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Mr. Hanes draft

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approved 5/1/39

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When I appeared before your Committee on March 24th, I said that I would be prepared to discuss the tax system at your convenience. Your Chairman, Mr. Doughton, has expressed a willingness to receive our recommendations for consideration by the Congress at this session. It is my desire to address myself to two important phases of the Treasury's relationship to business recovery: (1) our fiscal policy and (2) remedial Federal taxation.

We are all familiar with the fact that our National income and the employment of our people are dependent upon the prosperity of private enterprise. We have all the essentials of economic prosperity - resources, labor, capital, managerial ability, and a vast outlet for our products in the domestic market. Although we have made substantial progress from the depths of the depression of 1932, we are still in a period of incomplete business recovery and we have a large number of unemployed. It is highly important furthermore that we increase our National income. Not only is our material well-being at stake - the very future of the Democratic form of government rests on our ability

to solve the economic problems before us. As Secretary of the Treasury I would feel derelict in my duty if I left one stone unturned that might contribute to recovery and the continued prosperity of the country.

In November 1937, I stated before this Committee "the basic need of today is to foster the full application of the driving force of private capital." That statement is as true today as it was then. I think the events of the past two years have made it even more apparent today than it was in 1937, that without the free flow of private capital to industry, recovery is hopeless. It is, therefore, my desire to point out to your Committee all of those things which appear to be obstacles to private investment. An important obstacle seems to be the uncertainty over the general fiscal policy of the Government. Almost everyone believes that the budget should be balanced eventually, and, moreover, everyone knows that it cannot be done except in one of two ways, namely by cutting expenditures or by increasing taxes. So long as there is uncertainty as to the desire

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to balance the budget, or when and how it is to be achieved, investors will not risk their savings in venturesome enterprises.

It is my belief that the only way we will ever be able to put the large part of ten million people, now idle, back to work is through investment in private enterprise. Under our economic system we know that \$7,000 is required as investment in land, buildings, machinery, and tools to put each man to work. We know further that there are 600,000 men and women coming to employable age each year who are candidates for jobs. Therefore, to provide capital assets sufficient to put this new army of people to work, requires a minimum investment of \$4,200,000,000 each year. It is this type of investment that we have failed to attract during the past decade.

It may not be necessary for Federal revenue to exactly balance Federal expenditure each year any more than each month or each week. In periods of depression it is inevitable that there will be deficits. Revenue declines may occur so quickly that immediate achievement of a balance by tax increases becomes impossible. We all agree that relief

must be given to human needs caused by a depression. It is long continued deficits and uncertainty caused by the fear that the policy has no terminus which causes the investor to become timid and to hesitate in the making of new commitments.

A necessary sequel to deficits in time of depression is that in years of activity and prosperous business an excess of taxes above current expenditures should be collected and applied to reducing the public debt. In this way only can the Government be prepared for the strain of new emergencies without the burden of excessively high taxes. Fiscal deficits are thus defensible, only if they are followed by substantial surpluses and, further, if they are the result of a carefully formulated program announced in enough detail to remove major uncertainties and fears concerning fiscal policy/

The present task is made even more difficult by the fact that a very large part of our expenditures is caused by the necessity of supplying armaments for our National defense. I call your attention to the fact that Great Britain has recently departed from a

long established tradition of annually balanced budgets, and in the fiscal year 1940 is spending \$580,000,000 on armaments, of which \$352,000,000 will be supplied by borrowed money. Forty-three percent of the French budget in 1939 is for the same kind of expenditure; in Italy, 50 percent of the 1939 National budget is devoted to this purpose; and in Germany, the National government has been spending from 40 to 60 percent of its total outlay in the last few years on armaments. Relatively speaking, therefore, we have not devoted such a large proportion of our National expenditures to National defense.

I wish to be realistic about our fiscal policy. I know that balancing the budget this year or next year is impossible. I think it is clear to everyone that appropriations by this Congress will be far in excess of estimated revenues. Furthermore, the formulation and adoption of a sound financial plan pointing clearly to a balanced budget in a later year will be difficult. The inescapable conclusion, however, is that if higher taxes are to be avoided, the total of appropriations by the Congress must be sharply curtailed. The time to begin is now.

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By way of introduction to the specific suggestions which the Treasury is submitting to you, it will be desirable, I believe, to state briefly the considerations which have guided us.

The expenditures of the government are, with the exception of self-sustaining public enterprises, paid for out of taxes, which are a levy upon the earnings of the people, and out of loans, which are borrowed from the savings of the people. It is plain, therefore, that the source of the government's income is the productive effort of the nation.

The expenditures of the Federal Government today are very much larger than they have ever been before in time of peace. The increase of the expenditures is due to the expansion of the functions of government, such as the National defense, and the assumption of new functions in the field of social security, in the social services, in the protection of the National interest in agriculture, and in the conservation and development of natural resources. While it is most important that waste and extravagance should be reduced to a minimum in these activities

of government, the activities themselves are not likely to be terminated, or drastically curtailed by this Administration or any other.

It is necessary, therefore, to base our fiscal policy on an acknowledgment of the fact that retrenchment in expenditure will not balance the budget with a surplus sufficient to reduce the National debt. The support of the enlarged activities of the government for National defense and necessary social services can come only out of a larger National income. A larger National income can be produced only by more work, more investment, and more enterprise. If the enlarged public activities are to be maintained permanently without impairing the standard of life of the people or the credit of the nation, then more wealth must be produced than is now being produced in the United States. This means that the social reforms desired by the people can be sustained and developed only by the recovery of private enterprise.

There are fundamentally only two ways of producing wealth. One way is to conscript labor and capital and put them to work under

government compulsion. This way is unthinkable in the United States. The other way is to provide the incentive of wages, interest, dividends, and profits. This is the way to which we are committed, the only way we can think of taking.

That being the case, it becomes our duty in the Treasury to examine carefully the fiscal policies of the government with a view to determining whether they provide all legitimate and necessary incentives to private enterprise in the production of wealth. Wherever we find that the tax system destroys the necessary incentive and so interferes with legitimate and necessary enterprise, it is the duty of the Treasury to report its conclusions to the Congress.

I am reporting to you today that after thorough examination the Treasury finds that there are in the present tax system serious impediments to private enterprise. The Treasury recommends that they be removed, and that it be made clear to the whole country that it is the intention of the government to establish a tax system which preserves and increases the incentives that are essential to the perpetuation of a system of free enterprise in a nation of free men.

The Treasury makes these recommendations in the conviction that in no other way can the country produce enough wealth to maintain and elevate its standard of living, to sustain and improve its social services, to conserve and develop the natural resources which it has inherited, to adhere unmistakably and successfully to the free economy with which democratic institutions and human rights are indissolubly connected. The Treasury is not prepared to say that the tax reforms it is suggesting will at once remove all the impediments to the full resumption of private enterprise. Further reforms of the tax system may be necessary. There may be other impediments that need to be removed which lie outside the province of the Treasury. There are no doubt impediments also arising in the disturbance of the outer world which the government as a whole cannot remove, though it may mitigate the effects.

But while the suggestions which the Treasury is offering are not a panacea, it is our conviction that in principle they are just and that they are sound, and it is our belief that to enact them will greatly

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increase the confidence of the people and greatly improve the unity of the nation. Out of that confidence and that unity will come that increase of the National income which will provide the revenues that the Treasury must find to support the government and to balance its budget.

This is what the Treasury has in mind in submitting its program to you.

1. I recommend that the Ways and Means and Appropriations Committees of this House and the Finance and Appropriations Committees of the Senate meet at the beginning of each session of Congress as a Joint Committee on fiscal policy to consider the over-all aspects of the expenditure and revenue programs. It is apparent that only in this way can each expenditure proposal be compared with all others in the light of total resources available. Such a method has been in successful use in the State of Wisconsin for a quarter of a century. I understand that similar methods are pursued in Sweden and Great Britain.

2. I recommend that Congress create at this session a small, temporary, national commission to be made up of men having ability and public confidence for the purpose of studying Federal, State and local government taxation. At the present time, more than one-half the total tax revenues is collected by State and local governments. There is no unity or ordered relationship between the Federal fiscal system and the State and local fiscal systems. Overlapping taxes have grown in number and size as both Federal

and State governments have sought new revenues. Grants-in-aid are being demanded of the Federal government in increasing amounts. The results of the fiscal situation have become increasingly unsatisfactory to both the State governments and the Federal government, and are becoming intolerable burdens upon our taxpayers.

✓3. I recommend the repeal of the Capital Stock and Excess Profits tax ~~when~~ it can be done without increasing the rate of corporate tax. Pending that time, I recommend that the calculation of the Capital Stock tax be placed on an annual basis instead of on a three year basis as it is at present.

✓4. I recommend the repeal of the limitations on the deduction of net capital losses from other income of corporations.

✓5. I recommend the allowance of a three year carry-over of net losses for corporations, including in net losses the net capital losses.

✓6. I recommend the repeal of the Undistributed Profits tax.

7. I recommend that corporations be allowed to file consolidated returns and that the tax on inter-corporate dividends be abolished.

✓ 8. I recommend the exemption of dividends from individual normal tax.

✓ 9. I recommend a wider latitude of deductions for capital losses be allowed to individuals, and I recommend further that the period of holding capital assets be reduced from twenty-four months to six months.

✓ 10. I recommend that the surtax rates in the upper brackets be substantially reduced.

In conclusion, there are many other friction points in the present tax structure, as well as administrative difficulties, which my staff will submit to you at the proper time. I am grateful to your Committee for permitting me to place my views before you.

Draft with
FDR suggestions

May 2, 1939

When I appeared before this Committee on March 24, I said that the Treasury would soon be ready to submit for your consideration its suggestions for changes in the tax system. Your Chairman, Representative Doughton, together with Senator Harrison, has expressed a desire to receive our views in time for possible action at this session of Congress.

~~In formulating our suggestions for a fiscal program~~
 We have taken account of the fact that we are now in the midst of a world situation which imposes on this government a special responsibility. We must demonstrate that a democratic government has the power and the flexibility to survive prolonged crisis and chaotic world conditions and yet emerge with the strength of its free institutions unimpaired.

Preservation of our democratic form of government ^{over a long period of years} requires, in my opinion, a fiscal program which has a fourfold objective: (1) The promotion of free enterprise and private investment; (2) the attainment of full business recovery; (3) ^{and maintenance} ~~the placing~~ of our public finances in a sound and unassailable position, and (4) an

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equitable distribution of tax burdens and ^{A more} equitable distribution of national income.

Successful operation of democracy demands that all four objectives be solidly linked together. When we consider any specific change in our fiscal program we must satisfy ourselves that the change makes for a better and not a worse distribution of tax burdens and of national income; that the change promotes and does not retard business recovery, and that the change makes it easier and not more difficult to establish a balanced relationship between revenue and expenditures.

Full attainment of these objectives is made more difficult by a new and ominous development in world affairs -- the armament race now gripping the important nations of the world. Great Britain in the coming fiscal year is spending \$3 billion on armaments, or almost 50 percent of its national budget; France is devoting over 40 percent of its governmental expenditure to the same purpose; Italy, 50 percent; Germany, probably 60 percent; Japan over 70 percent. These huge expenditures are being financed largely by borrowing. The race is becoming more intense and there is no end in sight.

^{necessarily} For us the danger is that these developments may mean a ^{abroad} increased cost for national defense, ^{have together with} monetary instability

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abroad, disruption of our foreign commerce, and perhaps other unsettlements which we cannot accurately measure. It is against this background that we ~~we~~ reexamine our fiscal program. No major problem facing this government today can be properly solved without full consideration of the position of this country in relation to the present international crisis. The unmistakable implication of this international situation is that we ~~should look ahead to~~ ^{should look ahead to} ~~improve~~ our fiscal ^{position} ~~house in order and~~ ~~we~~ redouble our efforts to attain full recovery. High national income and a sound fiscal position are essential to adequate national defense.

A fundamental objective of sound finance is clearly a balanced budget. There is, of course, no good reason why taxes must exactly balance expenditures each year any more than each month, each week or each day. ^{Also} There ~~are~~ ^{are} ~~may well be~~ periods during which sound fiscal policy calls for an excess of outgo over income. In a depression it is inevitable that there will be deficits. Revenues decline at the same time that the Federal Government is called upon to undertake inescapable social and economic burdens. If, however, deficits are too long continued, the depressive effects of uncertainty tend to make recovery more difficult. ~~We cannot face~~

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~~an endless succession of governmental deficits and~~
~~survive as a democratic people.~~ The sequel to de-
 ficits in emergencies should be surpluses during years
 of prosperity, (A)

Mere talk of a sound fiscal policy is not enough.
 In my opinion we must work out a plan which the community
 recognizes to be realistic.

B. ~~In order to move in this direction I suggest that~~ *of the*
 the Ways and Means and Appropriations Committees of *instance*
 this House and the Finance and Appropriations Committees
 of the Senate ^{could} meet each session as a Joint Committee on
 Fiscal Policy to consider the over-all aspects of the
 expenditure and revenue ^{modification would be made} programs. At the present time
 machinery is lacking for the development and execution
 of such a plan. The Budget Act of 1921 set up the
 procedure for the orderly formulation by the executive
 of fiscal proposals and for their submission to the
 Congress as a unified budget. No comparable procedure
 has been set up in Congress for considering revenues
 and expenditures together as two inter-related aspects
 of a single problem either in regard to the budget or
 to the numerous proposals for expenditures outside
 the budget. I hope this committee will agree with me
 that ^{such an} innovation would improve the efficiency of the

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Government. By providing for ~~the~~ ^{a preliminary} legislative consideration of ~~the~~ ^{the overall of} appropriation and revenue measures it would ~~centralize the responsibility~~ ^{give a broad picture} within ~~the~~ ^{the} Congress ~~for~~ ^{of} the management of the government's finances and permit a ~~closer~~ ^{better ordered} coordination between the executive and the legislative branches in this field.

This Joint Committee might be a funnel through which all appropriations and revenue measures should pass so that Congress could scrutinize each of them in the light of what the country can afford. Such a Joint Committee would enable Congress to accept or reject each revenue or expenditure proposal on the basis of a fundamental, consistent fiscal policy. This Committee ~~should~~ ^{could} have continuous life and ~~should~~ ^{should} be actively studying fiscal problems between sessions of Congress as well as during the sessions. The Treasury Department would, of course, cooperate fully in this work to the extent that the committee desired. I understand that a method similar to this Joint Committee suggestion has been in successful use in the State of Wisconsin for a quarter of a century and that Sweder goes even further by combining both revenue and appropriation legislation

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in a finance act which is voted at the end of the session.

Thus far I have dealt with the financial problems of the Federal Government alone. We must remember, however, that even if we had in operation the best conceivable Federal fiscal plan, we still would have touched only half of the tax problem which confronts the nation. More than 50 percent of the total tax revenues of the country are collected by State and local governments.

We have talked about removing injurious Federal-State tax conflicts for the past five years, and our predecessors talked about the same problem. ~~It is now time to act.~~ I recommend that Congress create a small temporary national commission to report to Congress, (as soon as possible) on the most desirable intergovernmental fiscal policy. Such a commission should be made up of men of ability who enjoy the highest possible public confidence, who are familiar with the fiscal problems of Federal, State and local governments, but who will represent the public at large rather than any governmental unit.

Overlapping taxes have grown in number and size as both Federal and State Governments have sought new revenues.

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Grants-in-aid are being demanded of the Federal Government in increasing amounts. The results of our fiscal situation are increasingly unsatisfactory to both the State Governments and the Federal Government, and are becoming ~~intolerable~~ to many taxpayers. As the result of this Commission's work, we should be able to achieve ^{a more} ~~an~~ orderly relationship between the Federal fiscal system and the State and local fiscal system.

Thus far I have talked about two matters of great importance to the Treasury. Each of my suggestions, if you agree with me, may require some time to be worked out. Let us see what we can do now. It seems to me that Congress has three choices on revenue legislation during this session:

*L. J. ...
R. W. ...*

1. Congress can merely renew the excise taxes and the corporation income tax which expire this year, or
2. Congress can reexamine the whole tax structure and in the light of this examination can renew expiring taxes in their present or a revised form, and can eliminate those features that are found to be business deterrents, making provision for additional taxes to replace losses in revenue, -- these revisions to be made effective beginning with 1939, or
3. Congress can follow the same procedure as I have

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just outlined, but make the revisions effective beginning in 1940.

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I know that everyone on this Committee is as anxious as I am to foster the full driving force of private capital. It is generally recognized that the following tax revisions would remove factors which in the opinion of businessmen act as deterrents on private productive enterprise:

Tax-exempt securities

Present law. At present the interest on State and local obligations is exempt from the corporation income tax and from the individual normal income tax and surtax. The interest on Federal obligations is in part similarly exempt and in part exempt only from the corporation income tax and the individual normal tax.

Recommendation. Enact legislation providing for full Federal taxation of the interest on Federal, State, and local obligations issued in the future and conferring power on the States to tax interest on Federal obligations issued in the future.

Reasons for change. The exemption of interest on government obligations from the income tax is incompatible with the principle of ability to pay. It provides a tax-free haven to persons in the higher income brackets, and consequently they are less likely to invest their capital in private enterprise. Further, to the extent that the higher income classes avoid their share of taxes by holding tax-exempt securities, persons with smaller incomes must be taxed higher to make up the revenue loss. The elimination of tax exemption would make the tax system more equitable and stimulate investment in risky enterprises by those best able to bear such risks.

Example. A married man with no children or other dependents with an income of \$100,000, half of which is derived from tax-exempt interest, is at present taxed at an effective rate of 8.9 percent, whereas if all his income were taxable, the effective rate would be 32.5 percent. For an individual with net income from other sources of \$500,000 an investment in fully tax-exempt securities at 8 percent results in the same net yield as taxable securities bearing rate of 10.71 percent.

Revenue effects. For years following the complete retirement of tax-exempt securities the additional annual income tax revenue to the Federal Government is estimated from \$179,000,000 to \$337,000,000. The annual increase in interest costs to the Federal Government and Federal instrumentalities is estimated from \$19,000,000 to \$50,000,000 and to the State and local governments from \$40,000,000 to \$105,000,000. It is difficult to estimate the increased revenue to State and local governments. For the immediate future there will be little additional revenue or interest cost for either Federal or State and local governments.

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1. Interest on future issues of government obligations -- Federal, State, and local -- should be made fully taxable.

Carry-forward of business losses

Present law. Individuals and corporations are now taxed on their annual incomes without being allowed a deduction for business losses sustained in prior years. During the period 1921-1932 taxpayers were allowed to offset current income with prior year losses.

Recommendation. Allow net losses of business, both individual and corporate, to be offset against the income of the succeeding year, and any loss not thus absorbed to be carried forward and offset against the income of the following two years.

Reason for change. The taxation of business income on a yearly basis may result in taxes being imposed on businesses which over a period of years have no net income. Types of business with irregular incomes pay higher taxes than those with regular incomes. The allowance of a net loss carry-over helps to eliminate this discrimination. It would tend to stimulate new enterprise and the capital goods industries, both of which characteristically have variable incomes.

Reasons against change - chances of surpluses
Example. A corporation that loses \$5,000 in each of three years and in the fourth makes \$15,000 obviously has no income for the whole four-year period. Yet under the present law, because losses cannot be carried forward, the income tax will be \$2,025. If losses could be carried forward, no tax would be levied.

Revenue effects. If individuals were allowed to carry forward business losses for three years. It is estimated that the loss in revenue would amount to from \$7,500,000 to \$10,800,000 and for corporations the loss would be from \$17,800,000 to \$167,200,000 depending upon the level of business conditions assumed and the pattern of income in the prior years.

I have been asked to give the
pros and cons on

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1. Allowance ~~could~~ be made for
business losses to be carried
forward and offset against
income in a limited number of
subsequent years.

The limitation on deduction of corporate capital losses.

Present law. Under the present law any excess of corporate capital losses over capital gains can be deducted from ordinary income only to the extent of \$2,000. Prior to 1934 corporations were permitted to deduct capital losses from ordinary income without limitation.

Recommendation. Allow corporate capital losses to be deducted in full from ordinary income.

Reason for change. The failure to offset net capital losses fully against ordinary income may result in imposing a high income tax on corporations with a very low income or even with a deficit. If corporations were allowed to deduct their net capital losses from other income without limitation, they would be less cautious in investing in securities of other corporations and in undertaking expansion of their own plants.

Cms Example. A corporation that has ordinary income of \$25,000 and net capital losses of \$125,000 is nevertheless required under the present law to pay a tax of \$3,025, depending upon the amount of dividends paid out. If capital losses could fully offset ordinary income, no tax would be levied.

Revenue effects. If the limitation on the deduction of net capital losses from other income were eliminated it is estimated that on the basis of calendar year 1939 level of business conditions the revenue would be decreased \$68,100,000.

I have been asked the

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3. Corporations ~~be~~ be allowed to deduct capital losses from their ordinary income.

Capital losses of individuals

Present law. Short-term losses from assets held not more than 18 months are allowed to offset short-term gains but may not offset ordinary income. Short-term losses in excess of short-term gains may be carried forward to offset such gains of the succeeding year. In computing taxable income two-thirds of the long-term losses are taken into account if the assets are held more than 18 but not more than 24 months, and one-half if the assets are held more than 24 months. The amount of long-term losses taken into account may be fully deducted from net income, or segregated and a tax credit computed at a rate of 30 percent, whichever method results in the greater tax.

Recommendation. Allow short-term losses to offset both short- and long-term gains instead of only short-term gains; allow net short-term losses to be carried forward for three years instead of one year; allow net long-term losses to the extent not offset against ordinary income of the current year to be carried forward for three years; and increase the rate for the computation of the tax credit on long-term losses under the method of segregation from 30 percent to 50 percent, to accord with the corresponding recommendation on capital gains.

Reasons for change. The present capital loss provisions are inequitable and discourage the assumption of business risks. Short-term losses should be allowed to be carried forward for more than one year and offset against long-term capital gains. Since capital gains and losses are highly irregular, the taxation of large gains in one year without allowing an offset for both short- and long-term capital losses of preceding years cannot be justified. The allowance of the capital loss carry-over, like the allowance of the net loss carry-over, would, by putting the tax more nearly on an average basis, improve its equity.

Example. A married man with no dependents receiving \$75,000 ordinary income and \$25,000 long-term capital gains is now required to pay \$22,659 income tax. If two years ago he had net short-term capital losses of \$50,000 and net long-term capital losses in excess of ordinary income of \$25,000 under the present law he would still be required to pay the same amount of tax, because such losses are not taken into account in the computation of his current year's tax liability. Under the recommendations, on the other hand, his short-term capital losses of two years ago could offset his current long-term capital gains, and the long-term capital losses of two years ago could reduce the ordinary income from \$75,000 to \$50,000 resulting in a tax of \$8,869 and leaving and leaving \$25,000 of short-term capital losses to be carried forward.

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4. Somewhat greater deduction of capital losses ~~could~~ be allowed individuals.

Repeal of capital stock and excess-profits taxes

Present law. At present the capital stock tax is based upon a declared value which the taxpayer may revise every three years. The declared value may be any figure the taxpayer desires to make it regardless of the actual value of the stock. The excess-profits tax applies to profits in excess of 10 percent of the declared value.

Recommendation. Repeal the capital stock and excess-profits taxes -- the capital stock tax effective for years beginning after June 30, 1939, and the excess-profits tax effective for the first income tax year ending after June 30, 1940.

Reason for change. The capital stock and excess-profits taxes are highly uncertain and inequitable. These taxes depend upon the amount of profit actually realized during each year of a three-year period and the taxpayer's ability to forecast these profits accurately at the beginning of the period. Forecasts of profits are especially difficult to make in the case of new businesses and businesses with unstable incomes. The repeal of these taxes would be stimulating to such businesses, because it would remove the unduly high tax burdens resulting from erroneous forecasts.

Example. A corporation with incomes of \$100,000, \$200,000 and \$50,000 respectively, in each of three years, declaring a capital stock value of \$1,000,000, is under the present law required to pay capital stock and excess-profits taxes of \$12,000 for the three years. If the value declared had been \$750,000, the taxes would have been \$16,500 and if the value declared had been \$1,250,000, the taxes would have been \$9,000. The closer the declared value is to ten times average earnings, the lower are the combined capital stock and excess-profits taxes. Any substantial departures from such a declared value result in higher taxes.

Revenue effects. If the capital stock tax and excess profits taxes are repealed, it is estimated on the basis of calendar year 1939 business conditions that the revenue would be reduced \$122,400,000.

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5. The capital stock tax, the excess profits tax and present corporation income tax could be consolidated into a single tax on corporation incomes.

Continue deterrent against
family corp. having profits
write up.

Reduction in top surtax rates

Present law. The maximum surtax rate is now 75 percent on net incomes in excess of \$5,000,000. Under the 1932 Act it was 55 percent on incomes in excess of \$1,000,000, and under the 1926 Act, effective for the period through 1931, it was 20 percent on incomes in excess of \$100,000.

Recommendation. Reduce the upper surtax rates to a maximum of 60 percent, leaving the maximum combined normal and surtax rate at 64 percent.

Reason for change. The present top bracket rates are too high. Disregarding State taxes, the taxpayer is left with as little as twenty-one cents out of his highest dollar of income. If State taxes are taken into account, even less is left. The high rates tend to discourage the assumption of business risks, to bring about the hoarding of savings or the purchase of tax-exempt securities, and to depress the economy. If the surtax rates were reduced, wealthy individuals would be encouraged to assume certain business risks which with the present high rates do not appear to be worthwhile.

Revenue effects. If the top bracket surtax rate is limited to 60 percent and all other provisions in present law remain unchanged, it is estimated on the basis of calendar year 1939 business that the revenue from the individual income tax would be reduced \$11.5 million.

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6. The top rates in the individual

I shall not discuss in detail any of the six possible changes just mentioned. If you are interested in further information, my staff and I are prepared to furnish it and will be happy to work with you to the extent you may desire. Also, I recognize that other features of the tax law are considered by some to be business deterrents, and, if you feel they are substantial deterrents, we will be glad to assist in their examination.

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Most of the tax changes that I have mentioned will reduce the revenue-producing capacity of the system. If these or other similar changes are adopted ways must be found of replacing the lost revenue. If tax revision were to take the form only of tax reductions uncertainty of business with respect to our fiscal program would be accentuated. The result would be to injure and not help business. We must take no step which the public may interpret as moving away from the objective of a balanced budget. The taxes resorted to for replacement of lost revenue should have the least harmful effects on business and should contribute to greater equity. I suggest the following possibilities:

A single corporation tax on net income

Present law. Under the present law several corporation taxes are imposed: a capital stock tax, an excess-profits tax, an undistributed profits tax, and the ordinary income tax. The income tax itself is complex. A flat rate, together with what in effect is a tax on undistributed profits, is imposed on corporations with incomes over \$25,000. Graduated rates are imposed on corporations with incomes of \$25,000 and less. Further, several classes of corporations, irrespective of their size, are subject to flat income tax rates.

Recommendation. Substitute for the capital stock tax, excess-profits tax, and the corporation income tax (which in the 1938 law includes a tax on undistributed profits in the form of a credit for dividends paid) a single corporation tax on net income. If other previously recommended changes in corporation taxes are made to permit loss carry-over and deduction of capital losses from ordinary income, the rates of such a tax would need to be approximately 18 percent on net incomes under \$10,000, 19 percent on net incomes of \$10,000 to \$25,000, 21 percent on net incomes of \$25,000 to \$50,000, and 22 percent on net incomes of \$50,000 and over, in order to replace the revenues of the existing corporation tax structure.

Reasons for change. The present system of corporate taxes is complex, discouraging to enterprise, and inequitable. The capital stock and excess-profits taxes have been discussed previously. The undistributed profits tax component has added substantially to the complexity of the corporation income tax. At the present rate it is ineffective and there seems no possibility of securing passage of an effective tax, while the hostility to it is very great. If all corporate taxes are consolidated into a single tax on net income, the taxes on new business, on business with unstable incomes, and on business with no income would be substantially reduced. The increases would, in general, fall on the larger and more stable businesses.

Example. A corporation with net income of \$1,000,000 declaring the most favorable value for its capital stock, \$10,000,000, is required under the present law to pay corporate taxes of from \$175,000 to \$200,000, depending upon the distribution of dividends, as against \$218,900 under the proposed single corporation income tax. If the corporation made a less favorable declaration of capital stock value -- either higher or lower -- the taxes under the present law would be relatively greater. If in the next year this corporation had no net income, it would under the present law still be required to pay a capital stock tax of \$10,000, whereas under the single corporation income tax there would be no tax liability.

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1. The corporation income tax rate could be increased.

Middle bracket individual income tax rates

Present law. The individual income tax rates under the present law are relatively low on incomes under \$250,000. The effective rate of tax on \$10,000 received by a married man with no dependents is only 4.2 percent; on \$20,000 it is 7.9 percent, on \$40,000, 14.9 percent, on \$100,000, 32.5 percent, and on \$250,000, 51.3 percent.

The existing surtax rate schedule of the income tax is as follows:

Amount of surtax net income	Rate per- cent	Total surtax cumulative	Amount of surtax net income	Rate per- cent	Total surtax cumulative
0 - \$ 4,000	0	0	62,000 - \$ 68,000	39	\$ 14,000
4,000 - 6,000	4	80	68,000 - 74,000	43	16,580
6,000 - 8,000	5	180	74,000 - 80,000	47	19,400
8,000 - 10,000	6	300	80,000 - 90,000	51	24,500
10,000 - 12,000	7	440	90,000 - 100,000	55	30,000
12,000 - 14,000	8	600	100,000 - 150,000	58	59,000
14,000 - 16,000	9	780	150,000 - 200,000	60	89,000
16,000 - 18,000	11	1,000	200,000 - 250,000	62	120,000
18,000 - 20,000	13	1,260	250,000 - 300,000	64	152,000
20,000 - 22,000	15	1,560	300,000 - 400,000	66	218,000
22,000 - 26,000	17	2,240	400,000 - 500,000	68	286,000
26,000 - 32,000	19	3,380	500,000 - 750,000	70	461,000
32,000 - 38,000	21	4,640	750,000 - 1,000,000	72	641,000
38,000 - 44,000	24	6,080	1,000,000 - 2,000,000	73	1,371,000
44,000 - 50,000	27	7,700	2,000,000 - 5,000,000	74	3,591,000
50,000 - 56,000	31	9,560	5,000,000 up	75	
56,000 - 62,000	35	11,660			

The tax and effective rate of tax on a married man with no dependents at various income levels is as follows:

Net income before exemption	Amount of tax	Effective rate	Net income before exemption	Amount of tax	Effective rate
\$ 3,000	\$ 8	0.3	\$ 100,000	\$ 32,469	32.5
6,000	116	1.9	250,000	128,294	51.3
10,000	415	4.2	500,000	304,144	60.8
20,000	1,589	7.9	1,000,000	679,044	67.9
40,000	5,979	14.9	5,000,000	3,788,994	75.8

Recommendation. No specific recommendations are made.

Reason for change. If the revenue system is to be made more equitable by removing certain of the undesirable indirect taxes that now unduly burden the low income classes, and if the income tax itself is to be improved by allowing losses to offset profits and gains and in other ways, so that it will not curb business enterprise, it is necessary to increase the revenue-raising powers of the individual income tax. The top rates are now too high and should be lowered. Consequently, if the individual income tax is to raise more revenue, the middle bracket rates must be increased.

Example. No specific example can be given. Regarded Unclassified

2. Individual income tax rates could be increased.

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Exemptions, insurance exclusion, and middle bracket rates of the estate and gift taxes

Present law. Under the present law a specific exemption of \$40,000 and an exclusion of \$40,000 for insurance payable to beneficiaries other than the estate are allowed under the estate tax, and a specific exemption of \$40,000 is allowed under the gift tax. The middle bracket estate tax rates are low. The effective estate tax rate on a net estate of \$50,000 is only 6 percent, on a net estate of \$100,000, 9.6 percent, and on a net estate of \$400,000, 16.7 percent.

The estate tax rate schedule is as follows:

(Dollars in thousands)

Net estate	Bracket	Rate	Cumulative tax	Net estate	Bracket	Rate	Cumulative tax
\$ 0 - \$ 10	2%		-	\$2,000 - \$2,500	38		\$ 557.6
10 - 20	4		.2	2,500 - 3,000	41		747.6
20 - 30	6		.6	3,000 - 3,500	44		952.6
30 - 40	8		1.2	3,500 - 4,000	47		1,172.6
40 - 50	10		2.0	4,000 - 4,500	50		1,407.6
50 - 70	12		3.0	4,500 - 5,000	53		1,657.6
70 - 100	14		5.4	5,000 - 6,000	56		1,922.6
100 - 200	17		9.6	6,000 - 7,000	59		2,482.6
200 - 400	20		26.6	7,000 - 8,000	61		3,072.6
400 - 600	23		66.6	8,000 - 9,000	63		3,682.6
600 - 800	26		112.6	9,000 - 10,000	65		4,312.6
800 - 1,000	29		164.6	10,000 - 20,000	67		4,962.6
1,000 - 1,500	32		222.6	20,000 - 50,000	69		11,662.6
1,500 - 2,000	35		382.6	50,000 -	70		32,362.6

The gift tax rates are three-fourths of the estate tax rates.

The tax and effective rates under existing law for selected sizes of net estate (before exemption) are as follows:

3. Estate and gift taxes could be increased.

Net estate before exemption	Tax	Effective rate
\$ 50,000	\$ 200	0.4%
100,000	4,200	4.2
400,000	58,600	14.7
1,000,000	211,000	21.1
4,000,000	1,388,800	34.7
10,000,000	4,936,600	49.4
60,000,000	39,334,600	65.6

Recommendation. No specific recommendation.

Reasons for change. The excessive specific exemptions allowed under the present estate and gift taxes limit transfer taxation to a comparatively few large estates. The insurance exclusion discriminates in favor of investment in life insurance as against other desirable forms of investment. The transfer tax, like the individual income tax, is levied at graduated rates and is one of the most important instruments for bringing about an equitable distribution of tax burdens and a more equal distribution of wealth. The role of the transfer taxes should be increased, especially since it is desirable to repeal some of the indirect and other regressive taxes that now are included in the tax system. This would be done if the estate and gift taxes were coordinated, if the exemptions were lowered, if the insurance exclusion were disallowed, and if the middle bracket rates of the single transfer tax were raised substantially above those in the present estate tax.

Example. No specific example can be included.

Percentage depletion

Present law. Percentage depletion is allowed in the present law for oil and gas wells at the rate of $27\frac{1}{2}$ percent of gross income; for metal mines, 15 percent; for sulphur mines or deposits, 23 percent; and for coal mines, 5 percent. The percentage depletion is limited, however, to 50 percent of the net income computed without allowance for depletion.

Recommendation. Reduce the percentages for depletion by 50 percent, to be $13\frac{3}{4}$ percent for oil and gas wells, $7\frac{1}{2}$ percent for metal mines, $11\frac{1}{2}$ percent for sulphur mines or deposits, and $2\frac{1}{2}$ percent for coal mines. (Even greater decreases could be justified.)

Reasons for change. The purpose of depletion, like the purpose of depreciation, is to enable the taxpayer to recoup his capital investment in the property tax-free. If, however, the depletion charges are related to gross income rather than cost, it is possible for the taxpayer to continue to take a deduction for depletion long after the full cost of the property has been charged off. So long as the property is producing, the depletion charges continue. Percentage depletion thus provides what is in effect a subsidy to the oil and mineral interests, a privilege not granted to other types of business. This subsidy is not uniform among the different oil and mineral industries or among concerns in any of them. Concerns with low-cost, long-lived properties receive the most benefit. The excessive deductions under percentage depletion are thus inequitable, while they result in a substantial loss in revenue.

Example. If a corporation takes \$5,000,000 depletion allowance for oil and gas properties on the basis of $27\frac{1}{2}$ percent of gross income, while only 10 percent of gross income is required to return the cost of the properties, the corporation in effect receives a tax subsidy of from \$525,000 to \$604,545, depending upon the amount of dividends distributed. Sample studies indicate that on the average the percentages of gross income necessary to return cost are less than 10 percent, and that in many instances much less than 10 percent would be sufficient.

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In the 4. A special privilege of the present law is the allowance of excessive deductions for depletion of oil and gas wells and certain mines. As the Treasury has often pointed out, a substantial amount of revenue can be recovered by closing this loophole. In suggesting this change I am fully

aware that it will be opposed by powerful vested interests, despite its obvious equity. Obviously, fiscal factors constitute only one of many aspects of our economic problem. I feel, however, that if something substantial is done along the lines I have discussed people can look forward with more assurance for the next five or ten years and business growth and development will proceed more rapidly than they otherwise would.

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In this statement emphasis was laid first on the importance of sound fiscal policy, and a suggestion was made for a Joint Congressional Committee as a means to the formulation of such policy. Secondly, the need for a commission to study Federal-State fiscal relations was stressed, and thirdly, alternative programs for adjusting federal taxes to eliminate features that may deter business were outlined.

It will take time for the results of fiscal planning toward a balanced budget and for the removal of tax deterrents to be fully effective. Obviously, fiscal factors constitute only one of many aspects of our economic problem. I feel, however, that if something substantial is done along the lines I have discussed people can look forward with more assurance for the next five or ten years and business growth and development will proceed more rapidly than they otherwise would.

Draft with FDR sug-
gestions — HMJr copy

When I appeared before this Committee on March 24, I said that the Treasury would soon be ready to submit for your consideration its suggestions for changes in the tax system. Your Chairman, Representative Doughton, together with Senator Harrison, has expressed a desire to receive our views in ~~time~~ ^{regard to certain suggestions} for possible action at ~~this session of Congress.~~ ^{made by Doughton, Harrison and others} ~~and others~~ ^{them} ~~congress~~

~~In formulating our suggestions for a fiscal program~~ we have taken account of the fact that we are now in the midst of a world situation which imposes on this government a special responsibility. We must demonstrate that a democratic government has the power and the flexibility to survive prolonged crisis and chaotic world conditions and yet emerge with the strength of its free institutions unimpaired.

Preservation of our democratic form of government, ^{over a long a period of years} requires, in my opinion, a fiscal program which has a fourfold objective: (1) The promotion of free enterprise and private investment; (2) the attainment of full business recovery; (3) ^{maintenance} ~~the placing~~ of our public finances in a sound and unassailable position, and (4) ~~and~~

- 2 -

a more

equitable distribution of tax burdens and an equitable distribution of national income.

Successful operation of democracy demands that all four objectives be solidly linked together. When we consider any specific change in our fiscal program we must satisfy ourselves that the change makes for a better and not a worse distribution of tax burdens and of national income; that the change promotes and does not retard business recovery, and that the change makes it easier and not more difficult to establish a balanced relationship between revenue and expenditures.

Full attainment of these objectives is made more difficult by a new and ominous development in world affairs -- the armament race now gripping the important nations of the world. Great Britain in the coming fiscal year is spending \$3 billion on armaments, or almost 50 percent of its national budget; France is devoting over 40 percent of its governmental expenditure to the same purpose; Italy, 50 percent; Germany, probably 60 percent; Japan over 70 percent. These huge expenditures are being financed largely by borrowing. The race is becoming more intense and there is no end in sight.

abroad
 For us the danger is that these developments may mean increased cost for national defense, *here together with* monetary instability

- 3 -

abroad, disruption of our foreign commerce, and perhaps other unsettlements which we cannot accurately measure. It is against this background that we ~~must~~ reexamine our fiscal program. No major problem facing this government today can be properly solved without full consideration of the position of this country in relation to the present international crisis. The unmistakable implication of this international situation *should look ahead* is that we ~~must immediately act to place~~ ^{to} our fiscal *position* ~~house in order~~ and to redouble our efforts to attain full recovery. High national income and a sound fiscal position are essential to adequate national defense.

A fundamental objective of sound finance is clearly a balanced budget. There is, of course, no good reason why taxes must exactly balance expenditures each year any more than each month, each week or each day. There *also there are* ~~may well be~~ periods during which sound fiscal policy ¹ calls for an excess of outgo over income. In a depression it is inevitable that there will be deficits. Revenues decline at the same time that the Federal Government is called upon to undertake inescapable social and economic burdens. If, however, deficits are too long continued, the depressive effects of uncertainty tend to make recovery more difficult. ~~We cannot face~~

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1937

~~an endless succession of governmental deficits and survive as a democratic people.~~ The sequel to deficits in emergencies should be surpluses during years of prosperity.

(a) Mere talk of a sound fiscal policy is not enough. In my opinion we must work out a plan which the community recognizes to be realistic.

B - *If for instance*
~~In order to move in this direction I suggest that~~
the Ways and Means and Appropriations Committees of this House and the Finance and Appropriations Committees of the Senate ^{could} meet each session as a Joint Committee on Fiscal Policy to consider the over-all aspects of the expenditure and revenue programs. ^{simplification would result} At the present time machinery is lacking for the development and execution of such a plan. The Budget Act of 1921 set up the procedure for the orderly formulation by the executive of fiscal proposals and for their submission to the Congress as a unified budget. No comparable procedure has been set up in Congress for considering revenues and expenditures together as two inter-related aspects of a single problem either in regard to the budget or to the numerous proposals for expenditures outside the budget. I hope this committee will agree with me that ^{some such} ~~this~~ innovation would improve the efficiency of the

- 5 -

a preliminary
 Government. By providing for ~~unified~~ legislative consideration of ~~all~~ ^{the overall} appropriation and revenue measures it would ~~centralize the responsibility~~ ^{give a broad picture} within ~~the~~ Congress for the management of the government's finances and permit a ~~more intelligent~~ ^{better ordered} coordination between the executive and the legislative branches in this field.

~~A~~ This Joint Committee might be a funnel through which all appropriations and revenue measures should pass so that Congress could scrutinize each of them in the light of what the country can afford. (~~Such a Joint Committee would enable Congress to accept or reject each revenue or expenditure proposal on the basis of a fundamental, consistent fiscal policy.~~) This Committee ~~should~~ ^{could} have continuous life and ~~should~~ be actively studying fiscal problems between sessions of Congress as well as during the sessions. The Treasury Department would, of course, cooperate fully in this work to the extent that the committee desired. I understand that a method similar to this Joint Committee suggestion has been in successful use in the State of Wisconsin for a quarter of a century and that Sweden goes even further by combining both revenue and appropriation legislation

~~in a finance act which is voted at the end of the session.~~

Thus far I have dealt with the financial problems of the Federal Government alone. We must remember, however, that even if we had in operation the best conceivable Federal fiscal plan, we still would have touched only half of the tax problem which confronts the nation. More than 50 percent of the total tax revenues of the country are collected by State and local governments.

We have talked about removing injurious Federal-State tax conflicts for the past five years, and our predecessors talked about the same problem. ~~It is now time to act.~~ I recommend that Congress create a small temporary national commission to report to Congress, (as soon as possible) on the most desirable intergovernmental fiscal policy. Such a commission should be made up of men of ability who enjoy the highest possible public confidence, who are familiar with the fiscal problems of Federal, State and local governments, but who will represent the public at large rather than any governmental unit.

Overlapping taxes have grown in number and size as both Federal and State Governments have sought new revenue.

Grants-in-aid are being demanded of the Federal Government in increasing amounts. The results of our fiscal situation are increasingly unsatisfactory to both the State Governments and the Federal Government, and are becoming ~~intolerable~~ to many taxpayers. As the result of this Commission's work, we should be able to achieve ~~an ordered~~ ^{a more orderly} relationship between the Federal fiscal system and the State and local fiscal system.

Thus far I have talked about two matters of great importance to the Treasury. Each of my suggestions, if you agree with me, may require some time to be worked out. Let us see what we can do now. ~~It seems to me that Congress has three choices on revenue legislation during this session:~~

1. Congress can merely renew the excise taxes and the corporation income tax which expire this year, or
2. Congress can reexamine the whole tax structure and in the light of this examination can renew expiring taxes in their present or a revised form, and can eliminate those features that are found to be business deterrents, making provision for additional taxes to replace losses in revenue, -- these revisions to be made effective beginning with 1939, or
3. Congress can follow the same procedure as I have

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out just outlined, but make the revisions effective beginning in 1940.

I know that everyone on this Committee is as anxious as I am to foster the full driving force of private capital. It is generally recognized that the following tax revisions would remove factors which in the opinion of businessmen act as deterrents on private productive enterprise:

Tax-exempt securities

Present law. At present the interest on State and local obligations is exempt from the corporation income tax and from the individual normal income tax and surtax. The interest on Federal obligations is in part similarly exempt and in part exempt only from the corporation income tax and the individual normal tax.

Recommendation. Enact legislation providing for full Federal taxation of the interest on Federal, State, and local obligations issued in the future and conferring power on the States to tax interest on Federal obligations issued in the future.

Reasons for change. The exemption of interest on government obligations from the income tax is incompatible with the principle of ability to pay. It provides a tax-free haven to persons in the higher income brackets, and consequently they are less likely to invest their capital in private enterprise. Further, to the extent that the higher income classes avoid their share of taxes by holding tax-exempt securities, persons with smaller incomes must be taxed higher to make up the revenue loss. The elimination of tax exemption would make the tax system more equitable and stimulate investment in risky enterprises by those best able to bear such risks.

Example. A married man with no children or other dependents with an income of \$100,000, half of which is derived from tax-exempt interest, is at present taxed at an effective rate of 8.9 percent, whereas if all his income were taxable, the effective rate would be 32.5 percent. For an individual with net income from other sources of \$500,000 an investment in fully tax-exempt securities at 3 percent results in the same net yield as taxable securities bearing rate of 10.71 percent.

Revenue effects. For years following the complete retirement of tax-exempt securities the additional annual income tax revenue to the Federal Government is estimated from \$179,000,000 to \$337,000,000. The annual increase in interest costs to the Federal Government and Federal instrumentalities is estimated from \$19,000,000 to \$50,000,000 and to the State and local governments from \$40,000,000 to \$105,000,000. It is difficult to estimate the increased revenue to State and local governments. For the immediate future there will be little additional revenue or interest cost for either Federal or State and local governments.

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1. Interest on future issues of government obligations -- Federal, State, and local -- should be made fully taxable.

Carry-forward of business losses

Present law. Individuals and corporations are now taxed on their annual incomes without being allowed a deduction for business losses sustained in prior years. During the period 1921-1932 taxpayers were allowed to offset current income with prior year losses.

Recommendation. Allow net losses of business, both individual and corporate, to be offset against the income of the succeeding year, and any loss not thus absorbed to be carried forward and offset against the income of the following two years.

Reason for change. The taxation of business income on a yearly basis may result in taxes being imposed on businesses which over a period of years have no net income. Types of business with irregular incomes pay higher taxes than those with regular incomes. The allowance of a net loss carry-over helps to eliminate this discrimination. It would tend to stimulate new enterprise and the capital goods industries, both of which characteristically have variable incomes.

Example. A corporation that loses \$5,000 in each of three years and in the fourth makes \$15,000 obviously has no income for the whole four-year period. Yet under the present law, because losses cannot be carried forward, the income tax will be \$2,025. If losses could be carried forward, no tax would be levied.

Revenue effects. If individuals were allowed to carry forward business losses for three years. It is estimated that the loss in revenue would amount to from \$7,500,000 to \$10,800,000 and for corporations the loss would be from \$17,800,000 to \$167,200,000 depending upon the level of business conditions assumed and the pattern of income in the prior years.

*Reasons
against
change
of
losses*

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- X*
2. Allowance ~~could~~^{to} be made for business losses to be carried forward and offset against income in a limited number of subsequent years.

have been asked to give the pros
cons on #1

The limitation on deduction of corporate capital losses.

Present law. Under the present law any excess of corporate capital losses over capital gains can be deducted from ordinary income only to the extent of \$2,000. Prior to 1934 corporations were permitted to deduct capital losses from ordinary income without limitation.

Recommendation. Allow corporate capital losses to be deducted in full from ordinary income.

Reason for change. The failure to offset net capital losses fully against ordinary income may result in imposing a high income tax on corporations with a very low income or even with a deficit. If corporations were allowed to deduct their net capital losses from other income without limitation, they would be less cautious in investing in securities of other corporations and in undertaking expansion of their own plants.

Cous
Example. A corporation that has ordinary income of \$25,000 and net capital losses of \$125,000 is nevertheless required under the present law to pay a tax of \$3,025, depending upon the amount of dividends paid out. If capital losses could fully offset ordinary income, no tax would be levied.

Revenue effects. If the limitation on the deduction of net capital losses from other income were eliminated it is estimated that on the basis of calendar year 1939 level of business conditions the revenue would be decreased \$68,100,000.

and cons

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3. Corporations could be allowed to deduct capital losses from their ordinary income.

Capital losses of individuals

Present law. Short-term losses from assets held not more than 18 months are allowed to offset short-term gains but may not offset ordinary income. Short-term losses in excess of short-term gains may be carried forward to offset such gains of the succeeding year. In computing taxable income two-thirds of the long-term losses are taken into account if the assets are held more than 18 but not more than 24 months, and one-half if the assets are held more than 24 months. The amount of long-term losses taken into account may be fully deducted from net income, or segregated and a tax credit computed at a rate of 30 percent, whichever method results in the greater tax.

Recommendation. Allow short-term losses to offset both short- and long-term gains instead of only short-term gains; allow net short-term losses to be carried forward for three years instead of one year; allow net long-term losses to the extent not offset against ordinary income of the current year to be carried forward for three years; and increase the rate for the computation of the tax credit on long-term losses under the method of segregation from 30 percent to 50 percent, to accord with the corresponding recommendation on capital gains.

Reasons for change. The present capital loss provisions are inequitable and discourage the assumption of business risks. Short-term losses should be allowed to be carried forward for more than one year and offset against long-term capital gains. Since capital gains and losses are highly irregular, the taxation of large gains in one year without allowing an offset for both short- and long-term capital losses of preceding years cannot be justified. The allowance of the capital loss carry-over, like the allowance of the net loss carry-over, would, by putting the tax more nearly on an average basis, improve its equity.

Example. A married man with no dependents receiving \$75,000 ordinary income and \$25,000 long-term capital gains is now required to pay \$22,659 income tax. If two years ago he had net short-term capital losses of \$50,000 and net long-term capital losses in excess of ordinary income of \$25,000 under the present law he would still be required to pay the same amount of tax, because such losses are not taken into account in the computation of his current year's tax liability. Under the recommendations, on the other hand, his short-term capital losses of two years ago could offset his current long-term capital gains, and the long-term capital losses of two years ago could reduce the ordinary income from \$75,000 to \$50,000 resulting in a tax of \$8,869 and leaving \$25,000 of short-term capital losses to be carried forward.

4. Somewhat greater deduction of capital losses ~~could be~~ allowed individuals.

Repeal of capital stock and excess-profits taxes

Present law. At present the capital stock tax is based upon a declared value which the taxpayer may revise every three years. The declared value may be any figure the taxpayer desires to make it regardless of the actual value of the stock. The excess-profits tax applies to profits in excess of 10 percent of the declared value.

Recommendation. Repeal the capital stock and excess-profits taxes — the capital stock tax effective for years beginning after June 30, 1939, and the excess-profits tax effective for the first income tax year ending after June 30, 1940.

Reason for change. The capital stock and excess-profits taxes are highly uncertain and inequitable. These taxes depend upon the amount of profit actually realized during each year of a three-year period and the taxpayer's ability to forecast these profits accurately at the beginning of the period. Forecasts of profits are especially difficult to make in the case of new businesses and businesses with unstable incomes. The repeal of these taxes would be stimulating to such businesses, because it would remove the unduly high tax burdens resulting from erroneous forecasts.

Example. A Corporation with incomes of \$100,000, \$200,000 and \$50,000 respectively, in each of three years, declaring a capital stock value of \$1,000,000, is under the present law required to pay capital stock and excess-profits taxes of \$12,000 for the three years. If the value declared had been \$750,000, the taxes would have been \$16,500 and if the value declared had been \$1,250,000, the taxes would have been \$9,000. The closer the declared value is to ten times average earnings, the lower are the combined capital stock and excess-profits taxes. Any substantial departures from such a declared value result in higher taxes.

Revenue effects. If the capital stock tax and excess profits taxes are repealed, it is estimated on the basis of calendar year 1939 business conditions that the revenue would be reduced \$122,400,000.

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5. The capital stock tax, the excess profits tax and present corporation income tax could be consolidated into a single tax on corporation incomes.

The continue deterrent against family corp. leaving profits.

Reduction in top surtax rates

Present law. The maximum surtax rate is now 75 percent on net incomes in excess of \$5,000,000. Under the 1932 Act it was 55 percent on incomes in excess of \$1,000,000, and under the 1926 Act, effective for the period through 1931, it was 20 percent on incomes in excess of \$100,000.

Recommendation. Reduce the upper surtax rates to a maximum of 60 percent, leaving the maximum combined normal and surtax rate at 64 percent.

Reason for change. The present top bracket rates are too high. Disregarding State taxes, the taxpayer is left with as little as twenty-one cents out of his highest dollar of income. If State taxes are taken into account, even less is left. The high rates tend to discourage the assumption of business risks, to bring about the hoarding of savings or the purchase of tax-exempt securities, and to depress the economy. If the surtax rates were reduced, wealthy individuals would be encouraged to assume certain business risks which with the present high rates do not appear to be worthwhile.

Revenue effects. If the top bracket surtax rate is limited to 60 percent and all other provisions in present law remain unchanged, it is estimated on the basis of calendar year 1939 business that the revenue from the individual income tax would be reduced \$11.5 million.

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I shall
 6. The top rates in the individual
 possible changes ^{to} surtax schedule ~~could~~ be lowered.
 ad in further information, my staff and I are prepared
 to furnish it and will be happy to work with you to
 the extent you may desire. Also, I recognize that

Income tax returns of 1000 riches
 people.

Do they report income from state & municipal
 income from gifts.

(Carter glass amendment 60-75 depending
 on income from gov.)

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I shall not discuss in detail any of the six possible changes just mentioned. If you are interested in further information, my staff and I are prepared to furnish it and will be happy to work with you to the extent you may desire. Also, I recognize that other features of the tax law are considered by some to be business deterrents, and, if you feel they are substantial deterrents, we will be glad to assist in their examination.

Most of the tax changes that I have mentioned will reduce the revenue-producing capacity of the system. If these or other similar changes are adopted ways must be found of replacing the lost revenue. If tax revision were to take the form only of tax reductions uncertainty of business with respect to our fiscal program would be accentuated. The result would be to injure and not help business. We must take no step which the public may interpret as moving away from the objective of a balanced budget. The taxes resorted to for replacement of lost revenue should have the least harmful effects on business and should contribute to greater equity. I suggest the following possibilities:

A single corporation tax on net income

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Present law. Under the present law several corporation taxes are imposed: a capital stock tax, an excess-profits tax, an undistributed profits tax, and the ordinary income tax. The income tax itself is complex. A flat rate, together with what in effect is a tax on undistributed profits, is imposed on corporations with incomes over \$25,000. Graduated rates are imposed on corporations with incomes of \$25,000 and less. Further, several classes of corporations, irrespective of their size, are subject to flat income tax rates.

Recommendation. Substitute for the capital stock tax, excess-profits tax, and the corporation income tax (which in the 1938 law includes a tax on undistributed profits in the form of a credit for dividends paid) a single corporation tax on net income. If other previously recommended changes in corporation taxes are made to permit loss carry-over and deduction of capital losses from ordinary income, the rates of such a tax would need to be approximately 18 percent on net incomes under \$10,000, 19 percent on net incomes of \$10,000 to \$25,000, 21 percent on net incomes of \$25,000 to \$50,000, and 22 percent on net incomes of \$50,000 and over, in order to replace the revenues of the existing corporation tax structure.

Reasons for change. The present system of corporate taxes is complex, discouraging to enterprise, and inequitable. The capital stock and excess-profits taxes have been discussed previously. The undistributed profits tax component has added substantially to the complexity of the corporation income tax. At the present rate it is ineffective and there seems no possibility of securing passage of an effective tax, while the hostility to it is very great. If all corporate taxes are consolidated into a single tax on net income, the taxes on new business, on business with unstable incomes, and on business with no income would be substantially reduced. The increases would, in general, fall on the larger and more stable businesses.

Example. A corporation with net income of \$1,000,000 declaring the most favorable value for its capital stock, \$10,000,000, is required under the present law to pay corporate taxes of from \$175,000 to \$200,000, depending upon the distribution of dividends, as against \$218,900 under the proposed single corporation income tax. If the corporation made a less favorable declaration of capital stock value -- either higher or lower -- the taxes under the present law would be relatively greater. If in the next year this corporation had no net income, it would under the present law still be required to pay a capital stock tax of \$10,000, whereas under the single corporation income tax there would be no tax liability.

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1. The corporation income tax rate could be increased.

will have to bring in as much revenue. This is a very difficult problem for congress.

Recommendation. No specific recommendations are made.

Reason for change. If the revenue system is to be made more equitable by removing certain of the undesirable indirect taxes that now unduly burden the low income classes, and if the income tax itself is to be improved by allowing losses to offset profits and gains and in other ways, so that it will not curb business enterprise, it is necessary to increase the revenue-raising powers of the individual income tax. The top rates are now too high and should be lowered. Consequently, if the individual income tax is to raise more revenue, the middle bracket rates must be increased.

Example. No specific example can be given.



Middle bracket individual income tax rates

Present law. The individual income tax rates under the present law are relatively low on incomes under \$250,000. The effective rate of tax on \$10,000 received by a married man with no dependents is only 4.2 percent; on \$20,000 it is 7.9 percent, on \$40,000, 14.9 percent, on \$100,000, 32.5 percent, and on \$250,000, 51.3 percent.

The existing surtax rate schedule of the income tax is as follows:

Amount of surtax net income	:Rate: per- cent:	Total surtax cumulative:	:	Amount of surtax net income	:Rate: per- cent:	Total surtax cumulative
0 - \$ 4,000	0	0	\$	\$ 62,000 - \$ 68,000	39	\$ 14,000
4,000 - 6,000	4	80		68,000 - 74,000	43	16,500
6,000 - 8,000	5	180		74,000 - 80,000	47	19,400
8,000 - 10,000	6	300		80,000 - 90,000	51	24,500
10,000 - 12,000	7	440		90,000 - 100,000	55	30,000
12,000 - 14,000	8	600		100,000 - 150,000	58	59,000
14,000 - 16,000	9	780		150,000 - 200,000	60	89,000
16,000 - 18,000	11	1,000		200,000 - 250,000	62	120,000
18,000 - 20,000	13	1,260		250,000 - 300,000	64	152,000
20,000 - 22,000	15	1,560		300,000 - 400,000	66	218,000
22,000 - 26,000	17	2,240		400,000 - 500,000	68	286,000
26,000 - 32,000	19	3,380		500,000 - 750,000	70	461,000
32,000 - 38,000	21	4,640		750,000 - 1,000,000	72	641,000
38,000 - 44,000	24	6,080		1,000,000 - 2,000,000	73	1,371,000
44,000 - 50,000	27	7,700		2,000,000 - 5,000,000	74	3,591,000
50,000 - 56,000	31	9,560		5,000,000 up	75	
56,000 - 62,000	35	11,660				

The tax and effective rate of tax on a married man with no dependents at various income levels is as follows:

Net income before exemption	: Amount of Tax	: Effective rate	:	Net income before exemption	: Amount of Tax	: Effective rate
\$ 3,000	\$ 8	0.3		\$ 100,000	\$ 32,469	32.5
6,000	116	1.9		250,000	128,294	51.3
10,000	415	4.2		500,000	304,144	60.8
20,000	1,589	7.9		1,000,000	679,044	67.9
40,000	5,979	14.9		5,000,000	3,788,994	75.8

2. Individual income tax rates could be increased.

There is merit to suggestion between 15,000 and 250,000. as relatively low compared with incomes less than 15 and more than 250. and additional income could be gotten here.

The ~~the~~ Furthermore good city shift its is felt that every individual more than \$800.00 a year and up to 1500 and families 2500 should could pay and would be willing to pay a small flat tax

Net estate before exemption	Tax	Effective rate
\$ 50,000	\$ 200	0.4%
100,000	4,200	4.2
400,000	58,600	14.7
1,000,000	211,000	21.1
4,000,000	1,388,800	34.7
10,000,000	4,936,600	49.4
60,000,000	39,334,600	65.6

Recommendation: No specific recommendation.

Reasons for change. The excessive specific exemptions allowed under the present estate and gift taxes limit transfer taxation to a comparatively few large estates. The insurance exclusion discriminates in favor of investment in life insurance as against other desirable forms of investment. The transfer tax, like the individual income tax, is levied at graduated rates and is one of the most important instruments for bringing about an equitable distribution of tax burdens and a more equal distribution of wealth. The role of the transfer taxes should be increased, especially since it is desirable to repeal some of the indirect and other regressive taxes that now are included in the tax system. This would be done if the estate and gift taxes were coordinated, if the exemptions were lowered, if the insurance exclusion were disallowed, and if the middle bracket rates of the single transfer tax were raised substantially above those in the present estate tax.

Exemptions, insurance exclusion, and middle bracket rates of the estate and gift taxes

Present law. Under the present law a specific exemption of \$40,000 and an exclusion of \$40,000 for insurance payable to beneficiaries other than the estate are allowed under the estate tax, and a specific exemption of \$40,000 is allowed under the gift tax. The middle bracket estate tax rates are low. The effective estate tax rate on a net estate of \$50,000 is only 6 percent, on a net estate of \$100,000, 9.6 percent, and on a net estate of \$400,000, 16.7 percent.

The estate tax rate schedule is as follows:

(Dollars in thousands)

Net estate	: Bracket	: rate	: Cumulative tax	::	Net estate	: Bracket	: rate	: Cumulative tax
\$ 0 - \$ 10	2%		-		\$ 2,000 - \$2,500	38		\$ 557.6
10 - 20	4		.2		2,500 - 3,000	41		747.6
20 - 30	6		.6		3,000 - 3,500	44		952.6
30 - 40	8		1.2		3,500 - 4,000	47		1,172.6
40 - 50	10		2.0		4,000 - 4,500	50		1,407.6
50 - 70	12		3.0		4,500 - 5,000	53		1,657.6
70 - 100	14		5.4		5,000 - 6,000	56		1,922.6
100 - 200	17		9.6		6,000 - 7,000	59		2,482.6
200 - 400	20		26.6		7,000 - 8,000	61		3,072.6
400 - 600	23		66.6		8,000 - 9,000	63		3,682.6
600 - 800	26		112.6		9,000 - 10,000	65		4,312.6
800 - 1,000	29		164.6		10,000 - 20,000	67		4,962.6
1,000 - 1,500	32		222.6		20,000 - 50,000	69		11,662.6
1,500 - 2,000	35		382.6		50,000 -	70		32,362.6

The gift tax rates are three-fourths of the estate tax rates.

The tax and effective rates under existing law for selected sizes of net estate (before exemption) are as follows:

3. Estate and gift taxes could be increased.

Percentage Depletion

Present law. Percentage depletion is allowed in the present law for oil and gas wells at the rate of 27 $\frac{1}{2}$ percent of gross income; for metal mines, 15 percent; for sulphur mines or deposits, 23 percent; and for coal mines, 5 percent. The percentage depletion is limited, however, to 50 percent of the net income computed without allowance for depletion.

Recommendation. Reduce the percentages for depletion by 50 percent, to be 13 $\frac{3}{4}$ percent for oil and gas wells, 7 $\frac{1}{2}$ percent for metal mines, 11 $\frac{1}{2}$ percent for sulphur mines or deposits, and 2 $\frac{1}{2}$ percent for coal mines. (Even greater decreases could be justified.)

Reasons for change. The purpose of depletion, like the purpose of depreciation, is to enable the taxpayer to recoup his capital investment in the property tax-free. If, however, the depletion charges are related to gross income rather than cost, it is possible for the taxpayer to continue to take a deduction for depletion long after the full cost of the property has been charged off. So long as the property is producing, the depletion charges continue. Percentage depletion thus provides what is in effect a subsidy to the oil and mineral interests, a privilege not granted to other types of business. This subsidy is not uniform among the different oil and mineral industries or among concerns in any of them. Concerns with low-cost, long-lived properties receive the most benefit. The excessive deductions under percentage depletion are thus inequitable, while they result in a substantial loss in revenue.

Example. If a corporation takes \$5,000,000 depletion allowance for oil and gas properties on the basis of 27 $\frac{1}{2}$ percent of gross income, while only 10 percent of gross income is required to return the cost of the properties, the corporation in effect receives a tax subsidy of from \$525,000 to \$604,545, depending upon the amount of dividends distributed. Sample Studies indicate that on the average the percentages of gross income necessary to return cost are less than 10 percent, and that in many instances much less than 10 percent would be sufficient.

4. A special privilege of the present law is the allowance of excessive deductions for depletion of oil and gas wells and certain mines. As the Treasury has often pointed out, a substantial amount of revenue can be recovered by closing this loophole. In suggesting this change I am fully aware that it will be opposed by powerful vested interests, despite its obvious equity.

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In this statement emphasis was laid first on the importance of sound fiscal policy, and a suggestion was made for a Joint Congressional Committee as a means to the formulation of such policy. Secondly, the need for a commission to study Federal-State fiscal relations was stressed, and thirdly, alternative programs for adjusting federal taxes to eliminate features that may deter business were outlined.

It will take time for the results of fiscal planning toward a balanced budget and for the removal of tax deterrents to be fully effective. Obviously, fiscal factors constitute only one of many aspects of our economic problem. I feel, however, that if something substantial is done along the lines I have discussed people can look forward with more assurance for the next five or ten years and business growth and development will proceed more rapidly than they otherwise would.

Berlin, May 2, 1939.

My dear Mr. Secretary:

I feel very grateful for the opportunity to return to the States which you gave me, and I hope its value will be proved in my later reporting. I think your decision to cancel my instructions to proceed to Poland, Hungary and Roumania was a wise one because this tense period is not one in which to get out of touch with the changing situation in Berlin.

I returned to find that the financial, monetary and general economic strain had intensified. But, as I have reported in my telegrams, the deterioration is so slow, the power of the Government is still so great and the passivity of the German people so extreme, that there is little likelihood that economic difficulties and the impairment of the standard of living will generate an effective public discontent which might modify the unfortunate policies here.

Many of my most useful sources of information and opinion here are in the second rank of officials. If you can get them to come out to lunch or dinner quietly, or, better, to take holiday or week-end excursions, they will speak more or less frankly. They are in almost all cases young Germans highly educated under the previous regime, who have gone into civil service as a career. Many, perhaps the majority, of this class have become members of the National Socialist Party. It is indeed a practical necessity for them to be members if they are to advance or even retain their positions in the Government. I know of some cases where this type of Government official is not a member of the Party, but usually it is because some previous connection, say with the Labor Movement or Social Democrats, made him ineligible for Party membership. The attitude of these young Liberals is

that

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

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that, given the strength of the National Socialist Movement, there is no possibility of combatting from without. The only alternative, they say, is to strengthen their position in the government and attempt to modify the movement and wait until a favorable internal or external event will bring about its downfall. It may be said here that in the majority this group are inclined to be moderately Socialist in their views. They do not disapprove of the increase of state intervention and the control of industry and commerce under the National Socialist regime. What they object to is the restriction on personal liberty, freedom of thought and the present policy of military aggression, instead of international cooperation, which they feel will eventually lead to a European war.

In the main, up to Munich, this group had believed that a firm stand would be made against Hitler. After Munich, and particularly after the taking of Czechoslovakia, about half of them have become entirely pessimistic, and the remainder do not have too much hope. They believe that had a firm opposition been manifested by France and England during the past few years, Hitler would have been afraid to go to war, and the check to his prestige would have been sufficient to have started the end of the regime. If he refused to obey the opposition and went to war, then they figure that the regime was also bound to crumble, and they hoped that with a change of regime war could be stopped on terms not too onerous to Germany.

During the crisis of last September the opposition to Hitler's policy was almost vocal, as were their hopes that Chamberlain would take a firm stand with regard to Czechoslovakia. Most of them profoundly distrust Chamberlain and the more ardent Democrats amongst them dislike him, if possible, even more than Hitler. They regard Chamberlain as being secretly very sympathetic to National Socialist organization, particularly as regards the control of labor, and still under the delusion that Hitler's aims are definitely limited to Eastern Europe and that the Führer can be "appeased" against making forays against the Western Powers. They are very dubious as to the real strength and capacity of Daladier. Their one hope is in President Roosevelt, in whose democratic ideals and ability they have a very considerable belief.

This group is more alarmist about Hitler's aims than the latter's foreign critics. They point to the

program

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program and psychology as exemplified in "Mein Kampf" and his actions since he has been in power. They think him obsessed with the idea of dominating Europe and with putting Germany in the position occupied by the British Empire in the first half of the Nineteenth Century. The limitations of education, experience, judgment and tradition which restrained Bismarck after the Franco-Prussian War do not exist in the case of Hitler. They declare it is only too obvious that he sees history as a sheer battle of force in which one race or country for a time battles its way to primacy knocking down its predecessors on the way up. They think that he judges that now or never is the time for Germany to make this effort because with further delay opponents will gain strength faster than she will.

I took a holiday walk in the country recently with one of this group, a man in the second rank of officers of one of the most important Ministries. He declined to believe that the 25 percent additional duties which the Treasury imposed on German exports to the United States was done in view of the provisions of our anti-dumping legislation, but said that he highly approved the action for what, in spite of my explanations, he insisted it was, - a political move. He said that in his opinion only further actions of economic restriction, the successful resistance of China to Japan, and a firm stand by England and France on the Polish question, even to the point of sending French and British troops to Poland, might have some chance of restraining Hitler and bringing about the end or progressive deterioration of the National Socialist regime. He remarked that as a German he thought that the return of Danzig and the Corridor to Germany must eventually be conceded; but he said that such concessions at the present time without exacting a firm commitment as to disarmament, would be fatal and merely lead Hitler on to keep up the tension until English public opinion gave way, and start stirring up feeling against and in Poland until the Poles capitulated. He remarked that he had little faith that either action would be taken; that Chamberlain would doubtless give way. He ended by saying that if the present regime were to be checked, that eventually concessions in the way of Danzig, colonies and trade would have to be given, but it would be a terrible error, given Hitler's psychology, to let the offer of concessions precede an unmistakable firm stand. If concessions were talked up in advance of opposition they would be taken as evidence of weakness.

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I recite the foregoing not as a suggestion of policy or as being a correct analysis of the aims and psychology of Hitler and the National Socialist Movement, but merely report it as an interesting example of the under-gover opposition that still exists against this régime among German officials. With Hitler's successes and ineffective opposition so far manifested against them, this type of opposition is tending, however, to dissolve into cynical pessimism that the world is deserting international cooperation for a period of power politics, and that if this is the case Germany might as well be the victor as well as any other country.

Sincerely yours,

Donald R. Heath
Donald R. Heath

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Berlin, Germany

DATE: May 2, 1939, 2 p.m.

Received: May 3, 7:20 a.m.

No.: 304

Reference is made to telegram No. 78 of April 4 from the Department.

The "voluntary" levies applied on practically all branches of German industry are still the chief source of the German export subsidy fund. An effort has been made to avoid the charge that the Government is subsidizing by having the industrial organizations which are comprised within the Reich Chamber of Economy collect the levies rather than the Government - but in this totalitarian state this Chamber is essentially a Government branch. Every industry is assessed a certain percentage of its domestic turnover. The amount is to be paid into the export subsidy fund. For certain branches of industry, however, quite complicated keys are used as a calculation basis in which production, turnover and profit are combined; for others there is applied something in the nature of a flat excise tax on each unit produced.

Under the original scheme, levies were prescribed which ranged from 1/2 percent to 3 percent. It was inaugurated in the early part of 1935, and in the 12 month period after its inauguration was expected

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to yield some 622,000,000 marks. It was understood that later certain industries which did not come under the levy at first were subjected to it, and the levy on others was increased, so that during the first year the fund operated some 750,000,000 marks were collected. It was expected that contributions to the subsidy fund from other sources would increase the fund to about one billion marks. Recently new warnings have been issued against revealing information about present levies, and because of the heavy penalties, details are practically unobtainable. However, it is understood from a reliable and still fairly well-informed source that the present levies take on the average about 1 percent more of the domestic turnover than was taken by the original levies. Therefore it is supposed that something over one billion marks per annum might be the total income from the levies now.

However, other sources of income than the levies help to build the export subsidy fund. As an illustration, domestic prices of many commodities which are imported have been fixed at levels which are far above the world prices - either for the protection of domestic producers, or because the commodity is in general imported and paid for in depreciated "aski marks" or over "inland accounts" which results in the imported goods being over-priced. If it is possible for an importer
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to get foreign exchange at the mark's official rate, he can purchase such commodities far below the price on the domestic market in Germany. However, the importer is not often allowed to keep this "windfall" profit. It is understood that in some cases he must pay it forthwith into the Gold Discount Bank, which in turn transmits it to the subsidy fund. It is understood that the subsidy fund also receives mark profits on other types of transactions, such as the repatriation of foreign bonds by German concerns.

I have at last been given what I consider is a roughly reliable estimate that the export subsidy fund proper will in the year 1939 receive some thirteen hundred million marks from the "voluntary levies" and miscellaneous sources, if there is continuation of the present rate of payments into the fund.

There must be added to the export fund proper, however, the hidden additional subsidy effect which results from the fact that German exporters are permitted to quote their wares in "aski" or other blocked marks selling at a discount in their trade with Latin America and other areas. A mark is a mark to the German exporter or to anyone else inside Germany, regardless of whether/^{or not} such mark was paid for by the foreign importer at the "aski mark rate". Therefore the German exporter does not
have

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have to apply for a bounty as long as the thirty percent discount, say, at which the mark exchange is bought by the Latin American customer, is sufficient to bring the prices quoted by the exporter in line with those of foreign competition. There is a similar effect from the "inland account" system by which much of the trade has been carried on with the United States recently. The subsidy effect is in this trade divided by the German consumer who is charged an over-price for commodities coming from these areas which is equal to the amount of the discount of the blocked mark which has been used in the transaction. For the year 1938 imports from Latin America by Germany totaled some 800,000,000 marks. Using 30 percent as the average discount of aski marks used in the trade with Latin America, apparently exports to Latin America have the effect of a hidden export bounty which presumably amounts to something like 240,000,000 marks. As yet I do not have available the figures for imports of cotton and copper from the United States into Germany under the "inland accounts". There was about a 33 1/3 percent over-price for cotton, and apparently some 66 2/3 percent over-price for copper. Many millions of marks must have been provided in "windfall profits" through the over-price received for these

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these commodities, and undoubtedly the ^{dollar} price of exports to the United States was brought down through these profits.

Reports come from certain newspaper correspondents that the money which was appropriated by the Reich budget law for the current fiscal year for the purpose of assuming "guarantees for promoting German foreign trade up to a maximum amount of 500 million marks" must be added to the regular subsidy fund of the Reich. The purpose of this appropriation, according to the best information and opinion available, is that of a revolving fund for granting long and medium term credits for German exports, rather than to provide export bounties. Attention is called to the fact that during the fiscal year just ended 100 million marks were appropriated for this purpose, and 300 million in the year 1937. The German Government appropriated similarly 200 or 300 million marks for long term export credits prior to the National Socialist Hungarian Government (sic). Therefore one can hardly class as subsidies funds from this appropriation except to the extent that the interest rate at which they are made available to German exporters constitute is so low (practically non-existent) as to ~~form~~ constitute an export bounty in the form of interest economies.

Recently

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Recently the Reichsbank inaugurated measures which tend to lower the cost of financing export business and to restrict the risk connected with foreign exchange transactions, and these measures are another form of indirect bounty. The exporter, under these measures, can discount his bills at the rate existing in the country in whose currency they are drawn, regardless of what the rate is in the country in which the bills are payable. In other words, if a German exporter to Turkey quotes in pounds, instead of ~~quoting~~^{discounting}/at the Turkish or the German rate of 4 percent, he can discount at the British discount rate of 2 percent. The Reichsbank will discount at 1 percent bills drawn in dollars. The reduction from previous discount rates is as much as 3 or 4 percent in the case of export bills drawn on certain countries. The handling charges for export bills has also been reduced by the Reichsbank, which is offering exchange fluctuation insurance in discounting export bills now.

Still another indirect subsidy the value of which cannot at the present time be computed in terms of money is the provision in the new finance plan whereunder concerns exporting one-fourth of their production are permitted either to make a deduction from taxable income or an additional write-off for depreciation of up to

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10 percent of the amount they hold in certain tax anticipation certificates which the Reich is now issuing. Those establishments which do not export as much as one-fourth of their production may make additional write-offs or subtract from taxable income 1 percent of the amount of such certificates in their possession for every 2 percent of increased exports made by them.

There may also be mentioned, in conclusion, the inducement to export in the form of preferential allocation of raw materials to establishments which export a substantial part of what they produce. There is a chronic shortage of raw materials at present, and firms are prepared to take on or keep up export business even if they lose on it so that raw materials can be secured to carry on profitable production for domestic use. No way is of course known of computing how much this preferential treatment amounts to.

Taking the estimate of 1,300,000,000 marks as the amount in the "subsidy fund proper", and if exports continue at the 1938 level of 6,000,000,000 marks, the rate of subsidy would on the average be some 22 percent. If there is added two hundred and forty hundred(sic) million marks for the subsidy effect on export trade by transactions

transactions with Latin America in the aski mark, slightly more than 25 percent would be the average rate of subsidy. There must be added to this the unknown amounts from the subsidy effect of "aski mark" or inland account transactions with countries other than those of Latin America. Allowance must also be made for the subsidy effect of Reichsbank discount reductions for exporters and the tax reductions to exporters which the "new finance plan" will effect.

The rate of subsidy is not uniform. There are wide variations from time to time, in different industries, in different factories, in different products, in different shipments, and in different export markets. No subsidy is needed or granted for certain German specialties. Where certain countries have considerable blocked balances forcing them to purchase from Germany, exports to those countries can be passed on with a minimum subsidy or not any at all even though competing suppliers could supply the goods more cheaply. German goods require little or no subsidies in certain cases where the prices are maintained and markets are allocated by international cartel arrangements. Every factory in practice keeps on file with the subsidy fund examining office their "rock bottom" prices in marks for the products which they export.

Fairly

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Fairly reliable information becomes available from time to time as to subsidy rates on given transactions or on given commodities. It is thus known that one factory which exports manufactured copper products receives subsidies which vary from 11 percent to 22 percent. The average motor vehicle subsidy is about 30 percent, according to a fairly reliable indication, although there has been reported one instance of a sale in South Africa where a 46 percent subsidy was paid. It is also known that a subsidy of 50 percent was offered in the case of a cotton glove shipments from the Sudetenland.

Publicly and privately various officials have insisted that the average subsidy rate is well below the dollar devaluation of 40 percent, but I have been inclined to discount their assertions. However, last week a similar assurance was given to me by a person who is in touch with the subsidy program (although not connected with the administration of the program) and in whom I have great confidence. This person told me that he had been surprised at the relatively low bounties with which German export trade had been able to maintain itself, in view of the disparity between German domestic and world prices. He said that if bounties of more than 40 percent had been given, they constituted

constituted rare exceptions, that in general subsidies were "considerably" under 40 percent.

Very good information has come to us, on the other hand, that the over-price for American copper imported over inland accounts was about 66 $\frac{2}{3}$ percent. Such an over-price would enable firms engaged in such operations to take a loss of 40 percent, minus their profits, on German goods which is exported in return for the copper.

Reference is made only to bounties paid from the subsidy fund, in the foregoing examples of subsidy percentages. If the inland price level is the standard of measure, then we must add at least several percent, since German exporters have been frequently content to export at little or no profit, and recoup from their domestic sales, in order to maintain old markets to spread their overhead costs or as a result of Government pressure or preferential treatment in allocation of raw materials. It is reported that one large electrical firm conducted its export business at a loss, although international cartel arrangements protect it in certain areas.

It is requested that the foregoing be transmitted to Treasury as Heath's telegram No. 25.

QV1323R

END OF MESSAGE.

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Approved and Forwarded

TREASURY DEPARTMENT

299

INTER OFFICE COMMUNICATION

DATE May 3, 1939

TO Secretary Morgenthau
FROM Mr. Foley, Acting General Counsel

For your information

At the request of the State Department, Bernstein and I went over to see Judge Moore and Mr. Hackworth relative to a group of proclamations and orders which the War and Navy Departments have been preparing in consultation with the State Department. These proclamations and orders relate to the neutral position which the United States will take in the event of the existence of war. The Treasury was asked to go over the documents and participate in a conference together with the State, War and Navy Departments to be held some time during the coming week. I was told that these documents are being drafted simply as a measure of preparation and that they were to be kept entirely confidential.

F. N. F. H.

REB

GRAY

Berlin

Dated May 3, 1939

Rec'd 1:25 p. m.

Secretary of State,
Washington.

313, May 3, 7 p. m.

No. 24 FOR TREASURY FROM HEATH.

The currency circulation of the Third Reich reached a new high at the end of April according to the Reichsbank statement issued today. It stood at ten thousand seven hundred twenty-six million marks a figure two hundred forty million marks higher than a month ago and roughly two thousand six hundred million marks higher than a year ago.

Since the end of February 1938 the currency circulation has increased to date some three thousand five hundred million marks. Of this increase one thousand one hundred and twenty-four million marks is attributable to the exchange of Austrian schillings and Czech crowns as a result of the Anschluss and the Sudetenland acquisition. An undetermined amount of the increase is occasioned by the Memel acquisition and the taking over of Bohemia, Moravia,

REB

2-#313, From Berlin, May 3, 7 p.m.

Moravia, in which latter areas the mark has the status of the secondary currency. Making due allowance for these two last developments and for the increase in employment and business activity in all sections of the Reich there remains an increase of apparently something over a billion marks which must be considered as of an inflationary nature.

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MAY 4 1940

THE ARMY DEPARTMENT
Office of the Secretary
The Adjutant General's Office

PAP

TELEGRAM SENT

GRAY

May 3, 1939

2 p.m.

AMEMBASSY

PARIS (FRANCE)

332

FOR COCHRAN

The Secretary of the Treasury requests you to return for discussion with the Treasury on the NORMANDIE sailing May 10. If this is agreeable to the Ambassador the Department authorizes it.

HULL
(HF)

EA :HF:LWN

RECEIVED

MAY 4 1939

THE TREASURY DEPARTMENT
 OFFICE OF THE SECRETARY
 WASHINGTON, D. C.

PAP

GRAY

LONDON

Dated May 3, 1939

Rec'd 2:22 p.m.

Secretary of State

Washington

600, May 3, 6 p.m.

FOR TREASURY FROM BUTTERWORTH

Strictly Confidential

One. I questioned the British Treasury regarding the war risk insurance situation referred to in paragraph No. 1 of my 595, May 2, 6 p.m. and was definitely informed that the war risk insurance measures had not been designed to hinder or limit arbitrageurs; that they had been put on a sterling basis merely because the British monarchical authorities did not wish to undertake a large contingent dollar liability which, if it matured, would be at a time when the British Government would have urgent need of such dollar funds as were available to it for other purposes. The British Treasury referred to the informal assurances given to the arbitrageurs by the Bank of England and said that this was an attempt to effect a working compromise.

Two. The British Treasury stated that the press reports to the effect that Leith-Ross had been authorized

to

PAP -2- 600, May 3, 6 p.m. from London

to increase the credit to be given to Rumania under the "political" export credit guarantees scheme from five to ten million pounds were incorrect and arose out of the fact that a reduction in the proposed interest charges from six to five per cent would be accorded the Rumanians. But the capital sum of 5,000,000 pounds stood. Leith-Ross is still discussing the rate of exchange problem and I gathered that an Anglo-Rumanian Trade Corporation would be set up in which King Carol will have a personal and perhaps lucrative interest.

Three. Leith-Ross has been authorized to offer the Greeks a two million pound credit under the political export credit guarantees scheme.

Four. Again, for no ascertainable reason, the London Stock Exchange was firmer today: most equities were up and war loan improved one fourth to close at 91 3/4. The foreign exchange market was very inactive but the British control today had to give some spot dollars and a good deal of forward at 2 1/16. 126 bars were sold at gold fixing of which 37 were married the Bank of England supplying some 50 bars. Samuel Montagu was the only buyer.

RECEIVED

KENNEDY

HPD

MAY 4 1940

THEATRE DEPARTMENT
Office of the Secretary
General Building at the University

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: May 3, 1939, 6 p.m.

NO.: 876

FROM COCHRAN.

Very quiet Paris exchange market, with neither sales nor purchases by French control. It is said that yesterday subscriptions to the new French three-year national defense bonds amounted to 250,000,000 francs. Attempt is being made by officials to sell to investors 50 percent in these bonds, and 50 percent in the two-year national defense bonds.

Beck's reply to Germany is awaited on the market, but in the meantime the market is fairly cheerful.

BULLITT.

RECEIVED

MAY 4 1939

TELEGRAPH DEPARTMENT

RECEIVED BY THE DIRECTOR
 OF THE BUREAU OF INVESTIGATION
 MAY 4 1939

EA:LWW

Continued giving me export world
TREASURY DEPARTMENT
INTER OFFICE COMMUNICATION
Figured
306

DATE May 3, 1939

TO Secretary Morgenthau

FROM Mr. Haas *HA*

Subject: Causes of the recent upturn in wheat prices.

The recent rise in wheat prices has been confined largely to this country and Canada, and appears to have been due chiefly to speculative buying on unfavorable crop news from the Southwest, coupled with covering of short positions in the May future where a tight technical situation apparently exists. An increase in the demand for cash wheat abroad has apparently been a market influence, though it is difficult to determine whether the price rise has stimulated the export demand, or whether a more active export demand has been an underlying price factor.

Recent price trends

In the attached chart we compare the trends of May wheat futures in leading world markets from April 17 through May 2, which covers the period since the beginning of the recent upturn.

It will be noted (1) that the price at Buenos Aires has not shared in the rise, and that the Liverpool price has been affected only during the past two days (though other wheat futures at Liverpool have been slightly stronger); (2) that the price at Winnipeg has risen less than at Chicago; (3) that the price at Chicago is substantially above those in the other markets, making it impracticable at present to use this country as a source of supply, except under an export subsidy. The Federal Surplus Commodities Corporation says that the rise has spoiled our export business.

Causes of rise

According to trade reports (concurrent in by Mr. Mehl of the Commodity Exchange Administration) the rise has apparently been due to buying induced by adverse crop and weather accounts coming from western Kansas and Oklahoma,

and to a lesser degree by the need for additional moisture in the spring wheat areas. While it appears that most of the crop damage is still in the potential stage, lack of a subsoil moisture reserve over important western areas has intensified the effect of recent dry weather on prices.

A possible contributing factor, in the belief of Mr. Mehl, may be a tight technical position in the May future at Chicago, resulting from a relatively small supply of ordinary grades available for delivery on contracts. While trade interests with short hedges in May could deliver premium grades which they hold, they would receive less than the market premiums, hence there has apparently been a movement to cover short positions in the May future.

Evidence of this tightness appears in a rise in May futures to a premium of $1\frac{3}{4}$ cents over September (on May 1) as compared with a $1\frac{1}{4}$ -cent premium a week earlier. In contrast, the May future at Liverpool during the same period had weakened in comparison with the October future, dropping to a discount of $2\frac{1}{4}$ cents (on May 1) as compared with a discount of $1\frac{1}{4}$ cents a week earlier.

No evidence was available in the C.E.A. to indicate any accumulation of wheat futures (in anticipation of war, for example). While an increased volume of trading has accompanied the rise in prices, there has been a decline in the open interest -- total of outstanding long (or short) futures contracts -- from 67,354,000 bushels on April 22 to 65,526,000 bushels on May 1. The open interest in May futures alone has declined during this period from 20,421,000 bushels to 10,700,000.

World export demand increased

Trade reports, confirmed by the Federal Surplus Commodities Corporation, indicate that an active export demand for wheat from Canada, Argentina, and Australia has been evident in the past week, representing a marked increase over previous weeks. The F. S. C. C. reports the following export transactions during the past week:

	<u>Bushels</u>
April 26: Argentina to United Kingdom	150,000
Australia to United Kingdom	150,000
Australia to Shanghai	500,000

		<u>Bushels</u>
April 27:	Canada to Greece	750,000
	Australia to United Kingdom	200,000
	Australia to China	500,000
April 28:	Canada to United Kingdom	1,500,000
	Australia to United Kingdom	250,000
May 1:	Canada to United Kingdom	500,000
	Australia to United Kingdom	250,000
	Australia to China	250,000
May 2:	Canada to United Kingdom	1,500,000
	Argentina to United Kingdom	500,000
	Australia to United Kingdom	500,000
	Australia to China	500,000

(Exports to China, it should be noted, may be destined for Japanese consumption.)

Reports appear to have been definitely confirmed that Argentina has contracted to sell 10,000,000 bushels to Spain on credit. Argentina also is apparently pressing wheat on the British market, part of which is expected to be delivered on May Liverpool futures. This may explain the relative weakness in that future in comparison with other futures on the Liverpool market.

Export demand for American wheat has fallen to practically nothing, since the price rise has put our markets still further out of line with other world markets. Exports from Gulf ports recently reported have been on earlier sales. The F.S.C.C. reports that they have made no export sales of wheat in nearly a week, though subsidized flour sales have continued at about the usual level. On May 2, for example, 29,000 barrels of flour were sold, of which 18,000 went to the Philippines, 4,600 to China, and the rest in small lots to various other countries.

309

Cents per Bushel, May Delivery

Closing Prices for Wheat



5-3-39

My dear Mr. President:

In accordance with your request, I am enclosing my proposed draft of reply for your signature to the letter of Mr. Braden.

The file is returned herewith.

Sincerely,

The President,
The White House.

Enclosures

2014
4/24/39

Dear Spruille:

I was very pleased to receive your letter of March 27, to be informed of the problems confronting you, and to learn of President Santos' cordial attitude regarding cooperation with the United States. It is apparent that there is enough work in Bogota to utilize your energy, tact, and insight.

I have noted the President's statement to you that he arranged for the military and naval missions from our country in large part as a demonstration of Colombia's confidence in the United States. This, of course, is extremely gratifying. I am determined, however, that these missions shall prove their efficacy upon a purely professional basis. Both the War and Navy Departments know of my keen interest in this matter, and I have every confidence that they will give immediate attention to any recommendations received from Captains Whitson and Reifmider.

I was glad to find that President Santos was interested in the relationship between the peso and the dollar. This, it seems to me, might usefully represent an item in a broad program of economic collaboration which might be developed to the benefit of both countries. I am sure he understands that such a program would be facilitated if there were a prior settlement or at least an accompanying settlement, of the Colombian debt default.

I know that you will do what you can to overcome such difficulties as those presented in the Bogota telephone situation, and that you will continue to exercise the excellent judgment which you have shown in the past in such matters, endeavoring to be helpful without undertaking responsibility in matters not of direct concern to us.

You know of the importance that I attach to the improvement of our relations with the other American republics, and it will be a pleasure to hear from you from time to time about developments in Colombia.

With warm personal regards, believe me, I am

Yours very sincerely,

The Honorable
Spruille Braden,
American Ambassador,
Bogota.

4/26/39

(In Miss Le Hand's writing:
"HM, Jr, Is this all right
on the financial end".)

April 14 1939

My dear Mr. President:

I have received your memorandum of April 4 enclosing a letter of March 27 from Ambassador Braden, in which he commented on various matters of interest in our relations with Colombia.

In response to your request, I take pleasure in enclosing a draft of a suggested reply to Mr. Braden for your signature.

Faithfully yours,

Sumner Welles

Enclosure:

Draft as stated.
From Spruille Braden,
March 27, 1939.

The President,

The White House.

RA:EPW:GHE 3/11/39

Dear Spruille:

I was very pleased to receive your letter of March 27, to be informed of the problems confronting you, and to learn of President Santos' cordial attitude regarding cooperation with the United States. It is apparent that there is enough work in Bogotá to utilize your energy, tact, and insight.

I have noted the President's statement to you that he arranged for the military and naval missions from our country in large part as a demonstration of Colombia's confidence in the United States. This, of course, is extremely gratifying. I am determined, however, that these missions shall prove their efficacy upon a purely professional basis. Both the War and the Navy Departments know of my keen interest in this matter, and I have every confidence that they will give immediate attention to any recommendations received from Captains Whitson and Reifsnider.

I was glad to find that President Santos was interested in the relationship between the peso and the dollar. This, it seems to me, might usefully represent an item in a broad program of economic collaboration which might be developed to the benefit of both countries. I am sure he appreciates, however, that it would be very difficult, if not impossible, to proceed with any such program unless there had been a prior settlement or at least an accompanying settlement, of the Colombian debt default. I was delighted to learn that both the President and the Minister of Finance

have

The Honorable
Spruille Braden,
American Ambassador,
Bogotá.

have agreed in the desirability of a mutually satisfactory debt settlement rather than a unilateral arrangement unfair to the bondholders, and it would indeed be gratifying if this troublesome problem could be quickly and satisfactorily adjusted.

I know that you will do what you can to overcome such difficulties as those presented in the Bogotá telephone situation, and that you will continue to exercise the excellent judgment which you have shown in the past in such matters, endeavoring to be helpful without undertaking responsibility in matters not of direct concern to us.

You know of the importance that I attach to the improvement of our relations with the other American republics, and it will be a pleasure to hear from you from time to time about developments in Colombia.

With warm personal regards, believe me, I am

Yours very sincerely,

RA:LD:OZS:GRS 3/11/39

C
O
P
Y

Dear Spruille:

I was very pleased to receive your letter of March 27, to be informed of the problems confronting you, and to learn of President Santos' cordial attitude regarding cooperation with the United States. It is apparent that there is enough work in Bogota to utilize your energy, tact, and insight.

I have noted the President's statement to you that he arranged for the military and naval missions from our country in large part as a demonstration of Colombia's confidence in the United States. This, of course, is extremely gratifying. I am determined, however, that these missions shall prove their efficacy upon a purely professional basis. Both the War and the Navy Departments know of my keen interest in this matter, and I have every confidence that they will give immediate attention to any recommendations received from Captains Whitson and Reifensider.

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The Honorable
Spruille Braden,
American Ambassador,
Bogota.

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You know of the importance that I attach to the improvement of our relations with the other American republics, and it will be a pleasure to hear from you from time to time about developments in Colombia.

With warm personal regards, believe me, I am

Yours very sincerely,

File Six

Bogotá, March 27, 1939.

Let. drafted 4/1/39
PA: -D

Personal and Confidential

My dear Mr. President:

Having on February 15 presented my letter of credence as your Ambassador to Colombia, I should have reported to you long before now had I not been completely overwhelmed by work on certain situations requiring immediate attention. For example:

1. From 1935 to 1937 inclusive, I find the Texas Petroleum Company has rendered false salary returns, thus - although without direct benefit to itself - bilking the Colombian Government of taxes. I urged the company's manager, who apparently is not responsible for the fraud, to make a clean breast of it to the President and to pay the defalcation (which including fine amounts to \$171,000 U.S.Cy.). But, hoping not to be found out and fearing his confession would not be treated in

the spirit

The President,

The White House.

the spirit it was made, he prefers to follow the advice of his Colombian lawyers and to risk possible discovery by the authorities with resulting fine, imprisonment and public denunciation.

2. Through the device of having subsidiary corporations take up oil concessions, some of the American companies (although the Shell group is the worst offender) have evaded the acreage restrictions of the Colombian petroleum law. This is an unsound basis on which to initiate, especially with foreign capital, an industry which promises to develop greatly in this country and it may lead to trouble in the future; therefore I am endeavoring with both the Government and the companies to assist in the accomodation of the matter.

3. The Associated Telephone and Telegraph Company, controlling close to eight million dollars of telephone properties in Colombia, has given such execrable service, so antagonized the public and irritated Colombian officials by stupid and procrastinating, not to mention worse, tactics over the last seven years that the summary expropriation of their Bogotá subsidiary was only averted on March 6 by a hair's breadth. The situation still is delicate, although in a long distance telephone call to the president of the company in the United States I sufficiently aroused him to bring about a more constructive attitude by his representatives here. Also the mayor of Bogotá has promised me not to resort to extreme measures without first consulting me and giving sufficient time to arrive at some solution other than expropriation and, if worse comes to the worst, there will be prior indemnification.

The foregoing

The foregoing and some other similar situations, such as the United Fruit Company, American and Foreign Power Company, etc., seem to justify President Santos' request that I cooperate with him in regard to the American corporations operating in Colombia. He added: "Formerly the American interests endeavored to coerce our governments by threatening appeals to Washington - now we warn them we will protest to Washington." I, of course, told the President that while I was here his complaints would not have to go beyond me since I was satisfied I could bring any erring and recalcitrant American companies into line.

Pursuant to your instructions, I informed President Santos that you desired me to discuss with him: A. The stabilization of the Colombian peso with the dollar; and B. political cooperation between our two Governments.

A. When I outlined your ideas concerning the need for and the manner in which stabilization might be accomplished through a Treasury to Treasury loan of gold bullion, including therein the right to purchase the metal over a period of time, President Santos said he was very

grateful

grateful for the suggestion and decidedly interested, particularly as Colombia's problem was not to sustain the peso but rather to prevent its appreciation in value. He is anxious to explore the possibilities of such cooperation and will instruct his Minister of Finance to pursue the subject with me.

B. President Santos in his reply to my speech presenting credentials seized upon certain expressions of mine to say:

"Never were circumstances for the intensification of a policy of rapprochement between our nations more suitable than today. The doctrine of President Roosevelt, of solidarity for common defense, based upon constant fidelity to the principles of right and of justice, has made understanding between our peoples easier and will make our friendship more solid, cordial and lasting."

In a subsequent conversation, he emphasized this viewpoint and said he often had told his fellow citizens that Colombia's greatest need was not merely for friendship with the United States but for the most intimate confidence and collaboration. Moreover Colombia, having coasts on both the Atlantic and Pacific, constituted the first line of defense for the United States, and especially for the Panama Canal, and since any armed attack on us might well be made through Colombia, she, too, would suffer severely therefrom.

A month ago he feared only Japanese activities but recent events in Europe have impressed him deeply and on March 22 he promised in person to keep me fully

informed

informed with respect to all Rome-Berlin-Tokyo activities in Colombia and to have a ranking officer in the War Department act in a liaison capacity with this Embassy on these matters. Furthermore, the War Minister expressed to me the desire to have a United States intelligence officer attached to either our Naval or Military-Aviation Missions. This would be all to the good.

President Santos believes that Germany and Italy, now that Franco's victory in Spain is assured, will attempt to forward their propaganda and other activities in South America through the new Spanish Government. He promised to watch this situation and keep me posted. He solemnly assured me that Colombia always would stand with the United States in defense of democracy and never would play with the totalitarian States through Franco or otherwise. Finally he asked me to tell you that he had contracted for our Military and Naval Missions not merely to obtain the benefit of their superior instruction for Colombian forces but even more as a demonstration of this country's confidence in the United States.

While on this subject, it is fitting to remark that Colombia both in principle and in practice is the most basically democratic country in South America. Nevertheless it must be kept in mind that living standards are low and the masses inexperienced and uneducated. These conditions if not cured, in view of the sweeping alteration now occurring in the country's economic structure, can conceivably result in social troubles

troubles with political repercussions.

Captains Reifsnider and Whitson, respectively, chiefs of our Naval and Military-Aviation Missions, have made excellent impressions here but their recommendations should be met promptly and fully by the War and Navy Departments in Washington. If their advice is not followed the value of the missions will be greatly lessened both for the Colombians and ourselves and we may unwittingly slight our contractual obligations to the Colombian Government. A word from you to War and Navy would be most helpful. Moreover, the work of these missions should be supplemented by arrangements which would enable Colombia to send officers and students to the United States for training without being subjected to the heavy expenditures now required. For instance, to place an Army captain, accompanied by his wife, with one of our military units for a year's training presently means that officer's receiving, in addition to traveling expenses, a larger salary than does the Commander-in-Chief of the Colombian Army. It has been my experience throughout South America that the greatest boosters and friends we have

have are precisely those who have lived in the United States. It is also pertinent to observe that our German and Italian friends give such officers trips to and from Europe, training, and even entertainment allowances while there, free of all charge.

Both our missions have a task to perform as difficult as it is important and will have to build from the ground up; in fact the Naval Mission must undo much that was done by their predecessors, the British Mission, who apparently performed a very sloppy job and incidentally tried to prejudice the Colombian officers against our mission.

I am already greatly impressed with the benefits resulting from our loaning at small or no cost civilian experts to the American Republics and I do hope the program for so doing with military and naval officers may be promptly put in effect.

Since my arrival, occasional references to our former "Imperialism" have been made to me; as for instance when the Governor of Cundinamarca, in good humor, amusingly told of the Yankee who, irked by the tedious piety of Heaven, moved to Purgatory only to be bored

bored by the many priests and holy people in transit there, and so went on to Hell where he found himself surrounded by all the great figures of history, and life thoroughly charming. Inquiring why Hell was so defamed on Earth, he was told it was because of the fear that were the truth known the Americans would grab it. The manner in which this story was told illustrates that the Panama incident while not entirely forgotten is at least now forgiven by most Colombians. Although presumably for reasons of internal politics, some of the Conservative or opposition Party and press are still disposed to be critical of the United States, the Liberals and the general public are sincerely our friends. By all odds, the greatest influence in this development is their admiration for and complete confidence in you and your policies.

In my opinion the Colombian Government so far have been honest in their attitude on the foreign debt and the responsibility for the continued default lies at least equally in the United States, where it has been inexpertly and untactfully handled by the Foreign Bondholders Protective Council, to say nothing of

certain

certain maliferous interlopers such as a man called Hoover. President Santos tells me he will make another attempt in April to reach an adjustment. I think he may be successful if the Protective Council will abandon its arbitrary and undiplomatic attitude and instead, by conciliatory and educational methods, endeavor to lead the Colombians, who are inexperienced in such matters, to a mutually satisfactory agreement. I shall, of course, lend my good offices in every way possible and I may say that both the President and Finance Minister have agreed with me that they should not seek a debt agreement on the lowest possible basis but rather should accept a resumption of service at a rate which in so far as possible will reestablish Colombia's credit.

I am impressed with the potentialities of this country and believe it is on the eve of a very important industrial development, particularly in oil. It will be a good credit risk and will present an attractive market for our exports. The Colombians are economically dependent on us and therefore prefer to direct their purchases of airplanes (especially for
military

military purposes), railroad and power plant equipment, etc., to the United States, even at higher prices. But we must meet the competition, especially on long term credits - up to five years - of the Germans. Hitherto the Export-Import Bank has held off from financing here because of Colombia's debt default. I am not unmindful of the political kickback which would ensue were the United States Government to finance Colombia prior to at least some token accomodation of the debt being made. Nevertheless the Export-Import Bank's financing of trade with this country might even be utilized to aid in adjusting the debt. On the other hand, if the debt is not settled it would be somewhat in the nature of biting off our nose to spite our face to continue the refusal of credits, thus losing to our competitors orders especially in the heavy industries where they are most needed and which moreover mean a continuing business in spare parts and replacements. Therefore, I hope some plan analogous to that recently entered into with Brazil may be made with Colombia.

The President, in my conversation with him, warmly reciprocated your personal best wishes which I delivered

- 11 -

delivered to him and particularly requested me to convey his very cordial regards to you.

Please permit me once again, Mr. President, to express my great pride and deep sense of responsibility for the confidence you have reposed in me and with my sincerest expressions of respect and loyalty, I am

Faithfully yours,

A handwritten signature in cursive script, appearing to read "Franklin D. Roosevelt". The signature is written in dark ink on a light-colored paper background.

GROUP MEETING

May 3, 1939.
9:30 A. M.

Present: Mr. Hanes
Mr. Gaston
Mr. Duffield
Mr. White
Mrs. Klotz
Mr. Foley
Mr. Haas
Mr. Lochhead
Mr. Graves
Mr. Gibbons
Mr. McReynolds

H.M.Jr: John?

Hanes: I just got a memorandum for you on that thing Graves did for me on that Tom Heflin thing. I'll just leave that with you. We'll talk about that afterwards.

H.M.Jr: Yes. I liked your talk very much; think it was fine.

Do you think I have to do anything about this?

Hanes: I don't think so, no.

H.M.Jr: When I go to the President, I'll take it with me.

Hanes: Just hold it when you go over there, so you'll be familiar with the facts.

Gaston: I have a letter, which I didn't bring in, to me from White, New York State Bank Commissioner, on behalf of the National Association of Bank Supervisors, very strongly and vigorously opposing the Brown bill and any movement to separate the national bank supervision from - or to combine the national and state bank supervision. I don't know whether we want to make it public or leave it to them, but they indicate that it is their desire to do anything they can to prevent the combination of the Comptroller's office with FDIC.

H.M.Jr: I'd give it out. Give it out from your office.

Gaston: All right.

- 2 -

- H.M.Jr: And if these fellows will come through with a letter - you coming through with a letter?
- Hanes: I okayed it last night.
- Duffield: I circulated it last night, said in a little note they should call either you or Mr. Hanes by noon.
- McR: You mean the one that was signed?
- Duffield: No, Mac.
- Hanes: It was a new letter.
- H.M.Jr: Well, I'm here.
No, I'd give it out.
- Gaston: What do you think of submitting a copy of that letter with your letter to the Hill on the question?
- H.M.Jr: Well, handle it any way you want. But I don't see any reason we shouldn't be aggressive about it.
- Foley: We ought to get somebody to put it in the Record, I think.
- H.M.Jr: That's good, too.
- Gaston: Yes, yes.
That's all I have.
- H.M.Jr: Will you let me know about Lowell?
- Gaston: Yes, I called his office, but he wasn't in yet; they're going to let me know.
- H.M.Jr: Do I do this in a broadcasting or recording machine?
- Gaston: You go to a recording company here, to their studio.
- H.M.Jr: Yes.
- Duffield: Nothing, except that I did send that letter out just saying that you opposed removal of the Comptroller's office from the Treasury at this time,

- 3 -

and if they had any comments or suggestions to call either you or Mr. Hanes. That's all.

H.M.Jr: Eddie?

Foley: I have a memorandum discussing the sub-committee of the Senate Banking and Currency, how they stand now. It's just for your information.

And here's an affidavit....

H.M.Jr: This goes with me to the President if and when he sees me.

Foley:to be used in an action in the State Court up in New York in which the Federal Reserve Bank is a party, and it involves the procedure followed in fixing the exchange rate for milreis in connection with customs matters.

H.M.Jr: Do you guarantee I won't go to jail?

Foley: Yes, sir, it's all in the statutes.

H.M.Jr: Any more?

(Foley points out places for signature on documents)

(On phone) Hello. (Holds conversation with Merle Cochran in Paris)

She (Mrs. Cochran) is here. She's had all these sinus operations. She's in - not Washington - she's in New York. You (Lochhead) take care of it.

Lochhead: I'll take care of it.

H.M.Jr: Feis comes at 10:00 o'clock. You can tell him. Government expense - he's coming back.

Lochhead: Regular trip.

Foley: Mr. Secretary, I think that we ought to indicate to the Germans what we are going to do about that countervailing duty proposal that they made.

- 4 -

H.M.Jr: I'm not familiar with it.

Foley: Well, they came in on the 22nd of April.

H.M.Jr: Oh, let's sit down and do that. I'll give you an appointment on that.

Foley: All right.

H.M.Jr: If you'll make a note - I mean I want Johnson in on that.

Foley: Sure.

H.M.Jr: And Cairns, see?

White: We got some cables from our own men that might alter the situation. I don't know whether they're available to you yet or not.

H.M.Jr: Well, when you men are ready and have got a definite recommendation, let Mrs. Klotz know. But get together first, will you please?

Foley: Yes.

H.M.Jr: And then I'll see you.

Foley: All right.

There was a letter from Morris Ernst asking for an appointment on the 8th of May to discuss legislation to continue the President's power to alter postage rates for books.

H.M.Jr: I know. Well, we've sent word to him that when he comes he should call up in the morning. I can't make these long-distance appointments, long distance being more than one day.

Foley: Well, we don't have a direct interest in that. That's a matter for the Post Office. But I guess he feels that maybe some push from you would be necessary to get action.

Klotz: Can't we write him that?

- 5 -

- H.M.Jr: No, I'd like to see him. No, I'd like to see him. He very seldom asks to see me.
- Klotz: See him, yes. But he wanted, I think, some advance
....
- H.M.Jr: Well, if you think I should write, I'll write.
Anything else?
- Foley: Nothing else.
- H.M.Jr: George, this report this week is particularly good, I thought. And continue to watch commodities, copper, et cetera.
- Haas: We're making quite an extensive study of that, so we'll give you a report on commodities alone.
- H.M.Jr: And the thing that surprised me was to see our unemployment figures move with the British. Went off in '37, did they?
- Haas: Yes.
- H.M.Jr: Went off almost the same day. It's very interesting. I was surprised to see how they moved. You know, the unemployment figures - that they should move together.
- Haas: And they are going up very sharply over in Great Britain now - I mean employment.
- H.M.Jr: Is what's-his-name back - your man - from Detroit?
- Haas: Yes, I have his report.
- (Haas hands report to H.M.Jr.)
- H.M.Jr: So you can tell your people what I decided on my bonds last night....
- Haas: That 19th there was the one that came in at 3:00 o'clock. Probably feels a little better now, Keller does.

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H.M.Jr: Give Mr. Hanes a copy.

Haas: Yes, sir.

H.M.Jr: Oh, that's swell. Chrysler jumped almost 2,000 cars the week of April 29 - up.

Haas: Of course, the peak of automobile production has probably passed.

H.M.Jr: Well, Ford is up.

Haas: That's right.

Now, on the wheat - if you gave me the full 24 hours that would have meant a little later yesterday. The reason I asked is this, that yesterday's market - some very interesting situations developed in yesterday's market. I have the report, but I want to include yesterday's, I want to check on it.

H.M.Jr: Well, get it to me by 1:00 o'clock.

Haas: I can have it before then.

H.M.Jr: I don't know how long the situation will wait on me.

Haas: I'll have it here by 11:00 o'clock. That's all.

H.M.Jr: Harry?

White: Just something of passing interest. I learned last night from some men who know that there is a very substantial movement of Dutch-owned American securities into American names, so that they cannot be touched in the event of any difficulties. They still belong to the Dutch, but they are putting them in American trustees in amounts - very large sums. The British are doing it on a smaller scale.

H.M.Jr: Anything else, Harry?

White: That's all.

Lochhead: You have decided about this HOLC?

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- H.M.Jr: Yes, I knew there was something I wanted to say. Walking home last night with Bell, we decided we are going to Monday refund the 325 million dollars worth of notes - 40 percent, one-year notes; 60 percent, two-year notes - and nothing else, sit tight and see what happens.
- Lochhead: For your information, we do not have any other maturities around those dates - that is, on those dates. RFC note comes due on July 20, '41; that's about the closest. But we don't have any identical dates.
- H.M.Jr: Nothing else coming due on June 1.
- Lochhead: None of our regular.
- Haas: Just going to take the little one that you have to take.
- H.M.Jr: 325 million dollars. Of course, you fellows are all....
- Haas: I've been reading Einstein on relativity.
- H.M.Jr: That's the danger, I swear. I mean - Dan isn't here; he's in New York - a billion two, just like that. And if something happens, believe me, 325 millions will look like a lot of money.
- Haas: That's right.
- H.M.Jr: I've got to watch you fellows. "It's just a little one - 325."
- Haas: Well, it's only one-third of the 955.
- H.M.Jr: I would be surprised if private capital from the first of January to date has done 325 million. Do you (Hanes) think they have?
- Hanes: I doubt it very seriously.
- H.M.Jr: What?
- Hanes: I doubt it very seriously.

- 8 -

- Lochhead: They have put out some very good issues.
- H.M.Jr: I'm very serious. We've just got to watch ourselves that we don't get in the attitude "a billion two - bing - just like that."
- Haas: This refunding of that large one, the 955 - the way it's distributed would not make an easy refunding.
- H.M.Jr: A million pieces out.
- Haas: That's right.
- H.M.Jr: I've got myself - I do my homework. There's a million pieces out. A million different people hold that thing.
- Haas: Be very difficult to price the refunding issue, too.
- H.M.Jr: O. K.
- Lochhead: Nothing else. The securities markets - the foreigners are doing just as little as our own domestic people; you'll notice that these last two or three days.
- H.M.Jr: I talked to General Watson about getting me a fellow. I said, "A General."
- He said, "No, I won't get you a General because he always has to have somebody to assist him." He said, "I'll get you a good working Colonel."
- I said, "Some fellow that would even be willing to change a tire if he had to."
- He said, "That's the kind of fellow." He said, "These Generals lose their touch." He said, "I'll have somebody for you in a day or two."
- And now what I've offered him - and you (Lochhead) might sound out Chen - ten thousand dollars and traveling expenses for himself and his wife there and back, and a per diem when he is away from his base.
- Foley: Can I go?

- 9 -

H.M.Jr: Are you an expert on transportation?

This fellow isn't going to be any stuffed shirt. This fellow is going to know how to move trucks and move other things related also. And I told General Watson, "This man is a personal representative of the President, so he can't be any booze hound or anything else."

Gaston: Is it to Burma?

H.M.Jr: It's to take charge of directing for Chiang Kai-shek all transportation for the Chinese, and unify all transportation.

Gaston: Well.

H.M.Jr: I mean this can't be any booze hound or any tin-horn soldier. What?

Klotz: It's a wonderful job.

H.M.Jr: It's a hard job. This man will have to be working night and day, night and day, traveling all the time.

Gaston: Have to have more than one pair of boots.

H.M.Jr: What?

Gaston: More than one pair of heavy boots.

Foley: Rubber ones.

H.M.Jr: The kind of man I visualize will be on the road all the time.

Klotz: That's wonderful. That sounds grand to me.

Lochhead: All right, I'll take care of that.

Graves: (Nods nothing).

Gibbons: In connection with the list that Ed gave you, I talked to Bob Wagner yesterday afternoon (handing H.M.Jr. a list of names), and those checked in red are members of the sub-committee that he's

- 10 -

sure of. Now, he talked to Jimmy Byrnes. He's not sure they'll go along with the stabilization.

Foley: That's the full committee you have there. I'll talk to Jimmy Byrnes today.

H.M.Jr: The red is absolutely O. K.?

Gibbons: Yes. The ones in pencil, for instance, Herring of Iowa - he's sure of him but hasn't talked to him. And Frazier, the Republican, he's sure of.

Now, Jim is going to talk to Bob this morning. Miller of Arkansas is sore because Murphy is giving everything to Mrs. Caraway. He won't talk to anybody. Just a question of patronage. We haven't anything in our shop that we can give him.

H.M.Jr: Who did you talk with?

Gibbons: I talked with Jim and Bob Wagner.

H.M.Jr: Well, get that....

Gibbons: I'm going to talk to him - going to talk to Jim as soon as I get out of this meeting again. I'll send you a memorandum about it.

H.M.Jr: Mac, you got anything on Procurement?

McR: Yes. There is probably in my office now a memorandum. Briefly, the thing is just this, that this fellow Stevens is one of six men who were assigned at the request of the Committee, and Peoples tells me at the request of and with the approval of the Budget, to assist that investigating committee in WPA. They asked for six of their engineers.

H.M.Jr: Well, I want photostated copies of the communications from the Committee to Peoples. In other words, I'd like to see the whole stuff. Will you get it, Mac?

McR: I'll see you get everything that is in writing.

H.M.Jr: Well then, this isn't this investigation....

McR: Hasn't anything to do with the former investigation. This fellow Stevens....

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- H.M.Jr: That's what Gene thought.
- McR: I thought it was.
- H.M.Jr: Thought it was the old stuff. But this is new.
- McR: This is new, and what he testified before the Committee was on current projects that he had investigated by direction of the Committee.
- H.M.Jr: Well, if that's it, it's all right. But in case anybody - but will you please get after it for me?
- McR: There's a memorandum probably on my desk now. Peoples told me he'd have it over there.
- H.M.Jr: But this is new stuff and not what you....
- McR: All the new.
- H.M.Jr: Not what you and I thought it was.
- McR: Not what we thought it was.
- H.M.Jr: In case anybody - I mean this is - I gather that we loaned them some men. Confidentially, we made an investigation a year or two ago.
- McR: A year and a half ago.
- H.M.Jr: I was afraid this was it, and they might jump on me and say, "Why turn over your stuff?" I wouldn't without direction of the President. But if that's - this was a loan of six men and they went up there and found this stuff.
- McR: Current investigation of what went on in building these projects.
- H.M.Jr: Now if McReynolds and Graves and Gaston and Hanes would stay a minute, please. Incidentally, we have this 10:00 o'clock meeting with the State Department, you know.

May 3, 1939
9:35 a.m.

Operator: Go ahead.

HMJr: Hello.

H. Merle Cochran: Hello, Mr. Secretary.

HMJr: How are you?

C: This is Merle Cochran. I'm quite all right, sir, thank you.

HMJr: Go ahead.

C: Saturday I talked with Archie about two things.

HMJr: Yeah.

C: About regulating markets and also about coming home.

HMJr: Yeah.

C: I had hoped then that that operation on my wife could be delayed until about May 25th.

HMJr: Yeah.

C: But I had a cable this morning and she's not getting on at all well and that an earlier operation appears imperative.

HMJr: Well now, where is she?

C: She has been in New York; then she went down to Washington to have some dental work done which she wanted done before the operation. Then she wired me that she had to go back to her Doctor in New York at once. She wired me that yesterday.

HMJr: Is she in Washington now?

C: Oh, she -- she's probably in New York today. She was to go back to New York today.

HMJr: I mean, is there anything that I can do?

C: No, there -- there's not a thing, Mr. Secretary. The only thing, I was going to try to make some about what -- what I am to do myself.

HMJr: Well, when did you want to sail?

C: Well, I -- I planned to stay here on account of that B.I.S. meeting this weekend, you see.

HMJr: Yeah.

C: I mean, this is the annual meeting and I'm seeing your friends down there on this other matter to see if you have any new ideas and so on.

HMJr: Well, when did you want to sail?

C: Well, that -- that would have me sail the 10th on the Normandie.

HMJr: The tenth?

C: That is if you feel that you could order me home properly.

HMJr: Well now I tell you what you do, you make your reservations and I'll get an order out.

C: Yes.

HMJr: But a little bit depends upon what's going to happen in Europe.

C: I know. That's why I've stayed over here. I sent my wife home alone, but I of course, because I wanted to stay.

HMJr: Well, unless -- unless things -- I tell you, we'll get out a -- an order today and I'll tell Archie that -- to give you definite orders on Monday.

C: Definite orders on Monday.

HMJr: How's that?

C: Well, the thing is -- is just this, to be quite frank -- I -- I've got to wire my wife tonight because she's going up there, or she's probably there by this time. They'll have to make the decision to have the operation or wait until I get there or what not.

HMJr: Well, if -- if she's -- if she's that sick you better look after your wife and we'll -- we'll have to take our chances.

- C: Well, I -- I don't think I should postpone it beyond the tenth.
- HMJr: All right. Well then.....
- C:order me by that time.
- HMJr: All right. Well, we'll get out a telegram today telling you to come back on the tenth.
- C: Because if I were on my own, I -- I would probably leave tomorrow or the next day, but I
- HMJr: All right. Well, I'll -- Archie is here now and I'll tell him.
- C: Good! I appreciate it a lot and if I should get any word from her that it could be postponed, why I -- I would postpone my sailing too.
- HMJr: All right.
- C: But if you can do that it would help a lot. Now, I'll send her a cable right away then that I'll sail on the tenth.
- HMJr: How do things look in Poland?
- C: Not too bad yet. It's all mainly gossip -- and so on; that the Poles will give a pretty stiff counter-proposal tomorrow. On the other hand there's a ^{some} intervention by the British may come about.
- HMJr: Um-hm.
- C:
- HMJr: All right, Cochran.
- C: Well, thank you a lot. Here everything is fine. The markets are very, very dull.
- HMJr: If I can do anything for Mrs. Cochran, tell them they can get in touch with me. In your cable, tell her to get in touch with me if there's anything that I can do.
- C: Thank you so much, and when I sail on the Normandie, then I'll let you know when I get to New York. If I can

I'll come down. If she's there and she has to have the operation, I'll go right there and telephone you.

HMJr: Yeah, but tell her if she wants anything to get in touch with me.

C: Fine! Thank you a lot.

HMJr: O. K.

C: Good bye.

May 3, 1939
3:38 p.m.

HMJr: Hello.

Operator: Captain Collins. Go ahead.

HMJr: Hello.

Captain
Collins: Good afternoon, Mr. Secretary.

HMJr: Collins, how are you?

C: Very well, thank you, sir.

HMJr: Mac told me about what the French want to do for you and I'm delighted.

C: Well, I appreciate your calling, sir.

HMJr: Mr. Chen is here with me.....

C: Yes, sir.

HMJr: And he's got a copy of the contract with the Chinese Government -- on planes from the United States.

C: Yes, sir.

HMJr: And they'd like you to take a look at it to make sure that they're getting a fair deal.

C: Yes, sir.

HMJr: Will you cooperate with them?

C: I'll be very happy to, Mr. Secretary.

HMJr: Well, Mr. Chen will call on you.

C: Thank you very much, sir.

HMJr: O. K.

C: Thank you for calling, sir.

HMJr: Good bye.

C: Good bye.

ROOSEVELT TO CONFER WITH MORGENTHAU ON
REORGANIZATION PLANS

1050

MAY 3 - 1939

WASHN - PRES ROOSEVELT WILL CONFER THIS
 AFTERNOON WITH SECY OF TREASURY MORGENTHAU
 ON THE SECOND REORGANIZATION PLAN WHICH WILL
 CONCERN INTER-DEPARTMENTAL AND INTRA-DEPARTMEN-
 TAL CHANGES IN GOVERNMENT AGENCIES AND THE
 DEPARTMENTS - THE PLAN IS EXPECTED TO BE
 SUBMITTED TO CONGRESS EITHER THE END OF THIS
 WEEK OR THE BEGINNING OF NEXT WEEK

SECY MORGENTHAU VISIT WILL BE PRECEDED
 BY A CONFERENCE WITH BUDGET DIRECTOR SMITH AND
 MEMBERS OF THE REORGANIZATION COMMITTEE

ADD ROOSEVELT

WASHN - THE WHITE HOUSE SECRETARIAT STATED
THAT THE CONFERENCE WITH SECY MORGENTHAU
DEFINITELY WOULD NOT CONCERN TAXES

-0-

Taxes ✓

HSC

SPEAKER BANKHEAD SAID AT HIS PRESS CONFERENCE THAT HOUSE LEADERS ARE LEAVING TAX PROBLEMS ENTIRELY TO THE WAYS AND MEANS COMMITTEE, AND ARE NOT ATTEMPTING IN ANY WAY TO INFLUENCE ITS DECISIONS.

HE MADE THE STATEMENT IN REFERENCE TO SENATE STATEMENTS THAT THE HOUSE LEADERS HAD AGREED ON A THREE POINT TAXATION PROGRAM OF CONTINUANCE OF NUISANCE TAXES, RETAINING THE SOCIAL SECURITY TAXES AT THEIR PRESENT LEVEL, AND CONTINUATION OF THE UNDISTRIBUTED PROFITS TAX.

BANKHEAD SAID, AND HOUSE MAJORITY LEADER RAYBURN AGREED, THAT THE LEADERS "HAVE NOT UNDERTAKEN IN THE SLIGHTEST DEGREE TO IMPRESS ANY VIEWS ON THE WAYS AND MEANS COMMITTEE AS TO THE CHARACTER OF LEGISLATION TO BE BROUGHT OUT.

"AS FAR AS OUR ATTITUDE IS CONCERNED, WE ARE LEAVING IT TO THE GOOD JUDGMENT AND DISCRETION OF THE WAYS AND MEANS COMMITTEE WITHOUT UNDERTAKING IN ANY WAY TO INTERFERE WITH THEIR DECISION."

RAYBURN SAID "THE LEADERSHIP HAS UNDERTAKEN IN NO WAY TO LAY OUT A PROGRAM OF TAX REVISION."

BANKHEAD ADDED THAT HE WANTED HIS ATTITUDE TO "BE THOROUGHLY AND FULLY UNDERSTOOD."

5/3 ON1233P

May 3, 1939

Jesse Jones sounded me out about selling Russia one million bales of cotton on credit and I said that I had a much better idea and that is why not swap cotton for manganese. He said yes that he had heard about it some months ago and that he would go after it. I asked him to keep me informed.

May 3, 1939

Present:

Mr. Chen
Mr. Lochhead

Mr. Chen handed the Secretary the attached memorandum on inviting American experts to China, which the Secretary read.

HM, Jr: I have a suggestion for you, from the President, for your Government. I told him about our conversation and what you were doing and he was very much interested and he reminded me of the suggestion he made, about a year ago, about dividing the Army so that you have the Eighth Route Army. He wants to know whether you have a dynamite factory. He thinks it is very important that you should have a factory for dynamite somewhere up in a remote corner, some place where you are making airplanes. He thinks that it is very easy to build such a factory and the materials that go into dynamite and TNT are not difficult to get. It is like a macaroni factory. For the kind of warfare that you have, dynamite will be very useful to you. He wanted me to tell you this unofficially and of course (facetiously) you know we are strictly neutral.

Mr. Chen: We used to have one in Changsha. However, it has been moved and I do not know where it is now.

HM, Jr: I am passing this on to you from the President.

Mr. Chen: Just as soon as I find out whether we have such a factory, I will let you know.

The other day you asked about the airplane contract between China and Mr. Patterson of the United

-2-

Aircraft. In the meantime, I found a copy of the contract. I have made a digest for you. (Copy is attached.) I also received a letter from Mr. Kung asking me to find out whether these prices are correct.

HM,Jr: Didn't you speak to Captain Collins about that?

Mr. Chen: No. I wanted to speak to you about it first.

HM,Jr: I would like Captain Collins to see this.

(At this point, HM,Jr phoned to Capt. Collins and the following is a record of their conversation.)

HM,Jr: Hello.

Capt. C: Good afternoon, Mr. Secretary.

HM,Jr: Collins, how are you?

Capt. C: Very well, thank you, sir.

HM,Jr: Mac told me about what the French want to do for you and I'm delighted.

Capt. C: Well, I appreciate your calling, sir.

HM,Jr: Mr. Chen is here with me

Capt. C: Yes, sir.

HM,Jr: And he's got a copy of the contract with the Chinese Government -- on planes from the United States.

Capt. C: Yes, sir.

HM,Jr: And they'd like you to take a look at it to make sure that they're getting a fair deal.

Capt. C: Yes, sir.

-3-

HM, Jr: Will you cooperate with them?

Capt. C: I'll be very happy to, Mr. Secretary.

HM, Jr: Well, Mr. Chen will call on you.

Capt. C: Thank you very much, sir.

HM, Jr: O. K.

Capt. C: Thank you for calling, sir.

HM, Jr: Good-bye.

Capt. C: Good-bye."

* * *

P. S. When the Secretary went to the White House to see the President at four o'clock today he gave a copy of the memorandum on inviting American experts to China to General Watson and he immediately sent it over to the Chief of Staff of the Army.

Memorandum on
Inviting American Experts to China.

1. Title. The experts invited to China are suggested to be at the invitation of the Ministry of Communications. Their mission is to inspect the existing road conditions and to make studies on plans of improvement. No special organization will be established for the mission.
2. Number of Experts. Two experts are suggested to be invited: one with full knowledge and experience on road transport management and automobile operation, and the other on automobile mechanical engineering including repairing, maintenance and servicing.
3. Scope of Mission. When the experts have arrived in China, the Ministry of Communications will send competent men accompanying the experts to inspect the different roads. The experts will then make recommendations upon improvement plans to the Ministry for its consideration and putting into execution. In case there arise any problems relative to road traffic or mechanical features, the Ministry may also refer them to the experts for their study and suggestion.
4. Time of Mission. Time for the experts to stay in China will be one year.

5. Compensation. Compensation for the service of the experts and their travelling expenses in China will be borne by the Ministry of Communications. As to the amount it is suggested to leave this to Mr. K. P. Chen in consultation with Secretary Morgenthau.

MEMORANDUM RE PURCHASE
by
CHINESE GOVERNMENT
of
AIRPLANES AND AIRPLANE PARTS

On February 24th, 1939 a contract was signed between the Chinese Government and Consolidated Trading Company, Ltd. for the purchase of airplanes and airplane parts of not exceeding U. S. \$12,800,000.

It was agreed that any and all orders under the principal contract had to be placed within thirty days.

The present supplementary contract dated March 25th, 1939, an outline summary of which is attached, is to carry out this requirement, and contains both a delivery schedule and specifications.

Under both the principal and the supplementary contract the prices are subject to certain adjustments, based upon prices paid by the United States Government for the same type of planes and parts.

Dr. H. H. Kung, Chinese Minister of Finance, has asked me to assist him in checking on these prices. He says in his letter of April 3rd, 1939:

"As you know, Secretary Morgenthau has taken quite an interest in assisting the Chinese Government to obtain the most advantageous prices and the best qualities in the case of goods purchased in the United States. Hence I should appreciate your confidentially making available this contract and the price list for spare parts to an expert or experts designated by the American Treasury or Government in order to ascertain whether the prices charged are aboveboard. Please telegraph in Chinese as soon as practicable their views."

Outline Summary of Supplemental Contract
dated March 25, 1939
for
Purchase
by
Chinese Government
of
Airplanes and Airplane Parts

Principal contract dated February 25, 1939 was for purchase of not exceeding U. S. \$12,800,000. worth, and any and all orders were required to be placed within thirty days.

1. Purchases.

Seversky

54 planes plus parts \$3,875,000.

Vought

25 planes plus parts 2,130,000.

Ryan Trainers

70 planes plus parts 725,00.

North American Trainers

50 planes plus parts 2,100,000.

Total approximately \$8,830,000.

2. Delivery Schedule.

Second month - one plane.

Third to eleventh months - balance of planes in install-
ments of 7 to 48 per month.

3. Equipment and Parts.

Flexible provisions for variation.

4. Payment.

Cash - approximately \$2,215,000.

Balance of \$6,615,000. - notes payable in thirty equal

monthly installments at 6% per annum (simple) with acceleration provision in the event of any default.

5. Adjustment of Prices.

Prices to be compared with those paid by United States Government for similar items at approximate time of contract, to be determined by person appointed by mutual agreement. Any items found at prices excessively higher than those paid by the United States Government to be readjusted accordingly. Not more than 3% for expenses and 1% for commissions (on manufacturer's prices) to be allowed in determining difference.

6. Transportation.

Charges cover c.i.f. Rangoon, subject to adjustment if shipped at request of buyer to another port, war risks to be borne by the buyer, but only actual boxing and transportation charges within the United States are to be paid by the buyer.

7. Inspection and Testing.

To be made at the places of manufacture by a duly accredited representative of the buyer.

8. Manufacturing Rights.

For Seversky, Vought and Ryan airplanes, to be furnished gratis by the seller.

MAY 3 1939

My dear Mr. Secretary:

Recently you asked me about the possibility of the Treasury issuing additional bonds against the Panama Canal without obtaining further authorization from the Congress.

In the opinion of this Department, no additional bonds can be issued against the Panama Canal for the reason that the Second Liberty Bond Act, as amended, absorbed and extinguished the right to issue additional Panama Canal bonds, leaving, therefore, no specific unused authorization to borrow against the Canal.

Sincerely yours,

(Sgd) H. MORGENSTERN J.

Secretary of the Treasury

Honorable Harry H. Woodring,

Secretary of War.

DWB:HBW
4/26/39

May 3, 1939
5:54 p.m.

HMJr: Hello.
Johnny
Hanes: Hello, Henry.

HMJr: Johnny?

H: Yes, sir.

HMJr: Well, what's left of me is back.

H: Yeah.

HMJr: I'm 75 per cent successful.

H: Really?

HMJr: Yeah.

H: Oh, good!

HMJr: Yeah, I think it's all right.

H: Oh, fine!

HMJr: And we went over every single word. None of the suggestions have been eliminated.....

H: Yeah.

HMJr:but the method of presentation -- he wants to change it a little bit.

H: Yeah.

HMJr: But I'm very happy and he said -- I asked him should I show it to anybody, discuss it with anybody. He said, "No, make the changes I've suggested and as soon as you're ready, come back again."

H: I see. Well, were the -- were the changes suggested bad?

HMJr: No, no. It's the method. He wants to get a wage recommendation, you see.

H: Yes.

HMJr: But as to the particular items, he's left them all in.

H: Yeah.

HMJr: But it's merely on the -- more or less on the presentation and toning down some, and instead of my saying, "Maybe the spending program was helpful - makes me think it was helpful -- my pussy foot." Well, that's my conception -- that's my thought; I'll have to bear that.

H: Yeah.

HMJr: But I thought on the whole, considering the various positions he has taken, I -- I think that he was fair.

H: Yeah, in view of yesterday's interview, I should say you were 98 per cent successful.

HMJr: But I'm glad I was there alone. I wouldn't want anybody to see what happened to me the first twenty minutes.

H: Why?

HMJr: Well, there was plenty!

H: Was it really?

HMJr: Yeah.

H: Tough?

HMJr: Tough. An hour and forty-five minutes.

H: Yeah.

HMJr: But it's all right, Johnny. I -- the only thing that I'm worried about is that -- that something or somehow some damn columnist will write something and get him off on his ear.

H: Yeah.

HMJr: But right now he's all right.

H: Yeah.

HMJr: See?

H: This -- this -- I was awfully afraid about this damn Chamber of Commerce thing. I thought that would upset him.

HMJr: Well, as of tonight, I'm going to bed satisfied.

H: Yeah.

HMJr: And there's nothing in it he suggested that you couldn't underwrite either.

H: Yeah.

HMJr: See?

H: Well, that's grand, Henry. I congratulate you. I think you've done a swell job and nobody in God's green earth but you could have done it -- that's the truth.

HMJr: Well, in all due modesty, I agree with you.

H: I swear, I think -- I know it's the truth.

HMJr: Because nobody could have gone through and watched him the way I did, and let him get it all out of his system.

H: Yeah.

HMJr: And then say, "All right, Mr. President, what will you do?"

H: Yeah.

HMJr: Well, what he's done is -- calling it pro and con number one. Then I'd say about the taxes -- pro and con number two. Well, o.k., it's all right with me, I'll call it con and pro -- anything.

H: Yeah.

HMJr: What?

H: That doesn't make any difference.

HMJr: And then he said, "Give the con as well as the pro." Well, that's all right.

H: Yeah.

HMJr: So we'll have to rewrite the thing where we show why it's good. He also wants to show why the -- where they could evade it, you see, -- the loopholes.

H: Yeah.

HMJr: I think -- I think it's swell. Let's call it pro and con number one and pro and con number two.

H: Yeah.

HMJr: What?

H: I don't see any objection to that.

HMJr: He can call it anything he wants.

H: Sure.

HMJr: It's all right, and he was -- on the whole, very fair.

H: Yeah.

HMJr: So if we can just keep it in the Treasury now, so that no fellow will stir him up, why I think we're all right.

H: Well, that's grand!

HMJr: And I said, "When do you want to see me again"? He said, "Just as soon as you've got it rewritten."

H: Yeah.

HMJr: He said, "I'm here."

H: Yeah. Well, that's all right. Well, I think that's grand. I congratulate you. I knew you'd do it.

HMJr: Well I.....

H: But I'm delighted for you.

HMJr: Well, put five dollars on a horse for me, will you?

H: All right, I will.

HMJr: Don't forget now.

H: I promise you I will.

HMJr: Put five dollars.

H: You bet, I promise you I will.

- 5 -

HMJr: All right.

H: Thank you, Henry, very much for calling me. You've taken a load off my mind like forty tons of brick. And I'm delighted for you -- I can't tell you how happy I am.

HMJr: Well, we're both in the same boat, Johnny.

H: Well, I'm delighted for you. I swear I am.

HMJr: All right. Well, thanks for all the help.

H: O. K.

HMJr: Good bye.

H: Good bye.

C O P Y

May 3, 1939

To: Commissioner Helvering

From: Mr. Hanes

With respect to Mr. Berkshire's memorandum of April 26th, which was submitted at my request, pertaining to the applications received from members of the alcohol industry who wish to use specially denatured alcohol in anti-freeze preparations, it has been determined that the current Treasury policy established in July 1934, should be revised in accordance with the opinion expressed by Mr. Berkshire, to wit:

"In the event there is contemplated a change in the Department's policy authorizing the use of wood alcohol as a denaturant for anti-freeze compounds, it is believed that the proposal to withdraw Formula No. 1 should be approved, provided there is no further addition of methanol and the product is packaged and sold in gallon and quart containers under a trade name and without the use of the word 'alcohol' on the container, and with such poison label as may be approved by the Bureau.

"Those producers still desiring to produce and distribute in bulk containers will be required to continue to use the present completely denatured alcohol formulae."

PY:bj

April 27, 1939

AA

OK.

To: The Secretary
From: Mr. Hanes

Members of the Alcohol Industry have appealed to you for a change in the policy which you established in July, 1934, pertaining to the use of wood alcohol in anti-freeze preparations.

It appears that during the past few years the consumption of completely denatured alcohol for anti-freeze purposes has progressively decreased from approximately thirty-eight million gallons in 1934 to approximately eighteen million gallons in 1938, largely because of the competition of materials such as synthetic methanol and other non-odorous liquids over which the Treasury exercises no control.

Considered both from the point of view of protection to the revenue and of public health liability, it now appears possible to permit the use of a denatured alcohol containing a small quantity of slightly odorous wood alcohol if such a product were merchandised under strict regulatory control.

Although the distillers in their filed applications have requested a denatured alcohol completely free of warning odor and, incidentally, of high toxicity, they have in conference indicated not only the acceptability of a considerably less poisonous product such as described above, but also their willingness to abide by strict regulations which can be so designed as to reduce public health hazards.

The question that arises is one of policy, and it is my belief that in accordance with the opinion of the Alcohol Tax Unit a ruling can be issued which will give the wood and ethyl alcohol people a chance to live. Although it is my belief that these manufacturers will be driven out of the anti-freeze business eventually by the manufacturers of synthetic materials, it seems only fair and reasonable to give them an opportunity to compete for the business as long as possible.

I recommend that the policy outlined above by the Alcohol Tax Unit be accepted.

J.W.H.

TREASURY DEPARTMENT
WASHINGTONOFFICE OF
COMMISSIONER OF INTERNAL REVENUEADDRESS REPLY TO
COMMISSIONER OF INTERNAL REVENUE
AND REFER TO

April 26, 1939.

Memorandum for Mr. Hanes:

In accordance with your request, I am giving you a brief review of the use of wood alcohol (methanol) as a denaturant for ethyl alcohol sold for anti-freeze purposes.

The law provides for the denaturation of ethyl alcohol under regulations of the Commissioner of Internal Revenue so that it may be withdrawn taxfree for industrial use.

The regulations of the Commissioner provide for two classes of denatured alcohol, - specially denatured alcohol and completely denatured alcohol.

Specially denatured alcohol is handled only under permit issued by the Alcohol Tax Unit and includes alcohol denatured for special purposes, such as the manufacture of pharmaceuticals, lacquers, solvents, etc.

Completely denatured alcohol is sold freely in commerce as any other merchandise, virtually without supervision on the part of the Alcohol Tax Unit. It is used chiefly in the manufacture of anti-freeze compounds.

From 1906, when the law authorizing the denaturation of alcohol was first adopted, until 1930, wood alcohol was commonly used as a denaturant for completely denatured alcohol. On January 1, 1931, following numerous deaths supposed to have resulted from the drinking of completely denatured alcohol, the use of wood alcohol as a denaturant was discontinued by order of the Secretary of the Treasury.

During the early months of 1934, great pressure was brought on the Department to restore denaturing grade wood alcohol as a denaturant for completely denatured alcohol. A public hearing was held on this question on July 19, 1934, at which representatives of all interested groups appeared and gave testimony. Following this hearing, the Commissioner submitted to the Secretary a recommendation that the use of wood alcohol as a denaturant for completely denatured alcohol should be authorized. This

recommendation was disapproved on the ground that the proposed restoration of wood alcohol would be bound to be misinterpreted by the press of the country and would weaken public support of the Department's enforcement program. The same question was again considered by the Treasury Department in May, 1935, and February, 1936. Following conferences with interested groups, and after considering their proposals, no change was made from the present policy.

Members of the ethyl alcohol industry have appealed to you for a change in policy and, with your approval, a conference was held April 6, 1939, at which various phases of the problem were again discussed. It appears that during the past few years the consumption of completely denatured alcohol for anti-freeze purposes has progressively decreased, largely because of the competition of materials such as synthetic methanol and other non-odorous liquids. The producers of ethyl alcohol claim that this decrease is due to objectionable odor, while methanol and other competitive materials are odorless. These producers do not request, as heretofore, that the formula for denaturing completely denatured alcohol be changed by the addition of wood alcohol, but petition the Treasury Department for authority to withdraw one of two recognized specially denatured alcohol formulae; to wit, Formula No. 1 or Formula No. 30, under permit and bond, for the purpose of manufacturing on their premises anti-freeze preparations to be packaged and sold in gallon and quart containers and bearing poison caution labels to be approved by the Department.

Since this hearing, several producers have filed application for the use of Formula No. 30, which contains 10% of pure methanol, and propose to manufacture anti-freeze products by the addition of dye, odorless petroleum distillates similar to kerosene, rust inhibitors, and an additional amount of approximately 5% of synthetic methanol. Synthetic methanol is not only odorless, but also tasteless, and furnishes no warning of its presence in ethyl alcohol. Formula No. 30, by virtue of its content of 10% pure methanol, is toxic if used as a beverage in substantial quantities, and the proposal to add an additional quantity of methanol would definitely increase its deadly effect. For that reason, it is not believed that the Treasury Department should approve the withdrawal of Formula No. 30 for use in the manufacture of anti-freeze products.

Specially Denatured Alcohol Formula No. 1 contains 5% of denaturing grade wood alcohol, which is the natural product extracted from wood, and contains only approximately 60% methanol,

Page 3.

the remaining constituents being volatile substances which impart a characteristic taste and odor to the denatured alcohol and are relatively difficult to remove. Alcohol thus denatured is considerably less toxic than Formula No. 30, on account of the reduced methanol content. Thus if any diversion of a product containing Formula No. 1 were undertaken, there would be less hazard involved, - first because of its lower poison content and, second, because of its distinct warning taste and odor.

So long as the Department adheres to the policy determined by the Secretary in July, 1934, however, it is not believed that the applications now pending could consistently be approved.

In the event there is contemplated a change in the Department's policy authorizing the use of wood alcohol as a denaturant for anti-freeze compounds, it is believed that the proposal to withdraw Formula No. 1 should be approved, provided there is no further addition of methanol and the product is packaged and sold in gallon and quart containers under a trade name and without the use of the word "alcohol" on the container, and with such poison label as may be approved by the Bureau.

Those producers still desiring to produce and distribute in bulk containers will be required to continue to use the present completely denatured alcohol formulas.



Stewart Berkshire,
Deputy Commissioner.

gta

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Treasury Department
Division of Monetary Research

Date May 4, 1939. 1938

To: Secretary Morgenthau

This article by Keynes is stirring a lot of interest because it represents the program that England is very likely to follow in her armament boom.

MR. WHITE
Branch 2058 Room 208

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE May 3, 1939

TO Mr. White

FROM S. Adler

Subject: Mr. Keynes on "Crisis Finance" (the London Times, April 17 and 18)

Employment and the Budget

(a) As the prospective increase in demand resulting from increasing government expenditure on armaments will involve the employment of not less than 750,000 and perhaps as many as one and a half million of the unemployed, and as the total number of unemployed in England is now 2 million, the problem of abnormal unemployment will cease to exist in the financial year 1939-40, and no budgetary provision should be made for it.

(b) The national income will increase by about 8 percent over 1938 (£4.8 billion in 1938). The Treasury can therefore legitimately expect increased tax receipts and a fall in expenditures on unemployment.

(c) Loan expenditures will be at least £350 million, an increase of £220 million on last year. This expenditure will involve an increase in direct demand of £200 million and in indirect demand of another £200 million, or perhaps a total of £400 million, which is 8 percent of the 1938 national income.

If loan expenditure is £400 million, it will be, expressed as a percentage of the national income, almost twice as much relatively as the highest United States Treasury deficit (excluding bonuses).

(d) The problem facing the United Kingdom, therefore, will soon be not that of unemployment and unused capacity but of shortage of labor and capital resources.

(e) The other important "physical" problem will be the shortage of foreign exchange resources, as (i) imports will increase, and (ii) political loans to foreign countries will be necessary.

(f) As ultimate gold resources should be left unimpaired, and the Treasury in its loan policy must be free to pay regard solely to domestic considerations, it follows that:

- i. The handling of foreign trade should not be left in the hands of individual enterprise.
- ii. The embargo on British nationals sending capital funds overseas must be tightened.

Mr. White - 2

The Supply of Savings

(a) If private investment is not curtailed, the public will have to save £200 million more than last year.

(b) Net savings last year were £400 million. But there are three sources from which the extra savings can come.

- i. Depreciation and maintenance, estimated at £400 million annually, can be curtailed.
- ii. The waste of savings to offset business losses will largely disappear and there will be an increased retention of profits within business.
- iii. Personal savings will increase with increased income.

(c) The main problem with respect to savings will be not their adequacy but the form in which they should be held (Bank of England balances, Treasury bills and bonds, longer-dated debt).

(d) There is no danger of inflation as long as the physical capacity of the country is not strained and the adverse balance of trade does not rise too rapidly. The form in which the government debt is held has no relevance to inflation.

(e) The two principles of loan policy to be followed are:

- i. Loans must be raised after and not before expenditure is incurred, or a stringency in the money market will result.
- ii. The form of the loans should be dictated by the preferences of the public. If they prefer short-term loans it would be futile and dangerous to force long-term loans into their hands.

(f) Stability of interest rates should be preserved. If capacity is approached, the correct remedy is not higher interest rates, but government priorities and the control of new issues. The correct policy is under no condition to issue loans at more than $2\frac{1}{2}$ percent, and to begin with a large addition to the volume of Treasury bills.

(g) A Department of Coordination attached to the Treasury should be set up for dealing with the supply and mobilization of labor, the allocation of limited resources, and preventing an excessive adverse balance of trade.

THE WHITE HOUSE
WASHINGTON

May 3, 1939.

MEMORANDUM FOR SECRETARY MORGENTHAU:

I spoke to the Chief of Staff and they are now searching for such an officer as you suggested for service in China.

I told them that the salary would be \$10,000, plus passage there and back for self and wife, and a suitable per diem for days spent away from headquarters.

I also assured them that at least ~~one~~ years' salary would be guaranteed by a suitable deposit in America.

E.M.W.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE

TO Secretary Morgenthau

May 3, 1939

FROM E. H. Foley, Jr.

Larry Bernard reports that Senator Glass will be out of town until the first part of next week. I think you may forget about appearing before Senator Glass' subcommittee on the repeal of the Silver Purchase Act until his return.

It is Senator Townsend, the author of the repealing legislation, who is insisting upon your appearance. When you have lunch with Senator Wagner tomorrow you might discuss with him your reluctance to appear since you have already testified on silver before Senator Pittman's special committee and have nothing further to offer.

In the meantime, Larry Bernard will continue with his efforts to make it unnecessary for you to appear.

E. H. F.

Secretary Morgenthau

May 3, 1939

E. H. Foley, Jr.

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In the meantime, Larry Bernard will continue with his efforts to make it unnecessary for you to appear.

(Signed) E. H. Foley, Jr.



TREASURY DEPARTMENT
PROCUREMENT DIVISION

371

PUBLIC BUILDINGS BRANCH

WASHINGTON

IN REPLYING QUOTE THE ABOVE SUBJECT MATTER, AND THESE LETTERS PB- 82

May 3, 1939.

MEMORANDUM TO THE SECRETARY:

In response to a request from Honorable Edward T. Taylor, Chairman of the Appropriations Committee, House of Representatives, addressed to you, for assignment of engineers from the Procurement Division to duty with a Subcommittee of the House making an investigation of the Works Progress Administration activities, the following engineers were assigned: A. W. Stephens, P. L. Hein, H. W. Rath sack, Chester L. Post, W. C. Spiker and John England, Jr.

The Committee delegated Messrs. Stephens and Hein for investigation in the New York and Pennsylvania area and these engineers were called to Washington for personal report to the Committee on May 2.

Without having the benefit of the records of the Committee I am unable to analyze what was said on the witness stand, but the following information is derived from personal conversation of Messrs. Stephens and Hein with Supervising Engineer Melick, of this Division.

Nine projects have been investigated in the New York City area, as follows; all as selected by the Committee.

1. Highway Improvements & Landscaping
Queensboro Bridge Plaza,
Long Island City, N.Y.
2. Trunk Sewer, 19th Ave & 32nd St.
Boro of Queens.
3. Public School Building No. 64,
101st Ave & 83rd St.
Ozone Park, L.I., N.Y.
4. Residential Highway Construction
near World's Fair.
5. Police Station, 94th St.
& 43rd Ave., Elmhurst, L.I.
6. W.P.A. Exhibit Building,
New York Fair.
7. Repaving upper roadway of
Bridge & Manhattan approach,
Queensboro Bridge.
8. Public School #27, Hicks &
Huntington St., Brooklyn.
9. North Beach Airport.

These engineers are reporting on facts as they find them as to costs, methods of construction and employment. They are carefully refraining from expressions of opinions. They are not making any investigation regarding alleged political activities nor any alleged personnel grievances.

Messrs. Stephens and Hein have been ordered by the Committee to the Pennsylvania area. It is understood Messrs. England and Spiker have been ordered in for a report on projects in Tennessee.

It must be borne in mind that these men are acting in accordance with instructions received direct from the House of Representatives Committee itself. They are conservative, capable men in every respect.


Director of Procurement.

5/3

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Miss Callaway:

Re: Paragraph 3 - letter of April 12

Each engineer received a sealed envelope containing his authority and instructions. If you wish this information I shall be glad to obtain it as soon as I can contact one of the men.

Please let me know.

PMC

(Faint, mostly illegible text, likely bleed-through from the reverse side of the page)

HOUSE OF REPRESENTATIVES
COMMITTEE ON APPROPRIATIONS

Washington, D.C.

April 11, 1939.

Hon. Henry Morgenthau, Jr.,
Secretary Of The Treasury,
Washington, D. C.

My Dear Mr. Secretary:

The House of Representatives by House Res. 130 has directed the Committee on Appropriations to make a study and investigation of the Works Progress Administration. A supplementary resolution, House Res. 152 contains the following section:

"Sec. 3. The heads of the executive departments and other executive agencies are requested to detail personnel temporarily to assist the committee or subcommittee upon request of the chairman thereof."

In accordance with the foregoing I beg to request that the subcommittee may have the use of four or five construction engineers of the Procurement Division for assignment in connection with the duties imposed upon it by the House.

Your compliance with this request will be greatly appreciated.

Very cordially yours,

(signed) Edward T. Taylor

Chairman.

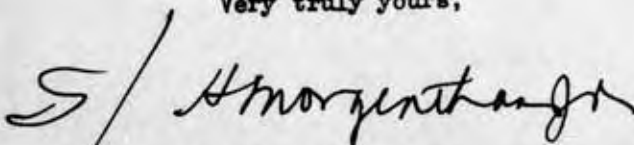
April 18, 1939

My dear Mr. Chairman:

The Director of Procurement advises that he has detailed Construction Engineers from the Procurement Division for assignment to duty with the sub-committee making a study and investigation of the Works Progress Administration.

This is in reply to your communication of April 11.

Very truly yours,


Secretary of the Treasury.

Honorable Edward T. Taylor,
Chairman, Appropriations Committee,
House of Representatives,
Washington, D. C.

HOUSE OF REPRESENTATIVES
COMMITTEE ON APPROPRIATIONS

Washington, D.C.

April 12, 1939

Hon. C. J. Peoples, Director
Procurement Division,
Treasury Department,
Washington, D. C.

Dear Admiral Peoples:

Request is hereby made for the assignment of the following engineers to the subcommittee of the Committee on Appropriations investigating WPA under House Resolution 130: P. L. Hein, A. W. Stephens, H. W. Rathsack, Chester L. Post, W. C. Spiker, and John England, Jr.

It is contemplated that Mr. Hein and Mr. Stephens will be assigned for investigative work in the New York-Pennsylvania area, Mr. Rathsack and Mr. Post will be assigned for investigative work in the Ohio-Illinois area, and Mr. Spiker and Mr. England will be assigned to Tennessee and Louisiana.

There is enclosed for the use and information of these engineers authority for their investigations and both general and special instructions covering the manner in which they shall conduct their work. There is also enclosed a project data sheet, copies of which will be furnished them and which they will use in making their reports.

Traveling expenses in accordance with the general instructions will be allowed these men while away from Washington, D.C. We have taken up with the House of Representatives the question of possible advancement of funds to cover their expenses, but find this impossible under the rules of the House.

Your cooperation in this matter is greatly appreciated by the Committee.

Very cordially yours,

(signed) Edward T. Taylor

Chairman.

PROJECT DATA SHEET (FIELD)

Project _____ Date _____

Classification _____ Examiner _____

Project No. _____

PERSONNEL

NAME

ADDRESS

State Director _____

Resident Engineer _____

Project Manager _____

CONTACTS

SPONSOR - _____

DESCRIPTION OF PROJECT

PROJECT DATA SHEET (FIELD)

ESTIMATED

ACTUAL

COST OF PROJECT

Sponsor's share of cost	_____	_____
Government's " " "	_____	_____
Overhead	_____	_____
Materials by Government	_____	_____

SPONSOR'S FORM OF CONTRIBUTION

(Cash, Land, Materials, Etc.; Check prices charged.)

PRESENT STATUS OF PHYSICAL COMPLETION

DESIGNER-

ADEQUACY OF DESIGN - DRAWING AND SPECIFICATIONS

(Good - Over - Under)

PROJECT DATA SHEET (FIELD)

PAGE 3

ADEQUACY OF SUPERVISION(Too Much or Too Little)(Good - Over - Under)

COORDINATION OF PLANS AND SPECIFICATIONS WITH FIELD OPERATION

MATERIALS EMPLOYED AND TYPES OF CONSTRUCTION

(Include any appropriate comments as to suitability of materials and types of construction)

PROJECT DATA SHEET (FIELD)

PAGE 4

CONSTRUCTION PROGRAM AND PROGRESS

QUALITY OF WORKMANSHIP

EQUIPMENT

(1) How secured.

(2) Adequacy of utilization.

(3) Care of equipment.

PREVALENT WAGE SCALE (Determined in what manner. Through what Agencies is labor obtained - union and non-union)

PROJECT DATA SHEET (FIELD)

PAGE 5

EFFICIENCY OF RELIEF LABOR

ESTIMATED COST OF THIS PROJECT IF BUILT UNDER CONTRACT ON BASIS
OF PREVAILING WAGE

JUSTIFICATION OF PROJECT

(a) Economic

(b) Work Relief

(c) Is this project one that should have been done by some
other agency, public or private?

PROJECT DATA SHEET (FIELD)

ABILITY OF SPONSOR FOR FUTURE MAINTENANCE

COMPLAINTS

CORRELATIVE MATTERS

SE

April 15, 1939.

My dear Mr. Chairman:

Receipt is acknowledged of your letter of April 12, requesting the assignment of the following engineers to the subcommittee making a study and investigation of the Works Progress Administration: P. L. Hein, A. W. Stephens, H. W. Rathsack, Chester L. Post, W. C. Spiker, and John England, Jr.

Copies of your individual instructions, as addressed to these engineers, have been delivered to them.

The engineers have been detailed to your Committee in accordance with your requests.

Very truly yours,

(signed) C. J. Peoples

Director of Procurement.

Honorable Edward T. Taylor,
Chairman, Appropriations Committee,
House of Representatives,
Washington, D. C.

HAM:LE

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE

May 3, 1939.

TO Secretary Morgenthau
FROM E. H. Foley, Jr.

For your information

Larry Bernard has just informed me that the House Ways and Means Committee this afternoon adopted all of your recommendations as to changes in Title II of the Social Security Act, except the suggestion that the taxes be termed "contributions." The Committee is holding morning and afternoon sessions and it is expected that the bill will be reported out around the middle of next week.

Congressman Doughton told Larry Bernard that the Committee would take action on the President's recommendation to remove the partition as to the amount of bonds that the Treasury may issue just as soon as the Social Security legislation is out of the way.

E. H. F.

RE FINANCIAL ASSISTANCE FOR NICARAGUA
(AND OTHER LATIN AMERICAN COUNTRIES)

May 3, 1939.
10:00 A. M.

Present: Mr. White
Mr. Lochhead
Mr. Foley
Mr. Young
Mr. Jesse Jones
Mr. Warren Lee Pierson
Mr. Sumner Welles
Mr. Feis
Mr. Laurence Duggan
Mr. Briggs
Mr. Collado

H.M.Jr: All right, Mr. Welles.

Welles: Want me to start in?

H.M.Jr: If you please.

Welles: During the past week the Department of State has been canvassing this situation with regard to Nicaragua, and have come to the conclusion set forth in this memorandum. And I imagine that the wisest thing for me to do is simply read the memorandum.

H.M.Jr: Would you please?

Welles: "It is proposed that economic cooperation with Nicaragua take one or both of the following forms: (1) Export-Import Bank assistance in carrying out a modest program of road and other public works construction, and (2) a line of credit extended by the Export-Import Bank to the National Bank of Nicaragua, Incorporated."

On the first point: "It is suggested that the Export-Import Bank assist in financing road and other public works construction on the Haitian model. It is further suggested that such financing cover all external expenditures - for imported materials and equipment, foreign engineers, and the United States engineering firm's services - while the Nicaraguan Government finds funds for domestic materials and labor. This is the plan which has been put forward for Paraguay. A

- 2 -

partial indication of the relative amounts this would involve may be obtained from the following estimates of the expenditures necessary to complete the Pan-American highway in Nicaragua: Engineering supervision, \$787,000; materials, \$2,129,000; equipment, \$920,000; equipment upkeep and fuel, \$2,324,000; local labor and operators, \$2,258,000. Total, \$8,418,000. It is apparent that perhaps 50 percent or more of the cost would be borne by Nicaragua.

"It is suggested that projects to be considered might include certain links of the Pan-American highway, lateral feeder roads, and possibly some municipal sanitation and some hydro-electric development. It is suggested that credit not to exceed three million dollars over two to five years might be sufficient to accomplish suitable projects, including the central stretch of the Pan-American highway in Nicaragua. There is no need to plan to complete this highway at once to the borders, since neither Honduras nor Costa Rica are well advanced in their section."

Now, on the second point, that is, the line of credit to the National Bank of Nicaragua:

"It is suggested that a modest line of credit up to not more than 500 thousand dollars be extended to the National Bank of Nicaragua...."

(Jones comes in)

Well hello, Jesse. How are you?

Jones: Hello.

Welles: The second point... We are discussing here the possibilities of what we can do for Nicaragua.

H.N., Jr: By being late they have taken three million dollars away from you. So it's cost you three million dollars already.

Welles: Well, the second is more agreeable to you, then, because only 500 thousand dollars is involved in the second point.

- 3 -

"It is suggested that a modest line of credit up to not more than 500 thousand dollars be extended to the National Bank of Nicaragua, Incorporated, by the Export-Import Bank, for a term, possibly, of one year, renewable up to five years. The purpose of such a line of credit would be partly psychological, and partly to enable the Bank to eliminate seasonal and unusual fluctuations in the rate of exchange. Since it would not be the purpose of this line of credit to enable the Bank to maintain the exchange rate fixed in the secular sense, amortization should be possible in the normal course of exchange transactions."

Then comes a brief statement as to the position of the Bank:

"As of December 31, 1938, the Issue Department of the Bank held 329 thousand dollars of gold, 360 thousand dollars of devisen, a total of 689 thousand dollars equivalent at five cordobas per dollar to 3 million 448 thousand cordobas, against notes and coins outstanding of 10 million 770 thousand cordobas, or 32 percent. In addition, the Banking Department held gold and silver in the amount of 323 thousand cordobas and foreign balances of 3 million 143 thousand cordobas. Funds awaiting remittance abroad amounted to 1 million 666 thousand cordobas, leaving a net position of 1 million 477 thousand cordobas or about 295 thousand dollars. It is not known how much of this represented German blocked marks, but on August 31, 1937, an audit indicated that about 30 percent was in blocked marks.

"Following the marked depreciation of the cordoba, which fell in the official market from two to the dollar in 1937 to five to the dollar following the law of June 8, 1938, there has been a tendency for the exchange position of the Bank to improve. Imports have been restrained both by the great increase in import prices in terms of cordobas and by the restriction by the Bank of credit to importers. As a result the demand for foreign currencies relative to their supply has diminished, as is evidenced by strengthening the cordoba from 6.70 to the dollar in the then 'uncontrolled' market on April 30, 1938, to about 5.30 in the 'curb' market at the present time.

- 4 -

"It would be a necessary condition of the extension of any such line of credit that the Bank employ an American financial advisor, approved by the Export-Import Bank, to control the use made of the funds. Experience indicates that Nicaraguan management has regularly proved incapable of satisfactorily conducting the affairs of the Bank. When Mr. Edwards took over the management of the Bank in 1937 following the resignation of Dr. Vicente Vita, he found no accounting worth the name, and was forced to write to the Bank's foreign correspondents to find out what balances the Bank had abroad. Recently, following his resignation, the American auditor of the Bank, Mr. Alfred Gini, resigned over what he called improper methods in the preparation of the Bank's statements.

"In examining the prospects for the amortization of any credit which may be extended, one should investigate both the budgetary position of the Nicaraguan Government and the balance of international payments of Nicaragua. Satisfactory information is not available regarding either of these.

"Although no recent complete figures are available, we are informed by the Nicaraguan Minister that revenues have improved and that the budget shows a surplus. At the same time the debt, internal and external, of Nicaragua is very low, and has been reduced markedly during 1938.

"No complete balance of payment estimates are available. Tables indicating the foreign trade of Nicaragua are appended. It will be noticed that the position of the United States has improved considerably during 1937 and 1938, while that of Germany has declined. The large drop in the value of exports in 1938 was due to reduced prices for coffee following the decision of Brazil to diminish its coffee restriction program, as well as poor yields for coffee and bananas, the latter due to the ravages of banana diseases. The decline in imports may be attributed, as indicated above, to the fall in the cordoba and, to some extent, to credit restriction employed during part of 1938 by the National Bank.

- 5 -

"Other known items of the balance of international payments include annual payments of £22,500 on the sterling debt in accordance with the 1937 agreement with the Council of Foreign Bondholders, and about \$160,000 on the frozen commercial debt in accordance with the 1938 agreement with the National Foreign Trade Council, Incorporated."

Now, I have here a much further ampler memorandum in a form which is suitable to be handed to the President of Nicaragua when he arrives here, provided the general ideas are agreed to.

Jones: This is a proposed loan of a half million?

Welles: There are two things involved. Before you came in, I had suggested that a loan of three million dollars be extended to Nicaragua along exactly the same lines as that of the plan which we put through in Haiti; that is, through an American engineering firm.

Jones: For construction purposes?

Welles: Road construction primarily and one or two other minor public works.

Jones: And five hundred for some cash in the pocket, huh?

Welles: For the Bank.

Jones: What's the purpose of the loan?

Welles: Well, I think I'd better take up the second memorandum. Then we can go into it fully.

Jones: Well, you needn't read it, just....

Welles: Well, the first loan of the three million.

Jones: That's - I know that's the public works.

Welles: There would be a responsible United States engineering firm and so on.

Jones: And the other - I mean what do we want to attain, what's the object?

- Welles: Well, specifically, as I said here, the purpose of such a line of credit of 500 thousand dollars would be partly psychological and partly to enable the Bank to eliminate seasonal and unusual fluctuation in the rate of exchange.
- Jones: Well, you don't get my point. I mean what are we to gain from making the loan?
- Welles: The benefit, of course....
- Jones: The United States.
- Welles: The benefit, of course, would be partly political and partly to our own export trade.
- Jones: Well now, I assume....
- Welles: I ought to say at the beginning that the President of Nicaragua is coming up here with extremely high-flown ideas. First of all, he wants to persuade the United States Government that the Nicaraguan Canal should be constructed immediately. The estimate for that, as you may not know, and it was a surprise to me - I thought it was about 785 millions - I'm told the War Department now estimates the cost at one billion one hundred million dollars.
- Jones: The cost of the....
- Welles: The cost of the construction of the Nicaraguan Canal.
- Jones: That's what he's coming for?
- Welles: That's one of the things he's coming for. The second thing he's coming for is that under the terms of the so-called Bryan-Chamorro Treaty of 1915 - '13, I guess it is.
- Duggan: '16.
- Welles: '16 - by which we acquired the option for the right of way to construct a canal if and when we wanted it, for 99 years. We paid three million dollars for that option at that time. He now would like us to feel that they have waited a long time and they'd like some more money for that option. If he can't

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get that, he would like us to spend a good deal of money in the so-called canalization of the San Juan River in Nicaragua, which is a part of the line of the canal. And we feel that there is no reason, no valid reason at all for doing any of those things.

He has certain other ideas as well, which I needn't go into. But I think that the two things we have suggested here are relatively small in amount and I think they probably would be sufficient to maintain a friendly and satisfactory relationship with the Nicaraguan Government at a time of considerable importance, and I think they are inherently sound in the interests of American business.

Jones: Suppose we don't make the loan. What happens?

Welles: Well, of course, I can only speculate. I would speculate in this way: I think probably Nicaragua will increase very materially her barter trade with Germany, and I think it is not at all unlikely that certain German interests will undertake to construct some of these public works that they want in Nicaragua, and would undertake some form of more or less rigid, water-tight economic and financial relationship with Nicaragua, which would be very definitely to our prejudice. That's speculation, but I think it is probably fairly well founded.

Jones: How many people in Nicaragua?

Welles: Do you remember the exact population, Mr. Duggan?

Duggan: Around a million.

H.M.Jr: One thing I don't think you pointed out to Mr. Jones. I think you said the Nicaraguan Government on this road thing would spend as much money again. Is that right?

Welles: That's right.

H.M.Jr: Am I right on that?

- Welles: The Secretary is right. The Nicaraguan Government itself would spend approximately 50 percent of the estimated cost for the construction of the Pan-American highway in Nicaragua of eight millions. In other words, our engineering company would get paid 787 thousand dollars; American materials used in construction of that road would be two million one hundred twenty-nine thousand dollars; further equipment would be 920 thousand dollars; and part of the upkeep and so on would have to come from the United States; whereas Nicaragua would pay for local labor and operators and Nicaragua would pay approximately 50 percent of that total of eight million.
- Jones: If we put in three millions of that, two million one would be for materials and 800 thousand for cash, huh? Is that it?
- Welles: Let me show you this little estimate there, Mr. Jones.
- Jones: Does this indicate the amount that would be exported from this country?
- Welles: I think the first three items give you that fairly clearly.
- Jones: First three items: equipment and materials and engineering. Well, in this case the equipment and materials amount to three million dollars.
- Welles: Amount to what?
- Jones: The equipment and materials amount to three million and 49 thousand, on these figures, so we would be furnishing equipment and materials.
- Welles: That's right.
- Duggan: Might I point out,....
- Welles: Please.
- Duggan:Mr. Jones, that those figures there are the estimates for the total construction of the highway from the Honduran border to the Costa Rican border.

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It would only be proposed to construct that section which can be really utilized at this time, inasmuch as Honduras hasn't built its section up to the border, nor has Costa Rica. So those figures really are higher than necessary to build the piece which could be commercially utilized at the present time.

Those figures, moreover, aren't broken down precisely to show the foreign exchange necessary - that is, foreign expenses and domestic expenses - but total expenses; and some of the items include both domestic and foreign expenses.

Jones: Well, is this meeting to take action or to get acquainted with it or to anticipate the visit or what?

Welles: I think the purpose is to find out if these ideas in general are satisfactory, in order that we'll have a basis on which to talk with the President of Nicaragua the day after tomorrow, when he arrives.

H.M.Jr: Kind of short, isn't it? I've been accused by the State Department of giving time limits. This is kind of short.

Jones: Would it be feasible to - desirable to find out what they want first, and then have a meeting and time to consider it?

Welles: Well, we asked about six weeks ago what he did want. I've outlined to you in general what he does want. And we have had one further meeting here with the Secretary of the Treasury, which you were not able to attend - Mr. Pierson was here - in order to go over the general outline. And this second meeting is in order to make it possible for us to talk with the President when he gets here and not let him be in Washington with the feeling that we weren't even far enough advanced to be able to talk with him at all.

Jones: Well, I'd be glad - if my advice or counsel is desired, I'd like a chance to read it and get better acquainted with it.

Welles: Please. I think Mr. Jones had better have this second, more ample memorandum. Has Mr. Pierson got a copy of this?

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Collado: Yes.

Welles: Then I think I might give my own copy to the Secretary of the Treasury and Mr. Jones if they want to read it.

Jones: I'd like to - like time to read it.

Welles: This is an amplification of that.

H.M.Jr: Which is the....

Welles: This is the better one that you can take.

H.M.Jr: Well....

Lochhead: We have a copy of that, Mr. Morgenthau.

H.M.Jr: We have a copy. (Hands to Jones Mr. Welles' copy).
Well, in order that you people know what you want - I mean you're using this room as a meeting place - is 24 hours long enough for you?

Jones: I don't know whether it is or not.

H.M.Jr: Well, I mean to say yes or no.

Jones: Well, if that's one of the things to do - if 24 hours is all I could have - I would rather have 48.

Welles: I think Jesse had better have these schedules too.

H.M.Jr: When does this fellow get here?

Welles: At 11:20 on Friday morning.

Jones: We can get back to you before that.

H.M.Jr: He said 11:20 on Friday morning.

Welles: That's right.

Jones: You mean you're meeting him at 11:20 Friday morning.

Welles: He'll be met at the station here by the President.

Jones: At 11:20. Well, you're not going to talk business before you give him a cocktail and some food and mess around a little bit.

Welles: Well, he'll want to talk business with the President at 5:00 P.M. on Friday afternoon.

Jones: He will?

Welles: Yes.

H.M.Jr: Why don't we get together Thursday afternoon?

Jones: That'll be all right.

H.M.Jr: 4:00 o'clock?

Welles: (Nods yes).

Jones: Yes.

H.M.Jr: 4:00 o'clock.

Welles: That's all right.

H.M.Jr: Is that all right?

Jones: (Nods yes).

Pierson: Mr. Secretary, going back to our conversation of last week, this thing really has to be put largely on a political basis. Can't we all agree on that?

Welles: No, I want to take issue with that. I think the first section, that is, the road construction, public works construction, is a perfectly sound commercial transaction. I think the second item, the extension of a small amount of credit to the National Bank of Nicaragua, is frankly more political than anything else.

Pierson: You feel they can amortize the road construction expenditures all right?

Welles: Yes, yes.

H.M.Jr: Well, as a horseback opinion, I agree with Mr. Pierson.

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I think that that is the bridge that we've got to cross. I mean I charge it up to North and South American good neighbor....

Welles: Now wait a minute. Charge it up to something else as well. This expedites very much the construction of the Pan-American highway....

H.M.Jr: Well, that's part of it.

Welles:which I think is of commercial interest to us.

H.M.Jr: But the little I know about it - I mean I certainly don't think it's a banking risk.

Welles: Well, do you consider the Haitian road construction, facilitation of credit, a good banking risk?

Pierson: I think it is much better than the Nicaraguan. They have a miserable history of meeting obligations in Nicaragua.

Welles: I think if this is handled properly with proper supervision, as you did in the case of Haiti, it would be all right.

H.M.Jr: But that doesn't mean that I wouldn't instruct our representative, who is a director of the Export-Import Bank, not to vote for it. But I mean I'm....

Jones: You're just acknowledging what you think to be the fact. You're not fooling yourself.

H.M.Jr: Well, I try not to.

Lochhead: Mr. Pierson, have you got that much money uncommitted in the Export-Import Bank?

Pierson: We have four and a quarter million dollars.

H.M.Jr: How much?

Pierson: Four and a quarter.

Jones: What other customers have we got prospectively?

Pierson: Paraguay is quite close.

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Jones: Did you intend to talk about that this morning?

Welles: I'd be glad to, but the conversations have been held directly between the Minister and Pierson.

Pierson: I haven't seen him since that first time two months ago. He hasn't been in since he saw you.

Welles: In the meantime he was elected President on Sunday, and he was also up at the opening of the World's Fair; I imagine he just got back.

Pierson: He wanted substantially the same thing, money for an internal public works program, and money for their National Bank.

Jones: How much did they want?

Pierson: About five millions.

Welles: Yes.

Jones: And what else have you got in South America?

Pierson: Well, we have a very important question, I think, coming up soon in connection with Chile, and probably with Argentina. Also we have a more or less - something of a moral commitment to Brazil if and when we have the money.

H.M.Jr: Jesse, I don't know whether anybody told you the suggestion which I made the last time, that the Administration ask for a new bank, call it the Bank of North and South America, and ask for a hundred, two hundred million dollars worth of capital, whatever is necessary, and then tell Congress when we're asking the kind of loans that we expect to make.

Jones: Uh-huh.

H.M.Jr: And that there would be this sort of thing in the new Bank. But explain to Congress that this is the kind of thing we've got in mind. And maybe they'd like it. But rather than - the suggestion that I made - I don't know if it was passed along - rather than ask for an increase in the present Bank, a

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new Bank under the same management, same Board of Directors, but....

- Jones: Why shouldn't we between now and Thursday evening kind of cast up counts and see what it is that we might be willing to do regardless of what consideration - whether it was political or whether it was industrial loans? Why wouldn't we do that and see about what it's going to take to get by - do the things we want to do....
- H.M.Jr: Get a whole list.
- Jones:if we want to get into South America, and see what it comes to. Why isn't that an idea?
- H.M.Jr: I think Mr. Welles is prepared to give that to you today.
- Welles: Well, only in those general terms.
- Jones: Give it to us in general terms, then.
- Welles: You asked a few minutes ago what prospective customers there were.
- Jones: Yes.
- Welles: In addition to those that Mr. Pierson has mentioned, I think Ecuador would be a prospective customer for very much the same kind of thing that Nicaragua and Paraguay are asking for: primarily, road construction.
- Jones: Primarily what?
- Welles: Road construction.
- Jones: Road construction. How much?
- Welles: I haven't any estimate as yet. There have been no estimates sent down, have there?
- Jones: You'll make a note of these, will you, Warren?
- Pierson: (Nods yes).
- Welles: There's nothing definite. The Ecuadorean President has mentioned loans of ten to fifteen million.

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Our Minister believes that five million dollars would be more than acceptable.

In the case of Chile, we undoubtedly will have something coming from Chile before long. We have told, as a result of our last talk - told the Minister of Finance of Chile we'd be glad to have him come up, but at the same time we have asked him to specify very clearly what it is he wants and what it is he wants to talk about before he comes up; and we have not as yet had any reply.

Jones: What is that as far as we know? What do we think he wants?

Welles: Reconstruction in the devastated area, and the construction of one or two plants. The Chilean Government, for instance, wants to construct a smelter, which the Germans have already made a bid for. There are one or two things of that kind.

Jones: Have you any figures on that, Warren?

Pierson: The smelter would be around three million dollars, and they want substantial railway equipment - about two million additional. And then there is the reconstruction sum, which would go as high as twenty-five million according to some of the private letters I have received.

Duggan: That's twenty to twenty-five million spread over five years.

Collado: That would be the total.

Pierson: Quite a different situation in Chile, as you know, from our standpoint, than there is in Nicaragua and Paraguay; I mean from the standpoint of American interests.

H.M.Jr: How do you mean?

Pierson: Well, I was thinking of our copper - the copper people and the nitrate people; we have very heavy investments there.

Jones: What other countries?

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- Welles: That's all that I know of at the moment.
- Pierson: Well, there will be substantial sums in Colombia if the debt settlement goes through, and they'll be good loans.
- Welles: The Colombian Minister came in to see me yesterday and said that before the end of this week he was going to complete his memorandum as to his proposals for the settlement with the Government of Colombia. By that time he would send that to the Protective Council of Foreign Bondholders, and they would begin negotiating. That at last is under way.
- Pierson: Anything we are adding up now should include Colombia and probably the Argentine.
- H.M.Jr: I was going to say the Argentine.
- Duggan: Don't forget Cuba.
- Pierson: That's right.
- Welles: You have had Cuba on your list for some time.
- Pierson: But it isn't in this.
- H.M.Jr: New list.
- Pierson: It isn't included in the amount of money we have mentioned.
- Jones: We'll have to consider them all more or less together before we can make a plan.
- Welles: What I'm trying to do as quickly as I can is to get some idea of the amounts involved in each case. But in a case like Chile, where there is a political situation of some uncertainty, it is very difficult to get any concise statement from them.
- Jones: I think it is essential to know the priority of these in our consideration: which is of the most desirability, so forth and so on. So if you'll give us that, why, we'd like it.

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Welles: Right.

H.M.Jr: And I think we ought to recognize that in most of these loans that we're talking about we're going into a new field.

Jones: Oh yes, absolutely.

H.M.Jr: It's something new.

Jones: Absolutely.

Duggan: I think it would be possible for us, Mr. Welles, to prepare a brief statement with an estimate of the probable amount, or the amount at least being talked about, for each country. We could do that this afternoon.

Welles: I think the sooner we can send that to Mr. Jones and the Secretary of the Treasury, the better, although I repeat in some cases it is very difficult to estimate what the amounts involved would be. We'll do the best we can.

Jones: Did you promise any money to Bolivia?

Welles: There is no request.

Jones: Did they quit fighting or something like that?

Pierson: Just some private requests there - some private firms have come in - but they don't amount to much.

Jones: Haven't they quit fighting in the hope of getting some reward for it?

Pierson: Paraguay and Bolivia stopped fighting.

The over-all amount is about 125 million in South America.

White: How much does that allow for Brazil?

Pierson: That puts only 25 for Brazil.

H.M.Jr: Well, if you're going to get into these kinds of loans, you'd better multiply that by two.

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Welles: What was that?

H.M.Jr: Multiply it by two.

Jones: You mean like on Brazil.

H.M.Jr: I mean if these countries see we're going to do business this way, I think you're going to have a lot more customers.

Jones: No doubt about that. If we lend one and don't lend the other....

H.M.Jr: Wouldn't be a good neighbor.

Jones: That's right.

Welles: Well, it depends, of course, in each case on the type of project which they submit to us for our consideration and also the assurances they can give as to repayment. That varies in each case. But we're trying to - we'll try and send those estimates to you.

RE CERTAIN FINANCIAL ARRANGEMENTS WITH
GOVERNMENTS OF SPAIN AND POLANDMay 3, 1939.
10:45 A. M.

Present: Mr. White
Mr. Lochhead
Mr. Foley
Mr. Young
Mr. Jesse Jones -
Mr. Warren Lee Pierson -
Mr. Sumner Welles
Mr. Feis
Mr. Laurence Duggan
Mr. Briggs
Mr. Collado

Welles: If I may, before the meeting breaks up, speak about another matter which has not got anything to do with the American continent but which is of interest to the Secretary of the Treasury and also Mr. Jones and the Bank. The Spanish Ambassador came to see me a few days ago and was instructed officially by his Government to make a request for credit facilitation from the Export-Import Bank for the purchase by the Cotton Syndicate of Spain, which is an appendage of the Spanish Government, of 300,000 bales of cotton. I understood that some unofficial representatives from the Franco Government had been here last December and had seen you (Jones), but that nothing was done at that time. And now the present Government has officially asked that this matter be taken up with the Bank and is very anxious to get some word on it as soon as possible. We have asked the Ambassador to get us some information which he didn't have, by cable.

Jones: How does the State Department feel about it?

Welles: In principle we are entirely in accord. However, we feel that the time should be shorter than that which they have asked for. They have asked, as I recall it, for one year.

Feis: I'm finding out what the Ambassador - what information he had. We thought we'd save time and break the ice by asking him to secure further information on a series of points. As I remember them, we first asked for more information regarding this Cotton Syndicate and its relation to the Government. Second,

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we found him vague as to who would be the ultimate creditor, so we asked him to determine that rather decisively. At one point in the conversation he seemed to believe that J. P. Morgan was going to guarantee this credit, and then that faded out. At any rate, we asked him to ascertain that.

Then we asked him to ascertain what guaranties would be given as regards making exchange available when the thing fell due. We asked him to ascertain whether they'd agree that whole or part of this would be carried on American ships, something which the Maritime Commission had raised. And there were one or two other points. He's getting that material.

- Welles: One important point was some guaranty that the cotton would actually be used in Spain and would not either be resold or transferred.
- Lochhead: Keeping in mind also the suit they have against us - have you spoken to them about that at all?
- Welles: What's that?
- H.M.Jr: Let me just - I was going to wait. The Treasury Department officially brought to the attention of the State Department that there is a suit pending against the United States Government by the Franco Government, and we asked the State Department before they would recognize Franco that they would try to get them to drop this suit. As far as I know, the State Department didn't do anything about it.
- Jones: Could do nothing?
- H.M.Jr: Did nothing about it. They could have, but did nothing. Is that right?
- Foley: That's right. Very carefully brought to the attention of the State Department.
- Welles: May I interrupt to say that Franco stated very specifically that he would not agree to contingent or conditional recognition under any circumstances.
- H.M.Jr: Well, I certainly will do anything that I can to see that the Government does nothing in any way -

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I'm sure I have the 100 percent backing of the President - to give any kind of credit to Spain until this Government brings forcibly to the attention of the Franco Government this suit. And I'm sure I'll have the 100 percent backing of the President, because when we did this, bought this silver, I did it with the President's approval. And until the Government takes some steps to get them to drop this suit, certainly I'm going to do everything possible to get the President to say that nothing should be done with the present Government until they drop it. They are suing us over this purchase of silver, you see.

- Jones: I certainly wouldn't lend them any money or sell them any cotton or give them any credit until that was adjusted or, certainly, adjusted in the transaction.
- H.M.Jr: Well, the easiest thing is - I mean our own attorneys and Mr. Henry Stimson, who is our attorney, all advise us that the Spanish Government have no suit.
- Welles: What is the present status of that, Henry?
- Foley: Well, the Federal Reserve Bank of New York is the party that is being sued, as they bought the silver as our agent. The action is - summons from the complaint has been served in three or four actions; the matter hasn't come to trial yet. It's awaiting its turn on the calendar up in New York.
- Welles: Any idea when it's coming to trial?
- Foley: I couldn't say exactly. It depends on the congestion of the calendar. Probably won't be reached for trial before sometime next fall at the earliest.
- Welles: As late as that? How much are they suing us for?
- Foley: I think it's around three or four million.
- Lochhead: The total suit would be....
- Foley: The purchases involved about 15 million dollars. I don't think that all of that is....

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Lochhead: They put attachments on every shipment.

H.M.Jr: About 15 million dollars.

Welles: Poor leg to stand on.

H.M.Jr: No, but I just - I'm sure I have the 100 percent backing of the President, and I can't be too determined in my statement that until they drop the suit, why, I'm opposed to giving them any kind of credit, and I'm sure you'd (Jones) back me up.

Jones: Yes, I would do that. I might do it in a negotiation. I might say, "All right, here's one and the other. What're you going to do about it? If you want to do business with us, are you going to keep suing us or are you not?" I agree with you on that.

Welles: I think it might be more expedient to handle it that way. We've got a tremendous interest, as we all know, in trying to get rid of cotton. I think we could get rid of it this way. So much better if it could be washed out - the silver transaction - in the course of those transactions. Perfectly agreeable to me.

Jones: You'd have to wipe that out, I would think, or you wouldn't sell them any cotton, give them any credit, or anything.

H.M.Jr: The point I want to make is that certainly it hasn't been brought to the attention of the Franco Government yet that before we're going to do business with them as a Government, we expect them to drop that suit.

Welles: Their Minister hasn't even yet been received by the President. You see, it's preliminary.

H.M.Jr: Certainly they have left no stone unturned to be as aggressive as possible in trying to - I mean they went so far at one time that they had every shipping company frightened in even handling the silver.

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Jones: Any others that you've got in mind?

Welles: No.

Pierson: I have one small point which I'd like to bring up, since practically all the Committee is here, Mr. Secretary. We have a commitment now of six million to Poland for cotton and copper. Now, of that, about a little over two million is actually out. And they have recently asked us whether or not we will, first, make that commitment revolving, and second, whether if they give us the outright guaranty of the Polish Treasury we will reduce the interest rate from $3\frac{1}{2}$ percent to $2\frac{1}{2}$ percent per annum.

Now, in support of that last request they say they had some conversations with the Treasury last fall, when Mr. Taylor was here, and the point was brought up that if the Polish Treasury guaranty was given, the Bank might take a more reasonable view on the interest rate. No commitment, as I understand it.

H.M.Jr: Young, will you look that up to see if there is any memorandum from Mr. Taylor on that. I'm not familiar with it.

Pierson: It may have been with Dr. Feis.

Jones: We talked about that the other day.

Feis: We talked about it.

Pierson: We talked about making it 3 percent.

Jones: And something about the revolving fund - that we would continue until stopped, huh?

Pierson: Yes.

Jones: Instead of making a definite commitment, an indefinite commitment; we would just go ahead with the right to stop anytime we thought we should stop.

H.M.Jr: Well, I have no interest in it.

Jones: That strike you (Welles) all right?

Welles: Does to me.

Pierson: They're pressing this very hard on the interest rate. They always have. The first time the question came up three years ago, they didn't take a loan at that time because the interest rate asked was $\frac{3}{4}$.

Feis: I'll just add what you probably know, that on their dollar bonds here they have maintained service, and about six months ago they put through a settlement with the Council which is probably the most satisfactory settlement that any foreign government has made on its bonds.

Jones: Well, our experience with them has been very satisfactory and I think we ought to continue along, do business in the same way.

Feis: Second, the Minister of Commerce is going to be here in two weeks with the idea of negotiating a trade agreement with them. So everything seems to be moving satisfactorily.

Jones: Our principal risk would be war, as I see it. It is a perfectly good loan as long as they can - unless there is war. That's our risk. We take that risk in everything we do.

Have you got anything else, Mr. Pierson?

Pierson: No, but I'd like to go ahead on the compromise of 3 percent.

Jones: I don't think anybody objects.

Pierson: There's no objection?

Jones: He cried me out of that half percent the other day.

H.M.Jr: Then he must be pretty good.

Jones: Yes, he's pretty....

H.M.Jr: Have you got anything else?

Welles: That's all.