiations which continue in order to complete certain questions of detail and the drafting of texts should result in the near future in the conclusion of a treaty which will serve as a stable basis for the financial and commercial relations between the two countries. Under these circumstances the tourist arrangement, the principle and the methods of which were accepted two months ago, will definitely come into force as from June first next.

M. Bastid added that his conversations with M. Schacht

had

- 2 -

had been marked with the sincere desire to arrive in the near future at a complete understanding".

Financial press suggests that new imports of Russian gold on to London market may revive gold scare.

Reference is made to telegram No. 243 of May 28, 6 p.m., from the Department. Sunday night I will leave Paris for Bern where on Monday I meet Bachmann. At 7 o'clock Tuesday morning I will arrive back in Paris.

END MESSAGE.

BULLITT.

EA:LWW

RECEIVED
MAY 29 1945
FEDERAL BUREAU OF INVESTIGATION
U. S. DEPARTMENT OF JUSTICE
WASHINGTON, D. C.

I hold *bill*
give me *Sunday May 30th* *J. I. 295*
at House 1937

FIRST ROUGH DRAFT

J. I. 295

MEMO
IN RE
HOUSING BILL

Purpose: To provide Federal financial assistance to slum reclamation and low-rent housing projects in a way that will assure a sound program that will give promise of eliminating substandard housing and of assuring an adequate supply of decent, safe and sanitary dwellings for all low-income families.

Items

Such a program must include:

1. Federal loan of capital at low interest rates (Going Federal rate of interest ~~plus 1/8 of 1%~~ raised to the nearest multiple of 1/8 of 1%).
2. These loans must be bona-fide loans to be repaid with interest. The security must be approved by the Secretary of the Treasury. The security may take the form of bonds issued by the housing agency and based upon the property owned by the agency; it may take the form of a mortgage. In any case the Director of Public Housing should retain the right to enter upon and operate or sell the property if there is any violation of the conditions of the loan.

-3-

3. Federal grants to public housing agencies, not to limited-profit corporations. These grants, which are not returnable (unless the property is sold at a profit, in which case the grant shall be returned in full before any other use is made of the profit) are to be used in various ways in the discretion of the Director. They may be used to write-down acquisition cost to an approved use value, or to reduce rents, or to subsidize incomes of families unable to pay the rent necessary to secure a decent, safe and sanitary dwelling. This means that a grant may be paid in a lump sum, or in installments. If paid in installments, the installments shall be capitalized at the value at the time of making the grant to assure that the total of grants to any project does not exceed 45% of its total acquisition and development cost.
4. The local government (or housing agency) shall contribute to the extent legally and financially possible. Because of varying legal limitations and financial conditions, it is not practicable at this time to write into the bill any definite percentage contribution requirement. Consequently this matter is left

-5-

to the discretion of the Director. Later, when necessary legislation has been enacted, or opportunity given for such enactment, and when experience has shown what valuation may be put on various forms of local contribution (cash, tax-exemption, parks and playgrounds, streets and public services, local rent subsidies to families, etc.), it may prove practicable to write a percentage requirement in the Act.

5. Federal control of the project should be only to the extent of assuring that the project is developed in accordance with the terms of the loan or grant, and that it will be maintained in accordance with those terms during the life of the contract. Provision is made for terminating a project if and when it ceases to serve the purposes of the Act. There should not be contemplated perpetual Federal control or the continuance of a project during a long series of years if, due to changing conditions, that project ceases to serve the purpose for which it was developed.

-cOc-

BRITISH EMBASSY,
WASHINGTON, D.C.

May 31st, 1937

My dear Mr. Secretary,

I have much pleasure in communicating the following message which I have received for you from Mr. Neville Chamberlain:-

"On leaving my post as Chancellor of the Exchequer I wish to convey to you my sincere appreciation of the spirit of cordial collaboration now in existence between our two Treasuries. This has been, I believe, of inestimable benefit reaching far beyond our two countries. It was this spirit which made the tripartite declaration possible and thus enabled a serious crisis to be surmounted with the minimum of disturbance, and I have no doubt this same spirit will be of the greatest help in enabling us to surmount such difficulties/

The Honourable

Henry Morgenthau, Jr.,

United States Treasury,

Washington, D.C.

"difficulties as may trouble us in future.
I am sure that you will find my successor
no less anxious than I have been for the
fullest collaboration between the two Treasuries.

I would add that I have read with great
interest the account which Mr. Bewley gave me
of your recent conversation with him and that
the points arising will engage my successor's
close attention."

Believe me,

My dear Mr. Secretary,

Very sincerely yours,

H. C. Hoover

SUMMARY OF MEETING HELD MONDAY, MAY 31, 1937,
AT FOUR P.M. AT HOME OF SECRETARY MORGENTHAU
ON FEDERAL HOUSING LEGISLATION

In addition to the Secretary of the Treasury and Mrs. Morgenthau,
there were present:

William H. McReynolds, Administrative
Assistant to the Secretary of the
Treasury

Clarence V. Opper, Assistant General
Counsel, Treasury Department

John Ihlder, Executive Director, Alley
Dwelling Authority

Walter Dager, Financial Advisor, Federal
Housing Administration

^{Wisk}
~~Leslie~~ Lindow, Statistician, Treasury
Department

Dr. R. W. Patterson, Bureau of the Budget

Charles West, Undersecretary of the Interior

Howard Gray, Director, PWA Housing Division

E. H. Foley, Jr., General Counsel, PWA

David L. Krooth, Counsel, PWA

Secretary Morgenthau stated that he was unalterably opposed to the financial provisions of the Wagner-Steagall Bill and had been asked by the President to suggest some method of financing a housing program which would be acceptable. The Secretary added that under his direction, Mr. McReynolds had conducted a survey of various alternative methods for the Federal financing of a housing program. In this connection, he had consulted with representatives of local housing authorities. After these studies and discussions over a period of a month or six weeks, Mr.

-2-

McReynolds was unable to find an acceptable plan of financing upon which the housing experts could agree.

Secretary Morgenthau stated that the purpose of the meeting was to discuss with representatives of the Interior Department and Public Works Administration their experiences. With this opening statement, Secretary Morgenthau called on Mr. Gray for an explanation of the present PWA housing program and the method in which the present projects were being financed. Mr. Gray made a brief statement indicating that 52 housing projects have been undertaken by the Public Works Administration as Federal projects at a total cost of approximately \$150,000,000. Of these projects 12 have been completed to date, with 31 scheduled for completion by the end of this year and the remaining 9 projects scheduled for completion early next year.

Secretary Morgenthau inquired regarding the manner in which the rentals on these projects had been fixed. Mr. Gray explained that the operation of these projects was governed by the George-Healey Act which permitted the Public Works Administration to write off 45% of the cost of the project. This Act provides that the rentals in the projects shall be sufficient to pay operating expenses of the project and to repay 55% of the cost of the project over a sixty-year period with such interest as the Administrator of Public Works should determine. Mr. Gray further stated that the interest charge fixed on most of the projects which have been opened is 3%, but that the construction cost of these projects is relatively lower than that of the

-5-

projects which were undertaken at a later date. Mr. Gray further stated that the interest rate on several projects, including the Harlem project in New York, had been fixed at 1% and that the total subsidy for the Harlem project would therefore amount to about 60%. Mr. Krooth explained that the basis for this computation was a 45% grant, plus the grant represented by the reduced interest rate of 1%. Assuming that the cost of money to the Government is 2½%, a 1% interest rate on 55% of the cost of a project amounts to a subsidy of approximately 15%. This, together with the 45% write-off, makes a total grant of about 60% on the Harlem project and on the other projects where a 1% interest charge has been fixed.

Here Secretary Morgenthau asked several questions as to the amount of the grant which was written off and the interest rate charged in connection with the rentals fixed on PWA projects. It was pointed out that the George Healey Act provides that only 45% of the cost of the project may be written off by way of outright grant, but that the PWA Administrator was given discretion to fix the interest rate on the remainder of the cost of the project to be amortized out of rentals.

Secretary Morgenthau then asked Mr. Foley what PWA could do under its present powers, assuming that PWA and its powers and funds were continued by Congress for an additional two years after June 30, 1937. Mr. Foley explained that PWA could, if funds were made available, construct projects in the same manner as the 52 projects were constructed

-4-

under the original program. In addition, it was pointed out that grants up to 45% of the cost of the project could be made to local housing authorities created under state laws, such grants to be made from the PWA revolving fund. Upon questioning by Secretary Morgenthau, it was developed that the net capital balance of the PWA revolving fund after providing for the grants authorized under the First Deficiency Appropriation Act of 1936 and for 1938 administrative expenses, was approximately \$125,000,000. It was explained that this amount was not available in cash at this time, but that securities on hand and securities to be acquired would have to be sold in order to realize this figure. Nor could all of this amount be used for grants without additional legislation because of the existing limitation that only \$300,000,000 of the revolving fund may be used for grants.

Undersecretary West indicated that promises as to the use of this revolving fund money for non-Federal PWA projects had been made to some members of Congress in connection with the settlement of the attempt to earmark portions of the billion and one-half dollars provided in the relief bill now under consideration.

Secretary Morgenthau asked Mr. Foley what course would be followed to carry it out if \$100,000,000 were made available to finance such a housing program for the first year.

Mr. Foley replied that on the basis of its experience PWA was convinced that the most effective means of carrying on a housing program was through local public housing authorities and that further direct

-5-

construction and operation of projects by the Federal government was inadvisable. After a statement of his reasons for this view, Mr. Foley explained that the Federal Government had been encouraging the enactment of state legislation which would make it possible for local communities to undertake the construction and operation of housing projects, with Federal financial and technical assistance. Largely as a result of these efforts of the Public Works Administration, Mr. Foley explained that thirty states had now enacted legislation providing for the creation of public housing authorities which would have the power to issue bonds to aid in the construction of local housing projects.

Secretary Morgenthau made several inquiries regarding the nature of the bonds which local housing authorities could issue. Mr. Foley explained that the bonds issued by housing authorities would be similar to the bonds which had been issued to finance many revenue-producing undertakings in New York and other states. He explained that a similar method of financing had been used in connection with projects undertaken by the Buffalo Sewer Authority, Triborough Bridge Authority, The Saratoga Springs Authority, New York Tunnel Authority, Jones Beach Authority and numerous other projects. The bonds in connection with all of these projects were payable solely from the revenues of the projects undertaken by the Authority and did not involve any obligation on the part of the state or any political subdivision to resort to taxation for the purpose of paying principal and interest. Nevertheless, the financial soundness of these bonds has been demonstrated by their

marketability and price. Mr. Foley stated that about a month ago, PWA, through the RFC, had refunded its \$35,000,000 Triborough Bridge bonds, making a profit of \$525,000 on the portion of the refunding bonds offered for sale. He then indicated that the bonds of local housing authorities would also become recognized as sound financial investments, although at first it probably would be necessary for the Federal Government to purchase most of these bonds.

Secretary Morgenthau asked Mr. Foley whether the Public Works Administration could sell its housing projects to public housing agencies under existing Federal legislation. Mr. Foley said that PWA had power to sell the projects but not at a write-off of a fixed amount of the capital cost which would be necessary in order for PWA to permit a continuance of the operation of the projects on a low rent basis.

Secretary Morgenthau asked whether it would be feasible for PWA to sell its housing projects to public housing authorities if the Public Works Administration were given power to make such a sale at a write-off. Mr. Foley indicated that it would be feasible in most cases and that the bonds of the local authority could be accepted in payment for the purchase price.

Secretary Morgenthau then stated that several ideas had occurred to him regarding the manner in which a housing program might be authorized for the near future. He referred to the fact that the maximum grant allowed by PWA for any project amounted to about 60% (45% capital grant and 15% interest subsidy). The Secretary stated that he would regard a 60% capital grant as a reasonable basis upon which to undertake a future program. The Secretary inquired of Mr. Gray regarding the rentals which such a grant would permit. Mr. Gray stated that due to increased material

-7-

and construction costs that the rentals would approximate the present rentals on PWA projects.

Secretary Morgenthau indicated that it would be impossible to provide sufficient funds or obtain necessary materials in order to undertake a housing program which would meet the present needs for housing and that he believed the Government should undertake a program calculated to meet such part of this need as it could afford within its budget. Although the Secretary recognized that a 60% subsidy would not permit rents which would reach persons of very low incomes, he stated his opinion that the Government could not afford a larger subsidy and that the housing program should be undertaken in such a way as to enable the Government to stay within its seven billion dollar budget for 1938.

The Secretary stated his belief that a housing program along the lines he was suggesting could be undertaken within the budget, but that the Wagner-Steagall program would constitute too great a burden on the Treasury and involve too large a subsidy.

He further stated that any additional housing program should be carried on by the Housing Division of the Public Works Administration; that the experience of this organization qualified it to undertake a further program; and that the creation of a new independent housing agency was wholly unnecessary. However, Secretary Morgenthau suggested that the housing administration be created in such a manner that it could be readily transferred to a Department of Public Works pursuant

-8-

to any plan for the reorganization of the executive departments. In answer to a question, Secretary Morgenthau stated that everyone agreed that loans should not be made to limited dividend corporations because they had proven themselves unable to provide housing at sufficiently low rentals. The Secretary also agreed that there should be no further construction of housing projects directly by the Government. He then emphasized the need for local responsibility and for local acquisition of land. Mr. Foley pointed out that the power of local housing authorities to acquire land through condemnation had been recently established by the highest courts of two states so that many legal difficulties could be avoided if local housing authorities were to acquire the necessary land.

With respect to local contributions, Secretary Morgenthau stated that the local community should be prepared to contribute to the construction and operation of housing projects. Mr. Gray stated that tax exemption of housing projects would amount to a very substantial contribution by the states and political subdivisions, inasmuch as full taxation is the equivalent of a charge per room per month of from \$3 to \$5. Secretary Morgenthau then stated that the Federal legislation ought to contain a specific requirement that public housing projects be exempted from state and local taxation, so as to assure that the local communities would be making an adequate contribution toward assuring the low-rent character of housing projects.

Mr. Ihlder stated his opinion that a subsidy based on the project cost would encourage high construction costs and that he personally favored the construction of projects without a subsidy. According

-9-

to his view, the subsidy should be used solely for the purpose of offsetting the additional cost of slum land as compared with vacant land. Mr. Ihlder further stated that he had heard rumors that PWA could not anticipate what its rentals would be because of the great uncertainty regarding construction costs.

Mr. Gray strongly objected to this statement, saying that before a construction contract was let, the Housing Division knew the rentals which would be charged in the project. He added that the projects were designed with a view to meeting a certain low income group. Where the Housing Division received bids on a project which were too high to permit the proposed low rentals, such bids have been rejected and the project has been redesigned in order to make possible lower costs and lower rentals.

Mr. Morgenthau asked Mrs. Morgenthau for an expression of her opinion. She stated her opinion that the proposed 60% subsidy would not be sufficient to reach the low income group that should be served by a program of this character. Secretary Morgenthau replied that the Government finances would not permit a much larger subsidy and that the line would have to be drawn somewhere. He added that the proposed subsidy would permit a housing program for a part of the low income group, although it might not reach down into that group as low as might be desired.

Secretary Morgenthau then asked Mr. Foley to summarize the discussion regarding his proposal for a federal housing program. Mr. Foley summarized the program as follows:

-10-

1. The creation of a permanent housing agency in the Department of the Interior.
2. The authorization of a grant to public housing agencies of not to exceed 60% of the cost of the project.
3. The authorization of loans and grants only to public housing agencies.
4. As a condition to Federal aid, the requirement that housing projects be granted full exemption from state and local taxation or the equivalent thereof in the form of other local aid.
5. The authorization to sell or lease projects to public housing agencies at a write-off of not more than 60%.
6. The authorization of loans at not less than 3% interest, with power in the Housing Administration to resell the bonds which it acquires.
7. Conferring power on the Secretary of the Treasury to purchase these bonds from the Administration and to resell them; also to issue government obligations in an amount equivalent to any such bonds which the Treasury decides to retain.
8. The elimination of loans to limited dividend corporations and the elimination of further demonstration projects.
9. The appropriation of funds to finance the proposed program, the amount of the appropriation to be left blank.

SUMMARY OF MEETING HELD MONDAY, MAY 31, 1957,
AT FOUR P.M. AT HOME OF SECRETARY MORGENTHAU
ON FEDERAL HOUSING LEGISLATION

In addition to the Secretary of the Treasury and Mrs. Morgenthau,
there were present:

William H. McReynolds, Administrative
Assistant to the Secretary of the
Treasury

Clarence V. Opper, Assistant General
Counsel, Treasury Department

John Ihlder, Executive Director, Alley
Dwelling Authority

Walter Dager, Financial Advisor, Federal
Housing Administration

Leslie Lindow, Statistician, Treasury
Department

Dr. R. W. Patterson, Bureau of the Budget

Charles West, Undersecretary of the Interior

Howard Gray, Director, PWA Housing Division

E. H. Foley, Jr., General Counsel, PWA

David L. Krooth, Counsel, PWA

Secretary Morgenthau stated that he was unalterably opposed to the financial provisions of the Wagner-Steagall Bill and had been asked by the President to suggest some method of financing a housing program which would be acceptable. The Secretary added that under his direction, Mr. McReynolds had conducted a survey of various alternative methods for the Federal financing of a housing program. In this connection, he had consulted with representatives of local housing authorities. After these studies and discussions over a period of a month or six weeks, Mr.

-3-

McKays was unable to find an acceptable plan of financing upon which the housing experts could agree.

Secretary Morgenthau stated that the purpose of the meeting was to discuss with representatives of the Interior Department and Public Works Administration their experiences. With this opening statement, Secretary Morgenthau called on Mr. Gray for an explanation of the present PWA housing program and the method in which the present projects were being financed. Mr. Gray made a brief statement indicating that 52 housing projects have been undertaken by the Public Works Administration as Federal projects at a total cost of approximately \$150,000,000. Of these projects 12 have been completed to date, with 31 scheduled for completion by the end of this year and the remaining 9 projects scheduled for completion early next year.

Secretary Morgenthau inquired regarding the manner in which the rentals on these projects had been fixed. Mr. Gray explained that the operation of these projects was governed by the George-Healey Act which permitted the Public Works Administration to write off 45% of the cost of the project. This Act provides that the rentals in the projects shall be sufficient to pay operating expenses of the project and to repay 55% of the cost of the project over a sixty-year period with such interest as the Administrator of Public Works should determine. Mr. Gray further stated that the interest charge fixed on most of the projects which have been opened is 3%, but that the construction cost of these projects is relatively lower than that of the

-4-

projects which were undertaken at a later date. Mr. Gray further stated that the interest rate on several projects, including the Harlem project in New York, had been fixed at 1% and that the total subsidy for the Harlem project would therefore amount to about 60%. Mr. Krooth explained that the basis for this computation was a 45% grant, plus the grant represented by the reduced interest rate of 1%. Assuming that the cost of money to the Government is 2 1/2%, a 1% interest rate on 55% of the cost of a project amounts to a subsidy of approximately 15%. This, together with the 45% write-off, makes a total grant of about 60% on the Harlem project and on the other projects where a 1% interest charge has been fixed.

Here Secretary Morgenthau asked several questions as to the amount of the grant which was written off and the interest rate charged in connection with the rentals fixed on PWA projects. It was pointed out that the George Healey Act provides that only 45% of the cost of the project may be written off by way of outright grant, but that the PWA Administrator was given discretion to fix the interest rate on the remainder of the cost of the project to be amortized out of rentals.

Secretary Morgenthau then asked Mr. Foley what PWA could do under its present powers, assuming that PWA and its powers and funds were continued by Congress for an additional two years after June 30, 1937. Mr. Foley explained that PWA could, if funds were made available, construct projects in the same manner as the 52 projects were constructed

-4-

under the original program. In addition, it was pointed out that grants up to 45% of the cost of the project could be made to local housing authorities created under state laws, such grants to be made from the PWA revolving fund. Upon questioning by Secretary Morgenthau, it was developed that the net capital balance of the PWA revolving fund after providing for the grants authorized under the First Deficiency Appropriation Act of 1936 and for 1936 administrative expenses, was approximately \$125,000,000. It was explained that this amount was not available in cash at this time, but that securities on hand and securities to be acquired would have to be sold in order to realize this figure. Nor could all of this amount be used for grants without additional legislation because of the existing limitation that only \$500,000,000 of the revolving fund may be used for grants.

Undersecretary West indicated that promises as to the use of this revolving fund money for non-Federal PWA projects had been made to some members of Congress in connection with the settlement of the attempt to earmark portions of the billion and one-half dollars provided in the relief bill now under consideration.

Secretary Morgenthau asked Mr. Foley what course would be followed to carry it out if \$100,000,000 were made available to finance such a housing program for the first year.

Mr. Foley replied that on the basis of its experience PWA was convinced that the most effective means of carrying on a housing program was through local public housing authorities and that further direct

-3-

construction and operation of projects by the Federal government was inadvisable. After a statement of his reasons for this view, Mr. Foley explained that the Federal Government had been encouraging the enactment of state legislation which would make it possible for local communities to undertake the construction and operation of housing projects, with Federal financial and technical assistance. Largely as a result of these efforts of the Public Works Administration, Mr. Foley explained that thirty states had now enacted legislation providing for the creation of public housing authorities which would have the power to issue bonds to aid in the construction of local housing projects.

Secretary Morgenthau made several inquiries regarding the nature of the bonds which local housing authorities could issue. Mr. Foley explained that the bonds issued by housing authorities would be similar to the bonds which had been issued to finance many revenue-producing undertakings in New York and other states. He explained that a similar method of financing had been used in connection with projects undertaken by the Buffalo Sewer Authority, Triborough Bridge Authority, The Saratoga Springs Authority, New York Tunnel Authority, Jones Beach Authority and numerous other projects. The bonds in connection with all of these projects were payable solely from the revenues of the projects undertaken by the Authority and did not involve any obligation on the part of the state or any political subdivision to resort to taxation for the purpose of paying principal and interest. Nevertheless, the financial soundness of these bonds has been demonstrated by their

marketability and price. Mr. Foley stated that about a month ago, PWA, through the RFC, had refunded its \$55,000,000 Triborough Bridge bonds, making a profit of \$425,000 on the portion of the refunding bonds offered for sale. He then indicated that the bonds of local housing authorities would also become recognized as sound financial investments, although at first it probably would be necessary for the Federal Government to purchase most of these bonds.

Secretary Morgenthau asked Mr. Foley whether the Public Works Administration could sell its housing projects to public housing agencies under existing Federal legislation. Mr. Foley said that PWA had power to sell the projects but not at a write-off of a fixed amount of the capital cost which would be necessary in order for PWA to permit a continuance of the operation of the projects on a low rent basis.

Secretary Morgenthau asked whether it would be feasible for PWA to sell its housing projects to public housing authorities if the Public Works Administration were given power to make such a sale at a write-off. Mr. Foley indicated that it would be feasible in most cases and that the bonds of the local authority could be accepted in payment for the purchase price.

Secretary Morgenthau then stated that several ideas had occurred to him regarding the manner in which a housing program might be authorized for the near future. He referred to the fact that the maximum grant allowed by PWA for any project amounted to about 60% (45% capital grant and 15% interest subsidy). The Secretary stated that he would regard a 60% capital grant as a reasonable basis upon which to undertake a future program. The Secretary inquired of Mr. Gray regarding the rentals which such a grant would permit. Mr. Gray stated that due to increased material

-7-

and construction costs that the rentals would approximate the present rentals on PWA projects.

Secretary Horgenthan indicated that it would be impossible to provide sufficient funds or obtain necessary materials in order to undertake a housing program which would meet the present needs for housing and that he believed the Government should undertake a program calculated to meet such part of this need as it could afford within its budget. Although the Secretary recognized that a 60% subsidy would not permit rents which would reach persons of very low incomes, he stated his opinion that the Government could not afford a larger subsidy and that the housing program should be undertaken in such a way as to enable the Government to stay within its seven billion dollar budget for 1938.

The Secretary stated his belief that a housing program along the lines he was suggesting could be undertaken within the budget, but that the Wagner-Steagall program would constitute too great a burden on the Treasury and involve too large a subsidy.

He further stated that any additional housing program should be carried on by the Housing Division of the Public Works Administration; that the experience of this organization qualified it to undertake a further program; and that the creation of a new independent housing agency was wholly unnecessary. However, Secretary Horgenthan suggested that the housing administration be created in such a manner that it could be readily transferred to a Department of Public Works pursuant

to any plan for the reorganization of the executive departments. In answer to a question, Secretary Morgenthau stated that everyone agreed that loans should not be made to limited dividend corporations because they had proven themselves unable to provide housing at sufficiently low rentals. The Secretary also agreed that there should be no further construction of housing projects directly by the Government. He then emphasized the need for local responsibility and for local acquisition of land. Mr. Foley pointed out that the power of local housing authorities to acquire land through condemnation had been recently established by the highest courts of two states so that many legal difficulties could be avoided if local housing authorities were to acquire the necessary land.

With respect to local contributions, Secretary Morgenthau stated that the local community should be prepared to contribute to the construction and operation of housing projects. Mr. Gray stated that tax exemption of housing projects would amount to a very substantial contribution by the states and political subdivisions, inasmuch as full taxation is the equivalent of a charge per room per month of from \$5 to \$6. Secretary Morgenthau then stated that the Federal legislation ought to contain a specific requirement that public housing projects be exempted from state and local taxation, so as to assure that the local committees would be making an adequate contribution toward assuring the low-rent character of housing projects.

Mr. Thider stated his opinion that a subsidy based on the project cost would encourage high construction costs and that he personally favored the construction of projects without a subsidy. According

-9-

to his view, the subsidy should be used solely for the purpose of offsetting the additional cost of slum land as compared with vacant land. Mr. Ihlder further stated that he had heard rumors that PWA could not anticipate what its rentals would be because of the great uncertainty regarding construction costs.

Mr. Gray strongly objected to this statement, saying that before a construction contract was let, the Housing Division knew the rentals which would be charged in the project. He added that the projects were designed with a view to meeting a certain low income group. Where the Housing Division received bids on a project which were too high to permit the proposed low rentals, such bids have been rejected and the project has been redesigned in order to make possible lower costs and lower rentals.

Mr. Morgenthau asked Mrs. Morgenthau for an expression of her opinion. She stated her opinion that the proposed 60% subsidy would not be sufficient to reach the low income group that should be served by a program of this character. Secretary Morgenthau replied that the Government finances would not permit a much larger subsidy and that the line would have to be drawn somewhere. He added that the proposed subsidy would permit a housing program for a part of the low income group, although it might not reach down into that group as low as might be desired.

Secretary Morgenthau then asked Mr. Foley to summarize the discussion regarding his proposal for a federal housing program. Mr. Foley summarized the program as follows:

1. The creation of a permanent housing agency in the Department of the Interior.
2. The authorization of a grant to public housing agencies of not to exceed 60% of the cost of the projects.
3. The authorization of loans and grants only to public housing agencies.
4. As a condition to Federal aid, the requirement that housing projects be granted full exemption from state and local taxation or the equivalent thereof in the form of other local aid.
5. The authorization to sell or lease projects to public housing agencies at a write-off of not more than 60%.
6. The authorization of loans at not less than 5% interest, with power in the Housing Administration to resell the bonds which it acquires.
7. Conferring power on the Secretary of the Treasury to purchase these bonds from the Administration and to resell them; also to issue Government obligations in an amount equivalent to any such bonds which the Treasury decides to retain.
8. The elimination of loans to limited dividend corporations and the elimination of further demonstration projects.
9. The appropriation of funds to finance the proposed program, the amount of the appropriation to be left blank.