Genessee Valley Gas Co

Holding company Office in New York City.

Pavilion Natural Gas Co. - only asset has [illegible] at Geneseo N.Y.

Geneseo about 30 miles from Rochester South - a little west.

Regraded Unclassified

IN REPLYING PLEASE QUOTE

191

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON

PUBLIC UTILITIES DIVISION

January, 29, 1938.

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

My dear Mr. Secretary:

In keeping with your request of this morning I am transmitting to you herewith a brief story of the pending reorganization of Genessee Valley Gas Company and a copy of the Commission's Opinion and Findings. The enclosed chart will aid you to visualize the corporate set-up.

If we can be further helpful I hope you will feel free to call upon us.

Very truly yours,

C. Roy Smith

C. Roy Smith, Director,
Public Utilities Division.

THE STORY OF GENESEE

This is a stereotyped story of investment banker control, a story of how a group of Philadelphia and New York promoters:

1. Gained control of the Pavilion Natural Gas Company, a small gas utility <u>operating</u> company, in New York's Genesee Valley, by the erection of a series of totally unnecessary holding companies;

2. Imposed a capital structure on the back of this small money making operating company far in excess of either its intrinsic value or income producing potentialities;

3. Perpetuated this parasitical superstructure by a ruthless milking program;

4. And sought finally to reorganize by a plan which would have perpetuated themselves in control, without benefiting the operating company in any way— the essential objective of any sound reorganization program.

The situation presented by the immediate reorganization is a microcosm of the evils which the Public Utility Holding Company Act was designed to prevent.

The following presentation demonstrates the role which the federal government can assume in the constructive rehabilitation of industry through insisting upon the formulation and consummation of sound financial and operating reorganization plans.

The Pavilion Natural Gas Company, of Geneseo, N. Y., is the focal point of this system. It supplies natural gas to the surrounding territory of Livingston County, about thirty miles southwest of Rochester N. Y., off the main line of the New York Central Railroad, and serves approximately 4,800 consumers in a predominantly agricultural territory.

The investment bankers organized the following three holding companies above Pavilion, their only foundation:

First above was Genesee Valley Gas Company;

Then, Eastern Utilities Service Company;

And finally, on top of the pile, Citizens Public Service Company.

Pavilion has a gross annual income of only $57,000, to support this superstructure of corporate leeches with their combined outstanding securities of some $2,200,000 requiring annual interest and dividends of some $130,000 — more than twice Pavilion's annual gross income.

This Genesee Valley "empire" was created and acquired by the investment bankers in the following manner:

In the territory now served by Pavilion Natural Gas Company, there was also in existence Churchville Oil & Natural Gas Company and Valley Gas Corporation. In order to acquire the common stocks of these three operating companies, the investment bankers organized the first holding company of the system - Genesee Valley Gas Company.

Genesee issued bonds, debentures, preferred and common stock. The bonds and debentures were sold to the public, and the proceeds were used to buy the above-mentioned operating companies. The stock of Genesee, however, was retained by the investment bankers; the bankers neither contributed property nor cash therefor which was issued solely for their "promotional" services.

In order to realize on the common stock of Genesee and to concentrate control in one organization, the investment bankers organized Citizens Public Service Company to acquire such stock.

The investment bankers organized the following three holding companies above Pavilion, their only foundation:

First above was Genesee Valley Gas Company;

Then, Eastern Utilities Service Company;

And finally, on top of the pile, Citizens Public Service Company.

Pavilion has a gross annual income of only $57,000, to support this superstructure of corporate leeches with their combined outstanding securities of some $2,200,000 requiring annual interest and dividends of some $150,000 — more than twice Pavilion's annual gross income.

This Genesee Valley "empire" was created and acquired by the investment bankers in the following manner:

In the territory now served by Pavilion Natural Gas Company, there was also in existence Churchville Oil & Natural Gas Company and Valley Gas Corporation. In order to acquire the common stocks of these three operating companies, the investment bankers organized the first holding company of the system - Genesee Valley Gas Company.

Genesee issued bonds, debentures, preferred and common stock. The bonds and debentures were sold to the public, and the proceeds were used to buy the above-mentioned operating companies. The stock of Genesee, however, was retained by the investment bankers; the bankers neither contributed property nor cash therefor which was issued solely for their "promotional" services.

In order to realize on the common stock of Genesee and to concentrate control in one organization, the investment bankers organized Citizens Public Service Company to acquire such stock.

The bankers then caused Citizens to issue its own securities to the public, consisting of bonds, and preferred stocks, using the proceeds thereof to buy from themselves their stock holdings in Genesee Valley Gas Company. Thus, the bankers without ever having advanced a single penny or a jot of property were able to make a profit of several hundred thousand dollars.

As a consequence of the heavy, overcapitalization thus imposed by the bankers, Genesee, in 1931, defaulted in the payment of interest on its debentures held by the public. To avoid receivership, the bankers persuaded the debenture holders to postpone further receipt of interest until 1933. But in 1933, Genesee was unable to pay the postponed debenture interest. To avoid a default, which would have precipitated foreclosure proceedings, the investment bankers organized another holding company, Eastern, which it interposed between Genesee and Citizens. Thereafter, the investment bankers proposed a so-called reorganization plan, which merely served to retard the inevitable collapse of this house of cards.

It was at this time that Genesee, in order to carry out its designs, bought in the open markets its defaulted bonds at considerably less than their face value. It is the profit to Genesee resulting from this transaction which the Treasury Department regards as taxable gain.

In 1936, Genesee again found itself in financial difficulties as it was without sufficient cash to redeem its debentures which had matured and upon which no interest had been paid since March 1, 1931. In order to prevent the first lien bondholders from foreclosing on the properties. Genesee sought the sheltering haven of the courts and filed a petition for reorganization under 77B of the Bankruptcy Act.

The reorganization plan submitted by Genesee to this Commission made no effort to relieve the capitalization which has already been described, nor did the plan contain any provisions for the revitalization of the essential underlying operating company. The plan merely left undisturbed the first lien bonds and the government's claim for taxes. The plan proposed to eliminate the claims of creditors by issuing common stock in lieu thereof. The plan likewise proposed to allocate new common stock to the old stock, which is held by its parent, Eastern. But Eastern was not to be required to contribute any cash for the privilege of being included in the reorganization. Inclusion of the old stock in the reorganization plan was neither justified on an earnings basis nor upon an asset value basis of the underlying properties.

Our studies demonstrate that if the uneconomic holding company structure were eliminated and the operating companies merged into a single operating unit the resulting company would be in a sound financial and operating position.

Tentatively, this Commission has suggested in its Findings and Opinion, which is attached, an outline of a rational and thorough-going plan of reorganization which not only would be in the interest of the public and consumers but the investors of this company, as well ~~as~~ Pavilion Natural Gas Company, as thus reorganized, would require only a relatively small amount of cash for rehabilitation purposes.

This could undoubtedly be obtained from the local bankers, provided the matter were presented under proper auspices. Financial participation by local bankers would aid in eliminating the control which the New York and Philadelphia interests now possess.

In an acceptable plan of reorganization, the ultimate capital structure should be so simplified as to include only bonds, with a sinking fund, and common stock. The trustee for the first lien bondholders favors this concept and, in fact, has urged it upon the present management without avail. The operations of the sinking fund would eventually eliminate the bonds, leaving common stock capital only. This is particularly important since the company's principal assets, being natural gas, are so subject to depreciation and exhaustion as not to be the most economic collateral for bonds.

The situation in its entirety is a classic example of an essentially local operating company managed and controlled by financial interests outside of the State, and, who are not only out of touch with the local situation but have no real interest in developing it.

If this company were reorganized along the lines indicated and placed under a management familiar with the needs of the community, it would undoubtedly be a successful enterprise.

The Commission has pointed out in its Findings and Opinion that before any plan of reorganization can be consummated, it will first be necessary for the New York Public Service Commission to rule upon the propriety of certain bookkeeping transactions which occurred during the formative period of this holding company system.

If impetus were given by the Treasury Department and the S. E. C., and the entire problem properly presented to the New York State Public Service Commission, this reorganization could be expedited and a plan presented for the approval of the security holders within a relatively short period, thus concretely demonstrating in practical situations a method by which the federal government can constructively cooperate with one section of industry.

For IMMEDIATE Release Monday, January 24, 1938

SECURITIES AND EXCHANGE COMMISSION
Washington

HOLDING COMPANY ACT
Release No. 981

UNITED STATES OF AMERICA
BEFORE THE SECURITIES AND EXCHANGE COMMISSION

In the Matter of GENESEE VALLEY GAS COMPANY, INC. File No. 52-1 (Public Utility Holding Company Act of 1935)	FINDINGS AND OPINION OF THE COMMISSION Pursuant to Section 11(f)

Genesee Valley Gas Company, Inc. (hereinafter referred to as "Applicant"), has filed an application pursuant to Section 11(f) of the Public Utility Holding Company Act of 1935, 1/ for approval of a plan of reorganization under Section 77B of the Bankruptcy Act, as amended.

Proceedings for the reorganization of Applicant were commenced in the United States District Court for the Southern District of New York on December 16, 1936. A plan of reorganization was filed with this Commission on May 27, 1937, and a public hearing held thereon on June 23, 1937. Thereafter an examination of the records of Applicant was made by the Commission's staff; the hearing on the plan was reconvened and held on October 7, 9 and 11, 1937. Oral argument on the plan was heard by the Commission on December 1, 1937. 2/

FIRST: An appreciation of the issues presented by the application and the Commission's position with respect thereto requires a review of the holding company system of which Applicant is a member.3/ Applicant is an intermediate holding company with two tiers of holding companies above it, Eastern Utilities Service Company and Citizens Public Service Company, respectively,

1/ Section 11(f) of the Holding Company Act provides that, "... a reorganization plan for a registered holding company or any subsidiary company thereof shall not become effective unless such plan shall have been approved by the Commission after opportunity for hearing prior to its submission to the court".

2/ In connection with its oral argument, Applicant filed a brief hereinafter sometimes referred to as "Applicant's brief".

3/ A chart of the holding company system is attached hereto.

the latter being a registered holding company. Applicant likewise has operating companies below it, consisting of Pavilion Natural Gas Company, Valley Gas Corporation, Churchville Oil & Natural Gas Company, Putnam Natural Gas Company, each of which subsidiary operating companies (other than Valley Gas Corporation, all of the common stock of which is held by Pavilion Natural Gas Company) is wholly owned by Applicant. The controlling interest in Citizens Public Service Company is held by Battles & Company; 95% of the common stock of Eastern Utilities Service Company is held by Citizens Public Service Company and 100% of the common stock of Applicant is in turn held by Eastern Utilities Service Company.4/

All of the subsidiary companies, with the exception of Putnam Natural Gas Company, a West Virginia company engaged in the production of natural gas, are gas utility companies, organized in New York and operating in contiguous territory in that State.

Applicant was organized under the laws of the State of New York in 19[illegible] by a group of investment bankers for the purpose of acquiring the common stocks of certain of the Applicant's present gas utility subsidiaries. Acquisition of the common stock of such companies was financed through a public sale of bonds and debentures of Applicant. However, Applicant received neither monies nor properties for its common and preferred stocks which were distributed to the members of the investment banking group in consideration only of their promotional services.

In 19[illegible] the investment banking group organized Citizens Public Service Company for the purpose of acquiring the common stock of the Applicant. This acquisition was financed by the sale to the public of debentures and preferred stock of the new company. The bulk of the common stock, however, was retained by Battles & Company, a member of the banking group, thereby enabling it to retain control over the system.5/ Applicant's next immediate parent, Eastern Utilities Corporation, was organized in 193[illegible], the purpose of which organization we shall discuss subsequently.

Applicant's capital structure as of December 10, 1938, consisted of the following outstanding securities and obligations:

4/ Cf. Judicial Financial Corporation v. Sonbur Corporation, 45 F. (2d) 90[illegible] (D. C. S. D. N. Y., 1930), where Woolsey, J., had occasion to describe a not dissimilar intercorporate relationship as "incestuous".

5/ Subsequent to the organization of Eastern Utilities Service Company, hereinafter described, Citizens Public Service Company defaulted in the payment of its Delaware corporation tax and its charter became forfeited.

Security or Obligation	Amount	Face Amount and Interest to Date of Filing of Petition for Reorganization
First Lien 6% Bonds due in 1959	$735,000.00 6/	* -
10-Year 7% Debenture Gold Bonds due in 1938	283,500.00 7/	303,047.80
Secured Notes	106,087.80	121,85[illegible].18
7% Cumulative Prior Preferred Stock ($100 Par) (396 Shares) 8/	39,600.00	-
Common Stock (No Par) (841 Shares) 9/	55,111.[illegible]	-

Applicant's major assets consist of common stock and other obligations of its subsidiary companies, the most valuable of its assets being the bonds and stock of Pavilion Natural Gas Company, from which it derives practically all of its income. All of Applicant's assets are in pledge as collateral for its own obligations.

While the immediate cause for Applicant's resort to reorganization under the Bankruptcy Act, as amended, was its inability to redeem or refinance its 7% Debenture Gold Bonds (hereinafter referred to as "debentures") which had matured on September 1, 1938, its financial difficulties were presaged as early as March, 1931, when Applicant found itself unable to meet interest payment on its bonds and debentures.10/ In order to avoid default on its bonds, applicant obtained the consent of the debenture holders to postpone interest payments on such debentures until March 1, 1933, thereby enabling Applicant to borrow sufficient funds with which to meet its bond interest within the period of grace permitted under the bond indenture. However, early in 1933 Applicant found that it would be unable to resume the postponed debenture interest payments. Accordingly, a management committee proposed a plan of readjustment for the debentures and obtained the necessary deposits thereto. For the present purposes, a detailed discussion of the

6/ Held by the public.

7/ Held as follows: $215,000 - Eastern Utilities Service Co.
57,500 - Officers and Banking Group (approx.)
11,000 - Public (approx.)

8/ Held by Eastern Utilities Service Company.

9/ Held by Eastern Utilities Service Company.

10/ In addition, at this time, a substantial amount of short-term loans, incurred primarily in connection with additional properties acquired in West Virginia, became overdue as to principal and were in arrears as to interest.

terms of such plan is unnecessary, it being sufficient to state in passing that, under that plan, a new company, Eastern Utilities Service Company, was interposed between Applicant and its top holding company, Citizens Public Service Company. Depositors under the plan received securities of the new company in exchange for the junior securities of Applicant, each debenture holder depositing two debentures for one collateral trust bond of such new company. Applicant thereby, in effect, reduced its debenture requirements by approximately fifty percent. The fact that prior to the consummation of the readjustment plan Applicant purchased $181,000 of its debentures out of $410,000 of such debentures then outstanding, undoubtedly contributed to the success of that plan.

SECOND: The plan of reorganization before us provides for the issuance and exchange of common stock for all of the outstanding securities and obligations of Applicant. But the plan expressly provides that Applicant's First Lien Bonds in the principal amount of $893,000 shall remain undisturbed.

For purposes of the plan, debenture holders and general creditors are placed in the same class. To the debenture holders there is allocated a total of 24,007.5 shares of common stock, or approximately 85 shares for each $1,000 debenture with interest. 11/ To the other general creditors representing claims in the amount of $5,385 there is allocated a total of 298 shares of new common stock, or approximately 56 shares for each $1,000 of claim with interest. Applicant explains the foregoing differentiation by reason of accumulated interest due on the debentures from March 1, 1931, the date of the last coupon paid, to December 15, 1938, the date of the filing of the petition for reorganization.

Under the provisions of the plan the secured notes are placed in separate classes because of differences in security. The note in the amount of $2,237.80, on which, with interest, $2,800 (approximately) was due on the date of the filing of the petition for reorganization, is secured by $20,000 of Eastern bonds, representing, in effect, $40,000 of Applicant's debentures, and by 950 shares of Eastern preferred stock. This note is held by Eugene L. White, President of Applicant. The so-called secured notes in the amount of $104,850, on which, with interest, $131,000 (approximately) was due on the date of the filing of the petition for reorganization, are secured by $100,000 of the notes of and 800 shares of common stock of Putnam Natural Gas Company. These notes are held by Eugene L. White ($73,550) and Battles & Co. ($31,300).

11/ The plan and the testimony (Tr. pp. 38-40) state that the basis of exchange for the debentures is 58 shares of new common stock for each $1,000 of principal and interest, or a total of 85 shares for each debenture with unpaid coupons appurtenant thereto. As will be seen from the subsequent discussion, the allocation is actually on the basis of approximately 85 shares for each debenture with unpaid coupons.

To the $2,800 secured note, there is allocated 1,800 shares of common stock, an arbitrary figure representing the amount of common stock which the holder of the note consented to accept, and to the $131,000 of "secured notes" there is allocated 10,460 shares of common stock, or an allocation on the basis of 100 shares for each $1,000 of claim. The old common and preferred stock is given a total of 738 shares of new common.

Upon consummation of the plan, on the basis of exchange proposed therein, 48.6% of the voting control will be in the hands of the public and 51.4% in the hands of the present management, i.e., directors, officers, and companies controlled by them.

THIRD: Several aspects of the plan are susceptible to criticism and when taken collectively would prevent our sanctioning the plan. We need, however, advert only to the following difficulties which arise in considering the plan on its merits as persuasive factors in moving us to express disapproval.

(1) *The propriety of a transfer from depreciation reserve to earned surplus account.* Preliminary to a discussion of this aspect of the application, it is essential to note that the focal point of the plan is the earning power of Pavilion Natural Gas Company. It is conceded by the Applicant, and it is borne out by the testimony, that Applicant's income is derived almost exclusively from this single operating company. 12/ Moreover, in passing it may be noted that it is this operating company, with an annual gross income of some $57,000 for the year ended December 31, 1938, which in the past has attempted to support a superstructure of three layers of holding companies (and the plan before us contemplates no immediate change in this respect) having outstanding securities aggregating approximately $2,200,000 with annual dividend and interest requirements of approximately $130,000.

12/ The following tabulation shows the income received by Applicant from its subsidiaries, either in the form of dividends or interest, from the time of its organization to December 31, 1938:

	Receipts	*% of Total*
Pavilion	$498,775	91.9
Churchville	11,003	2.0
Valley	9,336	1.7
Putnam	23,748	4.4
Total	$542,862	100.0

In this connection it is significant to note that during the same period Applicant's disbursements have been in excess of its receipts. The testimony shows that Applicant paid out $558,905 for interest on funded debt, resulting in an excess of disbursements over receipts in the amount of $16,044. If to this amount there be added Applicant's total operating expenses for the same period, in the amount of $47,608, the excess of disbursements over receipts is $63,653. No satisfactory explanation for this discrepancy was made by Applicant.

The transfer from the depreciation reserve was effected as follows:

In December, 1927, the management of Pavilion calculated the difference between the amount in the depreciation reserve at the end of 1926 and the amount which would have accrued at the rate of 12-1/2% of gross revenue from January 1, 1907, to December 31, 1926. This difference, amounting to $196,100, was transferred from the retirement reserve account to the corporate or earned surplus account. This transfer had two effects: (a) it reduced the retirement reserve of Pavilion from $497,085 to $300,985, and (b) with other adjustments, it changed the corporate surplus of Pavilion from a deficit of $112,000 to a credit balance (surplus) of $101,000. The testimony before us shows that such transfer was made without the consent of either the stockholders or directors of Pavilion or of Applicant. Nor is there any evidence of a property survey having been undertaken which would lend support to the propriety of such a transfer. Moreover, this transfer was made in violation of the Uniform System of Accounts for Gas Corporations prescribed by the Public Service Commission of the State of New York in effect at the time. 13/ Account 251 of which required that "no portion of the amount reserved for retirement shall be diverted to surplus, or other use made thereof, except as above provided, without the approval of the Commission." 14/ Approval for such transfer was not obtained from the New York State Public Service Commission. 15/

Not only was this transfer improper in the absence of prior approval by the Public Service Commission, but had the amount of $196,100 not been transferred to the surplus account in 1927, all dividends subsequently declared by Pavilion would have been paid at a time when the earned surplus account in reality showed a deficit. In addition, the provisions of Applicant's First Lien Indenture prohibit the payment of dividends by its subsidiaries except from surplus earned since September, 1925.

The New York Public Service Commission has recently initiated an investigation of the books and records of Pavilion Natural Gas Company to

13/ See Uniform System of Accounts for Gas Corporations (1923), Public Service Commission, New York, p. 24.

14/ This provision is carried over in the current regulations. See Uniform System of Accounts Prescribed for Gas Corporations, Class A and B, Public Service Commission, State of New York (1937), Account 250 at p. 25.

15/ The testimony discloses that as of February 25, 1929, Pavilion Natural Gas Company was advised by the Secretary of the New York State Public Service Commission that the adjustments described above were made in violation of the Order of the Commission establishing an accounting classification and requiring that permission shall be received from the Commission before any amounts may be transferred from the retirement reserve for purposes not embraced by the text of that account.

determine, among other things, the propriety of the aforementioned transfer. Plainly, the result of the State Commission's determination in respect to the propriety of such transfer will have a direct bearing upon the ultimate feasibility of Applicant's plan. For if the Public Service Commission should order a reversal of the transfer and impose a restriction upon the declaration of dividends until the earned surplus deficit 16/ is eliminated, or if the Public Service Commission should order future earnings of Pavilion to be allocated to a retirement reserve until such time as the amount transferred therefrom has been restored, the source of Applicant's future income will be cut off. In this connection, it is to be borne in mind that the fixed charges on Applicant's First Lien Bonds remain undisturbed under the terms of the plan. Accordingly, in either contingency above noted such an order by the State body would have the effect of preventing for some time the receipt by Applicant of future dividends with the result that the interest requirements of Applicant's First Lien Bonds could not be met. This would precipitate a default under the First Lien Indenture and Applicant would once again be "sitting under the Chancellor's umbrella and watching the weather outside". 17/ Therefore, so long as this contingency exists the present plan merely embodies the protective coloration of "reorganization" in reality, the plan is an incubator for future reorganization.

It would appear, therefore, that Applicant has placed itself in a position where, even assuming, *arguendo*, that we could give approval to the plan, the absence of a prior determination by the state body on the validity of the transfer made by Pavilion would leave our approval without administrative finality, since it would be subject to an antithetical order by a state body. The problem may be stated in other terms: The core of the plan lies in the ability of Pavilion to make its income available to Applicant. Whether or not this can be accomplished remains suspended in doubt until such time as the State body determines the propriety of the aforementioned transfer. Since administrative action—no less than the judicial process—requires finality at some stage in the proceedings, we should not be asked to indicate our approval of a plan which is not before us in such a way that our ruling thereon can be made effective.

(2) *Propriety of a distribution of new stock representing an equity over and above Applicant's First Lien Bonds.* (a) The face amount represented by Applicant's outstanding debentures is $653,500. To this figure, however, there must be added the sum of $109,147.50, representing interest accrued to the date of the filing of the petition for reorganization, or a total of $762,647.50. As against this amount of debentures, it is proposed to allocate a total of 24,097.8 shares of new common stock. This would require an

16/ A reversal of the unauthorized transfer would leave Pavilion as of December 31, 1938, with an earned surplus deficit of $147,160.

17/ Cf. Hough, J., dissenting in *Manhattan Rubber Mfg. Co. v. Lucey Mfg. Co.*, 5 F. (2d) 39 (C.C.A. 2d, 1925).

allocation of approximately 61 shares for each $1,000 of claim. On this basis, since the plan contemplates the issuance of 37,225 shares, including the allocation to the old stockholders, the outstanding shares would aggregate approximately $600,068. If to this figure there be added the amount represented by the undisturbed First Lien Bonds, in the principal amount of $735,000, Applicant's capitalization would total $1,335,068. (b) An analysis of the total fixed capital, retirement reserve and net property value of Applicant's subsidiaries as now shown on their own books 18/ not support a capitalization in the amount above mentioned. For after giving effect to a reversal of the transfer by Pavilion from the retirement reserve, which has been discussed above, and after a further deduction of such retirement reserve as adjusted, the properties of Applicant's subsidiaries, exclusive of Putnam, would have a net book value of approximately $881,060. Putnam Natural Gas Company no longer represents an income-producing unit to Applicant's system. If effect be given to its admitted salvage value, the aggregate book valuation of Applicant's subsidiaries after adjustment in respect of Pavilion's transfer to earned surplus, would be but $891,060. 19/ This figure, moreover, may be subject to a further reduction as there is at present included in the fixed capital accounts a substantial amount of abandoned property 20/ which, if written off, might well leave the remaining retirement reserve inadequate for the future retirement of substantial but undetermined amounts of property. 21/ (c) If we turn to the earning capacity of Applicant's properties as a criterion of the worth

---

18/ The testimony does not disclose any estimations of value other than book value and earnings. Under these circumstances, we have confined our discussion to these bases of valuation.

19/ The manner in which this figure is arrived at may be seen from the following tabulation:

	Fixed Capital	Retirement Reserve	Net Property
Pavilion	$1,421,087	$621,555*	$ 799,532
Valley	72,529	30,286	42,243
Churchville	82,169	14,884	67,285
	$1,575,785	$666,725	$909,060
Less: First Mortgage of Valley			28,000
			$ 881,060
Add: Salvage value of Putnam as conceded by Applicant			10,000
			$ 891,060

* Adjusted Reserve

20/ Approximately $200,000 of abandoned gas wells and leases.

21/ Equipment in the plant shut down March 1937 and other gas wells and leases now being carried in the fixed capital accounts and which should be classified as not used and useful.

of its assets 22/ —and for purposes of reorganization as distinguished from "value for rate-making purposes" 23/ earning power becomes in the final analysis a paramount criterion—it is plain that on an earnings basis the properties have a value far below the total capitalization, in the above mentioned figure of $1,335,068. Applicant anticipates (by way of both interest and dividends) the receipt of all of Pavilion's gross income which it estimates to be approximately $63,000 annually. But as against this forecast of future earnings there must be balanced the following factors incident to the operation of Pavilion: (1) inadequacy of annual accruals to the depreciation reserve 24/ and annual maintenance requirements; (2) the possibility of rate reductions being imposed to conform with allowable rate of return on fair value; (3) the likelihood of a dividend restriction as more fully discussed above. Hence, if these factors are weighed against the aforementioned forecast of Pavilion earnings, it is not unreasonable to conclude that Applicant's income may be insufficient even for Applicant's fixed charge requirements.

(2) *Allocation of common stock between the secured notes works a discrimination as between creditors.* As was stated in the preceding section, the debenture holders will in fact receive 61 shares of new stock per $1,000 of claim. This allocation is to be contrasted with the treatment accorded to the secured notes. One class of secured notes in the face amount of $104,850 has accrued interest owing thereon in the amount of $16,447.50, a total of approximately $121,000. Under the provisions of the plan, it is proposed to allocate to these notes 10,465 shares of new stock.

22/ Cf. *In re Consolidation Coal Co.*, 11 F. Supp. 594, 597 (D. Md., 1935).

23/ Valuation for rate-making purposes is not the same. There the question is how much the utility will be allowed to earn—if it can. Here the question is how much can it earn—even if allowed. See, for example, *Tanner v. Denver Tramway Co.*, 16 F. (2d) 220 (C.C.A. 8th, 1927); *N.Y. Trust Co. v. Continental & Commercial Trust & Savings Bank*, 26 F. (2d) 872 (C.C.A. 8th, 1928), *cert. den.*, 278 U.S. 644 (1928); *National Waterworks Co. v. Kansas City*, 62 Fed. 853 (C.C.A. 8th, 1894) (opinion by Justice Brewer); *Atlanta, Birmingham & Coast Railroad Co. v. United States*, 296 U.S. 33, 39 (1935).

Cf. The statement of Mr. Justice Brandeis in *Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276, 310 (1923): "value is a word of many meanings"; "A word is not a crystal, transparent and unchanged; it is the skin of a living thought, and may vary greatly in color and content according to the circumstances and the time in which it is used"—Mr. Justice Holmes in *Towne v. Eisner*, 245 U.S. 418, 425 (1918). See, also, for a similar expression of opinion, *Paul, Studies in Federal Taxation*, (1937) esp. pp. 159-234; II *Bonbright, The Valuation of Property* (1937) c. XXXII.

24/ Thus, for example, as of December 31, 1936, the fixed capital account of Pavilion amounted to approximately $1,420,000, while the depreciation accrual for the same year was only $10,665, or approximately .77% of such fixed capital.

Applicant states 25/ that the security underlying these notes has a value of only $8,000 (approximately) leaving an unsecured balance due of $113,000 (approximately). In short, as to the deficiency claim, Applicant recognizes that the notes stand in no better position than the debentures. If these notes, in so far as they represent unsecured claims, were to be accorded the same treatment as the debentures, the holders of such notes would be entitled to receive 6,893 shares of new common stock. For the actually secured portion of the notes ($8,000) there is thus, in fact, being allotted 3,572 shares or an allocation, as to the secured portion of the notes, on the basis of approximately 446 shares per $1,000 of secured claim. It should require no extended discussion to demonstrate that retention of this $8,000 amount of collateral in the reorganization at the cost of 3,572 shares is open to question since the amount of shares being allocated in respect of such collateral is disproportionate to the income potentialities represented by it. In the case of the secured note in the amount of $2,307.50, which with unpaid interest totals approximately $2,600, it is stated 26/ that the underlying collateral is such that the note is fully secured. The plan calls for an allotment to this note of 1,600 shares or an allocation on the basis of approximately 616 shares per $1,000 of claim. 27/

Plainly, such a glaring differentiation of treatment as between the so-called secured note now aggregating $121,000 face amount, including accrued interest, and the debentures is arbitrary in the extreme. Since this redemption of the $8,000 collateral with its resulting differentiation in the allocation of new stock as between the secured note and the debentures has not been adequately explained by the Applicant, we cannot justify it.

While conceivably there might, perhaps, be some justification (although none was advanced) for such a differentiation if nothing were allocated to the old stock, there can be no justification for such differentiation in view of the fact that, without any assessment, the old stock is to participate in the reorganized company. To put it differently, the differentiation merely serves to underscore the impropriety of allotting any new shares to the old stock. This appears more fully from the following:

25/ Tr. p. 30; Brief on Behalf of the Applicant, p. 31.

26/ Tr. p. 46; Brief on Behalf of the Applicant, p. 32.

27/ The Applicant attempts to justify such allocation by pointing to the value of the pledged collateral. That is to say, the collateral underlying this note is, in effect, 40 debentures of Applicant. Applicant, therefore, assumed that the allocation of new common stock should be predicated on the 40 debentures, and should receive 3,500 shares of new common stock. The theory, apparently, was that the holder of the note could realize to the full extent of the pledged collateral. Obviously, the holder of the note could realize on the pledged collateral only to the extent of the face amount of the note with interest.

Taking the treatment accorded to the secured note in the face amount of $104,850 (with an amount of $121,000 actually due thereon) as a yardstick, and since, as above noted, 100 shares are being issued for each $1,000 of claim, on this basis it must be assumed that, in order to pay the debentures (with an amount owing thereon of $392,500) in full, it would be necessary to issue to the debentures 39,430 shares.

Employing the same reasoning, but estimating the value of the new shares on the basis of the allotment to the $8,000 secured portion of the other secured notes above referred to (which is treated on the basis of 446-1/2 shares per $1,000 of claim) it would be necessary to issue to the debentures, in order to pay them in full, 175,338 shares.

Since in fact the plan calls for the issuance to the debentures of 24,307.5 shares, it is impossible to justify the issuance of new shares to the old stock. 28/

(4) *Effect of allocating new stock to old stockholders on the fairness of the plan.* The plan calls for the allotment of 780 shares of new common stock to Applicant's parent, Eastern Utilities Service Company. While the amount of new stock which is allocated to the holder of Applicant's old stock is comparatively small in amount, the effect of this allocation is of significance in our determination of the question of the fairness of the instant plan and, therefore, merits some discussion. We said *In the Matter of the Application of International Paper and Power Company*, 2 S.E.C. ____, (1937) (Holding Company Act Release No. 770) that "Under Section 7 [of the Act] the question of fairness of the plan would be before this Commission. That involves the question of the equity of the allocation of earnings, assets and control among the various classes of securities as provided by the plan." 29/ Similarly, the question of the fairness of the plan would be before us under the provisions of Section 11 of the Act. Turning first to the relevant provisions of Section 11(b)(2), this Commission is authorized, after notice and hearing, affirmatively to require that registered holding companies and their subsidiaries shall take such steps as the Commission shall find necessary "to ensure that the corporate structure or continued existence of any company in the holding company system does not . . . unfairly or inequitably distribute voting power among security holders, of such holding company system"; likewise, in connection with plans of reorganization submitted to the Commission pursuant to Section 11(e), this Commission, as a basis for its approval thereof, must find not only that such plan is necessary to effectuate the provisions of Section 11(b), but that the plan is ". . . fair and equitable to the persons affected by such plan, * * *." Applicant has urged, in justification for an allotment of new shares to the old stock, under the peculiar facts of this case, two reasons which may be stated as follows: (a) It was less expensive to assign some value to the old stock than to undertake an appraisal in order

28/ The conclusion as to impropriety is also borne out by the treatment accorded to the $5,000 of notes and accounts payable.

29/ See, also, Rule 11F-1(a), Holding Company Act Release No. 855.

(a) [illegible] whether or not Applicant was in fact insolvent. 30/ Applicant has since stated its position: "Assuming that the Applicant is insolvent, which appears to be the fact, the allotment of stock to Applicant's present stockholders is in the nature of a gratuity." 31/ (b) by allotting new common stock to its present stockholders, i.e., Eastern, the latter would be provided with a potential source of cash so as to be in a position to effectuate its own [illegible] liquidation. With respect to the first of Applicant's reasons for including the old stock in the reorganization, the short answer is that an appraisal by outside experts would scarcely appear to have been required on the facts of this case. As we have previously demonstrated, Applicant's earning power would not warrant participation in the reorganization by the old stockholders. 32/ With respect to the second of Applicant's reasons, the inclusion of the old stockholders in the reorganization, under the facts of this case, runs counter to the statutory standards of Section 7 and Section 11. For the practical effect of granting a participation in the reorganization to the old stockholders would not only work an unjustified dilution of future earnings [illegible] of the present stockholders, but would materially aid in perpetuating the control of Applicant which now obtains. Moreover, in determining the question of the fairness of an allocation of stock to all stockholders, we must look to the established precedents of the courts (whether in Equity or under Section 77B of the Bankruptcy Act) in their construction of the concepts of a "fair" plan. Under these precedents our decision is clear: the old stockholders should not have been permitted to participate in the reorganization. For, as was said by the Court of Appeals for the Second Circuit in the case of *In re Barclay Park Corporation*: 33/

> "We see no justification for cancelling large amounts of interest on the claims of either the secured or the general creditors and giving common stock to persons who had no interest left in the enterprise. It was to prefer the stockholders at the expense of the creditors * * *. To justify a retention of a stock interest by the present shareholders it should appear that they have furnished an additional consideration or have an equity in the estate of the debtor after the rights of the creditors are fully provided for in some way." 34/

30/ Tr. p. 51; Applicant's Brief, p. 33.

31/ Applicant's Brief p. 33.

32/ *Cf. In re Consolidation Coal Co.*, *supra*, where Coleman, J., in approving the creditors' reorganization plan severely cutting down the par value of outstanding securities and giving stockholders no participation other than stock-subscription rights, defended its refusal to "waste money" in securing an appraisal. This procedure he stated, was unnecessary, since "the real worth of assets of any such industrial corporation depends, in the final analysis, upon its earning capacity." (p. 597)

33/ 90 F. (2d) 595 (C.C.A. 2d, 1937).

34/ See, also, *Railroad Company v. Howard*, 7 Wall. 392 (U.S. 1868); *Louisville Trust Co. v. Louisville & C. Ry.*, 174 U.S. 674, 684 (1899); *Northern Pac. Ry. Co. v. Boyd*, 228 U.S. 482, 502 (1913); *In re 620 Church Street Corp.*, 299 U.S. 24 (1936); *In re New York Railways Corp.*, 82 F. (2d) 739, 741 (C.C.A. 2d, 1936), cert. den. 298 U.S. 687 (1936); *In re Hotel Governor Clinton, Inc.*, 15 F. Supp. 819 (D. S.D.N.Y., 1936).

20A

Admittedly, Applicant's stockholders have not furnished any consideration by way of an assessment or otherwise for the sacrifice on the part of Applicant's creditors of their prior rights; nor is it clear that there is any equity for them in Applicant's enterprise. True, the amount of an allocation of new stock to old stockholders whose equity in the enterprise is no longer apparent may be so small, in view of doubts as to the potential or "nuisance" values of the old stock, as not to vitiate a plan of reorganization otherwise unobjectionable. But such is not true of the instant case. In view of the narrow margin of voting control as between the public and the management interests in the Applicant and the excessive allocation of new stock to the secured note, as discussed above, the treatment accorded to the old stock is one of the factors which prevents us from finding that the instant plan is fair.

FOURTH: Although it is not essential to the conclusions which we have reached in this case, it, nevertheless, appears desirable that we should point out a distinct limitation in the scope of the present plan, namely, the absence of any provisions for eliminating Applicant's existing holding company system. Admittedly, the effort toward simplification of Applicant's capital structure is a step in the right direction. Nevertheless, the crucial factors underlying the system (and which have made necessary the present reorganization) urge something more than a mere palliative; removal of three uneconomic structures from the back of an income-producing unit might well be considered as the first requirement of any effective therapeutic.

Again, while not essential to our opinion in this case, it may not be amiss to observe that a thorough-going plan of reorganization, one more nearly consonant with the declared objectives of the Act, would have contained provisions (in addition to the elimination of the present holding company structure) for the merger of Applicant's New York State operating subsidiaries into a single operating unit. In this manner would concrete expression have been given to the operating realities which in fact now prevail.

The disproportionate relationship which now exists between funded debt, on the one hand, and earning capacity and the value of underlying assets, on the other hand, should have received consideration from the reorganizers.

By including in such a plan a provision for the distribution to Applicant's First Lien Bondholders of their pledged collateral, 35/ namely, the First Mortgage Bonds of Pavilion, constituting 85% of the face value of their security, and allocating par value common stock for the balance of their holdings, the bondholders would possess an obligation reasonably adapted to the security structure and the earning power of Applicant. 36/ Segregation of a portion of net income to a sinking fund for such bonds would, through the

---

35/ The holders of collateral mortgage bonds of a holding company occupy, at best, the position of pledgees of the securities of the subsidiaries. Only in an indirect sense do they have a "mortgage" lien.

36/ The testimony discloses that Applicant's First Lien Bonds have not been adequately secured from the standpoint of earnings or property.

operations of the sinking fund, ensure an increasingly greater equity for the common stock. And upon retirement of the bonds, the resultant capital structure would consist only of common stock -- a result much to be desired in view of the exigencies peculiarly incident to Applicant's business.

For the reasons discussed and on the basis of the findings made above, Applicant's plan of reorganization is not approved.

An appropriate order will issue.

CITIZENS PUBLIC SERVICE COMPANY

CAPITALIZATION CHART

December 31, 1936

CITIZENS PUBLIC SERVICE COMPANY		
Issue	Outstanding	Held Within System
Bonds	$ 340,000	-
Notes	21,400	-
1st Cum. Pref. Stk.	Shs. 4,400	-
Non-Cum. Pref. Stk.	Shs. 3,542	-
Common Stk.	Shs. 27,444	-

[illegible]%

EASTERN UTILITIES SERVICE COMPANY		
Issue	Outstanding	Held Within System
6% Collateral Bonds	$ 107,500	$ 35,000(a)
Notes	104,850	104,850(b)
1st Preferred Stk.	Shs. 1,505	Shs. 378(c)
Class A Preferred Stk.	Shs. 446	-
Common Stk.	Shs. 335½	Shs. 335½(d)

(a) Held by Genesee Valley Gas Company, Inc. and $20,000 pledged under $2,337.50 note held by E. L. White.
(b) $73,550 held by E. L. White, Pres. $31,300 held by Battles & Company.
(c) 378 Shs. held by Genesee Valley Gas Company, Inc.
(d) 300 Shs. held by Citizens Public Service Company. 35½ Shs. held by E. L. White.

100%

GENESEE VALLEY GAS COMPANY, INC.		
Issue	Outstanding	Held Within System
1st Lien 6% Bonds, 1956	$ 732,000	
15 Year 7% Deb. Gold Bonds, 1936	782,500	$277,500(a)
Notes	106,988	106,988(b)
7% Cum. Prior Pref. Stk. ($100 Par)	Shs. 336	336(c)
Common Stock	Shs. 341	341(c)

Net Current Assets $26,234 Deficit

(a) $215,000 pledged under Eastern Utilities Service Company collateral bonds. $67,500 held by officers and [illegible].
(b) $2,338 held by E. L. White, President. $104,650 held by Eastern Utilities Service Company, securing its notes in amount of $104,850.
(c) Held by Eastern Utilities Service Company.

100%

THE PAVILION NATURAL GAS COMPANY		
Issue	Outstanding	Held Within System
1st Mtg. Bonds 6%	$ 440,000	$440,000(a)
Common Stock	Shs. 25,000	Shs. 25,000(a)

Net Current Assets $9,297

(a) Held by Genesee Valley Gas Company, Inc., and pledged under its 1st Lien 6% Bonds.

100%

CONNECTICUT OIL & NATURAL GAS COMPANY		
Issue	Outstanding	Held Within System
Common Stock $100 Par	Shs. 500	Shs. 500(a)

Net Current Assets $[illegible]

(a) Held by Genesee Valley Gas Company, Inc., and pledged under its 1st Lien 6% Bonds.

100%

VALLEY GAS CORPORATION		
Issue	Outstanding	Held Within System
1st Mtg. Bonds	$ 30,000	-
Common Stock	Shs. 50	Shs. 50(a)

Net Current Assets $500 Deficit

(a) Held by The Pavilion Natural Gas Company.

100%

PUTNAM NATURAL GAS COMPANY		
Issue	Outstanding	Held Within System
Notes	$ 150,640	$150,640(a)
Common Stock	Shs. 250	Shs. 250(a)

Net Current Assets $110

(a) Held by Genesee Valley Gas Company, Inc., and $136,000 of notes and all the common stock are pledged to secure notes in amount of $[illegible].

UNITED STATES OF AMERICA
BEFORE THE SECURITIES AND EXCHANGE COMMISSION

At a regular session of the Securities and Exchange Commission, held at its office in the City of Washington, D. C., on the 24th day of January, A. D., 1938.

In the Matter of GENESEE VALLEY GAS COMPANY, INC. File No. 52-1 (Public Utility Holding Company Act of 1935)	O R D E R

Genesee Valley Gas Company, Inc. having filed an application pursuant to Section 11(f) of the Public Utility Holding Company Act of 1935, for approval of a plan of reorganization under Section 77B of the Bankruptcy Act, as amended;

A hearing on such application having been held after appropriate notice; oral argument on the plan having been heard and the record in this matter having been duly considered by the Commission; and the Commission having filed its opinion and findings herein;

IT IS ORDERED that such plan of reorganization be and the same hereby is disapproved.

By the Commission.

(SEAL)

Francis P. Brassor,
Secretary.

---oOo---

St Louis Star Times
Jan 22, 1937.

MORGENTHAU AND KENNEDY TO SWAP JOBS

New Envoy to London Scheduled to Return for Treasury Post Before March 1, [illegible].

PLAN EVOLVED BY F. D. R.

Desires 'Ace Trouble-Shooter' For Service on Firing Line in 1940 Campaign.

FROM THE STAR-TIMES WASHINGTON BUREAU.
BY SAM O'NEAL.

WASHINGTON, Jan. 21.—Joseph Patrick Kennedy, newly confirmed American ambassador to the Court of St. James's, is headed for a post in the Roosevelt cabinet.

Some time in March of next year, it was revealed by an authoritative source today, the freckle-faced former chairman of the securities and exchange and maritime commissions, will swap jobs with Secretary of the Treasury Henry Morgenthau.

This plan, evolved by President Roosevelt himself, not only has the entire approval of both men but was agreed upon long before the announcement of Kennedy's appointment to the London post then held by the late Robert W. Bingham. Kennedy's appointment was, in fact, merely the first step in a carefully prepared plan.

Strategy Outlined.

Strategy behind the move was described in detail to the Star-Times today by [illegible] as follows:

1. Kennedy [illegible] trouble-shooter [illegible]

2. At the [illegible]

[illegible] can be used to best advantage.

[illegible]

[illegible] the Court of St. James's.

He displayed more interest, in fact, in the London assignment than in a cabinet post, but readily acquiesced to the president's proposal when assured of Morgenthau's complete approval. It then was decided Kennedy would serve in London throughout the pending Anglo-American trade conferences, though not later than March of next year.

This date was set by the President himself as the "psychological moment" for a cabinet change. He pointed out that a shift at this time would give both Kennedy and Morgenthau sufficient opportunity to acquaint themselves with the new duties before the opening gun of the 1940 presidential campaign.

Emphasizes Aid in Campaign.

The President was described as particularly insistent that Kennedy be in the front-line trenches, ready to take an active part in the fight when the time came to select a presidential candidate.

Moreover, the President pointed out that Kennedy's appearance in a high administration post prior to the opening of the 1940 campaign would do much to establish amicable relations between the New Deal and big business and ease the course of Mr. Roosevelt's choice for his White House successor.

Morgenthau, on his part, was entirely agreeable to being relieved of the necessity of "fronting" for the [illegible] of New Deal monetary policies. [illegible] administrator, he nevertheless has [illegible] approved of some [illegible] for which the [illegible]

Although aware of Morgenthau's [illegible], the President's Dutch heritage has refused to permit him to jettison a friend and adviser who has been staunchly loyal and trustworthy. The planned Morgenthau-Kennedy swap, therefore, has provided the President with a perfect [illegible]

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE Feb. 1, 1938

TO Secretary Morgenthau

FROM Mr. Opper

Chester Lane of the SEC called me again this afternoon about the matter discussed with you last Saturday. He says that the Commission has now taken the position that the Paganucci stock can not be distributed without registration; and furthermore that the same conclusion applies to any other stock held by the bank or the Transamerica group as collateral where the loans are under water and where an organized effort to distribute over the counter is in contemplation.

Neblitt came in alone this afternoon and was advised of this conclusion. He is coming in again tomorrow morning to complete the discussion but Lane thinks that nothing further will develop at that time.

The question of a general investigation of Transamerica to see how many "Paganuccis" there are is still open, but Lane thinks that the question will be decided by the Commission within a few days. He will continue to keep us advised.

CVO

February 2, 1938

MEMORANDUM FOR COL. McINTYRE:

In reply to your memorandum of February 1 plus the inclosed memorandum from the President, I showed these memoranda to the President at lunch today and he requested me to inform you that he sees no reason for my communicating with Mr. Giannini at this time as Mr. Giannini and his attorney, Mr. Neblett have been in touch, during the last few days, with the Federal agencies that have to do with the regulation of the various businesses that he is associated with.

Confidential

THE WHITE HOUSE
WASHINGTON

MEMORANDUM FOR THE PRESIDENT:

A. P. Giannini had a conference with Leo Crowley. It was a general discussion about the bank holding company situation.

During this discussion, certain suggestions were made about regulatory legislation that would serve the purpose desired and would eliminate the necessity for the so-called "death penalty" legislation.

A. P. asks me to suggest to you the possibility of sometime within the next thirty days having a small group, including himself, representing the banking interests involved, discuss with you the possibility of such a solution. A. P. obviously feels that the legislation as generally accepted by press reports, etc., would be very destructive to property values.

I think that Mr. Giannini realizes the necessity for some action such as is contemplated, but feels that the results we desire can be obtained by less drastic measures.

M. H. M.

THE WHITE HOUSE
WASHINGTON

February 1, 1938

CONFIDENTIAL MEMORANDUM FOR

SECRETARY MORGENTHAU

The attached is self-explanatory.

The President suggested that I take it up with you. I think probably the best thing to do would be to have you communicate with Mr. Giannini who is now in Florida, and tell him the President referred the request to you and that you will be very glad to arrange to meet with these gentlemen and discuss the matter he mentions. How about?

M H M

M. H. McINTYRE
Secretary to the President

Enclosure

February 2, 1938.
2:48 p.m.

H.M.Jr: Hello.

Operator: Mr. Bell. Go ahead.

D. Bell: Hello.

H.M.Jr: Dan?

B: Yes.

H.M.Jr: Morgenthau talking.

B: Yes.

H.M.Jr: When I got over there the President asked me to come in and hear what Aubrey Williams had to say. Aubrey Williams telling the President people were starving in Toledo and he didn't have money enough. Well, I got good and mad. I said, "He's just left Bell and me and left a statement, which we accepted, and in which you said you had enough money to do what you wanted." And I said, "Why tell the President that people are starving - if there's any starving," I said, "I'm anxious to know it, I want to know where they are starving." "You just left us and here's this letter." I handed it to the President and he was amazed.

B: Is that right?

H.M.Jr: Yes he was. So the President said, "Well, there's an emergency in Detroit and Cleveland - Detroit and Toledo." I said, "Well, Williams didn't tell us anything about it." And I think I told him that Williams wanted to lay off a hundred thousand men and we told him to wait until we had a chance to see you.

B: I don't know.

H.M.Jr: So I told the President, after Williams left, I said, "Dan and I can get along with Hopkins, can get along with Harrington." I said, "We can't get along with Williams or with Corrington Gill.

B: That's right.

H.M.Jr: And then the other thing which interests you. That thing that was in that paper -

B: Yes.

H.M.Jr: Joe Murphy pointed out to me the letter that was mailed to Mrs. Morgenthau three days ago. Had practically the same language.

B: Is that right?

H.M.Jr: Yes. He thinks that that letter was written in - in the - over here.

B: Yes.

H.M.Jr: Mailed in New York.

B: Well, some of these days, we're going to find something like that.

H.M.Jr: Well, Joe's on it now.

B: Well I hope he finds something.

H.M.Jr: He's on it now.

B: That - I've always had my suspicions.

H.M.Jr: Yes. Well, what do you know about that?

B: Well, I think that would be very interesting.

H.M.Jr: Yes. That's just between us.

B: Yes. I understand.

H.M.Jr: But I wanted to get you that.

B: All right.

H.M.Jr: And I got very angry.

B: Well, I don't blame you.

H.M.Jr: And -

B: Been told one thing, and now something different.

H.M.Jr: He didn't tell the President anything about this letter any more than he told us that he was going over to see the President.

B: Yes.

H.M.Jr:	You can't do those kind of things in this town and get away with it.
B:	Well, sooner or later they catch up with you.
H.M.Jr:	Yes. Well I wanted you to have that.
B:	All right. Thanks.
H.M.Jr:	Goodbye.
B:	Goodbye.

February 2, 1938.
2:55 p.m.

H.M.Jr: Hello.

Operator: Mr. Frank.

H.M.Jr: Thank you. Hello.

Jerome Frank: Yes.

H.M.Jr: Henry Morgenthau.

F: Yes, Mr. Secretary.

H.M.Jr: I thought you'd like to know that I reported to the President, at lunch, how far we were getting along with your organization.

F: Yes.

H.M.Jr: And he is simply delighted.

F: Well, that's fine.

H.M.Jr: And he says that when we get this thing tied up, he thinks it's important enough, that it's worthy of a radio speech by himself.

F: Fine.

H.M.Jr: And I thought you'd like to know.

F: All right. Thank you. Did you get that letter from me about expenses of registration?

H.M.Jr: No.

F: I sent it over this morning.

H.M.Jr: No.

F: I sent you a - it's - I've sent you a copy of a letter from Chairman Douglas to a Congressman, in answer of that inquiry, going into it in some detail.

H.M.Jr: My God, you're not going to treat me like a Congressman.

F: No, but I - but it set forth the facts much better than I could.

H.M.Jr: Oh!

F: That I put it - sent you a copy of it.

H.M.Jr: All right.

F: Wouldn't think of doing that.

H.M.Jr: But I thought you'd like to know.

F: Yes. Thank you very much.

H.M.Jr: The President is just itching to get the thing done and get his hands on it.

F: Fine.

H.M.Jr: See?

F: Thank you.

[illegible], 1938

<u>Report of Mr. Paul Van Zeeland of Belgium</u>

(Mr. Van Zeeland states he was asked by the Governments of England and France on April 3, 1937, to make "an inquiry into the possibility of obtaining a general reduction of quotas and of other obstacles to international trade". The report is addressed apparently to the world at large.)

1. The Van Zeeland report is a peculiar document in that those recommendations likely to be out of harmony with the present foreign policy of this administration are couched in terms apparently carefully designed to obscure their full significance. It requires very careful reading to distill the essential features of the report from the mass of commonplace and generally acceptable conclusions and recommendations.

2. The acceptable portions of the Van Zeeland report consist of recommendations which resemble very closely the program of the foreign commercial policy of this administration. They include the extension of bilateral trade agreements with most-favored-nation clause, reduction of exceptionally high tariff rates, elimination of administrative abuses tending to obstruct foreign trade, gradual reduction of the quota system on industrial commodities and of exchange controls, and extension of the principles of the Tripartite monetary statements.

3. The remainder of the report -- and the more significant portion -- deals with proposals which if adopted appear to pave the way for participation by the United States directly or indirectly in financial assistance to countries willing to retreat from the autarchic principle. This portion of the report raises serious questions of foreign policy. The heart of the recommendations buried in the report which raises serious questions of policy for this Government include:

(a) The United States to participate in an international agreement which would set up the machinery for financial assistance to countries willing to abolish exchange controls.

(b) The United States to participate in international agreements which may have as one of their chief purposes the reorganization of the mandate system and of exploitation rights of colonial resources. (This latter proposal is not specifically and clearly stated in the report, yet Van Zeeland includes it in a manner which gives the impression that he supports it but doesn't wish to accept the responsibility for suggesting it.)

It probably should be emphasized that the latter part of the report -- i.e., Part III, "General Conditions Necessary for Success" -- must be very carefully scrutinized in order to extract what appear to be its basic objectives.

A summary of the report follows.

3.

Van Zeeland's Report Summarized

Stated objective of the report:

"An inquiry into the possibility of obtaining a general reduction of quotas and of other obstacles to international trade."

I.

1. Obstacles to international trade

(a) Prevalence in tariff schedules of numerous particularly high and effective duties.

(b) Abuse of administrative provisions:- sanitary regulations; complexity of tariff schedules; anti-dumping.

(c) Use of import quotas.

(d) Sudden and violent changes in foreign exchange rates.

(e) Restrictions on the international transfer of funds.

2. Van Zeeland's proposed recommendations to reduce these obstacles to trade.

"Economic" measures

(a) Undertaking by governments not to raise present duties or impose new ones.

(b) Program of gradual reduction of such duties as are of an exceptional character.

(c) Negotiation of bilateral trade agreements based on "most-favored-nation" clause.

(d) Negotiation of bilateral agreements to reduce the number of abuses of administrative practices. When abuses arise to use the machinery of "joint committees" and arbitration award for their settlement.

(e) Gradual suppression of import quotas on industrial goods.

"Financial" measures

(f) Eventual reestablishment of the gold standard, but "it is probably too early to make any such attempt".

(g) Extension of the Tripartite monetary undertaking to include all countries "participating in the effort of collaboration", i.e., Germany and Italy.

Revision of the Tripartite declaration in which each country will define its currency in terms of gold (or some other currency) and pledge themselves to keep fluctuation within stated limits for a specified period, except under exceptional circumstances.

(h) Elimination of restrictions on foreign lending.

(i) Abolition by stages of exchange control and clearing agreements.

3. Before exchange controls and clearing agreements -- which are the result of a state of disequilibrium between the national economy and international markets -- can be removed there must take place

(a) Adjustment of external debts.

(b) Settlement and consolidation of clearing agreements.

(c) Provide extra facilities "with the help, if necessary, of international institutions" for mobilizing the bonds representing the consolidated clearing agreements.

(d) Provide short-term credits during the adjustment period to countries which are eliminating exchange restrictions.

(e) Establishment of "a common fund" by the interested countries to finance trade during the period of adjustment.

II.

4. To provide the conditions under which the foregoing proposed remedies will have a chance of being adopted.

The countries which now have substantial exchange restrictions must be offered advantages great enough to get them to abandon those restrictions.

What inducements are to be offered to those countries?

Van Zeeland avoids the responsibility for recommendations but lists "some of the suggestions elicited". These include:

(a) Mandate system to be made international.

(b) Adoption of "open-door" policy in all colonies.

(c) Creation of international private companies for exploitation of colonies.

(d) Barter of colonial raw materials for public works in the colonies.

(e) Strengthening international law guaranteeing private property held in colonial territory irrespective of nationality of ownership.

Van Zeeland believes political guarantees should be given that financial and economic assistance given in the execution of this program should not be employed to serve war-like ends.

Recommendations for immediate Actions:

1. A conference of representatives of principal economic powers; including at least France, United Kingdom, United States, Germany and Italy.

2. Agenda would contain following questions:

(a) "Are you agreed to take part in an attempt at international economic collaboration?"

(b) "Do you with this object in view, accept as a basis for discussion the main lines of the present report?"

(c) "What are the points, if any, which you would wish to see either omitted or emphasized"?

(d) "What points not mentioned in this report do you think it desirable to include within the scope of the attempt to be undertaken?"

3. Creation of a bureau whose chief function will be to ask each country three questions:

(a) Difficulties met in their international commercial relations.

(b) Measures of assistance which they feel entitled to expect from other states.

(c) Measures of assistance which they are prepared to render.

Prepared for the Secretary by Dr. White.

CONFIDENTIAL UNTIL PUBLISHED IN THE MORNING NEWSPAPERS OF FRIDAY, JANUARY 28, 1938.

CAUTION The following unofficial text of a report made on January 26, 1938, to various European countries by Mr. Paul Van Zeeland of Belgium is made available to the press in Washington. This is not an American Government document and the accuracy of the text is not guaranteed. Mr. Van Zeeland is making the document available to the European press on Thursday evening, January 27 for publication in the morning papers of Friday, January 28.

I. First part. Introductory.

A. Terms of reference.

In a communication dated 3 April 1937, the Governments of France and of the United Kingdom did me the honor of entrusting me with a mission consisting, to quote the text, of "an inquiry into the possibility of obtaining a general reduction of quotas and of other obstacles to international trade."

In compliance with the terms of this mandate, I have collected the information and suggestions which form the body of this report.

B. Preliminary question: International economic collaboration or autarchy?

At first sight, it would seem that a task of this kind assumes that one preliminary question is already settled, viz., is it a useful thing to develop international trade? Or, in other words, "Are the methods, which, taken as a whole, form the system of international trade, fundamentally preferable to those autarchic tendencies, which, in varying degrees, have inspired either new theories, or a series of practical measures taken in numerous places?"

In my opinion, there can be no doubt whatever as to the reply. It is the reply which follows from our experience of the crisis as well as from our experience of the period subsequent to the crisis.

The isolated, divergent and contradictory measures by which the nations, in the first period of the late crisis, attempted to protect themselves against it, and push off the burden on to their neighbors, have only served to precipitate it and to render it yet more grievous for all.

No country was able to escape the crisis, whatsoever may have been its means, its resources, or the degree of "self support" which it had reached or retained.

In

In certain large markets, international trade only constitutes a small portion--sometimes less than ten percent--of their total economic activity. Yet these countries were just as sensitive as any other to the international movements, both of crisis and of recovery.

This does not mean that a state has only to allow itself to drift with the general current in order to find prosperity. Here, too, the examples are clear: they show that it is necessary to row and to steer skillfully even to utilize and to follow the line of favorable currents.

But it does mean that no country can avoid being influenced by general movements of the international economy, whether for good or for evil.

Must we conclude then that autarchy is unattainable? Theoretically, no. It is evident that autarchy is out of the question except in a large national market, dominated by an exceptionally powerful central authority. If a country, which fulfills these conditions, wished, at any price, to isolate itself from the rest of the world--economically, financially, monetarily--it could do so, at any rate to a very large extent, as the existing technique would probably enable it to do so.

But that is not the question. It is rather a matter of knowing whether such regime--theoretically possible--would in fact be better than the other; or in other terms, what is the price which would have to be paid for its realization?

Such a regime involves--as its definition almost implies--an increase in the real cost of living, that is to say, a lowering of the standard of life of the population concerned. International economic life is founded on exchanges, which only start or continue if the two parties find them to their advantage. Artificially to interrupt these currents is to deprive the country concerned of that advantage. More effort must be made in order to achieve the same result, or rather the result will probably be less, whatever may be the effort.

In several old countries with dense populations, it is even doubtful whether under autarchy the present population could continue to live, to whatsoever level of existence it might resign itself; the regime, if it were pushed to extremes would in the long run be liable to result automatically in a reduction in the number of the population.

What has been demonstrated, however, by a whole series of attempts in the direction of greater economic independence, is the elasticity of the home market. Perhaps the absolute importance of the international market had, in certain cases, been exaggerated. Whether that be so or not, its relative importance appears today to be as great as ever; its marginal influence is real and powerful; whatever may be the role of the home market, the fostering of international trade must remain an element of capital importance for economic prosperity within the national frontiers.

C. Results of the first tentative inquiries.

We must assume that these views are, in the long run, shared practically unanimously by all statesmen of the present day. In fact, the preliminary consultations which I undertook enabled me to ascertain that everywhere the mission with which I had been entrusted would meet with a most sympathetic reception.

As regards the principle of collaboration in order to reduce the obstacles to international economic relations, not a single discordant voice was heard.

The attitude adopted in all the capitals has been so sympathetic that it revealed something more than a mere polite, but platonic interest; it took the form of an active interest in an effort the results of which could not fail to be beneficial.

But if this first reception was thus far encouraging, the positive reactions, which I was able to record, were less so. I was anxious to elicit some concrete suggestions and to collect some practical proposals in order to place them side by side, to compare them, and to evolve from them the rudiments of a general solution. I could not but note, however, that when once the first and eminently favorable stage had been passed, the attitude, almost everywhere, became qualified by a very marked reserve. It seemed that nobody wanted to commit himself to advance in any direction, before being certain that the path had been taken, or that, at any rate, it had been mapped out by several others.

Besides, it must be recognized that the numerous and diverse problems, which a return to better international collaboration is bound to raise, are closely inter-related; in most of these problems, practical solutions can only be conceived in connection with their counterparts in other directions. One can understand that statesmen hesitate to take a step forward without knowing whether others will make their contribution, and if so, in what form. So, the first conclusion, which immediately emerges, is that we find ourselves confronted with a general problem which equally demands a general solution.

The following, therefore, is the general impression, which I gathered in the course of a large number of contacts:

On the one hand, every possible interest, evident good will, a definite desire to collaborate in a general action directed towards the development of international trade;

On the other hand, very great reserve as soon as it comes to the question of actually embarking upon the stage of practical solutions.

However, initiatives have been taken which emphasize the general will to advance in the direction indicated; and constructive suggestions have been made, for instance,

by

by the Economic Committee of the League of Nations during its session in June-September, 1937; by the International Chamber of Commerce, in its Congress at Berlin in June-July, 1937; by the committee appointed by the League of Nations to study the problem of raw materials in its report dated September, 1937; et cetera.

Besides, a whole series of suggestions or of interesting and helpful ideas have been submitted to us in the course of our many conversations both semi-official and private.

If one takes account of all the numerous elements, then it seems possible, with some chance of success, to attempt to take action in the direction of international collaboration.

I have done my best, therefore, to collect a statement of proposals or suggestions which, if applied as a whole, would, in my opinion, be of such a nature as to guarantee a fresh impetus to international economic relations, and which, in the long run, would provide indubitable benefits to those national economies which would accept the program.

II. Second part.

The principal direct obstacles in the way of international trade and the means for reducing them.

The factors which most seriously prejudice international trade are to be found, some in the economic sphere properly so-called and some in the financial sphere.

Among the former, I shall concentrate on three, viz tariffs, methods of indirect protection, quotas.

Among the latter, I shall refer to sudden and excessive exchange variations, hindrances to capital movements, and restrictions on payment.

I shall examine in turn each of these points, and I shall try to find the methods by which it would be possible to reduce the obstacles which they present to international relations.

A. Economic sphere.

One. Tariffs.

(a) The existence of a general tariff is not in itself to be included in a list of the most serious obstacles to international trade. The average incidence of a tariff taken as a whole has its repercussion on internal prices and especially on the cost of production: little by little, it is absorbed therein. In this way, at the end of a certain time, a sufficient degree of equality of competition is established between home and foreign producers.

But there are certain characteristics which produce in the case of customs duties such harmful effects that they constitute a serious, and in some cases an insurmountable, obstacle to international transactions.

We must observe, first of all, that the argument set out above applies only in cases where a tariff has existed long enough for its incidence to have become absorbed in internal prices. During the whole intermediate period, the duties undoubtedly act as a kind of brake, the force of which gradually lessens but which in the meanwhile is liable to interrupt or disturb normal or regular commercial currents.

On the other hand, the diminution of the harmful effects of a tariff taken in its entirety does not extend to the damage caused by duties the amount of which is considerably more than the average incidence of the tariff: these, indeed, constitute a real and permanent measure of protection in the degree in which they exceed the average level of the tariff.

For example, let us take the instance of a tariff, the average incidence of which is ten percent: products, in the case of which there is an import duty of one hundred percent, will be effectively and permanently protected to the extent of ninety percent. It is clear that duties of this kind must be regarded as real obstacles to trade.

Finally, there are tariffs which are applied to such numerous categories of goods, or which have so heavy an effective incidence, or which are so complicated that they constitute, by their very nature, a real hindrance to international transactions.

(b) What means are there of improving this state of things?

There is no doubt that a general movement for the reduction of tariff duties would acquire a symbolic significance, and would thus have a powerful moral effect. Unfortunately we are bound to recognize that a gesture of this kind, however desirable it might be, does not at present come within the range of possibility.

But if a policy, consisting from now onward in a progressive reduction of tariff duties, cannot be entertained in actual conditions, other measures could be applied which would suffice to achieve the object at which we are aiming within the limits of a more modest but more flexible plan.

It would be necessary and it would be sufficient for governments to undertake on the one hand not to raise nor to widen the range of their tariffs and, on the other, to carry out a gradual reduction of such duties as are of an exceptional character and the amount of which is notably greater than the average incidence of the tariff. Such transition could moreover be embodied in the most easily adaptable forms, if necessary even in parallel declarations.

It would be desirable that another undertaking should be given, of a different character, covering the suppression of duties or taxes, prohibitions or restrictions affecting the export of raw materials.

Such undertakings are not of such a kind as to revolutionize existing situations. Moreover, they could be accompanied by detailed arrangements which would cover the necessary transition stages. The undertaking to file down the sharp points of a tariff could be spread over a certain number of years; the level finally reached could be allowed to remain above the average rate of the tariff, provided that the excess over the average did not, in point of fact, retain its prohibitive character. Finally, the suppression of restrictive measures with regard to exports need not imply the complete suppression of duties, so long as their effect did not in any way injure the general economic interests of importers.

But side by side with such undertakings of a general character, it appears that, in the present state of affairs, the negotiation of bilateral commercial agreements, based on the most-favored-nation clause, remains one of the most efficacious methods for reducing tariff barriers.

The method has recently been consistently applied by certain countries and it has produced indisputable results.

For instance, no one would underestimate the effect which would be produced--either directly, in its reaction on the two national economies concerned, or indirectly, in its repercussion on the whole world by the conclusion, in a spirit of international collaboration, of a commercial agreement covering a wide range, between the two great Anglo-Saxon communities.

On the other hand, the most-favored-nation clause, in the form in which it has been conceived and applied in the years following the war, has often acted, not as a factor in reducing tariff barriers, but as a supplementary element of rigidity in this sphere. In order that the clause may completely recover its favorable influence, more respect should be paid to the spirit which originally inspired it. In this connection, among the observations which have been laid before us, there are some which seem to be particularly well founded, and which it would be opportune to adopt in future agreements. These observations can be summed up as follows:

The clause should remain, in principle, general and unconditional;

Nevertheless, there should be provided an exception, allowing its application to be suspended in the case of countries which employ inadmissible discriminations or which refuse to participate in a general effort aiming at the reduction of obstacles to international trade;

Finally, it ought to be drawn in such a way as not to obstruct the conclusion of group agreements or regional pacts, so long as these do not tend to constitute a discriminatory regime, but to lower tariff barriers, and so long as they are open to the accession of all those who are willing to accept the combined obligations and advantages.

Two. Indirect protection.

Under this general heading, it is usual to set out certain practices which constitute formidable hindrances to international trade.

(a) There are a whole series of regulations or of administrative practices which, by a restrictive interpretation or by an abuse of regulations in force, result in excluding certain foreign products. The best known example is the abuse of sanitary regulations, in order completely to close the home market against various agricultural products.

Another method consists in exaggerating the detail of tariffs and in elaborating specification to such a point that the regulations so drawn up are in fact aimed against some individual producer, while deceptively retaining the appearance of being general regulations.

Finally, one must remember how often "dumping" is invoked as a pretext for measures which prove, in fact, to be fatal not only to unfair competition but to all competition from abroad.

(b) It is, of course, right and proper that each country should defend itself energetically against any "dumping" methods. It is also necessary to apply strict measures of safeguard such as sanitary cordons. And there are cases where, failing sufficiently precise specifications, the wisest and most necessary regulations would be eluded in an improper way.

These reflections serve merely to illustrate the delicate nature of the measures which we are here discussing; but in no degree do they diminish the necessity of removing the hindrances which, in fact, arise from their misuse.

(i) Here, too, it seems that the method of bilateral agreements would, in the circumstances, be the best fitted to produce rapid results, whether it is a question of simplifying and stabilizing customs formalities, or of standardizing the criteria applied in determining the origin or place of shipment of goods as well as the value which serves as basis for the payment of ad valorem duties.

It would be useful, if, in such cases, the negotiators would base themselves upon the international conventions already concluded in this sphere and upon the very detailed studies on these specific points, which have been carried out by the competent organizations and especially by the Economic Committee of the League of Nations and by the International Chamber of Commerce.

(ii) However, when it comes to applying the stipulations of commercial treaties, or when we are confronted by one of those unforeseeable cases such as so often arise in business life, then it is desirable also to resort to another more elastic procedure, which reserves to the parties concerned all necessary liberty of action, while preventing abuses. For this purpose, it would be wise to have recourse much more widely to the creation of "joint committees", the opinion of which could be invoked by either of the interested parties if he feels that he has cause for complaint against some unfair practice in the nature of indirect protection.

Further, in cases where this method of conciliation does not succeed, it would be desirable that interested states should undertake to accept the award of an appropriate arbitral body.

There are already arbitral bodies in existence whose good offices it would be easy to utilize for this purpose. Mention may be made among others of the "procedure for friendly settlement between states of differences of an economic character" instituted by resolution of the Council of the League of Nations in 1932 and also the arbitral court of the International Chamber of Commerce.

As regards specifications, in the absence of special reasons, it would be highly desirable not to go beyond the limits laid down in the Geneva nomenclature; it ought, if necessary, to be possible to bring any case going beyond those limits before the arbitral body.

Three. Quotas.

The use of quotas appears from experience to be the of the most formidable obstacles to the development of international trade. As the years go by their arbitrary and artificial character becomes more and more evident. Even when they have been fixed according to figures which correspond to the level reached during a period of unrestricted trade, they remain harmful because they hinder desirable developments and prevent indispensable adjustments.

(a) In the first place I recommend the suppression of industrial quotas. This proposal does not exclude the possibility of spreading out the measures of suppression over a fairly long period, so that nobody should be taken by surprise. Neither does it exclude the possibility of replacing the quotas either by tariff duties or if absolutely necessary and on a temporary basis by "tariff quotas". This latter method consists of applying to one and the same product a reduced duty for a certain quantity first imported and thereafter a higher rate of duty for quantities imported after the first quota is exhausted.

Further, the suppression of the quotas would not prevent the state concerned from maintaining or from re-establishing whatever measures it might consider effective in order to resist "dumping" methods. In this connection it is impossible to overlook the serious problem constituted by the competition of countries whose standard of living is so much lower than that of their principal competitors that the normal conditions of international competition are thereby distorted: it is conceivable that measures may be necessary, in strictly defined cases, at least in order to give time for the necessary adjustments to take place without occasioning drastic disturbances.

On the other hand, the state which suppresses its quotas appears entitled to demand the reduction or suppression of any duties imposed by other states as a reprisal against such quotas.

Finally, the suppression of quotas by no means implies the suppression of international cartels. Cartel agreements proceed from entirely different conceptions and ought to be treated according to quite different rules. One might if necessary contemplate the maintenance of the quotas necessary to assure the working of such international cartels as conform to the general interest.

(b) As for agricultural quotas, they have often a special character of their own which distinguishes them from the industrial quotas. First of all, there are numerous cases where the seasonal or perishable nature of these agricultural products constitutes a dominating factor; at a given moment, to import unlimited quantities of, for instance, vegetables or fruits would result in the complete ruin of a whole category of national producers. In such cases, the agricultural quotas can be regarded as aiming not so much at a quantitative limitation as at an orderly regulation of imports throughout the year in such a way as to make competition normal.

Besides, the conditions which prevail in agriculture are peculiar. In times of crisis, agricultural production cannot adapt itself to the contraction of demand with the same elasticity as is possible with industrial production. Often indeed, in order to meet the fall in prices, the agricultural community shows a tendency to increase the volume of its production. A considerable surplus has to find outlets abroad. The number of free markets diminishes. Those which remain then find that they are being swamped because upon them are concentrated all the efforts made to dispose of these products, many of which are perishable and consequently have to be sold quickly and at any price they can fetch. Here, once again, we become aware of the character of reciprocity or of generality, which the solutions contemplated must necessarily present, if we wish them to be practicable or acceptable. In a case of this kind, the abolition of the quotas in question must be undertaken by the states principally interested, practically simultaneously.

To put it shortly, in the agricultural as in the industrial sphere, the tendency should be in the direction of suppression or reduction of quotas. At any rate, agreement ought to be reached that no new quotas should be imposed, and that no existing quotas should be tightened up. At the same time certain reservations are required in the case of agricultural quotas; quotas affecting seasonal or perishable products might be retained, but they should be made more flexible with a view to spreading importations over appropriate periods and not to restricting them absolutely; further, it might happen that in exceptional circumstances, in order to take account of the conditions peculiar to agricultural production, particularly the difficulty of restricting production at a given moment, transitional measures might prove necessary and proper, pending a fundamental solution of the problem of production.

B. Financial sphere.

Of all obstacles to international trade there are none more harmful and more formidable than those which arise either from monetary disturbances or from restrictions regarding the transfer of capital or of commercial payments.

One. The obstacles.

(a) Sudden or violent variations in the mutual relation of currencies run the risk of interrupting the normal currents of trade and causing financial movements along abnormal channels (hot money) at any rate during the period while internal prices are adapting themselves to the new monetary parity. Uncertainty in this sphere is a very grave impediment to the conclusion of business operations over any protracted period, as well as of the credit operations necessary for their normal execution.

(b) Restrictions regarding the transfer of funds, even when they are limited to movements of a financial character, deprive international trade of the essential assistance of credit facilities whether on short, middle or long term, without which such trade cannot develop fully and with certainty.

But these difficulties, real and serious as they are, appear slight in comparison with those which arise from prohibitions and restrictions of commercial payments. These introduce into international economic relations an element of absolute rigidity, which renders impossible most of the spontaneous adjustment which is so necessary to the normal functioning of the system; in particular they deprive commercial relations of their triangular or multilateral character.

In present circumstances, it seems that the continuance of exchange control systems and of "clearings", constitutes one of the most serious obstacles to the development of international trade.

Two. How can this situation be remedied?

(a) Let us consider first of all what can be done to reduce or to suppress the element of insecurity in monetary matters.

Admittedly the best policy would be to reach a definite solution of the problem of the international monetary standard. Such a solution would have to be sought in the reestablishment of the gold standard, though on a considerably altered basis. But as yet it is probably too early to make any such attempt. It would only succeed if we could find that a whole series of conditions had first been realized such as would permit the return of a sufficient degree of international equilibrium both in the economic and financial spheres. Now, this situation can only come about, so it seems to me, as the result of a prolonged application of international agreements in both these spheres. The final and definitive solution of the problem must therefore be placed not at the beginning but at the end of the effort of international cooperation towards which we are aiming.

However, we must find some interim solutions. There is one which does not appear to raise insurmountable difficulties, and which, while we await the hour for the final solution, should suffice to provide practical assurance of monetary security for international transactions. This would consist in the revision and extension of the agreement reached in the form of a tripartite declaration by the United States of America, United Kingdom and France with the adherence of Belgium, the Netherlands and Switzerland.

This agreement should be adapted to the new conditions and extended in such a way as to embrace all the countries participating in the effort of collaboration.

The parties interested would agree to define the reciprocal parities of their currencies, in relation to each other, and would pledge themselves to keep any eventual variations within certain limits. The undertaking should extend over a period long enough to free current commercial operations from any monetary risk; it should be for one year or at least for six months--proviso being made for quite exceptional circumstances, a character practically equivalent to that of force majeure.

The decision to fix the level at which the national currency would be exchanged for foreign monies clearly is

235

a matter involving the sovereign action of each state. But, in a balanced international economy, there are obligations and limitations which each state must accept, and duties which each state has towards others. In order to be a fair one, the solution, once again, must be found in a general agreement. As for the form of such an agreement, there would be no objection to its retaining the very flexible one of joint declarations.

The problem, moreover, has lost much of its extreme difficulty. Most currencies, after the devaluation operations resulting from the crisis, have recovered a relative equilibrium both as regards internal as well as external factors. Prudence advises us to retain this equilibrium on an empirical footing.

On the other hand there remain at present certain countries which have not yet reached this stage; general agreement could be reached as to certain criteria which would enable us to determine, with sufficient accuracy and in an atmosphere of fair play, the level of monetary equilibrium, internal and external factors being alike taken into account. All that is required is the existence of the will or the desire to arrive at a solution. This will, however, is of capital importance. Each country must, above all, rely on itself; it is for each country to take necessary action and pass the necessary measures which will make possible its participation in international action. It has the right to expect of the other states that they will not confront it with artificial obstacles, and even that they will await a general attitude in conformity with the requirements of a sincere spirit of international collaboration. But the decisive effort is essentially the responsibility of the individual state and of it alone.

Further, as soon as the international circuit has been reestablished, it is probable that a whole series of our present difficulties, and especially those which have to do with credit, would soon find an easy solution, thanks to the normal intervention of private initiative.

(b) Having provisionally dealt with the question of monetary security so far as foreign trade is concerned, we now come to the disadvantages presented by the various types of restriction on the transfer of funds from one market to another.

(1) As regards movements of a financial nature, it is not only the debtor markets which have adopted such measures but also the creditor markets. The latter by forbidding or restricting foreign lending--and particularly loans by means of public issues--have deprived international trade of a valuable support. It is exceedingly desirable that this policy should be altered in conformity with the other measures of international collaboration.

(2) But the principal difficulty obviously arises from the imposition of exchange controls and from "clearing" systems.

In this matter the only attitude which would

correspond

correspond with the effort of international collaboration at which we are aiming, and which would enable a country to resume its normal place in the framework of the international economy is the renunciation of the system in question, that is to say, the abolition of exchange controls and clearings.

Such a measure must of course be introduced by stages; it is only possible if a certain number of preliminary conditions are realized and if precautions are taken to ease the transition.

The recourse to clearings is a consequence, direct or indirect, of the establishment of exchange controls. The latter are themselves the result of a state of disequilibrium between the national economy concerned and the international markets. To attempt to get rid of exchange controls while allowing this disequilibrium to persist would be a waste of labor. But the measures suggested to us, both in the economic and in the monetary sphere, are designed precisely to facilitate a return to equilibrium. To this end measures must be taken, of which many depend solely on the will and the decision of the state concerned, but some are also dependent on the cooperation of other states. It is in this atmosphere and these conditions that the freeing of the exchanges might be and should be induced.

If the object at which we may aim is a return to complete freedom of all movements of funds, it is clear that what is most urgent and important is to free commercial transactions themselves and the settlements to which they give rise.

It is easily conceivable that, in certain cases, measures of control would have to be maintained, at least temporarily, in order to prevent capital movements which might endanger equilibrium after this had been restored.

However that may be, the first and most urgent step is to bring about the suppression of all restrictions on payments for merchandise.

Whether, however, it is to be carried out in one or in several stages, the suppression of exchange controls requires that the past should first be liquidated.

The liquidation of the past implies an agreed adjustment of external debts which weigh on the country, as far as may still be necessary and warranted; such adjustment should be carried out on conditions, with regard to interest and amortization, which should take into account modifications which may have arisen in the respective situations of creditor and debtor; and they must also take into account the general purposes of common interest to all which the measures studied in this report are designed to promote.

But the liquidation of the past, also and above all, implies the settlement of the clearing arrangement. In this connection we must distinguish between, on the one hand, the arrears which arise out of old credits completely immobilized and regarded as only payable little by little in the manner of a sinking fund on a long term debt, and on the other hand, the balances on current trade and the current financial debts arising out of recent transactions which are due to be paid in full and without any long delay under the operation of the clearing itself.

For the arrears of the first category I propose to recognize realities and to have recourse as far as possible to consolidation. It seems to me that any attempt to take the other course, in so far as it may succeed in expediting the liquidation of these heavy debts of the past, weighs on the present by reducing the resources which the debtor country could use for imports of goods.

In all cases in which such consolidation might prove practicable, it should, however, be carried out in a form which would make it possible to guard, to some extent, against the difficulties which it might otherwise entail for the creditor firms.

To this end, it would be desirable in particular that the bonds issued to the creditors by the debtor state should be expressed in the currency of the creditor at the parity fixed in the exchange agreement.

In addition, it would be well to envisage some kind of extra facilities for mobilizing the bonds for commercial purposes with the help, if necessary, of international institutions.

As regards the other arrears of a current nature, these should be treated in the same way as the new debts, which will be incurred under the restored regime of freedom.

The past having been liquidated in this way, it would be desirable to ease the transition. For this purpose it would be necessary to provide those countries which have been freed from restrictions, with appropriate facilities which would remain at their disposal during the period of adjustment.

These credits should enable them, on the one hand, to afford the necessary support to their export trade, and on the other to finance a part of their imports--at least at the start.

It would seem possible to secure this object to a certain extent by an agreed extension of the method of reciprocal credits recently instituted by the Bank for International Settlements. The banks of issue would open through the Bank for International Settlements credits in favor of one another in the national currency of each of these. These credits would be used to finance the exchange of merchandise between the countries concerned. The exchange risks entailed by these credits can be set off against one another in so far as the trading operations balance. As regards the remainder, the risk might be in part covered by a multilateral clearing carried out by the Bank for International Settlements acting as clearing agent.

For the balances, that is to say, the amounts which the

the Bank for International Settlements could not cover by clearing, it would be advisable to have recourse to the forward exchange markets where these are active and broad. Elsewhere, it would seem advisable to attempt to set up forward exchange markets whose terms would not unduly burden commercial transactions.

For the final balances which would not be covered otherwise, it would be necessary to require a special obligation the payment of which would in the last analysis have to be made by the debtor state. This risk would in any case be slight and of a temporary nature. In practice it would be quite a negligible burden.

But apart from this system, in consideration of the general advantages which the freeing of commercial settlements would bring, and in consideration further of the fact that this freedom would be based on the measures adopted by the interested parties to reestablish the external equilibrium of their economy, it would be appropriate that united effort should be made by all the states prepared to join in a program of international cooperation.

Among the suggestions brought forward to give effect to this idea, there is one which appears to me to merit special consideration; this is the possibility of establishing through cooperation of all these states, a common fund, the resources of which might be applied, under appropriate conditions, to facilitate the financing of legitimate trade operations during the period of readjustment.

It seems to me that the international organization designed to assume the direction of such a fund would be the Bank for International Settlements.

The activities of the fund should not in any case overlap or compete with those of existing institutions and organizations, whose business in normal times covers the financing of commercial operations. It would come into play only in special cases, to fill permanent or temporary gaps, where normal methods prove insufficient.

It may be added that, in this sphere, more than in any other, it is highly probable that the necessity for these exceptional methods--useful and, no doubt, indispensable during the period of transition--would very soon disappear. If the international economy were to recover its vigor and flexibility, private institutions would quickly respond, in the majority of cases, to the normal needs of business on almost all the international markets.

239

III. Third part

General Conditions Necessary For Success

I am convinced that the loyal and general application of a plan composed of suggestions such as have just been outlined might result in giving a new and considerable impetus to international trade.

But if I were to conclude my report at this point I would not have fulfilled the essential part of my mission.

Indeed, the important matter is not to provide theoretical definition of the difficulties, nor even to indicate the channel by the application of which they could be solved. The main point is to suggest methods which have some chance of being effectively adopted and of leading to concrete results. We must therefore push our examination rather further, so that we can discover the conditions in which such measures as are recognized as being useful or desirable will have a chance of being effectively applied by the great majority if not by the total number of the interested countries.

We must, at this point, admit the considerable difficulties which cumber the ground. If we consider the political plane, reasons to hope for a rapid and cordial rapprochement appear slighter than at any moment since 1918.

If we place ourselves on economic plane, it seems at first sight as if the most favorable moment for strictly economic collaboration were past. The general check in the recovery movement, and the special economic difficulties of certain great countries, are once again bringing back on to the program schemes of national protection, which bear a remarkable likeness to the efforts of the crisis.

In the course of the last few months I have several times had to modify the provisional conclusions which I had reached. I have postponed the submission of this report in the hope of collecting fresh indications or of witnessing the appearance of more favorable circumstances. At one moment, seeing the obstacles piling up, I asked myself whether it were not preferable to give up attempting at the present moment any major effort of collaboration in the sphere of international economics, and to await a serener atmosphere.

But, taking all in all, it seemed to me that such an attitude would have been sterile and even dangerous. One has never the right to renounce action or at any rate to renounce attempted action. No effort is ever completely lost, even if it does not succeed all at once.

On the other hand, the persistence of a general situation, which is very confused and bristles with contradictions, would incur the risk of very serious consequences, both in the political and in the economic order. More and more numerous are they who take account of this fact and draw the conclusion that a rapid and profound reaction is necessary. In such conditions, the moment is perhaps favorable, in spite of appearances, for a new attempt, based on reason and common interest.

Let

Let us try, therefore, to find the way for a practical solution, without going beyond the limits of this mission, which is of an economic character, by pretending that it can be artificially isolated from the political factors which surround it and which impose upon it their conditions.

A. The exact position of the problem.

The first reflection which occurs in this connection is that the difficulties which we have just been examining all interlock; in the same way the solutions which we have suggested are closely interdependent. Tariff policy, exchange control, capital movements, stabilization of currencies, quotas, clearings, et cetera, are closely connected problems. One cannot hope really to solve them except by means of a comprehensive solution.

On the other hand the attitude of a number of countries is dominated by the policy of certain great powers whose economic influence is a determining factor either for the world as a whole, or for certain parts of it. It is necessary then, in order that any solution should achieve its maximum efficacy, not only that it should cover the whole network of interlocking difficulties, but also that it should unite a very large majority, if not practically all of the nations concerned.

But international trade is not an end in itself, it is only a means directed towards an end. This end cannot be other than the improvement of the standard of life of the masses, the increase of the well-being of the population. Under our present organization this end is pursued by national entities.

Here we reach the heart of the problem. In order to diminish the obstacles to international trade and to restore to it a degree of flexibility which will allow of its development, it is necessary in particular to induce many countries to mitigate or to abandon the measures of protective self-sufficiency which they have adopted in different degrees and at different times, and to return to a more complete system based on the international division of labor. But these measures of national protection were not resorted to lightly or frivolously, and if the countries protected by them still retain today the armor which they felt bound to put on, it is not without serious reasons.

We must therefore make our dispositions in such a way that the new system shall offer to all participators advantages greater than those of the position in which they now find themselves; and at the same time that the transition from one system to the other may be brought about without danger, and even with immediate advantage.

As our task is above all to achieve practical results, it is not necessary to enter into a long analysis of the reasons which have provoked all these measures of national protection. Nevertheless, it is necessary to underline certain characteristics of the present situation.

Once more let us emphasize the futility of the arbitrary distinctions based on views or arguments of an oversimplified nature, in the light of which attempts are made to divide the nations into distinct groups. In fact, we do not find on one side states devoted to a policy of complete autarchy and on the other side faithful to a strict observance of international free trade. If we go beyond appearances and refuse to be satisfied with verbal distinctions, we cannot fail to note that on the one hand all states, one after another, have had recourse to measures of their own, differing widely in conception and effect, but all inspired by the idea of national protection; while on the other hand they have all continued and must continue to submit to a system of international exchange.

Movements so general and so pronounced must without doubt have a deep-seated cause. Let us recognize that international economic relations are today on a very different basis from those of the period before the war. Formerly international exchanges were exchanges effected across frontiers between individuals, private firms or private interests. Today international economic relations are taking on more and more a character of exchanges between economic units constituted by the states themselves. It is true that the part played by the private firms and undertakings which operate on either side as the connecting links in commercial exchanges remains without exception an essential one, but in determining the flow of trade considerations of national interest are assuming more and more importance; transactions are every day more and more dominated by decisions emanating from the constituted authorities and inspired by a national economic policy. That is a fact which we must take into account.

The tendencies which are driving states towards a greater degree of economic autonomy are based on widely differing considerations. Some of these tendencies are purely political in their origin; others are based on considerations of a social order, such as the problems of employment or of the adaptability of labor; others again are due to purely economic anxieties.

Among the latter there is one which is loudly invoked in several countries in which an effort is being made to substitute synthetic raw materials for the corresponding natural products, and which may be summarized as follows:

If the countries which are producers and exporters of raw materials refuse to take payment in manufactured goods, or place obstacles in the way of entry of such goods into their own country, the countries which are importers of these materials find themselves obliged to give up buying them, or at least to limit their purchases as much as possible; they must thus devote themselves to finding other sources of these same products or look for products which may take their place, especially synthetic products. The protectionist policy of the countries which are producers of raw materials thus reacts against themselves as well as being damaging to those who were counted among their traditional customers.

At the same time it must be added that this line of argument, though not rejected in principle, is regarded in other quarters as putting the problem in an oversimplified

form

form or even as reversing the true order in the allocation of responsibility; according to this view, we are in the presence of a vicious circle brought about in the first instance by the reduction of the importation of certain staple world products by countries which formerly imported them.

However this may be, in spite of the ravages of the last crisis, in spite of the profound modifications which the international economic structure has undergone, in spite of the increasing difficulties of all kinds with which business men are faced, international commercial exchanges had nevertheless until recently shown signs of renewed vigor, a striking proof of their inevitable necessity. The volume of international trade had returned during the second three months of 1937 to a level corresponding to that reached in 1929, that is to say, at the height of the period of prosperity.

Alas, we are still looking for the means of freeing ourselves from these hindrances; and already we are threatened with a fresh setback!

Is it simply a flattening of the curve, is it a minor crisis, or must we fear worse? The economic policy which we now adopt may, if it is good, mark the beginning of a new era of prosperity in the world; it may also, if it is bad, transform the present hesitations of trade into a new and more serious crisis.

It therefore becomes more urgent than ever to restore international economic relations to a sound basis.

The events of the last few months have served to emphasize another aspect of the problem. International trade may be not only impaired by causes of an economic and financial nature; it may suffer equally severely from political and especially from moral influences. For economic activity to develop it is not sufficient that a demand should exist, that the products should be available and that capital should be abundant; there must also be the will to show enterprise, to act, to run the risks inherent in the production and exchange of goods. These conditions require an atmosphere in which at least a certain degree of confidence, good will, sincerity, order and clarity prevails in international relations.

B. Actual hindrances.

Let us therefore seek to determine in a spirit of complete objectivity what are the difficulties or obstacles which, without being direct impediments to international trade, nevertheless hinder the smooth flow of commercial relations between nations.

(One) Review of the difficulties.

There are those who see the origin of their difficulties in the unequal distribution of raw materials, or more exactly, in the fact that certain great countries do not possess in the territory under their control the raw materials which they consider themselves to require.

At this point we cannot but record that certain states see no solution to the problem except in the redistribution of colonies.

There are others who attribute their difficulties to the exaggerated protectionism of countries or groups of countries which ought in their view to absorb a larger share of their products. Particularly numerous are those who protest loudly against systems of preference which distort the normal channels of trade.

Others again blame the unequal distribution of capital and the lack of adequate understanding on the part of the great markets which dispose of accumulated funds.

Certain states insist on the important influence on their economy of demographic problems, particularly those connected with emigration and immigration.

Intelligent judges do not fail to emphasize the depressing influence on financial markets--both in the moral and practical sphere--of the absence of a definite settlement of international political debts.

Many circles put the blame above all on the effects of the widespread policy of intensive rearmament. They express anxiety at the probable reaction which will take place when the orders due to rearmament will have reached saturation point; they emphasize the disastrous effects which the budgetary burden of rearmament imposes, or is liable to impose, on national economies, either directly or through its indirect repercussions.

Finally, there are many who maintain that political anxieties are determining factors in the present retarding of trade, and that those anxieties are more of an obstacle to the development of international commercial relations than all other hindrances put together.

There is no doubt that repeated shocks to the basic principles of international law exercise a pernicious influence on the economic as well as on the political relations between the nations. It is time to bring back to light the sanctity of plighted engagements and the necessity for respecting the rules of international law.

Whatever may be the degree of truth contained in these various assertions, we are bound to take the assertions themselves as facts and to see in them problems which call either directly or indirectly for solution.

(Two) <u>Some of the suggestions elicited</u>.

Suggestions have indeed already been made in widely varying directions with a view to solving those different points. It would be impossible to enumerate them all and I shall confine myself to reproducing a certain number which seems to me to have aroused interest in many quarters.

With a view to assisting the solution of the colonial problem it has been suggested that the regime of mandates should be revised, that the national element should be

removed

removed and that the system should be made completely international, both from the economic and the political point of view.

In the case of colonies properly so called, it would perhaps be opportune to seek for the means of generalizing the system of the open door which obtains in the conventional basin of the Congo, a system the general result of which it is impossible to criticize.

In those colonies when such a regime cannot be organized certain circles have recommended that the possibility be examined of creating privileged companies, whose activities would be strictly limited to the economic sphere and whose capital would be divided internationally in such a way as to offer real guarantees of impartiality.

With regard to raw materials a most interesting proposal has been formulated tending to the supply of colonial goods in exchange for industrial products. An agreement would be concluded between a colony and an industrial state, and colonial goods supplied would be carried to an account and paid for by the execution in return of important public works--bridges, railways, ports, et cetera. The intermediate finance would be provided by the metropolitan state.

Lastly, the rules of international law might, in the opinion of many, be specified and reenforced in such a way as to secure from seizure or confiscation in every case, even in time of war, private property held in colonial territories, whatever the nationality of the owner.

(Three) Guarantees of a political nature.

The conclusion which arises to my mind from the multiplicity of problems inherent in these complaints, demands and suggestions is that it is time to face them and submit them to a close discussion. This, however, can only be done in an atmosphere of loyal cooperation in which each one concerned would seek in his own interest to render assistance to the others.

Does such a spirit exist? If not, everything possible must be done to create it. If it exists steps must be taken to dissipate the mutual misunderstandings which prevent it from coming to light.

Surely there is no object in attempting to conceal from oneself the difficulties of such an undertaking.

In this report I have deliberately debarred myself from touching on the strictly political aspects presented by a number of questions with which we are faced. It is, however, impossible to ignore the fact that we are working in their shadow. There are indeed some which are so intimately bound up with certain of the suggestions which I have made that it is impossible to abstract them.

Thus one can understand the preoccupation of those who fear to see the financial assistance, the credit facilities, or the facilities for obtaining supplies which would

be

be granted in the execution of the remote program of action diverted from their object to serve war-like ends. Guarantees would have to be provided in this respect, and such guarantees are necessarily political in their nature.

Again, is it possible to provide an economic solution for the difficulties with which certain national economies will be faced when the point of saturation has been reached in their rearmament policy, without evoking the problem of the limitation of armaments?

Conversely, it also appears to be true that any concerted policy for the limitation of armaments would require, if its application were not to be obstructed, means accompanied by economic measures which would also have to be internationally concerted.

C. A pact of international collaboration.

Faced with a task of this complexity, our best course will be to attempt a new method very general in its nature, which should appeal to mutual good will, but the object of which will be above all to secure to each participant the tangible advantages of collective action.

The moment has thus perhaps arrived to propose the conclusion of a "pact of economic collaboration" embracing the largest possible number of states, and in any case open to all. This pact might perhaps, drawing inspiration from a precedent which has proved successful, take the form of a collection of joint declarations.

The object of the pact would be to assist the participants to raise the standard of living of their nationals by improving the general well being. It would contain two parts, one negative, by which the participating countries would bind themselves to abstain from a certain number of practices contrary to the interests of the community of participants; the other positive, but general in its nature, by which the participating countries would bind themselves one towards the other to take up and to examine in a spirit of understanding and mutual assistance the problems and difficulties arising in their economic relations.

Under the aegis of this general pact, and in accordance with it's spirit, might be concluded separately other more detailed arrangements incorporating, in so far as they could be satisfactorily worked out, the numerous suggestions which I have made or referred to in this report.

I have given these suggestions deliberately in a succinct and simplified form; I have intentionally refrained from entering into details; it has been my object to confine myself to the principal outlines. If the ideas on which these suggestions are based should be accepted, it would be comparatively easy to develop them, to give them precision, and to run them into the appropriate technical moulds. On most of the points which I have mentioned prolonged studies have been undertaken; plans for putting them into effect could be quickly drawn up with the assistance of specialized organs such as the Economic and

Financial

Financial Committees of the League of Nations, the Bank for International Settlements, the International Chamber of Commerce, the International Institute of Agriculture, et cetera.

As for the international arrangements for putting them into force, certain of these by their very nature would have to be of general application; others would include only certain countries; others again would have to take the form of bilateral agreements.

D. Methods of realization.

How are we to assure practically and effectively the success of such a plan? Let us recognize that to obtain the full results it would be desirable that an effort of this kind should receive the support of the great countries which are leaders in economic activities and in the different political tendencies.

(1) It is desirable, then, to bring together as soon as possible representatives of the principal economic powers; and at least of France, the United Kingdom, the United States of America, Germany and Italy. There would be advantages in a method which would ensure that this contact were of a purely preparatory nature. The object would be above all to take soundings and to prepare the ground. The agenda would contain four or five questions drawn up in some such terms as the following:

(One) Are you agreed to take part in an attempt at international economic collaboration?

(Two) Do you, with this object in view, accept as a basis for discussion the main lines of the present report?

(Three) What are the points in this report, if any, which you would wish to see either omitted or emphasized?

(Four) What points not mentioned in this report do you think it desirable to include within the scope of the attempt to be undertaken?

The answers given in the course of this preliminary and informatory stage would clearly determine the future course of the whole undertaking.

(2) If, as may be hoped, the answers were constructive and such as to encourage a serious hope, it would be appropriate to pass to a second stage.

This stage would be intrusted to a bureau appointed for the purpose; an invitation would be addressed to all states asking them to acquaint the bureau within the shortest possible time, and following the framework of the present report, with the difficulties which they meet with in their international commercial relations, as well as with the measures of assistance which they feel entitled to expect from other states and those which they are prepared to render.

The answers to this invitation would constitute substantially a review of the complaints brought by the nations against the economic commonwealth, and of the needs for the satisfaction of which outside assistance or collaboration would be more effective than national effort.

The bureau would proceed as rapidly as possible to classify and synthetise these answers. It would analyze their contents in an entirely objective manner, extract from them such suggestions as seemed reasonable, and would so draw up, basing its work on the present report, a program of constructive action.

(3) It is then that we should pass to the third and final stage of the undertaking. It would be necessary to ensure through the diplomatic channels that there was an agreement of principle among the interested parties on the main lines of the program drawn up. If a sufficient number of states, including the great economic powers, took up a favorable attitude the bureau referred to above would be instructed to draw up the texts for signature.

Lastly, a conference would be summoned to put the final touches to the necessary diplomatic instruments and to exchange signatures.

As I conceive it the pact so concluded would be only a portico to the work which it would be necessary to continue, to build up, to complete and to adapt to changing circumstances in a process of perpetual evolution.

Nevertheless, the conclusion of such a pact would be a feature of capital importance, for it is this pact which would give the initial impulse and would impart to the world the impetus which it is awaiting in order to recover its confidence in the pacific destiny of nations.

And this portico might perhaps lead to a new edifice in which, side by side with the halls devoted to economic collaboration, would arise others in which might be worked out the political conditions of a lasting peace.

Brussels, January 26, 1938.

P. Van Zeeland

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE February 2, 1938

TO Secretary Morgenthau

FROM Mr. Haas

Attached herewith is the comparison of estimated and actual receipts for January 1938 and for the first seven months of the fiscal year 1938, as requested by you yesterday.

Attach.

Comparison of estimated and actual receipts for January 1938 and for the first seven months of fiscal year 1938

Summary table - daily Treasury statement basis

(Amounts in millions of dollars)

	January 1938				July 1937 - January 1938			
	Estimated receipts	Actual receipts	Increase + or decrease - over estimate: Amount	Percent	Estimated receipts	Actual receipts	Increase + or decrease - over estimate: Amount	Percent
General and Special Accounts								
Internal revenue:								
Income taxes	48.3	52.3	+ 4.0	+ 8.3	1,205.5	1,209.6	+ 4.1	+ .3
Miscellaneous internal revenue	159.6	171.9	+12.3	+ 7.7	1,428.1	1,440.3	+12.2	+ .9
Other internal revenue	48.4	57.5	+ 9.1	+18.8	464.4	473.4	+ 9.0	+ 1.9
Total internal revenue	256.3	281.7	+25.4	+ 9.9	3,098.0	3,123.2	+25.2	+ .8
Customs	32.4	26.2	- 6.2	-19.1	246.1	240.0	- 6.1	- 2.5
Miscellaneous revenues and receipts	19.5	26.8	+ 7.3	+37.4	140.4	147.7	+ 7.3	+ 5.2
Total receipts, general and special accounts	308.2	334.7	+26.5	+ 8.6	3,484.5	3,510.9	+26.4	+ .8

Treasury Department, Division of Research and Statistics. February 1, 1938

MEMORANDUM OF THE DAY'S
ACTIVITIES

February 2, 1938

To: The Secretary

From: Mr. Magill

1. Tax bill

Senator Harrison called to say that his information was that the tax bill would be through the House about February 20th. He wants Mr. L. H. Parker and myself to educate him on the bill after a draft is published. He expressed no views on specific provisions in the bill.

Mr. Vinson has asked me to see Mr. Doughton and himself at 4:30 this afternoon. I will give him your message regarding the President and Congressman McCormack.

2. Exempt corporations

I have a preliminary report transmitted by Mr. Graves relative to the returned questionnaires sent out some time ago. Some 18,000 have been received back which the Rules and Regulations Division is examining as rapidly as possible. Out of 2100 cases examined so far a preliminary review indicates that 83 will be denied exemption and the remainder continued in their present exempt status.

3. "Small business man"

Assistant Secretary Draper called me about one o'clock to say that he had about a thousand business men on his hands, but that they did not manifest any particular interest in taxes. Consequently, he did not think it necessary for me to come over this afternoon. I told him I was available at his pleasure. I gather from the news ticker that the difficulty probably was to organize the group in such a way that inquiries about taxes could be satisfactorily handled.

RM

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE: February 2, 1938

TO: Secretary Morgenthau

FROM: M. A. Harris

In the event that the Treasury might be seeking new money on March 15th, in addition to refunding the $455 millions of 3% Treasury notes due on that day, a number of possibilities are given below. The estimated market basis for all open quarterly dates up to five years are given, as well as two possible bond offerings.

Treasury notes	Estimated Market Basis	Indicated Premium
1% due 9/15/40 (2 1/2 years)	0.85	12/32nds
1 1/4% due 9/15/41 (3 1/2 years)	1.05	22/32nds
1 3/8% due 6/15/42 (4 1/4 years)	1.24	18/32nds
1 1/2% due 3/15/43 (5 years)	1.32	26/32nds
Treasury bonds		
2 1/2% 3/15/47 (9 years)	2.36	1 point 4/32nds
2 3/4% 3/15/52 (14 years)	2.65	1 point 5/32nds

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE: February 2, 1938

TO Secretary Morgenthau

FROM M. A. Harris

The course of monetary events during 1937 and so far this year has resulted in a picture quite different from any in past history. Prior to recent years any change in monetary conditions was first reflected in short term money rates, and only later and to a lesser degree, in the high grade market, but now we find the high grade market the most sensitive money rate in the United States. The one reason for this appears to be fear of a price decline. Last Spring we saw high grade bonds drop sharply, while short term rates remained practically unchanged. Those few banks that needed to raise money to meet the final increase in reserve requirements did so in considerable part by sales of securities instead of liquidating short term paper or borrowing at the Reserve Banks.

However, since last Spring commercial loans have declined sharply and continue to do so and, as a result, idle funds continue to pile up in banks and the problem of investment for earning becomes more acute. Banks, since last September (principally New York banks), have been buying government securities and prices have regained a large part of last Spring's decline. The near future holds no prospect of any radical change in the present trend of prices of government securities. In the future we hope for, and expect, commercial borrowing to increase and when this does happen banks may be expected to become sellers again, mainly because of the high ratio of deposits to capital and the ever present fear of a price decline. High grade corporate bonds, with the exception of the rails, also continue to hold firm but the new issue market remains relatively dead due to fear and uncertainty. Banks may not be expected to be heavy buyers of corporate issues as long as there is such an urgent need of capital by them.

It seems that, since the fear of price decline plays such a big part, any steps that the Treasury Department and the Federal Reserve System can take to alleviate this problem and add stability to the high grade market could be considered constructive. For earning reasons, banks are forced to buy long term government securities, due to the extremely small returns obtainable on short term investments. Also the short term market is practically dead. Loans of all natures have declined, business in short term paper is at a standstill and there has been no recent new addition of discount bills. In short, at the present time there is a very limited short term money market in which funds might be put to work.

If, in the near future, the Treasury would obtain what new money it needs by sale of additional bills and at the same time the System, along with what aid the Treasury could give, would supply bonds to the market when there is definitely a need for such bonds as a medium of safety for funds, it would do much to add stability and prevent the aggravation of high prices. The bill market is concentrated in New York but the need for means of employment of short term funds is greatest there. New York banks were the heavy sellers in 1936 and the first part of 1937 and likewise they have been the heavy buyers since last September. Furthermore, if and when in the future money is needed by banks, it is likely that the pressure will be greatest in New York and they will again be the heavy sellers of government securities.

It might also be added that a bill program is by far the most flexible program and could be better adjusted to meet the Treasury's need of new money pending the result of the March tax returns.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE FEB 2 1938

TO Secretary Morgenthau

FROM Herman Oliphant

For your information.

In the conference at your house last week, "Jefty" O'Connor said that his office could do all the bank examining which F.D.I.C. is doing at 5 per cent of what F.D.I.C. is spending. On the contrary, the saving would not be substantial. The field force would have to be about as large as the two field forces now are. There would be some saving in overhead.

He said the cost of examinations by F.D.I.C. exceeded their losses. On the contrary, their losses last year were several times their total cost of operations, including examinations.

He said one of his examiners, while in town, could cross the street and examine one of F.D.I.C.'s little banks. On the contrary, this would defeat examination, since the F.D.I.C.'s little bank would know the examiner was in town and would be ready for him.

He left the impression that his office examined many banks while F.D.I.C. examined few banks. On the contrary, F.D.I.C. examines more banks than both the Comptroller and the Federal Reserve Board, although the larger banks are dominantly national banks or member banks. F.D.I.C. examines some 7,500, the Comptroller examines some 5,500, and the Federal Reserve Board examines about 1,000.

On receiverships, he did not disclose that the Comptroller has only the old receiverships, all since January 1, 1934, being placed by law in F.D.I.C. Of these new receiverships, there are about 180 and about 700 of the old ones that are active. It is a common belief that a large number of the old receiverships should be closed out and are being dragged on at the expense of depositors for patronage purposes.

He said that the Secretary of the Treasury had to pass on loans made by F.D.I.C. in connection with bank mergers. This is not true.

HO

February 2, 1938.
3:58 p.m.

Randolph Burgess: Hello, Henry?

H.M.Jr: Yes, Randolph.

B: I just wanted to tell you that I've just had word that the - these Appalachian power are all sold.

H.M.Jr: Oh, hurrah.

B: That's unusually fine news.

H.M.Jr: Hurrah.

B: 'Cos it's just a little better - as the day advanced - they just told me that the Syndicate has disposed of all its bonds.

H.M.Jr: How many millions is that?

B: Sixty seven million.

H.M.Jr: Well, that's grand.

B: Now, of course there's still some in retainer's hands, and the distribution is not entirely completed, but the wholesalers have passed them all on.

H.M.Jr: Grand.

B: And apparently there's sprung up a good demand.

H.M.Jr: Oh - I'm tickled to death.

B: So that - that's grand news.

H.M.Jr: Fine.

B: Thought you'd like to know it right off.

H.M.Jr: I certainly can stand it. Thank you very much.

B: All right. See you tomorrow.

9 30

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE FEB 3 1938

TO Mr. McReynolds

FROM Mr. Oliphant

Herewith are a memorandum to the Secretary and a further memorandum on which it is based. This matter you presumably will want to discuss with the Secretary.

Enc. 2

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE FEB 3 1938

TO Secretary Morgenthau

FROM Herman Oliphant

The study of the statutes has been completed, and I find that it is not lawful for the Treasury to employ a president of a national bank handling Federal and State bonds as national banks ordinarily do. He could work without oath and pay, but, in that event, could not be given access to some of the official records he would need to use.

Neither the rolls of R.F.C. or F.D.I.C. are under this limitation.

Herman Oliphant

U. S. C. title 5, section 254, provides as follows:

> "Restrictions upon clerks in department. Every clerk employed in the Treasury Department who carries on any trade or business in the funds or debts of the United States, or of any State, or in any kind of public property, or who takes or applies to his own use any emolument or gain for negotiating or transacting any business in the department, shall be deemed guilty of a misdemeanor, and punished by a fine of $500 and removal from office."

Although the word "clerk" has sometimes been defined narrowly to mean a person engaged in "clerical service" or a person employed "for keeping records or accounts" and has been used in the phrase "other officers, clerks and employees", and although penal statutes are to be construed strictly, the history of section 254 indicates that the section was not intended to cover merely the clerical service of the Treasury Department.

The Act of September 2, 1789, establishing the Treasury Department, provided for the following officers: The Secretary of the Treasury, a Comptroller, an Auditor, a Treasurer, a Register, and an Assistant to the Secretary of the Treasury. Section 8 of this Act provided that no person appointed to an office created by the Act "shall directly or indirectly be concerned or interested in carrying on the business of trade or commerce, or be * * * concerned in the purchase or disposal of any public securities of any state, or of the United States, * * *."

The Act of September 11, 1789, provided that the Secretary of the Treasury "shall appoint such clerks * * * [as he] shall find necessary." The use of the word "clerks" in this statute indicates that all persons appointed in the Treasury other than those specifically named in the earlier Act were designated "clerks" even though their duties were not limited to the keeping of records, etc.

The Act of March 3, 1791, provided that the provisions of section 8 of the Act of September 2, 1789, shall apply to "all and every of the clerks employed in the treasury department, as fully and effectively as if they and every of them were specifically named therein, * * *."

The Act of May 8, 1792, abolished the restrictions on the clerks of the Treasury so far as respects the carrying on of any trade or business other than in the funds or debts of the United States or of any state, and the latter restriction was extended "to the commissioner of the revenue, to the several commissioners of loans, and to all persons employed in their respective offices, and to all officers of the United States concerned in the collection or disbursement of the revenues thereof."

Sections 243 and 244 of the Revised Statutes codified the foregoing legislation substantially in the same form as they appear in the United States Code as section 254 of title 5.

It would seem that the underlying purpose of the legislation is such that it was meant as a limitation not merely on accounting or file clerks, etc., but also on those employees and officials of the Department who are much more likely to have information with respect to the Public Debt. Mr. Justice Brandeis in Burnap v. United States, 252 U. S. 512, 515, stated that the term "clerks and other employees" as used in R. S. sec. 169, authorizing the head of the department to employ "clerks of the several classes recognized by law, * * * and other employees" was "sufficiently broad to include persons filling positions which require technical skill, learning and professional training."

It seems clear that a bank carries on "business in the funds or debts of the United States, or of any State". In Mercantile Bank v. New York, 121 U. S. 138, 156, the Supreme Court said:

> "The business of banking, as defined by law and custom, consists in * * * negotiating loans, and dealing in negotiable securities issued by the government, state and national, and municipal and other corporations."

So far as can be ascertained, the Office of the Comptroller of the Currency has never taken a contrary view. It has several times ruled upon questions arising in connection with R. S. 5136, as amended, but such rulings and this section itself appear rather to be additional authority for the same conclusion. R. S. 5136 prohibits national banks from engaging in "the business of dealing in securities * * * for its own account" but these "limitations and restrictions shall not apply to obligations of the United States or general obligations of any state * * *". The Comptroller has not held that a bank does not engage in the business of dealing in such exempted securities. The rulings are to the effect that a national bank may engage in that business as a result of the express permission included in the law.

It seems clear also that the president of a bank is to be treated as though he personally were engaged in the business in which his bank is engaged. Thus, Attorney General Mitchell, in 36 Op. Atty. Gen. 12, held that Secretary Mellon was not disqualified from holding the office of the Secretary of the Treasury by reason of the fact that he owned stock in a business corporation, but implied in a dictum that Mellon might have been disqualified if he had continued to be an officer or director or owned a majority of the stock or gave his time or attention to the active conduct of any incorporated business.

It may be possible to avoid the limitations of section 254 in the following manner: Instead of "employing" a person at a salary to assist the Secretary of the Treasury in banking matters, the Secretary might be able to find someone who would agree not to ask for any salary and who, without assuming any duties or taking any oath of office, would be willing to consult with and advise the Secretary on banking matters. An office has been defined as a "public station, or employment, conferred by the appointment of the government. The term embraces the idea of tenure, duration, emolument, and duties." United States v. Hartwell, 73 U. S. 385, 393. In the previously mentioned situation, the person advising the Secretary would receive no emolument, would not be acting for any definite term, would have no prescribed duties, and would, therefore, probably be under no duty to take an oath of office (21 Op. Atty. Gen. 508). Since such a person would not be under "contract" or "order", it might be said that he was not "employed" by the Treasury Department. (Cf. The United States v. Morris, 38 U. S. 464, 475.) Furthermore, since such person would agree not to ask for remuneration, the Secretary would not be violating that provision of U. S. C. title 31, sec. 665, which prohibits any officer of the Government from accepting "voluntary service for the Government." See 30 Op. Atty. Gen. 51, and General Counsel's opinion re Riefler, dated June 25, 1937. However, it would be doubtful legality and propriety to give such person access to all official records on banks. (Cf. U. S. C. title 12, sec. 481.)

Another possible course of procedure would be to have RFC employ the person who would then spend a large part of his time assisting the Secretary of the Treasury on banking matters. (Cf. the case of Thomas Corcoran and see U. S. C. title 15, sec. 603.)

Herman Oliphant

FEB 3 1938

Mr. McReynolds

Mr. Oliphant

Herewith are a memorandum to the Secretary and a further memorandum on which it is based. This matter you presumably will want to discuss with the Secretary.

(Initialed) H O

Enc. 2

HO:von
2/3/38
5

FEB 3 1938

Secretary Morgenthau

Herman Oliphant

The study of the statutes has been completed, and I find that it is not lawful for the Treasury to employ a president of a national bank handling Federal and State bonds as national banks ordinarily do. He could work without oath and pay, but, in that event, could not be given access to some of the official records he would need to use.

Neither the rolls of R.F.C. or F.D.I.C. are under this limitation.

HO:von
2/3/38
5

U. S. C. title 5, section 254, provides as follows:

"Restrictions upon clerks in department. Every clerk employed in the Treasury Department who carries on any trade or business in the funds or debts of the United States, or of any State, or in any kind of public property, or who takes or applies to his own use any emolument or gain for negotiating or transacting any business in the department, shall be deemed guilty of a misdemeanor, and punished by a fine of $500 and removal from office."

Although the word "clerk" has sometimes been defined narrowly to mean a person engaged in "clerical service" or a person employed "for keeping records or accounts" and has been used in the phrase "other officers, clerks and employees", and although penal statutes are to be construed strictly, the history of section 254 indicates that the section was not intended to cover merely the clerical service of the Treasury Department.

The Act of September 2, 1789, establishing the Treasury Department, provided for the following officers: The Secretary of the Treasury, a Comptroller, an Auditor, a Treasurer, a Register, and an Assistant to the Secretary of the Treasury. Section 8 of this Act provided that no person appointed to an office created by the Act "shall directly or indirectly be concerned or interested in carrying on the business of trade or commerce, or be * * * concerned in the purchase or disposal of any public securities of any state, or of the United States, * * *."

The Act of September 11, 1789, provided that the Secretary of the Treasury "shall appoint such clerks * * * [as he] shall find necessary." The use of the word "clerks" in this statute indicates that all persons appointed in the Treasury other than those specifically named in the earlier Act were designated "clerks" even though their duties were not limited to the keeping of records, etc.

The Act of March 3, 1791, provided that the provisions of section 8 of the Act of September 2, 1789, shall apply to "all and every of the clerks employed in the treasury department, as fully and effectively as if they and every of them were specifically named therein, * * *."

The Act of May 8, 1792, abolished the restrictions on the clerks of the Treasury so far as respects the carrying on of any trade or business other than in the funds or debts of the United States of of any state, and the latter restriction was extended "to the commissioner of the revenue, to the several commissioners of loans, and to all persons employed in their respective offices, and to all officers of the United States concerned in the collection or disbursement of the revenues thereof."

Sections 243 and 244 of the Revised Statutes codified the foregoing legislation substantially in the same form as they appear in the United States Code as section 254 of title 5.

It would seem that the underlying purpose of the legislation is such that it was meant as a limitation not merely on accounting or file clerks, etc., but also on those employees and officials of the Department who are much more likely to have information with respect to the Public Debt. Mr. Justice Brandeis in Burnap v. United States, 252 U. S. 512, 515, stated that the term "clerks and other employees" as used in R. S. sec. 169, authorizing the head of the department to employ "clerks of the several classes recognized by law, * * * and other employees" was "sufficiently broad to include persons filling positions which require technical skill, learning and professional training."

It seems clear that a bank carries on "business in the funds or debts of the United States, or of any State". In Mercantile Bank v. New York, 121 U. S. 138, 156, the Supreme Court said:

> "The business of banking, as defined by law and custom, consists in * * * negotiating loans, and dealing in negotiable securities issued by the government, state and national, and municipal and other corporations."

So far as can be ascertained, the Office of the Comptroller of the Currency has never taken a contrary view. It has several times ruled upon questions arising in connection with R. S. 5136, as amended, but such rulings and this section itself appear rather to be additional authority for the same conclusion. R. S. 5136 prohibits national banks from engaging in "the business of dealing in securities * * * for its own account" but these "limitations and restrictions shall not apply to obligations of the United States or general obligations of any state * * *". The Comptroller has not held that a bank does not engage in the business of dealing in such exempted securities. The rulings are to the effect that a national bank may engage in that business as a result of the express permission included in the law.

It seems clear also that the president of a bank is to be treated as though he personally were engaged in the business in which his bank is engaged. Thus, Attorney General Mitchell, in 36 Op. Atty. Gen. 12, held that Secretary Mellon was not disqualified from holding the office of the Secretary of the Treasury by reason of the fact that he owned stock in a business corporation, but implied in a dictum that Mellon might have been disqualified if he had continued to be an officer or director or owned a majority of the stock or gave his time or attention to the active conduct of any incorporated business.

It may be possible to avoid the limitations of section 254 in the following manner: Instead of "employing" a person at a salary to assist the Secretary of the Treasury in banking matters, the Secretary might be able to find someone who would agree not to ask for any salary and who, without assuming any duties or taking any oath of office, would be willing to consult with and advise the Secretary on banking matters. An office has been defined as a "public station, or employment, conferred by the appointment of the government. The term embraces the idea of tenure, duration, emolument, and duties." United States v. Hartwell, 73 U. S. 385, 393. In the previously mentioned situation, the person advising the Secretary would receive no emolument, would not be acting for any definite term, would have no prescribed duties, and would, therefore, probably be under no duty to take an oath of office (21 Op. Atty. Gen. 508). Since such a person would not be under "contract" or "order", it might be said that he was not "employed" by the Treasury Department. (Cf. The United States v. Morris, 38 U. S. 464, 475.) Furthermore, since such person would agree not to ask for remuneration, the Secretary would not be violating that provision of U. S. C. title 31, sec. 665, which prohibits any officer of the Government from accepting "voluntary service for the Government." See 30 Op. Atty. Gen. 51, and General Counsel's opinion re Riefler, dated June 25, 1937. However, it would be doubtful legality and propriety to give such person access to all official records on banks. (Cf. U. S. C. title 12, sec. 481.)

Another possible course of procedure would be to have RFC employ the person who would then spend a large part of his time assisting the Secretary of the Treasury on banking matters. (Cf. the case of Thomas Corcoran and see U. S. C. title 15, sec. 603.)

OPEN MARKET MEETING

February 3, 1938.
11:00 a.m.

Present: Mr. Taylor
Mr. Upham
Mr. Lochhead
Mr. Haas
Mr. Harris
Mr. Bell
Mr. Eccles
Mr. Goldenweiser
Mr. McKee
Mr. Ransom
Mr. Burgess
Mr. Piser
Mr. Sinclair

H.M.Jr: All right, if you gentlemen are ready we'll first hear as to the needs, and then, if Mr. Burgess will be kind enough, he'll tell us as to the market condition.

Bell: Our balances going into February were 926 million dollars, and going out of February, without any new money, are estimated at 854 million dollars. If we raise 250 million dollars additional on bills in March, we'll go out of March with about a billion dollars. Then this contemplates additional bill issues the latter part of April and through May of 300 million dollars.

Burgess: September bills?

Bell: September bills, yes. That would make our balances at the end of April 828 million and at the end of May 911 million, and at the end of June 820 million. And this would contemplate paying off in March 400 million dollars of maturing bills, refunding 455 million of Treasury notes, and paying off in June 250 million dollars of maturing bills and refunding 618 million dollars in Treasury notes.

Eccles: No new money.

Bell: No new money except that bill money.

Eccles: Yes, but it would be replacing ....

Bell: That's right.

Eccles: Replacement largely.

Bell: In effect. We have less new bill issues than we take out of the market, because we take 650 out and put new bills out of 550.

Eccles: Take 400 out in March, put 250 in in June and three in September.

Bell: That's right.

Eccles: Take out a hundred million.

Piser: That's figuring out gold at zero all the way through, is it?

Bell: No, that's figuring gold at zero in February and March, 50 million dollars a month for April, May and June.

Lochhead: You can't figure gold at zero, even if you're not having any imports. We're producing, roughly, 15 million dollars a month domestic, which is coming in and has to be paid for under the present plan.

Eccles: That 50 million.- you don't mean 50 million a month.

Bell: 50 million net purchases of gold.

Eccles: For the three months.

Bell: For the three months of the period. Domestic purchases be taken care of out of current balance rather than out of the General Fund balance.

Haas: Just 50 total.

Bell: No, no, a month.

Sinclair: That's 50.

Bell: Yes, sir.

H.M.Jr: 150.

Bell: No, 50 million a month for April, May, and June makes 150 million ending June 30.

Eccles: If you didn't get that at the end of June, you'd have a billion of cash balances.

Bell: 970 million, yes.

Eccles: Yes.

Taylor: What average sales for Baby Bonds are you using?

Bell: Using 50 million for February, 40 million for March, 30 million for April, and 25 million each for May and June.

H.M.Jr: Mr. Taylor would like to point out that our Baby Bond sales for January exceeded a hundred million dollars.

Taylor: No, just under. Cash receipts 99 million, 700 thousand.

Sinclair: We congratulate you anyhow.

Burgess: Face amount was over a hundred.

H.M.Jr: Daily statement was over a hundred.

Sinclair: When would that be starting your additional bills? Right away or - February?

Bell: March 2.

Sinclair: March 2.

Eccles: That would bring in - that would be 50 million a week of new bills. Five ...

Bell: Five dates.

Eccles: Five dates in March. And let's see, we figured 50 million turnover up until the 23d, and then you'd have a hundred million turnover on the last two dates, so you'd be ....

Bell: 150.

Eccles: Have 150 million on the last two March dates.

Bell: That's right. You'd have 150 million issue - six dates, April and May.

H.M.Jr: How much?

Bell: Six dates.

H.M.Jr: 150.

Bell: 150 million.

H.M.Jr: The reason we're suggesting putting it off to - starting it the first week in March, is that we really don't need the money the month of February. While the interest rates are very low, why pay interest on money we just can't possibly use? Now, the only objection I could see is that Burgess might say, "Well, doing this all in the month of March, with the taxes and everything, might be upsetting to the money market." I don't know whether it would or not.

McKee: This program contemplates no increase in the outstanding debt.

H.M.Jr: A decrease.

Burgess: Increase for a few minutes the two weeks in March.

Bell: There would be an increase in the gross debt in unemployment trust and old age reserve.

Burgess: And Baby Bonds.

H.M.Jr: But not outstanding Government securities. We're paying off 400 million dollars bills in cash, putting out about 250 in place of it.

Eccles: In other words, you'd be borrowing from the funds instead of the market.

Bell: That's right. The debt in the hands of the public will remain practically the same.

H.M.Jr: We could start this Monday - next Monday, but I just raise the question, what's the use of taking this extra money when we don't need it, unless, as I say, you people say we're crowding too much in the month of March.

Burgess: No, I don't think so.

Eccles: Let's see, your bills - you have 400 maturing in March on the tax date. That would pretty well take care of the extra tax money, wouldn't it?

Bell: Oh, I think so, yes.

Eccles: With the large amount of excess reserves - if the excess reserve picture was close, it might be a little more upsetting; with the large amount that you have and no demand for funds anywhere, it seems to me that I don't - I can't see how this would upset the market at all.

Bell: Well, we could even handle that, because we could take the regular weekly bills which we sell and have them paid for by credit and pay the maturing out of the General Fund.

Eccles: Yes. Well, it doesn't seem to me you'd have that problem, with the 400 million coming due. Now, you might in June with only 250; 250 is rather a small amount for a tax date, and you may want to take the regular bills in June and give book credit for it, which you could do to offset it.

Bell: Well, you have a big interest date in June - 175 million; 150 million in March.

Burgess: Ordinarily it isn't awfully good technique to sell your tax date bills in the tax month three months preceding, that is, to sell June bills in March, because they are 90-day bills, which gives you an identical maturity with your current roll-over of bills; so you're not offering the investor any variety. If you sell them in January or February, you're selling four or five months bills and 90-day bills, which gives a little choice for a fellow. Now, the market is good enough now so that I don't think that's very important; it's just a minor point. Particularly in the last two weeks of March, you'd be selling 150 million 90-day bills instead of selling 100 million 90-days, and - well, you wouldn't - you'd lay off that if you started earlier, you wouldn't have any tax date bills in those last two weeks.

H.M.Jr: You people might or might not be interested in this relief situation. Bell and I have been on it for the last 24 hours quite hard, and we had a press conference here about an hour ago, and I might read you part of what the U.P. said I said, anyway, because I got a little angry on account of the stories that have been going around - the methods they have been using are outrageous - to try to force our hand, as though we were trying to hold out on the relief people, which is absolutely not so.

It says here: "Secretary Morgenthau said that relief needs of the country can still be met within latest budget estimates."

You see, Mr. Aubrey Williams was here yesterday and gave Mr. Bell and myself a statement as to his needs for February, and we still have sufficient funds in the budget to take care of what he says the needs are for February.

"Morgenthau said he canvassed the relief situation with Acting WPA Administrator Williams and Budget Director Bell yesterday. On the basis of the latest WPA figures, funds on hand are sufficient to take care of relief needs through June 30, he said.

"Morgenthau said the relief schedule submitted by Williams was practically the same as that set up in December. He added that because WPA was slow in early winter in taking on relief clients, it will be able to employ about 50,000 more people in February than originally contemplated."

Means they can take on a million 950 thousand.

"Morgenthau said the Treasury would use no 'sleight-of-hand' methods to secure money in case the relief needs become substantially greater." An awful lot of gossip around this town about raising money against R.F.C. assets and against gold sterilization and all that sort of thing. I thought I might just as well lay that one away.

"'If we need X millions of dollars, I'll ask for X millions of dollars,' the Secretary said. 'There is no use in walking three blocks where one will do.

"'If the time should come when there are not sufficient funds to take care of the needy, Mr. Bell and I will be the first to say so. In that case, we will make every effort to get the funds, even to asking Congress for a deficiency appropriation.'"

There has been so much misinformation - Bell and I have been kind of the goat - that I have really gotten .... I mean there's nothing gets under my skin so as to have people say falsely that Bell and I are the ones who are holding out on the money, which isn't so. And the facts are we brought all kinds of pressure to bear on the WPA to put more people on, and they haven't begun to put them on as fast as we outlined they could; and that's the reason they've got money over.

And I said, to lay that one that there was some scheme on foot, "If we need a hundred million dollars, why not say so? Why all these complicated scheme of some sleight-of-hand method that doesn't fool anybody?" I'd much rather come out and say, "We need a hundred million dollars. All right." I think it's much better to say so than to do it in a roundabout way; and I thought I would just once and for all lay it to rest, and Bell and I had a joint press conference on it.

Eccles: It wouldn't make any difference whether they got the money from the Government borrowing or from the gold or the R.F.C. It would all have to be appropriated in any case. Question of appropriation. The question of raising it - it isn't as if you could get it without Congress appropriating it.

H.M.Jr: But I mean we couldn't even get it out of the gold sterilization.

Eccles: Without an appropriation.

H.M.Jr: If we're appropriating, why not ask for a hundred million dollars clean?

Bell: Gold desterilization is just a means of financing an appropriation, that's all.

Eccles: And R.F.C. is the same thing. But the Congress has already appropriated a certain amount of money in this year's budget for relief which hasn't yet been used.

H.M.Jr: 680 million dollars.

Eccles: Yes. Now, I - it isn't as though the relief situation is very serious; it seems to me, as I get it, no one - I don't think the Treasury is blamed on it. At least, I haven't heard any blame passed here.

H.M.Jr: You read the stories in today's and yesterday's newspapers; you'll see; and both the President and I am very much blamed.

Eccles: Well, I have heard the blame passed upon the regulations of WPA, that - what they term the means test; that there are a great many people unemployed who would immediately take work if they didn't have to go through what they term the means test, and that in itself is the thing that makes it - reduces the number - keeps the number of people that lost their jobs from going on WPA work. It is the difference between the regulation, I think, and what the situation would be if it wasn't for that regulation.

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

Eccles: No, that was all.

H.M.Jr: I just want to add one other thing, so you people know what's going through my mind, and that is this - and that is this part of the reason I said this: that as far as the gold sterilization fund is concerned, I personally feel that with the world situation the way it is, with business so uncertain, and the first part of this year our export trade has fallen off very sharply, that we don't know when we may be called on in a real movement of gold going out, and then that fund will begin to function for the purpose it is set up, and we will be all tickled to death and say, "Look how smart we were to have that fund." I can't think of a worse time than now to monkey with that fund. I don't know - gold above $35 ....

Lochhead: About $35.02 in London.

H.M.Jr: We don't know - at any time, with this situation and the whole thing so upset, we may be called on for a good many hundred million dollars, and there the thing is, and it doesn't disturb you people and your excess reserve situation, and doesn't draw on the banks - draw down the reserves of the banks. It conserves the function. It's been there, we have taken all the criticism, and now, when it looks like any day we may be called on to let gold go, it seems to me to be very stupid to monkey with it at this time.

Sinclair: It is your extra pair of pants for the time being.

H.M.Jr: Yes. And I just - so that you hear and I take it like to know what's in my mind. And you can ask me any other question and I am more than glad, so that you people who are asked, "What is the Treasury thinking?" - at least I'll say I can or cannot answer. So if there is anything else on your mind that you want to know on where we stand, I'll be more than glad to answer it. I mean I see Mr. Eccles and Mr. Ransom once a week, but the other people I don't - up in New York they might want to have some question. But if you've got anything, any of you people, on your mind, here's a chance. Let's have it. I don't know whether you people ....

McKee: Well, Mr. Secretary, I'm worried about the trend of the Government bond market.

H.M.Jr: Which way?

McKee: Up. I think we're all going to be sitting around here in the not too far distant future and worrying about a forthcoming break in the market. Now, I don't know that we are all in a position to meet that and cushion it if and when it does happen, because we have ridden along with a large bond portfolio. And I think that - I've thought right along that all of us would certainly stay out of the bond market as far as buying bonds; and we ought to feed the market bonds when it would take it, to keep the abnormal amount of price increase from affecting the psychology of the investor.

Now, I think we're going to have to meet that; when, I don't know. But I don't - the underlying buying power, as I sense it, is going to drive this market into too new high ground unless something is done about it.

H.M.Jr: What do you suggest?

McKee: Well, personally I think we've got to go into an aggressive selling campaign or switching campaign to get rid of some of our bonds; then stand on the side lines and do what we can - can't do it all, but do what we can. And I certainly don't think it is any time for anybody to be buying Government ~~bonds~~ when there is this underlying demand for bonds.

And as you all know, New York banks have turned right around and are now buying bonds. They don't care what kind they are. They're buying any kind of bonds.

H.M.Jr: Buy Appalachians.

McKee: Yes, buy that.

Piser: Good sign.

Burgess: That's a very good sign.

McKee: Now, I'd just like to see whether - what your ideas are on it and whether I'm all haywire.

H.M.Jr: Well, I don't feel quite as disturbed about it as you, because in the four years I've been here we have always, at least once a year, usually two or three times, had a weak bond market, where we are very glad we have some reserve buying power. Now, we have a Postal Savings and F.D.I.C. - how much did they want us to invest?

Bell: About 55 million dollars in those two funds. We couldn't invest all of it, but certainly could invest up to around 40.

H.M.Jr: Well now, they've been crowding us, and I have held that for this meeting, just to talk it over with you. There's 40 million dollars. I spoke to Mr.

Eccles about it. Should we have those orders in, and if you fellows sell some bonds we'll buy them for this account, or should we give these fellows a two percent note and hold it against a rainy day?

Eccles: It seemed to me that for the present you should give them the two percent note, and then have us furnish the market with such bonds as are in demand. We have a large variety of them and we can pretty well stabilize it by selling what is in demand; and we can keep the market from going too high and save possibly - avoid a drastic readjustment at some time in the future by doing that. As long as the Treasury has this 40 or 50 million, then we would be in a position, in conjunction with them, at a later date, if you got real weakness in the market, where they could go in and buy up to the 40 or 50 million and we in turn could switch back. We'd pick up bills and could - that is, we could let some of our bills run off and buy bonds; to the extent that we could sell a hundred or two or three hundred million now, it would put us in a position then to reverse the action. And that, in conjunction with the Treasury, it seems to me, would enable us to meet any kind of a future condition.

H.M.Jr: I haven't talked it over with our boys, but our - my inclination is not to buy. I'd much rather give these boys a two percent note and sit back for another weak spot.

They tell me - I haven't seen it, but they tell me Tel & Tel is off six points this morning.

Eccles: That's the stock, yes.

Burgess: Report of the Communications Commission, I think, is responsible.

H.M.Jr: Well, Mr. Bell tells me that we still have 18 million of Civil Service fund bonds to sell. So we have 18 million dollars left to sell, and we'll give you a million dollars at a time.

Burgess: All right.

H.M.Jr: To feed out - just to kind of keep it stable. Then - I'll talk it over here again, but unless somebody disagrees with me - I say we'll talk it over; I haven't talked to Taylor - why, we'll give these Postal Savings and F.D.I.C. a two percent note and keep them out of the market for a while.

McKee: I'll tell you, this is just my own personal opinion, and I'd like to hear from Mr. Taylor or some of your men, just what they think about the future of the Government bond market. I'm interested in these banks' portfolios. They're just in one hell of a shape right now - depreciation on other bonds - and they certainly cannot take much more grief.

H.M.Jr: Well, I don't .. - want to say anything, Wayne?

Taylor: Well, I think there is - it gets back to whether we've got the proper volume of bills in the market at the present time. I'm inclined to think that we haven't.

Burgess: We have or haven't?

Taylor: We have not got enough bills in the market, and that throws the weight on the Government bonds - I mean purchasing standpoint as well as the selling standpoint, when any evening off comes out. I don't know whether I can express it any different way than that. I just have a feeling that you haven't got enough of very liquid short-term securities in the market to take care of the market needs.

Eccles: That is, in relation to the total debt.

Taylor: That's right.

McKee: Wayne, I think the banks that are buying bonds now are buying for earning power, not because they may want long bonds; but they just simply are up against earning power to meet overhead.

Burgess: That's right; that's the answer. And there isn't anything else coming along to put the money in.

Lochhead: We could hardly put out additional bills at the expense of the long-term bonds. It would restrict the supply of long-term bonds unless we put more Government obligations out in the market. So that would prevent any action of that nature just now.

H.M.Jr: Well, on this situation we said we wouldn't tell the boys anything until tonight. We usually announce four o'clock Thursday afternoon what we will do Monday. How would this be: if we told them this evening that, beginning with the first week in March, we would offer - I want to put it, between two and three hundred million dollars worth of bills falling due on or about the 15th of June. That gives us a little leeway. I mean if the tax receipts are better, why, then we might make it two, two fifty. If they are not so good, might make it 300. Or, if the tax receipts are very good, make it 200. But it gives us a little leeway. That's one of the reasons why Bell and I, talking this morning, thought we wouldn't start until the first week in March, by the tax date; just see what the tax receipts are. That doesn't make too much uncertainty, does it, to say between two and three hundred million dollars of bills?

Burgess: Does it give you enough leeway in case the tax receipts are very disappointing?

H.M.Jr: Well, I tell you ...

Burgess: That's my only question.

H.M.Jr: Well, I can't tell you what the tax receipts will be on the 15th, but I can tell you in strictest confidence that for the month of January the total Government revenue was 20 million dollars in excess of our estimates.

Burgess: Good.

H.M.Jr: Now, of course, that is still on the year-before business. Now, I don't know ... What George Haas is doing now, he's taking - we have two that we use, the Standard Statistics group of businesses and our own. We have two that we follow, and we are following the earning statements to see how those compare with what we are estimating.

When do you think you'll know, George, have something? Coming out pretty fast.

Haas: I think next week we'll have some kind of a comparison.

H.M.Jr: But I would answer your question - I don't - we have been terrifically conservative here on our estimates, and 300 million dollars I think will be all the money we could possibly use, see?

Bell: Still could go on, with two additional dates in April, then four dates in June, if they were disappointing, to the extent of three or four hundred million.

Burgess: That's true.

Eccles: Your March revenue can't be very disappointing, though. It isn't based on the present situation at all.

Bell: That's right.

H.M.Jr: And the other thing, Randolph, if it is bad, we can immediately start selling our September bills. I mean supposing we have to sell three hundred - I say between two and three hundred - into June; then we find they're terrible. When these things expire, we can immediately start selling bills into September. Huh?

Lochhead: Yes. Dan, in figuring your estimates, this - this free silver is coming up again Just now.

Eccles: Sell four into September.

Lochhead: 70 million could always be used at a pinch, couldn't it? Just right now that could be used in a pinch. You haven't counted on that.

Bell: What's that?

Lochhead: I say the free silver is starting to creep up again just now. The silver certificates outstanding don't get much over one billion four, don't seem to get .... So the new silver coming in, being paid for, piles up as free silver. Now, that always could be used in an emergency. Could always issue those certificates. Of course, be forcing them out. It's really money ...

Burgess: That's just the amount you paid for the silver.

Lochhead: That's just the cost price. And that's always backing up.

H.M.Jr: How much?

Lochhead: 70.

H.M.Jr: Well, the Federal Reserve always cooperates on silver certificates.

Lochhead: Well, I don't know whether they'd like a deposit of 70 million dollars of silver certificates. But from the standpoint - it is really money that could be used.

H.M.Jr: We'll buy 70 million dollars worth of bonds for those certificates.

Lochhead: I just mention that as an emergency item there that could always be used.

Bell: I have taken that into consideration to the extent of 20 million dollars over and above your purchases for the period, so your free silver would be, under this particular picture, 50 million.

Burgess: I don't see any argument against that program that is persuasive. It is a little better technique to start it earlier, so you don't double up quite so much toward the last of March and so you don't - you're not selling these two things in tandem and they are not both 90-days; but in the present market I don't think that is a real argument against it.

McKee: Well, in that connection, for the benefit of all of us, may I ask ....

H.M.Jr: Please.

McKee: ... Randolph this. If the Open Market Committee went into an aggressive campaign of switching bonds for certain maturities, with a lack of new bills in the market, what would be the effect on the short-term rate? For instance, if you - let's think in figures of 100 or 150 million bonds in the next 60 days or less.

Burgess: That's a little more than probably we would want to do. But, of course, it does ....

McKee: All depends on what the market - what the demand is.

Burgess: It does reduce the rate on notes and bills. I don't think that is very serious; it is one of the inevitable evils of making switches, as you put up the price of what you buy. But it isn't as bad to put up the price of notes as it is to have the price of bonds go way up, because there is less risk involved for the buyer.

Eccles: Well, where you buy bills mostly it doesn't make much difference, because they are almost negligible rate, and whether you put the price at six hundredths or eight hundredths or five hundredths - it's immaterial.

Burgess: I don't think supplying 200 million extra bills would make very much difference on that, Wayne.

Bell: What would happen if you let a few bills run off?

Burgess: Well, I'd be afraid to do it, Dan.

Eccles: Certainly would.

Burgess: I think it might be a jolt.

Sinclair: I've still got to be educated on that point.

H.M.Jr: Well, Dan likes to have his little joke.

Eccles: I tell you right here, with these hearings on the Hill on the Goldsborough and Patman and the rest of these bills, I think it would be about as dumb a thing as we could possibly do - is to start letting a lot of bills or notes or bonds run off. I just can't imagine anything that would invite more trouble and a possible Congressional investigation. Now, that may not make sense to you from a monetary point of view, but after all you're living in a particular ...

H.M.Jr: It does to Wayne Taylor, because he's got to go up - what is it you're going up to defend? That's the Goldsborough bill; that's - there's another one.

Taylor: I learned about the other one.

Eccles: I'm on two of them. If you can get on any more of these than I can, you're a good one.

H.M.Jr: Well, Wayne's going up to defend - is he going on the Goldsborough?

Taylor: Over an over-sized dead body.

Eccles: Mr. Goldsborough told me the Secretary is coming up.

H.M.Jr: Have to get a subpoena to get me up.

Taylor: Made any progress, Cy?

Upham: Oh yes, I made a little. I think I can get you out of it.

H.M.Jr: Yes, but don't slip me in.

I don't think it's fair that all of these members of the Executive Committee of the Open Market Committee never get a chance to testify on the Hill.

Sinclair: That time may come.

H.M.Jr: What?

Sinclair: The time may come.

Eccles: They're going to get a chance here; I understand that Mr. Patman is going to give all our fellows on the Board a chance.

Sinclair: Yes. Retirement system.

Eccles: I'm going to ask him to extend it to the members of the Open Market Committee. I'll be damned if I see why they need to confine it to the Board.

H.M.Jr: Well, does anybody have any objection to that announcement and that program from now until the 15th? Anybody got a better one?

Sinclair: I have no suggestion. I have sat here and tried to be critical, and haven't found any flaws in it. Therefore, I acquiesce in it.

H.M.Jr: Have anything? Well then, we'll do that.

Would you mind, as long as I've got the Doctor here, if I asked him if he's got anything good or bad on the business situation?

Eccles: Go ahead.

Golden.: I'm afraid I haven't anything that you haven't, Mr. Secretary. You know that in January things flattened out; they didn't go down any further. And the retail trade reports, which you see, ...

H.M.Jr: And may I thank you gentlemen for getting those. They are very, very helpful, those retail reports.

Golden.: The retail trade seems to be keeping up reasonably well. And we have seen reports - at the end of the year there were more inventories than there were the year earlier; and the amount, even as reported, wasn't as large as I had expected in view of general talk. It was only about six percent higher.

And I think that the business situation at the present time looks reasonably quiet, with no particular prospect of a breakdown and no indication, unless the building thing picks up very fast, of any rapid rise.

H.M.Jr: Have you your own idea what your index - production index will be for January?

Golden.: For January, 84 probably.

H.M.Jr: 84.

Burgess: The same as December, practically.

Golden.: That's right.

Burgess: I think the telephone people estimated one point lower, something like that.

Golden.: Well, within a point we can't be sure, but it is practically the same as December.

Burgess: Does the Secretary know about your latest effort to get more figures and so on?

Golden.: We have started an effort to get our Federal Reserve Banks to give us more current stuff from week to week.

H.M.Jr: Fine.

Golden.: And of course, we hope that that will get under way shortly and we'll give you anything we have.

H.M.Jr: Fine.

Eccles: Instead of waiting to get more or less complete statistical information, and then by the time you get it compiled it is after the event, it's a month late - the thought is to do a certain amount of what we may term sampling or spot checking, so that you can get within the week what's happening in the week in each of the areas and branches, by direct contact with a few businesses this week and a few other businesses next week, to find out, for instance, their selling - what's happening in sales, what's happening to their inventory, what is their purchasing policy, what is their labor policy. Now, if you can get that in 37 different sections of the country you can get the trend. If, for instance, a year ago we had had that, we would have possibly found out that they were buying much more than they were selling; might have gotten a better picture of inventories and an even closer trend on prices. As it was, why, damn it, we don't get it until 30 to 60 days after it happens. And we're going to at least try it.

H.M.Jr: Marriner, I talked to Stewart McDonald, oh, a month or six weeks ago, and at that time he was very much discouraged as to any effect before next fall, if and when this bill passed. Do you feel that way?

Eccles: Yes.

H.M.Jr: Do you think we'll get anything out of it this spring?

Eccles: I don't think so, as long as unemployment is where it is, because you're getting a surplus of housing. The question as to whether you have a shortage or a surplus is purely a relative thing. You'd have a shortage with reasonable employment situation, whereas you've got a surplus under the present situation of unemployment. Another thing that tends to influence the new construction, of course, is the trend of rents, and rents are tending down much faster than costs of construction are going down.

Now, we talk about maintaining current wages, which means maintaining current prices. That means that you have - we have frozen the cost, we've got a rigidity of cost here, whereas with unemployment and part-time employment rents are gradually going down, so that it becomes more unprofitable to build as the recession continues.

And my idea is that there is very little prospect of any pick-up in building - that doesn't come first; you've got to get an impetus of re-employment first. Then, if you do, we have a mechanism here that we haven't had before that will tend to take a hold and carry forward into a much more extensive building program. But we've got to have something, it seems to me, to give it an impetus. We'll get more building with this legislation than we would have gotten if we didn't have it, but I don't think it's going to be an important factor in the present situation.

H.M.Jr: Anybody want to ask anything?

Well, thank you very much.

ESTIMATE OF CASH POSITION

FEBRUARY - JUNE 1938

(In millions of dollars)

	1938 February	March	April	May	June	Total
Balances at beginning of periods:	926	1,004	1,016	828	911	926
Receipts:						
General revenue	353	972	314	393	804	2,836
Unemployment Trust Fund	75	40	35	75	45	270
U. S. Savings Bonds	50	40	30	25	25	170
Silver certificates	5	5	5	5	—	20
Sale of securities - Special Accounts	10	—	8	—	—	18
Treasury Bills	150 June	100 June	100 Sept.	200 Sept.	—	550
Total available	1,569	2,161	1,508	1,526	1,785	4,790
Expenditures:						
General	310	350	350	340	300	1,650
Emergency	190	210	190	170	160	920
Interest on public debt	20	155	70	10	175	430
Special transactions	15	—	—	30	—	45
Debt redemptions	30	430	20	15	280	775
Gold purchases	—	—	50	50	50	150
Total	565	1,145	680	615	965	3,970
Balances at end of period:	1,004	1,016	828	911	820	820
Refunding Operations:						
Treasury Bills:						
Regular	200	350	400	400	600	1,950
Special	—	400	—	—	250	650
Treasury Notes	—	455	—	—	618	1,073
	200	1,205	400	400	1,468	3,673

ESTIMATE OF CASH POSITION

FEBRUARY - JUNE 1938

(In millions of dollars)

	1938 February	March	April	May	June	Total
Balances at beginning of periods:	928	854	1,016	888	911	926
Receipts:						
General revenue	383	972	314	393	804	2,856
Unemployment Trust Fund	75	40	35	75	45	270
U. S. Savings Bonds	50	40	30	25	25	170
Silver certificates	5	5	5	5	--	20
Sale of securities - Special Accounts	10	—	8	—	--	18
Treasury Bills	—	250 June	100 Sept.	200 Sept.	--	550
Total available	1,419	2,161	1,508	1,526	1,785	4,790
Expenditures:						
General	310	350	350	340	300	1,650
Emergency	190	210	190	170	160	920
Interest on public debt	20	155	70	10	175	430
Special transactions	15	--	—	30	—	45
Debt redemptions	30	430	20	15	280	775
Gold purchases	--	—	50	50	50	150
Total	565	1,145	680	615	965	3,970
Balances at end of period:	854	1,016	888	911	820	820
Refunding Operations:						
Treasury Bills:						
Regular	200	350	400	400	600	1,950
Special	--	400	--	—	250	650
Treasury Notes	--	455	--	--	618	1,073
	200	1,205	400	400	1,468	[illegible]

[illegible]
February 2, 1938

TREASURY BILLS, CERTIFICATES, NOTES AND BONDS

TREASURY OBLIGATIONS OUTSTANDING

January 31, 1938

49
387

Series and Issue Date	Callable Date	Fiscal Year Callable or Redeemable	Maturity Date	Amount	Total
TREASURY BILLS:					
May 5, 1937		1938	Feb. 2, 1938	$50,214,000	
May 12, 1937		1938	Feb. 9, 1938	50,477,000	
May 19, 1937		1938	Feb. 16, 1938	50,044,000	
May 26, 1937		1938	Feb. 23, 1938	50,013,000	
June 2, 1937		1938	Mar. 2, 1938	50,077,000	
June 9, 1937		1938	Mar. 9, 1938	50,000,000	
June 16, 1937		1938	Mar. 16, 1938	50,040,000	
Oct. 27, 1937		1938	Mar. 16, 1938	50,045,000	
Nov. 3, 1937		1938	Mar. 16, 1938	50,119,000	
Nov. 10, 1937		1938	Mar. 17, 1938	50,044,000	
Nov. 17, 1937		1938	Mar. 17, 1938	50,090,000	
Nov. 24, 1937		1938	Mar. 18, 1938	50,150,000	
Dec. 1, 1937		1938	Mar. 19, 1938	50,040,000	
Dec. 8, 1937		1938	Mar. 19, 1938	50,143,000	
Dec. 15, 1937		1938	Mar. 19, 1938	50,030,000	
June 23, 1937		1938	Mar. 23, 1938	50,189,000	
Dec. 22, 1937		1938	Mar. 23, 1938	50,098,000	
June 30, 1937		1938	Mar. 30, 1938	50,010,000	
Dec. 29, 1937		1938	Mar. 30, 1938	50,077,000	
July 7, 1937		1938	Apr. 6, 1938	50,210,000	
Jan. 5, 1938		1938	Apr. 6, 1938	50,000,000	
Jan. 12, 1938		1938	Apr. 13, 1938	50,027,000	
July 14, 1937		1938	Apr. 13, 1938	50,000,000	
July 21, 1937		1938	Apr. 20, 1938	50,020,000	
Jan. 19, 1938		1938	Apr. 20, 1938	50,150,000	
Jan. 26, 1938		1938	Apr. 27, 1938	50,005,000	
July 28, 1937		1938	Apr. 27, 1938	50,022,000	
Aug. 4, 1937		1938	May 4, 1938	50,047,000	
Aug. 11, 1937		1938	May 11, 1938	50,097,000	
Aug. 18, 1937		1938	May 18, 1938	50,048,000	
Aug. 25, 1937		1938	May 25, 1938	50,081,000	
Sept. 1, 1937		1938	June 1, 1938	50,088,000	
Sept. 8, 1937		1938	June 8, 1938	50,314,000	
Sept. 15, 1937		1938	June 15, 1938	50,110,000	
[illegible]		1938	June 15, 1938	50,018,000	
[illegible]		1938	June 29, 1938	50,114,000	
[illegible]		1938	July 6, 1938	50,190,000	
[illegible]		1938	July 13, 1938	50,103,000	
[illegible]		1938	July 20, 1938	50,058,000	
					$1,951,888,000
TREASURY CERTIFICATES:					
				—	—
TREASURY NOTES:					
2-5/8% A-1938 . . . . . . Feb. 1, 1933		1938	Feb. 1, 1938	13,009,800	
3% C-1938 . . . . . . Mar. 15, 1934		1938	Mar. 15, 1938	455,175,500	
2-7/8% B-1938 . . . . . . June 15, 1933		1938	June 15, 1938	618,056,800	
2-1/2% D-1938 . . . . . . Sept. 15, 1934		1939	Sept. 15, 1938	596,416,100	
1-1/4% E-1938 . . . . . . Sept. 15, 1937		1939	Dec. 15, 1938	433,460,900	
1-1/8% C-1939 . . . . . . Sept. 15, 1936		1939	Mar. 15, 1939	941,613,750	
2-1/8% A-1939 . . . . . . June 15, 1934		1939	June 15, 1939	1,293,714,200	
1-3/8% B-1939 . . . . . . June 15, 1937		1940	Sept. 15, 1939	426,554,600	
1-3/8% D-1939 . . . . . . July 15, 1935		1940	Dec. 15, 1939	526,233,000	
1-3/8% A-1940 . . . . . . Mar. 15, 1935		1940	Mar. 15, 1940	1,378,364,200	
1-1/2% B-1940 . . . . . . June 15, 1935		1940	June 15, 1940	738,428,400	
1-1/2% C-1940 . . . . . . Dec. 16, 1935		1941	Dec. 15, 1940	737,161,600	
1-1/2% A-1941 . . . . . . Mar. 16, 1936		1941	Mar. 15, 1941	676,707,600	
1-3/8% B-1941 . . . . . . June 15, 1936		1941	June 15, 1941	503,877,500	
1-1/4% C-1941 . . . . . . Dec. 15, 1936		1942	Dec. 15, 1941	204,425,400	
1-3/4% A-1942 . . . . . . June 15, 1937		1942	Mar. 15, 1942	426,349,500	
2% B-1942 . . . . . . Sept. 15, 1937		1943	Sept. 15, 1942	342,143,300	
1-3/4% C-1942 . . . . . . Dec. 15, 1937		1943	Dec. 15, 1942	232,375,200	
					10,547,287,900
TREASURY BONDS:					
3-3/8% 1940-43 . . . . . . July 16, 1928	June 15, 1940	1940	June 15, 1943	352,993,450	
3-3/8% 1941-43 . . . . . . Mar. 16, 1931	Mar. 15, 1941	1941	Mar. 15, 1943	544,870,050	
3-1/4% 1941 . . . . . . Aug. 15, 1933	—	1942	Aug. 1, 1941	834,453,200	
3-3/8% 1943-47 . . . . . . June 15, 1927	June 15, 1943	1943	June 15, 1947	454,135,200	
3-1/4% 1943-45 . . . . . . Oct. 15, 1933	Oct. 15, 1943	1944	Oct. 15, 1945	1,400,528,250	
3-1/4% 1944-46 . . . . . . Apr. 16, 1934	Apr. 15, 1944	1944	Apr. 15, 1946	1,518,737,650	
4% 1944-54 . . . . . . Dec. 15, 1924	Dec. 15, 1944	1945	Dec. 15, 1954	1,036,884,500	
2-3/4% 1945-47 . . . . . . Sept. 16, 1935	Sept. 15, 1945	1946	Sept. 15, 1947	1,214,428,950	
2-1/2% 1945 . . . . . . Dec. 15, 1937	—	1946	Dec. 15, 1945	540,843,550	
3-3/4% 1946-56 . . . . . . Mar. 15, 1926	Mar. 15, 1946	1946	Mar. 15, 1956	489,080,100	
3-1/8% 1946-49 . . . . . . June 15, 1931	June 15, 1946	1946	June 15, 1949	818,627,000	
3% 1946-48 . . . . . . June 15, 1934	June 15, 1946	1946	June 15, 1948	1,035,874,400	
4-1/4% 1947-52 . . . . . . Oct. 16, 1922	Oct. 15, 1947	1948	Oct. 15, 1952	758,945,800	
2-3/4% 1948-51 . . . . . . Mar. 16, 1936	Mar. 15, 1948	1948	Mar. 15, 1951	1,223,495,850	
3-1/8% 1949-52 . . . . . . Dec. 15, 1934	Dec. 15, 1949	1950	Dec. 15, 1952	491,375,100	
2-1/2% 1949-53 . . . . . . Dec. 15, 1936	Dec. 15, 1949	1950	Dec. 15, 1953	1,786,130,050	
2-3/4% 1951-54 . . . . . . June 15, 1936	June 15, 1951	1951	June 15, 1954	1,626,687,450	
3% 1951-55 . . . . . . Sept. 16, 1931	Sept. 15, 1951	1952	Sept. 15, 1955	755,476,000	
2-7/8% 1955-60 . . . . . . Mar. 15, 1935	Mar. 15, 1955	1955	Mar. 15, 1960	2,611,092,650	
2-3/4% 1956-59 . . . . . . Sept. 15, 1936	Sept. 15, 1956	1957	Sept. 15, 1959	981,827,050	
					20,476,086,300
UNITED STATES SAVINGS BONDS					1,080,430,750
ADJUSTED SERVICE BONDS					842,895,750
					34,898,481,644

Treasury certificates, trust funds	$479,762,000	
Treasury notes, trust funds	1,134,299,000	
Total trust funds		1,614,061,000
Pre-war bonds, including Postal Savings		196,750,680
Non-interest-bearing debt, including Liberty Loan Bonds		545,054,586
		37,452,327,290

RECAPITULATION

Total Treasury bills	$ 1,951,905,000
Treasury certificates	—
Treasury notes	10,547,267,950
Total bonds	20,377,102,316
Trust fund obligations	1,614,061,000
Non-interest-bearing debt	744,014,426
	$ 37,452,327,290

REPORT OF SECRETARY MORGENTHAU'S
PRESS CONFERENCE, FEBRUARY 3, 1938:
(Mr. Bell also present)

H.M.Jr: There seems to be considerable interest in the employment situation and the amount of money available to take care of the unemployed, and Mr. Bell and I devote as much time to that particular subject as any subject that we have to do with, and I have made statements here at different press conferences that we still had sufficient funds on hand to take care of the requirements as they were given to us by Works Progress Administration. Now no less than yesterday at twelve o'clock--11:30 or 12--Mr. Aubrey Williams was over here and sat down with Mr. Bell and myself and submitted a new schedule, and under the schedule which he submitted to Mr. Bell and myself there are still sufficient funds in the budget to take care of the needs which Mr. Aubrey Williams put up to us. Now nobody in Washington are more interested or more sympathetic than Mr. Bell and I to the needs of the unemployed, and if the time should come when there are not sufficient funds in the Treasury to take care of the needy, why Mr. Bell and I will be the first to say so, and we will do everything possible to get additional funds, even to the extent of asking Congress for such funds through a deficiency bill, if and when that time comes. And there isn't a week, I think, that goes by that Mr. Bell and I don't study this subject, and, furthermore, we have our own field representative in the field constantly travelling and checking on the unemployment situation. We are in touch with the Social Security people to get the latest information. And, as a matter of fact, one of the situations which really worries Mr. Bell and myself even more than this, but they don't seem to have the knack of good publicity possibly as some others, and that is the farm people who are on relief under Resettlement, or what do they call it?

Mr. Bell: Farm Security.

H.M.Jr: Farm Security, under Dr. Alexander, and Mr. Bell and I are studying that situation very closely. Do you want to add anything to that, Bell?

Mr. Bell: No, I think that covers it very well.

Q. Mr. Secretary, in regard to these reports, did you ask Mr. Williams to reduce his schedule?

H.M.Jr: I have not asked Mr. Williams to reduce his schedule. We have taken it exactly as he submitted it to us.

Q. Can you tell us how long it runs? I assume it's revised from time to time.

A. This is a schedule originally set up in December?

Mr. Bell: That's right--December 20th.

H.M.Jr: And he revised it as of yesterday upward in the number of people that could be taken care of and the reason he could revise it upward without additional funds is that they were slow in December and January in putting additional people on the rolls, and that's why there is still money available to take on 50,000 more people in February than they originally contemplated.

Q. Is this schedule that he submitted yesterday for the month of February?

A. It is for the month of February--it's for the balance of the year.

Q. Fiscal year?

A. Running through to June 30th. But Mr. Bell and I have not once taken--reduced the number of people on their list--by not one. We haven't reduced it a single person. We haven't had to. There have been sufficient funds available up to now. As I say, if the time comes when there are not, we are as much, or more, interested as anybody else in seeing that nobody starves and the Treasury will be the first to say the money is available.

Q. Mr. Secretary, can you or Mr. Bell give us figures on the people to be taken care of or the money available?

A. I think the people should come out of the Works Progress Administration. There has been enough coming out of there the last couple of days and they might as well give it to you.

Q. When you say there are still sufficient funds, do you mean sufficient funds clear through to June 30th?

A. There are still sufficient funds for the schedule handed to Mr. Bell and myself yesterday at 11:30.

Q. Did you mean when you said that Farm Security was worried about that that there was likely to be a shortage there of some kind?

A. They have a $10,000,000 fund, haven't they?

Mr. Bell: No, $12,000,000.

H.M.Jr: $12,000,000 to take care of farm population on direct relief and the question is if that is enough money to take care of those people until June 30th. And we have had a conference this week with Mr. Alexander and he's given us additional figures and facts; based on that information right now, as far as we know, it's all right, but whether that is enough money to last them until June 30th we don't know, but that situation, without having checked it ourselves, looks as though it might be even more critical than Works Progress Administration because those people are on direct relief right now and the money they get from the Government is food and clothing, and if they don't get it they will go hungry.

Q. Mr. Secretary, that $12,000,000 is what is left for spending between now and June 30th?

A. Yes.

Mr. Bell: That's what was allocated to them in December in addition to what they had previously for the months beginning July 1. They said at that time they were about out of money in December so the $12,000,000 is for the six months running to June 30th.

Q. Could you give us the total figure of the amount to be spent for relief to June 30th?

Mr. Bell: I can't give you an over-all figure. The WPA has about $680,000,000 of new money for funds until June 30th. If they have any funds left over of the funds allocated previous to December 31, that increases that $680,000,000.

Q. Mr. Secretary, on the Daily Statement there appears this summary of emergency funds, the allocations, obligations and expenditures, and according to that at least until recently it appeared that there had been about $400,000,000 unobligated and an additional $400,000,000 unallocated; is that money available for this purpose?

Mr. Bell: Some of it; all of the unallocated is available either for Farm Security, WPA, or various departmentals.

Q. Without new appropriations?

Mr. Bell: Yes.

H.M.Jr: Does that kind of clear up that situation?

Q. Anything on your Treasury financing, Mr. Secretary?

A. No, if there will be, when Mr. Gaston makes his regular announcement Thursday evening as to what we do on Monday--if we come to any decision between eleven and twelve we will have it for you. Mr. Gaston will have the information for you.

Q. That includes the bills if you are going to have bills?

A. Whatever there is.

Q. Mr. Secretary, is the Interdepartmental Committee scheduled for any other meetings here?

A. No.

Q. Have you seen any of these memoranda allegedly suggesting gold desterilization and issues of debentures against recoverable assets, housing and relief all hooked up into one thing?

A. Not in written form. I got them word-of-mouth, just as you did. There's nothing has come formally to me.

Q. Is it true, sir, the agencies holding these recoverable assets have already got debentures against these things?

Mr. Gaston: Net proprietary interest is over and above any interest they have.

Q. I thought the RFC, for instance, was indebted to you for all the money it had gotten in any way at all and re-invested in any asset of any kind.

Mr. Bell: Well, it has for part of it, but they've got an earning. That proprietary interest does include capital stock, Herbert.

H.M.Jr: Are you through?

Mr. Bell: Yes.

H.M.Jr: If what we are talking about, if we need additional money for relief, as far as that is concerned, as Secretary of the Treasury, I will ask for funds. I'm not going to use any sleight-of-hand. I'm going to come right out openly and say we need so much money to take care of the needy and not do it in a sleight-of-hand or phoney manner, and these fellows who are sitting up nights trying to find some way to do it, this way or that way, as far as I am concerned they are wasting their time. I will come right out openly and above board and ask for X millions of dollars to take care of the needy for the rest of the year. There's no sense in the world in going around three blocks to do what is a very simple thing - we need so much money to take care of the needy.

Q. Have you gotten that report from the committee studying the small-loan problem?

A. No.

Q. How about this French situation--any change?

A. Nothing.

Q. Thank you, Mr. Secretary.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE FEB 3 1938

TO Secretary Morgenthau

FROM Herman Oliphant

In order to keep the records of my office clear, I enclose copy of a letter which Mr. Opper has shown me with the information that it is being forwarded without the initials of Mr. Bell, and for that reason is not being initialed by Mr. Opper insofar as it affects legal aspects of accounting, Mr. Hester insofar as it affects legislation, nor by myself.

Taylor has seen a copy of this Memo. HO

Enclosure

C O P Y

Dear Jesse:

Thank you for your letter of January 31st and its enclosures, to which I hasten to reply in view of my belief that no delay in the introduction of such legislation is desirable.

We have gone over the drafts of the proposed Balance Sheet and Commodity Credit bills and have no further suggestions to make. The Treasury will be prepared to report favorably on the two bills if a report is requested by the appropriate Committees.

Yours sincerely,

Acting Secretary.

Honorable Jesse H. Jones,
Chairman,
Reconstruction Finance Corporation,
Washington, D. C.

February 3, 1938

The attached was handed to me today by Senator Barkley when I saw him, Senator Guffey, Graves and Alexander from AT.

M E M O R A N D U M

American whiskey is a distillate from grain which has always been aged in charred new oak barrels. The charred new oak barrel is part of the manufacturing process. Storage in a charred new oak barrel creates a characteristic in the whiskey not otherwise obtainable. The whiskey extracts certain ingredients from the barrel, the barrel absorbs certain ingredients from the whiskey, the char acts as a catalyst, and the mingling of the wood ingredients with the grain ingredients of the whiskey (commonly called congeners) in the presence of the catalyst oxidized by the breathing of the barrel, results in chemical reactions creating esters and other ingredients which give the whiskey a flavor and aroma characteristic of American whiskey which is not otherwise obtainable.

Scotch, Irish and Canadian whiskies do not have those characteristics and they are aged in different kinds of containers.

Canadian whiskey is made from the same kind of grain mash as American whiskey is made from, and while the processes of distillation are somewhat different, the product coming from the still does not differ materially from American whiskey. The prime difference between Canadian and American whiskies is a difference developed by the difference in storage. Canadian whiskey is usually stored and aged in reused barrels.

Recently a few American distillers, primarily Canadians who have opened plants in this country, have made a whiskey in this country which they have stored in reused barrels. This whiskey is, in our judgment, a Canadian whiskey made in the United States. They have stated in Canada they reuse the barrels innumerable times, as much as forty or fifty years, and apparently plan to do that in this country. This would, of course, mean destruction of the cooperage business.

The Federal Alcohol Administration is now considering a request of those producers, authorizing them to label their whiskey identically with the labels prescribed for the normal American whiskey.

If that is done, or if the label distinction is not so great as to clearly distinguish the products so that one cannot be palmed off for the other, the American distillers will suffer materially, the banks who have financed the present inventories will suffer materially, and the American distillers will be driven to the use of second-hand barrels, thus destroying the cooperage industry, the timber growers, and the labor in the timber, cooperage, and steel fields. Steel hoops are used on barrels and the steel hoop is an important part of the steel industry, which would be materially affected should the use of new barrels be decreased.

This is true because it costs about ten to twelve cents a gallon less to make whiskey in a reused barrel than it does to make it in a new barrel. If the two whiskies can be palmed off as the ame thing to the consumer the differential in the cost of production ill drive the American distiller to use the second-hand barrel, and he resultant depreciation in the high inventory costs and the re- uction in labor in the production of barrels and in the cutting of he timber will automatically result.

The label distinction, therefore, is necessary, not only to pro- ect the American consumer but to protect employment and capital in- estment.

It is believed that the Federal Alcohol Administration and the reasury Department, the approval of the Treasury to the Federal lcohol Administration regulations being required by law, are fully ognizant of the problem. However, there is still open the question f what the label distinction should be in order fully to protect he consumer and the employment and capital investments. A great eal of the pres nt capital investment in the higher priced new arrels was brought about by the fact that until April or May of 1937 he Federal Alcohol Administration regulations did make adequate abel distinction between the products, which distinction has since een wiped out by the Federal Alcohol Administration's reinterpreta- ion of their own regulatory requirements.

There have been various label distinctions considered.

The reused cooperage users have suggested that the only label distinction which should be made is that on the reused cooperage whiskey the label show "this whiskey stored in a reused barrel for months" while on the new cooperage whiskey, the label show "this whiskey aged in a new charred barrel for months". Such distinction is not adequate. It is not obvious to the consumer and the consumer would not understand what difference there was in the whiskey. Explanation of the difference in the method of manufacture does not inform the consumer of the difference in the nature of the product, and an advertising campaign built around the reused statement on the label would not sufficiently deter the sale of reused whiskey to justify the American distillers' investments in new barrels. Such distinction therefore is inadequate and brings about all of the objections heretofore pointed out.

Another suggestion that has been considered is that the reused cooperage whiskey be unclassified and sold merely as whiskey. This is not only violative of the requirements of the Federal Alcohol Administration Act but gives the reused cooperage whiskey distillers an advantage over the new cooperage users in that the retail salesmen could sell the whiskey for whatever kind of whiskey the customer called for without any label description which would afford the customers a check against the salesman's representations.

As above stated, we are of the opinion that the reused cooperage is in fact a Canadian whiskey made in the United States.

It therefore should be labeled either "Canadian type whiskey" or "Canadian whiskey made in the United States".

In Canada no distinction is made between the whiskey made from a grain mash in which rye predominates or in which corn predominates. There is no such thing in Canada as a rye whiskey or as a bourbon whiskey. No matter which type of grain predominates in the mash the whiskey is Canadian whiskey. It has been suggested, therefore, that inasmuch as the reused cooperage distillers make a product which should have some description as to the grain mash, i. e., rye or bourbon, and that the product is a cross between the American whisky and Canadian whiskey, the product be called respectively "Canadian type rye whiskey" or "Canadian type bourbon whiskey". Either of these descriptions would sufficiently distinguish the product from the normal American whiskey to protect ~~both~~ the consumer, the employees in the barrel, timber, and steal indutries, and the American distillers' capital investment.

To summarize, therefore, reused cooperage whiskey made in the United States should be labeled either (1) "Canadian type whiskey", (2) "Canadian whiskey made in the United States", or (3) "Canadian type rye whiskey" or "Canadian type bourbon whiskey", as the case may be.

With any of these labels full age claims for the whiskey should be permitted, and in any event the length of storage should be shown so as to distinguish the whiskey stored for one day in reused barrels from whiskey stored for a longer period.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE FEB 3 1938

TO Secretary Morgenthau

FROM Herman Oliphant

For your information.

New York Old Post Office:

This case has now been assigned by the Department of Justice to Mr. Ward in the Washington office. He is now drafting a complaint and revising the stipulation submitted informally by us about three weeks ago. When the complaint and the stipulation have been approved, Mr. Ward intends to take them to New York City for discussion with the Corporation Counsel. We are following this matter closely and keeping Eddie informed since he is handling it for La Guardia.

Genesee Valley Gas Company, Inc.:

SEC has submitted informally a plan of reorganization for this company. We are examining the plan and will give SEC our suggestions. Pending receipt of advice as to action to be taken by the New York Public Service Commission in respect of the transfer in 1928 of $198,000 from Depreciation Account to the Surplus Earnings Account, it will be impossible to agree finally upon a plan. However, we are preparing alternative proposals to anticipate the probable action of the Public Service Commission.

MEMORANDUM OF THE DAY'S ACTIVITIES

February 3, 1938

To: The Secretary

From: Mr. Magill

1. Undistributed profits tax

In a memorandum received today Mr. Shoup indicates his disapproval of a substantial undistributed profits tax unless better treatment is accorded to corporations with highly fluctuating incomes, through a substantial net loss carry-over or otherwise. Mr. Shoup also dislikes the present proposal for the taxation of closely held operating corporations for similar reasons. He thinks we should devote time to finding ways and means of taxing the stockholder directly upon the retained earnings of his corporation.

2. Foreign personal holding companies

Mr. Brenner, one of our special agents, reports to me that no new corporations have been formed in the Bahamas during the past 60 days. During the same period a year ago 33 were formed. Furthermore, in the past 60 days 14 Bahamas corporations have been dissolved. These facts seem to indicate that the foreign personal holding company legislation has had a good effect.

3. Tax bill

Messrs. Doughton and Vinson informed me this afternoon that the Democrats on the Ways and Means Committee had a further inconclusive discussion of the provisions for taxing closely held companies.

I also had a long and difficult discussion with them on the proposal to enact a compilation of internal revenue laws prior to the enactment of the proposed revenue bill. The compilation has been prepared by Mr. Stam, counsel for the Joint Committee, with the cooperation of the attorneys in the Legislative Division; but according to my information has not been completely checked by Mr. Lusk, the head of the Legislative Division, Kent, Tarleau, or myself. I urged that the revenue bill should be adopted first; and further that Mr. Kent and I should be given an opportunity to check the proposed compilation for accuracy. Mr. Vinson took the position that my recent statement before the Ways and Means Committee amounted to a blanket endorsement of the compilation, and that there was no need for further checking. We adjourned without coming to any definite conclusion.

He saw Homer Martin, of the automobile union people and they are getting very restless - their hopes were raised so high.

In summarizing, he said, "The thing you have to watch is that the people do not lose their faith in Roosevelt because if they do the next form of government we have will be something quite different."

He said, "I want to ask your advice, as a friend, if I should run for Governor". I said, "Bob, if you were going to run next month my answer to you would be definitely 'no' but a lot of water can go over the dam between now and next September and it is too early to decide".

February 3, 1938.
4:34 p.m.

H.M.Jr: Hello Barkley.

Sen. Alben Barkley: I - I forgot to talk to you this morning about another matter that I intended to mention.

H.M.Jr: Please.

B: You know the Appropriation Committee has reduced the amount of - that's allowed to you for advertisement - advertising on account of these baby bonds.

H.M.Jr: Yes.

B: Are you interested in that? Are you going to have anybody over here to ask for its restoration?

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

B: You don't.

H.M.Jr: No.

B: Well. I didn't want to do anything about it unless you were interested.

H.M.Jr: No - the newspapers, I think, have been kinda putting on a fight, and I think they were very stupid about it.

B: Yes.

H.M.Jr: And here United States Government were doing a - what I think, a very high class constructive piece of advertising, and the only paid advertising United States Government is doing.

B: Yes.

H.M.Jr: And these newspaper fellows get busy and they have it put out all right. We'll do it now, the best we can, do it and rely on the Post Office.

B: Well, it was - of course it was a good investment because the fact the figures show, you know.

H.M.Jr: I know.

B: But still I didn't want to take any action.

H.M.Jr: Well, I appreciate it, but as Secretary of the Treasury, I can't be telling everybody else to cut down, and -

B: Yes. Well. All right, I just wanted to find out how you felt about it, and whether you wanted anything done.

H.M.Jr: Now, I appreciate it. Let me ask you this. The boys have been fixing up those labels and Alexander will let you know when he's got it. I told him to hurry up.

B: Yes.

H.M.Jr: And - till we get that straightened out.

B: All right. Appreciate it very much your - the time you gave us and your attitude, for that matter.

H.M.Jr: Well -

B: It's worthy right. We're right about this thing.

H.M.Jr: I - I know you are.

B: Yes.

H.M.Jr: O.K.

B: All right Henry.

H.M.Jr: All right.

B: Goodbye.

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE February 3, 1938.

TO CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH BANK OF ENGLAND.

FROM L. W. Knoke

I called Mr. Bolton at 10:34 this morning. Things looked pretty black, he said. At the moment, the franc was under attack again by the bears who were attracted by the fact that Saturday was a holiday in France, as a result of which francs sold by them today need not be delivered until Monday. Next week, Bolton said, the French were going to show a very heavy loss in their gold reserves due to the cumulative pressure applied to the franc recently. Volume of franc transactions was small in London as most of the operations were concentrated in Paris where they belonged since the whole thing was purely a French phenomenon, that is a fight between the Frenchmen and their own authorities.

The belga was being affected by the movement against the franc with the result that from time to time the Belgians lost gold to England. The weakness of the belga was actually a thing that made the manipulation of the gold price in London a bit difficult for this reason: that if they wanted to have a higher premium on gold in London above the 34.77 level, they raised the gold price against the Belgians and thus helped to draw gold out of Brussels which was the very thing they wanted to avoid if possible. Times were bad enough without deliberately making the problem of the Belgians more difficult.

I asked whether there was any gold business with Amsterdam and Bolton replied there was no market business, all gold transactions being handled between the two funds.

Switzerland was very obviously selling dollars, Bolton continued, not the Swiss authorities but the Swiss people themselves.

OFFICE CORRESPONDENCE

DATE February 3, 1938.

TO CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH BANK OF ENGLAND.

FROM L. W. Knoke

(His comment as regards the Swiss authorities is borne out by our figures which show no reduction in the Swiss National Bank's balances with us.) Seventy-five per cent of these dollar sales, he thought, was straight repatriation of funds and conversion into Swiss francs; the remaining 25% probably went into gold. It was different in the Dutch case, who also continued to sell dollars. But with them practically the bulk seemed to be against gold.

I asked whether he had any new figures on hoarding of gold in London and he thought that the last figure of £100,000,000 to £140,000,000 which he had given me back in May, 1937, was practically unchanged. Maybe they were £5,000,000 or £10,000,000 more today but that was the maximum.

Bolton inquired as to the situation in this country and I explained that the state of great uncertainty seemed to overshadow everything. As far as England was concerned, he thought, the feeling of depression was spreading in London.

He asked whether our outward movement of capital had continued during January and I replied that, according to the latest figures just available, the total for the last four months had reached about $550,000,000, of which about $50,000,000 had left us during January.

LWK:KMC

LMS

GRAY

London

Dated February 3, 1938

Rec'd 3:35 p. m.

Secretary of State,

Washington.

92, February 3, 7 p. m.

FOR TREASURY FROM BUTTERWORTH.

Answering a question in the House of Commons this afternoon, the Prime Minister stated "I have no reason to suppose that the setting up of an Anglo-American committee with a view to discovering to what extent Great Britain and the United States could agree upon the war debt problem would be welcome to the Government of the United States, nor do I see that it would be likely to serve any useful purpose".

CONFIDENTIAL: In the course of a casual conversation Bolton, who operates the British equalization fund in the Bank of England, made the following comments. (1) That there had in his experience never been more cross currents in the foreign exchange markets than existed today. (2) That the big speculators and a

great

LMS 2-No. 92, February 3, from London.

great many Frenchmen were now using Zurich as their point of operation. (3) That although at the time of the gold scare the gold problem seemed real, there might well develop in the course of this year a flight into gold. In this connection he inquired about the dollar and the course of American recovery. He obviously thought that there was a possibility of an important flight from the dollar. (4) That it seemed probable that New York banking was going through much the same process as took place in London in the nineties, one result of which would be that the large New York banks would increasingly tend to preserve a cash ratio around 10%. In this connection he commented on the cash squeeze of early August.

The pressure on the franc was considerable today and although the rate closed at 152 7/8, it reached at one time 153½. The Bank of France lost a fairly large quantity of sterling. The pressure was attributed here to report that the French Labor code negotiations were going badly.

JOHNSON

CSB:

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: February 3, 1938, 4 p.m.

NO.: 185

FROM COCHRAN.

French control has had a bad day. From opening rate of 152.95 sterling was bid up to 153.60. By 3:30 p.m. control had brought it back to 152-7/8 but this support has been very costly. One broker alone has taken 650,000 pounds from the control. Forward franc more offered and rentes lower. Money scarce with today final date for payment of subscriptions to Algerian loan. Bank of France statement as of January 27 showed no gold loss or other significant changes.

There is a gloomy atmosphere on the market. There has been no improvement in internal affairs, and it will apparently take some days to work out the labor code, which will probably involve serious differences. As for affairs outside of France, the French are concerned over the rumored developments between the Army and the Nazi party in Germany, and over the sinking in the Mediterranean of a British merchant vessel. As a result there has been a slump in international shares. There is recurrent gossip as to possibility of restrictive measures on franc exchange as the weekend approaches.

END MESSAGE.

BULLITT.

EA:LWW

PARAPHRASE OF TELEGRAM SENT

TO: American Embassy, Paris, France

DATE: February 4, 1938, 11 a.m.

NO.: 64

Reference is made to your telegram No. 176.

You are requested to tell the Minister of Finance that the Secretary of the Treasury is most pleased to have his message, and has asked you to transmit this word to the Minister.

HULL.

EA:LWW

PARAPHRASE OF TELEGRAM SENT

TO: American Legation, Bern, Switzerland

DATE: February 4, 1938, 11 a.m.

NO.: 3

Reference is made to your telegram of January 28, No. 7.

Secretary Morgenthau wishes to transmit his thanks for your telegram. He states that the information contained therein is extremely interesting to the Treasury, and that if you would continue to report on these matters whenever any development of Treasury interest arose, it would be helpful to them. The Department and the Treasury have an arrangement whereby the Treasury pays the cable expenses for reporting of this type on matters of Treasury interest.

HULL.

EA:LWW

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: February 4, 1938, noon

NO.: 189

RUSH. FROM COCHRAN.

STRICTLY CONFIDENTIAL.

The two following plans were undertaken in a final effort to avoid showing a loss of gold on the Bank of France statement covering the week ended February 3.

First.

The French officials talked with the Bank of England by telephone on Wednesday. They asked whether the British control would immediately give gold for the 2 1/2 million pounds which is under earmark for future exchange operations by the French control. The British gave an affirmative answer after they had had a short consultation.

The question was discussed at great length by the four leading officials of the Bank of France. Then they finally reported to the Ministry of Finance that while it would be legal to take this gold through the forward account, there might be criticism of using such gold to repay the Bank of France for gold borrowed from the Bank of France in recent days by the stabilization fund.

The Ministry of Finance, upon the recommendation of the four officers of the Bank of France, decided that they would not pursue the matter further, so no action was taken.

Second.

Second.

On Wednesday an urgent appeal was made by the French to the Dutch Banking Syndicate for a further instalment on its florin credit. This credit as originally envisaged was for 150,000,000 florins; by the fifteenth of January 112,500,000 florins had been paid across.

END SECTION ONE.

BULLITT.

EA:LWW

PARAPHRASE OF SECTION TWO, No. 189 of February 4, 1938 from Paris.

In communicating with the Dutch the French stressed the urgency of their situation and asked that the funds be paid to them in time to convert them into gold before the night of the third. The syndicate in response to this appeal gave an additional 7,500,000 florins. This amount brings the total up to 120,000,000 florins. On Thursday the gold was actually added to the resources of the stabilization fund.

The operation with the British ~~was~~ having been carried out, and the Dutch operation having yielded the small amount above mentioned, yesterday it was decided that the control would take from the Bank of France as of yesterday the four billion francs of gold which had been ceded to the Bank of France in the week ended November 10, 1937, by the fund. Such an operation will actually make 4,000,000,000 francs of gold available to the stabilization fund according to the fund's accounting system. However, the amount which will appear on the statement of the Bank as withdrawn during the week ended February 3 will only be 3,127,000,000 francs. ~~at this time~~. This is because the gold reserve of the Bank ~~is now~~ has not been revalued beyond 43 milligrams to the franc.

END SECTION TWO.

BULLITT.

EA:LWW

PARAPHRASE OF SECTION THREE OF TELEGRAM NO. 189
of February 4, 1938, noon.

There was very heavy pressure on the franc on Thursday morning, the largest seller of francs against sterling being Amsterdam. One of my contacts told me that he thought the Dutch bankers, when apprised of the urgent demand of the French control for a further tranche of the florin credit to be converted into gold immediately, concluded that the French were about out of funds. Therefore francs were sold heavily in Amsterdam. These sales contributed importantly to the loss for the day of 300,000,000 francs of foreign exchange by the French control. This amount is greatly in excess of the seven and a half million florins which were gained by the French in the operation mentioned above.

The stabilization fund, as of Thursday night - after receipt of the florin credit and after counting out the day's exchange loss of 300,000,000 francs - was in debt to the Bank of France about 900,000,000 francs for gold which was borrowed during the past week. The next statement of the Bank of France will show a total reduction in gold of 3,127,000,000 francs. The fund has already spent 900,000,000 francs, therefore 2,227,000,000 francs is the net balance.

At 11 o'clock this morning when I was at the Bank of France the exchange market was quiet; when the banks opened, sterling had been sought at 152.90. At this price the control

gave

gave a little sterling and there was a decline to 152.86 - 88 in the rate.

It is likely there will be serious pressure on the franc not later than Thursday, February 10. It is on that date that the above-described gold loss of the Bank of France will be shown.

END MESSAGE.

BULLITT.

EA:LWW

JR

GRAY

Paris

Dated February 4, 1938

Rec'd 3:10 p.m.

Secretary of State,

Washington.

190, February 4, 4 p.m.

FROM COCHRAN.

Paris exchange market has been extremely quiet today with control apparently losing only a little sterling this morning. Council of French Ministers yesterday unanimously agreed that no measures should be taken that would increase public expenditure or reduce revenue. Jenny had long article in the AGENCE ECONOMIQUE today on disadvantages of exchange control and difficulties in enforcement. Minister Bonnet has started a move toward increasing French exports. Rumor is current here that Bank of England may reduce its discount rate to one per cent next week which should weaken sterling exchange rate.

Today's inactivity is not indicative of any settled atmosphere. On the contrary worries on Bourse have been increased by ticker report of sinking of a British ship outside of Barcelona.

BULLITT

CSB

JR

GRAY

London

Dated February 4, 1938

Rec'd 7:50 p.m.

Secretary of State,

Washington.

97, February 4, 7 p.m.

CONFIDENTIAL FOR TREASURY FROM BUTTERWORTH.

At a dinner of the Political Economy Club N. F. Hall opened the discussion on "What should be the future of international currency relations?" and in his statements leaned so heavily on the financial section of the Van Zeeland report as to force the channel of discussion in that direction. As to the report, the concensus of opinion was expressed by Clay who described it as being an astute compilation of everyone's diagnosis of present ills together with a politic compilation of everyone's remedy; it therefore constituted a highly political document for its real efficacy must lie in its recommendation of a five-power meeting which in turn would depend for success upon political considerations.

The discussion for the most part wandered into vague and distant fields, but the following excerpts from the remarks of members of the British Treasury and the Bank of England have practical and realistic interest.

In the course of his remarks Clay, Economic Adviser of the Bank of England, made two other assertions which are

worthy

-2- #97, February 4, 7 p.m., from London.

worthy of note: First, he strongly urged the drastic extension of the recently introduced practice of publishing certain information regarding the status of the British equalization fund; secondly, he leveled a general criticism at the Van Zeeland report (which in its implications seems important) that throughout the report a greater stability in the dollar-sterling exchange rate was assumed than the circumstances warrant even though the rate has been reasonably stable during the past two years or more. Clay obviously was speaking as a practitioner and he mentioned in this connection the manner in which capital movements had fortuitously facilitated the stability of the dollar-sterling rate.

Waley in expressing his personal views made three points of interest: First, he strongly opposed the lending of further money to debtors already over-borrowed and unable to serve their previous obligations; secondly, he indicated that the B I S had no credit weapons such as individual central banks could commonly employ and therefore it would be at a grave disadvantage if it attempted to perform the functions allocated to it in the Van Zeeland report; thirdly, he reiterated a view which though widely current several years ago is now rarely expressed: Briefly, that

-3- #97, February 4, 7 p.m., from London.

that a return to the gold standard implies the right to use the bank rate to preserve the level of a currency, thus deliberately creating unemployment and "human misery". He queried whether "this unpleasant business of human suffering" would not require another approach.

Hawtrey made the following observations of interest: First, he thought the suggestion of extending as an interim measure the tripartite agreement from a twenty-four hour to a six months basis was impractical; that it was impossible for a country to give six months notice, it would change the value of its currency; therefore such an arrangement would either be a permanent one though lacking certain advantages associated with permanency or what Van Zeeland described as force majeure would in such circumstances really be stretched to cover all occasions when it was deemed desirable to change a currency's value; secondly, he pointed out that it was all very well for "an autocratic Bank of England" to discriminate between credit-worthy parties within a country but it would be quite another thing for the B I S to attempt to do the same between sey Italy and France; thirdly, he emphasized that the recommended operations in the futures market were based on an assumption that a movement out of a currency was sporadic and

-4- #97, February 4, 7 p.m., from London.

and temporary while in point of fact that out of the franc for example had already been going on for three years.

JOHNSON

SMS:NPL

JR

PLAIN

London

Dated February 5, 1938

Rec'd 8:45 a.m.

Secretary of State,

Washington.

100, February 5, 1 p.m.

FOR TREASURY FROM BUTTERWORTH.

1. The most significant event of the past week has been the renewal of institutional buying of gilt-edged securities which closed substantially higher war loan standing at 103-¼. This in turn gave rise to rumors of a fresh issue of defense bonds which however seemed premature inasmuch as new money is not required at present. Incidentally after an interval of seven weeks corporation borrowing has been resumed.

2. City's initial reaction to the shakeup in Germany is to regard it (A) as another victory of the Nazi party extremists over the more conservative elements the results of which may well prove serious; (B) but the struggle between the prewar army commanders and such Nazi leaders as Himmler is not considered by any means over although the power of the German army had been overestimated here and much reliance placed upon it; (C) the reorganization of the Ministry of Economics into five departments is

expected

-2- #100, February 5, 1 p.m., from London.

expected to diminish even further Schacht's importance for there will be no one pivotal point at which he can make his influence felt.

3. Inasmuch as the Prime Minister has refrained from public pronouncements for an unusual length of time I venture to quote below the concluding portion of a speech made before the Midland Conservative Associations.

"The absence of major industrial disputes arises from something in the nature of a permanent change in the methods of arriving at a fairer distribution of the profits of trade and industry. That in turn has sprung from a more complete and a more scientific organization of trade unions on the one side and of employers' associations on the other with the effect that we have largely cut out the old personal antagonisms so that in these days we can approach negotiations between employers and employed on a broader and a more objective basis. Whatever may be the cause of it undoubtedly the result has been eminently satisfactory. During these last few years the profits of trade -- and may I, as an ex-Chancellor, add the contribution which those profits make to the national revenue -- have been very handsomely expanded and the figures recently quoted by the Minister of Labour in the House of Commons when he stated that last year the

weekly

-3- #100, February 5, 1 p.m., from London.

weekly wage rates of over 5 million people had been increased by no less than 780,000 Pounds demonstrate most convincingly what benefits have accrued to the working people.

If I were to try to put in a single word the greatest boon that any government can bestow upon the country I would say that it is in the establishment and maintenance of confidence. It is confidence that stimulates enterprise and confidence that gives peace of mind to the people. I would say that in this country especially the establishment of confidence breeds a like result elsewhere. Only a little while ago there seemed to be some check to our confidence. I never believed that there was any foundation for such a check and I think it has already passed off as far as we are concerned. Only in the last few days we have given proof of our confidence in our future and in the future of our potential customers by making certain relaxations in the regulations that govern the lending of money to foreign borrowers. I believe that that change will tend to stimulate international trade and after all it is to international trade that we must chiefly look to take the place of our rearmament programme when

it

-4- #100, February 5, 1 p.m., from London.

it begins to approach its completion. If by joint effort we can succeed in securing some measure of political appeasement, that would bring in its train such a fresh accession of confidence as would give a new stimulus to industry and would bring new hope to the depressed areas of the world. To make this year of 1938 a starting point of renewed confidence and security -- that is the aim of His Majesty's Government.

JOHNSON

HPD

PARTIAL PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: February 7, 1938, 5 p.m.

NO.: 203

FROM COCHRAN.

Very quiet on Paris exchange market. Franc weakened against sterling from opening rate of 152.60 to 152.85. At that point control gave some sterling and pushed the rate down to 152.57 1/2. Through operations with Guaranty Trust and the Société Générale, it began to gain sterling at 152.57 1/2. Market observers believe that on balance for the day the control was gainer of foreign exchange. There has been no change in rentes. Continuing concern over the currency is shown by forward franc rate.

Jenny had very good article in today's TEMPS on tripartite agreement. He said that this agreement had resulted from French initiative; that the institution of exchange control by one of the parties to the agreement would be a flagrant violation of the spirit thereof; that progress along economic lines had not advanced with the lead given in monetary policy; that the technical arrangements of the tripartite are undeniably of a practical value; but that no international agreement can ensure the stability of the currency of a country - that depends essentially upon the country's own management of its national affairs.

BULLITT.

EA:LWW

Saturday, February 5, 1938

Today the Secretary proposed for consideration the plan to cease sterilizing newly-mined domestic gold.

Gold exported from Japan to U.S. during the period from September 1, 1937 to February 2, 1938 t[illegible]led approximately $116,000,000, all of which was sold to the U.S. Mint in San Francisco.

file

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE: February 5, 1938

TO Secretary Morgenthau

FROM Mr. Lochhead

The total Far Eastern deposits as reported by the New York agencies of Japanese banks from September 1, 1937 to February 2, 1938, inclusive, were as follows:

Sept.	1, 1937	$ 7,651,000
"	8	6,775,000
"	15	7,418,000
"	22	6,014,000
"	29	6,617,000
Oct.	6	6,839,000
"	13	5,816,000
"	20	6,144,000
"	27	16,127,000
Nov.	3	17,797,000
"	10	35,096,000
"	17	36,774,000
"	24	45,836,000
Dec.	1	51,748,000
"	8	45,200,000
"	15	41,624,000
"	22	46,722,000
"	29	43,046,000
Jan.	5, 1938	47,274,000
"	14	41,396,000
"	19	42,687,000
"	26	41,335,000
Feb.	2	36,029,000

February 7, 1938.
3:00 p.m.

H.M.Jr: Hello.

Sen. King: Hello, my dear friend.

H.M.Jr: How are you?

K: Oh, bully. How are you? Working hard. Worked all day yesterday.

H.M.Jr: Well -

K: Got committees today. I tried to have that sub-committee meeting Saturday, but Mor - but Oliphant called it off, he had to go out of town, and I'll have it within the next day or two.

H.M.Jr: I see.

K: I'm - I'm not delaying it at all.

H.M.Jr: Well, now, I appreciate it. Now Senator, you know, I'm - I stand ready to come up and be character witness for Opper.

K: Well, my dear friend, I don't think it's necessary. If it is, I'll let you know.

H.M.Jr: Well, now -

K: I'm taking it for granted that you endorse him.

H.M.Jr: That's right.

K: I don't think you ought to have done it, but it's all right.

H.M.Jr: All right, but -

K: And if it becomes necessary, I'll let you know, my dear friend. We'll get it disposed of right away.

H.M.Jr: Thank you very much.

K: We would have had it disposed of Saturday if Oliphant hadn't called it off.

H.M.Jr: Well, that's too bad.

K: So don't blame me now.

H.M.Jr: I - I - I'll be the last one to blame you.

K: And I don't blame him because he had made a previous appointment, and I think he ought to have kept it.

H.M.Jr: Right.

K: So I'm not complaining against him or anybody on earth, except myself.

H.M.Jr: Well, if they can clear it up this week, it'd be fine.

K: All right. Oh, we'll do it. We'll do it this week.

H.M.Jr: Thank you.

INITIAL DISCUSSION ON GOLD MOVE

February 7, 1938.
3:10 p.m.

Present:
Mr. Taylor
Mrs Klotz
Mr. Haas
Mr. Daggit
Mr. Murphy
Mr. White
Miss Michener
Miss Lonigan
Mr. O'Donnell
Mr. Gaston
Mr. Lochhead

H.M.Jr: Now, instead of listening, George, to your people the way I have every time, I'm going to ask them to listen to me. And what I am going to say is under no circumstances - all this is confidential; what I'm going to say is extra-confidential, and you can look around who's in the room and you can moan and groan afterwards to the people who are in the room, nobody else.

Now, what this week-end did for me is this. I want to give - some of you were with me in Farm Credit, so let me give you a little experience that I had in Farm Credit. I sat over at Farm Credit, and because the President of the United States couldn't get the then people in the Treasury to do something along the lines that he wanted after the bust-up of July '33, he looked to myself and the people with me over in Farm Credit to, as he put it, take the shackles off his hands and his arms, and we found a way after everybody in the Administration failed. And I'm talking about gold. And because I was young - call it youth - either courageous or foolhardy, either one you want - we took our chance. And after that terrible reaction in the fall of '33 - that and many things which I won't go into now weakened the bond market, everything else. But then the President - things flew our way and - I mean we did give him the idea and the support that he needed, and the result is I'm here now.

Now, I don't want, just because I've been here for four years, to be just an iron-clad and resistant to all ideas. Just because I happen to be here four years and find that I'm getting in a track and - I don't want to fail either the President or the rest of the country just because I'm here; and the longer you're here, the longer you're Secretary of the Treasury, the more difficult it is to do something new.

Now, without mentioning any names, I have a certain idea, and all I'm going to ask the people advising me is this: Is it bad economics? Now, if they tell me it's bad economics and they can convince me it's bad economics, I'll stop, look and listen.

But the argument one person advanced over the week-end that I called, who is not connected with the Treasury - "Well, to do something in a monetary field really won't help the situation. What you suggest - there is nothing the matter with it. But you've got to sit back and let the President sweat this thing through until he does what we really think he should do." See?

Well, the situation is so rapidly getting worse that if we sit by and do nothing, the first thing you know, whether I like it or anybody likes it, we're going to have to spend a lot of money. Whether it's transcontinental road, which is on the front page of the Times, which I worked on with Henry Lutz before he died last week, and mapped the whole thing out with the President, with Henry Lutz - we did that whole job three years ago - the transcontinental. The whole thing is done; I don't know where it is, but we worked the whole thing out.

Whether it's that or something else ..... I mean I made my speech on November 10 that the driving force of private capital should take the place of Government spending. Well, it hasn't, for lots of reasons. Now, I don't know whose fault it is, but it hasn't taken place. And, lacking that, the Government has to go back again and do this thing. Now, there's no two ways about it.

Now, I don't know whether I've got the time or the brains or the intelligence, with the help of you people, to find a way for private capital to do this thing. I'm not going to let up trying to find that way. But in the meantime I'm going to try some things; if necessary, within the next week or two I'm going to recommend to the President a couple shots in the arm. Why? Because if I don't do that, what we're going to get is a major operation.

Now, it's very nice for some of these people to sit back and say, "Well, we don't want any more monetary tricks, we don't want any more," so forth and so on. All right, then we'll get transcontinental highway, eight billion dollars or something like that, and then it isn't a shot in the arm; it's - I don't know what it is, but it's something so different than what we've got now.

Now, the further I go into this private capital thing - thank God there are no lawyers present; it's these blankety-blank lawyers that have got this thing so tied up with red tape that, by God, you can't borrow. The United States Government has got its nose into everything. It's so expensive that if you want to borrow money it costs you so much - rather than borrow, go to the banks - can't go to the banks. They've got this whole thing just tied up into a beautiful knot. And you can't - if I want to borrow money, it's so damn expensive, and the people don't know how or they can't get the right lawyer in Washington or some other place to get it.

Now, whether a fellow has got the time, with this very critical situation, to go into all this red tape, and have time - you got to wait for Electric Bond and Share case, until that's settled. I mean here's Mr. Douglas, Mr. Jerome Frank, the great Left and all that; but they'd rather see this thing crack up than - and wait for the Electric Bond and Share case rather than let some of these people go through, and meet these people half-way. I am personally sick and tired of it.

I say I'll listen to anybody who says to me, "What you suggest is poor economics." I don't want to do anything that is poor economics; and if it isn't poor economics, then I'm going to use the old elbow, see? Now, I'm not going to sit here and let this thing roll by just because I'm getting old, I'm

-4-

afraid to take a chance, I'm afraid to do anything. I mean that's - I'm dying of dry rot here, waiting for the country to go to hell. And what have we got? When a fellow wants to borrow some money - supposing a fellow wants new capital, junior capital; either they won't borrow or there's so many excuses.

Now, I want suggestions. I've got just one suggestion, and fortunately for the people here, everybody I've asked in this room tells me - I'll put it up to Harry - but everybody in the room told me he thought of it anyway, with the exception of Harry, and Harry may have.

Haas: He certainly has.

H.M.Jr: What?

Haas: He certainly has.

H.M.Jr: You said you had thought of it.

Haas: Well, that and a number of things.

H.M.Jr: All right. And Wayne said he'd been turning it over two or three times, and Archie said he's just been waiting to talk to me about it.

Haas: Archie talked to me about it.

Taylor: Wasn't claiming authorship, but ....

H.M.Jr: Well, anyway... and I got out Warren and Pierson and I read up on what they've got to say, and what they thought would happen I don't know. But the immediate suggestion is a very minor one, see; it's a very small one, and it can give us some wonderful trimmings.

And that is, I want you people to tell me why we should continue to sterilize newly-mined gold. I want somebody to take the affirmative, why we should continue to sterilize newly-mined gold. Now, anybody that's been with me - either he's mad enough to stand up and tell me why he thinks it's wrong, and so forth - and I'll listen. I want arguments why it's bum economics.

Haas: To continue to do it?

H.M.Jr: I mean I'll put it either way. You can argue on either side. I'll go around the room - those fellows who are on gold; go around the room. You can take either side: that you recommend we continue to sterilize newly-mined domestic gold, you're in favor of it; or you're "agin" it. Take either side of the question; I don't care which.

Haas: Want me to start?

H.M.Jr: Yes.

Haas: All right, I'll be very brief.

H.M.Jr: See, I'll deal the cards like this, go around.

Haas: I'll be very brief.

During a period when we were apprehensive of inflation, there were several moves taken. Among those moves was sterilization of incoming gold. Since that time, the situation has entirely changed. We are now in a period - have been in a period of very rapid deflation, with some evidence of a little halting now; but the outlook is by no means clear.

The stopping of the sterilization of domestic gold, I would say, should be done, but its effect will largely be, as you said, Mr. Secretary, that of a trial balloon, and the people may believe that that is a straw in the wind which indicates a change over from the inflation controls to a loosening up. But as of itself, it is a very minor thing mechanically. And I'd be for it, and, at least at the start, I'd be willing to go a little further than that. Because I think what is wanted now is not control methods. We put the brakes on; we want the car to go uphill. We should at least release the brakes. Another thing ...

H.M.Jr: Do you mind my interrupting you, George?

Haas: No.

H.M.Jr: You don't mind being first?

Haas: No.

H.M.Jr: Just doing that one thing - I want to be very careful - what do you think will happen?

Haas: I think if you do it, the public which are interested in these things - that is, the important part of the public - will wonder how to interpret it. And if they are just left that way to guess - leave it as a trial balloon and I think it may be interpreted as a loosening up, a release of the control or brakes, and it may have some favorable effect. I think if it has some favorable effect, it may ~~affect~~ commodities, and if we can get the movement going up, I think technically it is not in a bad situation for a thing like this to be put out.

If it gets the movement going up, the outlook for profits, etc. - that's what really will bring this driving force of capital back. But if we have these deflation controls still on, I am very apprehensive of the future outlook.

Now, it's just anybody's guess what the effect might be. I'd say - I'd be inclined to say it would be favorable.

H.M.Jr: Well, do you think it would be unfavorable?

Haas: No.

H.M.Jr: Can you see anything about it unfavorable?

Haas: Yes, some people would say, "Oh, inflation." Well, what they mean by inflation is recovery. That's what I want. But still that may scare - there's a certain group that that would - are never satisfied unless the country goes right through a wringer.

H.M.Jr: Well, that's one of the people I talked to. And they'd rather see us go on down in order to force the President into doing some of the things which he doesn't want to do, and which aren't good for the country for him to do.

And incidentally, if you people haven't read Jackson's speech at Syracuse, read the last half of it. The first half, no; but read just the last five pages. I recommend it. In the last five pages you can find out what it all is. The first is a lot of twaddle, but the last five pages you get what he's after. The Jackson speech at Syracuse.

Haas: That's about all I have to say on it.

H.M.Jr: All right. I don't know which of you want to talk on .... Let me take Mr. .... Well, we'll go around. Are you (Daggit) gold-minded?

Daggit: I haven't thought a great deal in terms of gold except for the talking we've done back and forth in the Division on the gold question. But I would say with Mr. Haas that we should first take the brakes off before we try anything to promote recovery, and this furthermore seems to be .....

H.M.Jr: You've got to talk a little louder.

Daggit: This seems a very good time for such a measure to have an important favorable effect, since we seem to be - since business has flattened out and seems to be in a good position for recovery. I doubt if it would have much effect if we had not already started to show signs of recovery.

H.M.Jr: Do you think we have?

Daggit: I think we have, definitely.

H.M.Jr: I hope you're right. Well, anyway, if you are right, and let's say - that's all the more reason - I mean if the thing is on the upgrade, then it's all the more reason that this will catch.

Daggit: Yes, that's my point.

H.M.Jr: You as a commodity man feel - I'll ask you - you feel that the conditions are technically right for such a move?

Daggit: Yes, I do.

H.M.Jr: That's what I - if you don't mind, for a moment, that's all.

Daggit: I'd like to add that my ideas have been that any so-called shots in the arm should really not be put in in a dramatic way, but this should be considered as a gradual loosening up of the credit situation.

H.M.Jr: Check. I think that nothing should be dramatized too much at this time.

Daggit: There is too much danger of reaction.

H.M.Jr: I agree with you. If the thing is done - given out with an intelligent explanation and no forecast and no claims - "We're doing this thing because we think it is the intelligent thing to do. Now, time will tell whether we are right or wrong." That's all.

Daggit: Exactly.

H.M.Jr: Well, let me go around the room, because I want you people to .... You (Murphy) got an opinion?

Murphy: I would be very much in favor of the move, for the same reasons given by Mr. Haas.

H.M.Jr: All right. Is that all? Any effect on the bond market?

Murphy: I think that it might have an upward effect in the bond market. It is very popular nowadays to be very much disturbed about pushing the Government bond market up, on the theory that after it goes up it goes down. I would be inclined to discount those fears myself.

H.M.Jr: All I could do when McKee was talking about worrying so - keep from saying, "Well, you people are worrying just the way you were worrying last March about commodities going up."

Murphy: I think the analogy is very well made.

H.M.Jr: Always do it.

Herbert, as an old Farm Crediter, Conservationist .....

Gaston: I wouldn't sterilize any more gold.

H.M.Jr: You wouldn't sterilize at all?

Gaston: No.

H.M.Jr: You go the whole hog?

Gaston: No, that's half. The other half is unsterilizing.

H.M.Jr: All right. Well, I wanted you to hear that. I wanted you to get my pulse, so forth and so on, see?

Gaston: Your pulse is all right.

H.M.Jr: Pulse is all right. Back's lousy, pulse strong.

Wayne Chatfield Taylor?

Taylor: Want all of it? I mean the name.

H.M.Jr: No, I want ....

Taylor: No, I'm for it. I think it can have very useful reactions, particularly if the market - commodity market is in the shape that Daggit thinks it is; why, a very little push ... If it isn't in that shape, it won't do much good, but I think this is the way to find out whether it is in that shape or not.

H.M.Jr: Well, as far as commodities go - I mean I won't say they're on the way up, but I think definitely it's been over two months now that they've made a floor.

Daggit: Yes, they have.

H.M.Jr: So I think he's all right on his commodities.

Taylor: We know that all the markets are thin.

H.M.Jr: Yes.

Taylor: Therefore, a moderate thing such as this is can have a great deal of effect. At another period it might not have any at all, because it wouldn't be enough.

H.M.Jr: Well, it's like the old saying - when the bond market was going down - it's like these stories "Now it Can Be Told" - and the President was worried and it kept going down and he had all kinds of - calls me up and I'm over at Farm Credit and we give an order to buy on a Saturday morning to about 20 dealers through our agent of a million dollars a dealer. I think we gave it to about 20 different brokers - to buy a million dollars worth of bonds at so much above the market. We never bought a bond, but we definitely turned the bond market. And it was the same thing in the wheat trend. Wheat was going down. We did it. It's just - it's a combination of having market sense plus picking the right time. I think this is the right time to do just this. And I may be all wrong, but we were right on bonds, we were right on wheat, we were right on gold.

Now, I don't know, but I'm just - as I say, I'm going to listen, give everybody plenty of time to tell me why I shouldn't do it.

Taylor: Well, I'm for doing it, so that ....

H.M.Jr: You don't have to be argued with.

Taylor: No.

H.M.Jr: Also for doing it one bite at a time?

Taylor: Yes, I'd do this thing that you're talking about and not any more.

H.M.Jr: For the time being.

Taylor: Yes.

H.M.Jr: Dr. Harry White.

White: Well, if you mean what you say, I'm for it.

H.M.Jr: Did you ever hear of a fellow by the name of Bob Moses? He was a marvelous shot with an inkwell.

White: Ever hear of the guy who could dodge it?

H.M.Jr: He always gets his man.

White: I suppose that requires a brief explanation.

H.M.Jr: I think it does.

Taylor: Or a very long one.

White: O.K. You called it a trial balloon. Now, my concept of a trial balloon is to send something up in the air and if the reaction is not unsatisfactory to follow it with something. Therefore, as a trial balloon I'm all for it. Namely, to try it; if the reaction is not unfavorable, then to follow it with something substantial, because I don't regard this move in itself as being at all substantial, either - obviously not in a mechanical way and possibly not in a psychological way; I'm a little less sure about that.

But if you feel that this step is a step in the right direction and then merely stop there and wait for it a long time, I think that the effect might be disadvantageous in the sense that it might give rise to certain impressions with respect to other ....

H.M.Jr: Well, you feel that 15 million dollars a month is going to make an insignificant difference, so on and so on.

White: Lot of things that might be ...

H.M.Jr: Well, unfortunately, you have never seen me operate in a depression.

White: That's not unfortunate.

H.M.Jr: And if you talk to some of the people who did, I don't think you'd raise any questions.

White: Well - but I see right now that Wayne and I are not in agreement, if I understood correctly, in which case my criticism is in point; not criticism, but comment.

H.M.Jr: I think I understood Wayne perfectly. He said he wouldn't go any further.

Taylor: Right at this point.

H.M.Jr: At this point.

Now listen, look. You do know me well enough to know that I don't come in and make a speech like - I don't make ...

White: I was very glad to hear what you said when you opened. For it a hundred percent.

H.M.Jr: All you fellows are going to have to do is to watch your brakes on me. As I say - talk to George - when I was over at Farm Credit, we really were operating there.

White: Well, as a trial balloon, I'm for it a hundred percent, but I'd like to underline trial balloon.

H.M.Jr: I'm serious. Have you ever talked to George about my operating from July 1 to November in '33?

White: No, but I will.

H.M.Jr: It will do you good.

Haas: We went to town.

H.M.Jr: That man knows.

Your (Daggit) man knows that.

Taylor: Oscar Johnston?

H.M.Jr: In the Farmers Union. What's his name? The fellow in Chicago.

Gaston: Miller.

White: Of course, I think you'll get some adverse criticism. I don't think that should stop you, but you've got to expect that.

H.M.Jr: Well, that's all right.

And the game is - another thing which I didn't add; I didn't think it necessary to add - we are not only playing for recovery of the United States; the stakes are now the recovery of the world, and a little criticism is unimportant when the whole world is slipping.

...

And I want to add here again: as it slips, the chances - every time it goes down a notch, the chances for war go up a notch. I mean I'm convinced of that. And that's the thing that bothers me so much. As we get into - times get worse, I mean, you can just feel the thing brewing in this country: "We must arm and take care of the unemployed." It's just fermenting. And as this world thing goes down - I mean the chances for a war - our getting into war are just that much more. Don't you agree on that, Harry?

White: A hundred percent.

H.M.Jr: Miss Michener?

Michener: It seems to me it is a step well worth taking.

H.M.Jr: Pardon me?

Michener: It seems to me it is a step well worth taking.

H.M.Jr: All right.

You (Lonigan) got anything on gold, young lady?

Lonigan: Well, I'm sorry, Mr. Secretary, but I would like to suggest cautions.

H.M.Jr: Good.

Lonigan: I hate to take a lone position. But I don't believe the difficulty in business is the supply of money; I think it is the rate of turnover. We've got plenty of money; the thing that's wrong is the turnover rate. I think the turnover rate is wrong for two reasons. One is that there is something radically wrong with the structure of business which you can't right away correct. Second, that there is something even more radically wrong with the financing of business, which might be cured right away. And whatever arguments might be used for or against this gold, I'd be extremely sorry to see it distract attention for one second from what I think is much more important. Take a business man who wants to run his business but needs money. I've got a story that I picked up in Rockport. Been more of a case study. This firm can't get the necessary money. That's been true for five years. They haven't ....

H.M.Jr: Well, I'll be glad to have the story.

Lonigan: I just mention it ....

H.M.Jr: I've asked for criticism. But you take the exact position that this other person takes. But, unfortunately, you can't cure this thing. I mean this thing of getting money cannot be cured in a week or a month. It's just a matter of months.

Lonigan: Well then, I'd like to leave as a question this .....

H.M.Jr: And gold - this gold business, if you don't mind my saying, has nothing to do with the philosophy of money.

Lonigan: Well, it's ....

H.M.Jr: I mean you don't - you take the position that you'd rather see me concentrate on other things, is that it?

Lonigan: I take the position that the other is the organic condition in the situation, and that it's got to be met with face to face.

H.M.Jr: I agree with you. But, in the meantime, if you do nothing, in a few months nobody's going to want any money for their business.

Klotz: That's right.

H.M.Jr: That's just it.

White: Well, this action doesn't preclude taking any other action.

H.M.Jr: I mean I'm working here - three meetings last week, I think, we had - or in the last week, with S.E.C., trying to finance one little company, see?

Lonigan: Got to be quicker than that.

H.M.Jr: I'm on that. I'll continue on that. But in the meantime, if we let the thing go on at the rate it's going, in three months nobody's going to want any money.

Now, what the patient needs just now is a little shot of ginger. It will make him last longer. I mean that's how depressed I am. I mean it's a question of - what is it, strychnine?

Gaston: Yes.

H.M.Jr: A needle of strychnine just to keep him going for a while. Then it's time enough after that for a blood transfusion, which is new money.

Klotz: That's well put.

H.M.Jr: What?

Klotz: Very good.

H.M.Jr: Yes. Remember that.

Lochhead: Of course I'm in favor of ceasing to sterilize newly produced domestic gold. First of all, you say it's only 15 million a month. Well, it is, but it's 180 ....

H.M.Jr: Little louder.

Lochhead: It's 180 million dollars a year, which is a fair amount in any case.

I think, secondly, that domestically produced gold has a little different standing than this imported gold - the money you spend for labor, spend for material, weight, so forth; and therefore, it is not only an offset but it is actually deflationary to sterilize this gold and take the money out of the market. Thirdly, the foreign countries have no call on it, so there is no use sterilizing it, keeping it aside to wait for a call.

Then fourthly, as far as the Federal Reserve System is concerned, about any objections they might have, you remember that their main objection the first time was that they - when they asked us to sterilize or we agreed to sterilize, was that they couldn't tell in making up their figures whether they were going to get 15 million dollars in this month or 200 million. Now, that's not the case with this. We know there's 15 million a month. It may vary a million, but they certainly can make up their plans very easily.

And then, I do think that we have built up too rigid a policy on sterilizing gold. It was only meant to be a temporary policy when it started, and we shouldn't allow ourselves to get frozen into a policy. That's one of the troubles, when you start a policy, you get frozen to it.

I think - I really think that if it was right to raise gold from twenty to thirty-five dollars, there was a reason for it; that we can't go on nullifying any effects that the rise in the price of gold should have.

H.M.Jr: All right.

Lochhead: It may be proper at times to hold the brakes down; but if you're going to raise the price from twenty to thirty-five and then turn around and nullify that indefinitely and hold it down, there's something wrong.

H.M.Jr: The thing - I mean no one has brought out - I think, which is comparable, is the fact that after all domestically mined silver is not sterilized. I mean I've been thinking about this thing. We don't sterilize domestically mined silver.

White: We have in a way.

H.M.Jr: What?

White: We have in the sense that we don't issue the full amount.

H.M.Jr: That is, for all of it.

Lochhead: No, at the present time we are sterilizing $72,000,000 worth of the cost price of the silver we have purchased.

H.M.Jr: How?

Lochhead: Because we're not putting out the certificates.

H.M.Jr: Well, that's Taylor's fault.

Taylor: Yes, sir.

H.M.Jr: I mean in a ... Right? I mean it's - you understand. I mean you're not crowding them. You understand what I mean.

White: Can I give the other point of view, since ...

H.M.Jr: Well, do you mind just holding it a minute?

White: Oh, excuse me.

H.M.Jr: Are you (O'Donnell) in on this at all?

O'Donnell: Well, I wouldn't weigh my opinion equal to that of Harry or Archie - they're both experts in the field - but I feel that you've got to judge it very largely on what you think the psychology of it may be. The fact that the 130 million dollars a year isn't near as important because that 180 million is a year removed and the immediate consequence is pretty small - the business situation - its outlook will be determined in the next 30 to 60 to 90 days.

H.M.Jr: Right.

O'Donnell: And I would judge the whole program on how I think the public, or the interested people, will react to it.

And I was very much interested to hear you say that you had some conferences with S.E.C. I think that's the bottleneck of the whole situation; in fact, so much so that I dislike talking about it.

H.M.Jr: Well, I mean we've had eight or ten of their people over here three times within the last week.

O'Donnell: Absurd.

H.M.Jr: And when you go up against them - I mean it's terrific. They're simply sitting back, the whole crowd; they're waiting for a decision on Electric Bond and Share, and they're just as bad as Mr. Willkie in their way. Just as bad. They're just as bad. But having gone up against these fellows and knowing how hard it is - and they're smart and they're interested in the Administration and they're New Dealers, and when it's as difficult to crack them ... I say by the time - when and if you can crack them, by the time we can, if business is set for the year, it may be 85 or 80. I don't want to wait.

When you boil it all down, this will be interpreted this way: "Oh, Roosevelt's going to start inflation again." And that's just what I want.

Haas: That's right.

H.M.Jr: That's what I want.

Haas: Sure.

H.M.Jr: That's exactly what I want. Always going back - "He's going to use inflation." Swell! Then everybody starts buying.

O'Donnell: Possibility they may interpret it the other way, though, and they say you're scared and this is just a makeshift.

H.M.Jr: Sure, we are. I am.

O'Donnell: Unless you give them a real shot in the arm.

H.M.Jr: We can give them a real shot. It all gets down - I'm going to talk just all week long, then, if I get set, we'll act Saturday.

And I thought - if you'll make a note, tell Mr. Eccles I won't lunch with him Tuesday, I'll lunch with him Wednesday, which gives Mr. Taylor and Mr.

White a chance to see Mr. Eccles and his crowd tomorrow, prepare them for what's coming. Will you take it on?

Taylor: Uh-huh.

H.M.Jr: Prepare them? You and Harry.

White: Delighted. Gladly.

H.M.Jr: What?

White: Gladly.

H.M.Jr: I mean if you think it's unfair to ask you ....

Taylor: No, no.

H.M.Jr: What?

Taylor: No, no, I think it's ...

H.M.Jr: Prepare them ....

Taylor: I think probably the way to do that is to do it not as a mass formation.

H.M.Jr: No, no.

Taylor: Have Harry talk to - George talk to Goldenweiser.

H.M.Jr: The two of you. And the man over there who studies gold.

Taylor: Gardner.

H.M.Jr: Gardner. Let George and White take on Gardner and you take on Eccles. You fellows have a little campaign when you leave here, for between now and Wednesday. Work hard between now and Wednesday, will you, the three of you?

Taylor: (Nods yes)

H.M.Jr: Now, Harry, what's the opposition?

White: It's in the memo. I can read it and emphasize a few of the points if you want to. I merely want to make sure that you are cognizant of what the other side will say, though I do not subscribe to their views.

H.M.Jr: Go ahead.

White: One is: The step will revive the dormant interest in gold, and the less said about gold now, the better.

H.M.Jr: Now, this is what the opposition will say?

White: These are the various probabilities. I'm giving all the reasons against ...

H.M.Jr: When is it the opposition and when is it White?

White: Well, whenever it's against the plan it's the opposition. But it doesn't mean there isn't some merit in the opposition.

H.M.Jr: Where is your memorandum?

Haas: I think it's in with Miss Chauncey.

White: Possibly you want to read that, and I won't repeat.

H.M.Jr: No, do it now.

White: And the less said about gold the better.

Secondly, if the Treasury is to take any monetary action at all, it should be forceful and substantial and not create the impression of timidity.

Thirdly, it is apt to give rise to the criticism that the Treasury misunderstands monetary management in that it appears to believe that a 15 million dollar a month reduction in its inactive gold is going to have any significant effect on the business situation.

Fourthly, if the Treasury considers it advisable at this time to stop sterilizing 15 million dollars of gold a month, why doesn't it desterilize larger amounts? Either the Treasury is in error in assuming that the desterilization will have beneficial effects, or it is in error in not doing it on a sufficient scale so as to be significant. In either case, there is no justification for using 15 million. If you think it's good, then you ought to do more. If you don't think it's good, what are you puttering around with 15 million even for?

There is one other possibility, that this might give rise to further expectation of depreciation of the dollar. They will say, "The inflation is beginning - next, depreciation of the dollar." Therefore, you have to anticipate that possible result. It is not a reason against, but merely another factor.

You have to anticipate the possibility that as a consequence of this step there may be a substantial outflow of gold. I don't think that is a bad thing.

H.M.Jr: If we depreciate?

White: If that happens because they think you're going to devalue the dollar again.

H.M.Jr: Why would gold leave the country?

White: Well, the dollar is going to depreciate.

H.M.Jr: Would it leave the country under those circumstances?

Lochhead: The price of gold would go up.

H.M.Jr: All right.

Taylor: Right along those lines, why, we do hear some rumors that people are thinking about it. I don't know whether you've heard any of that.

Lochhead: Oh yes, those rumors have been spread around.

Taylor: That they want to get their funds out of the country. The haven't done it yet, but they're thinking about it.

H.M.Jr: Well, we've got a million and a quarter dollars worth of gold. They can have it.

White: Got a lot more than that.

Lochhead: They don't know where to take it to.

White: Those are just the arguments they would make.

H.M.Jr: Harry, if such a rumor is started, and of course I'd be the last one to start it .....

White: But if it should, it would mean ....

H.M.Jr: It would be most unfortunate. But it would be helpful to start people buying commodities.

White: That is, there could be a dual movement, gold leaving the country because of expected devaluation and at the same time have an expansive influence here through the purchase of stocks by virtue of expected inflation. Now, we are glad to lose the gold, particularly if the price of it is to improve business here.

H.M.Jr: And the other thing which you will also find is that if the President decides he wants to do this after I recommend it to him, if I recommend it to him, it then puts certain other agencies in a very difficult position who took certain deflationary action during the last eighteen months. I mean then they've got to scratch the back of their heads and say what they're going to do.

Reading that thing, that 50 pages that you fellows prepared on what we have done since July 1, 1936 ..... Did any of you see the play last week?

Taylor: The one here?

H.M.Jr: Yes.

Taylor: Yes. No, I saw the Ina Claire one.

H.M.Jr: Yes. I saw that. Do you remember - to explain it, this woman eavesdrops on her husband and another lady, and when she gets all through she says, "You know what a good sailor I am, dear."

"Yes."

"Well, this is the first time I ever felt like saying, 'Steward, bring me the bowl.'"

Klotz: Oh, that's swell.

H.M.Jr: After reading that report of what we have done the last 18 months, I felt like saying, "Steward, bring me that bowl."

You see, I've read up everything that you fellows have given me the last two weeks. I've read every memorandum, including yours (Lonigan).

So what I'll do is - again, as I say, you can talk amongst yourselves all you want. You can look around and see who's here. Please don't mention anything to anybody else even in your own staff back there - I mean go outside of this group.

And then as to the business situation, 10 o'clock tomorrow I will give you the usual opportunity to talk at me. I've talked for 50 minutes. At 10 o'clock tomorrow.

Klotz: There's this appointment.

H.M.Jr: Well, I want to see them before the President, that's the only thing. Let's take it at 9:30. This is more important than the staff meeting. 9:30 tomorrow.

White: May I make one more comment?

H.M.Jr: You can make two.

White: Well, one is all I want to make now. And that is, emphasize the necessity - which you doubtless have in your own mind; I want to make sure - not to claim too much for this step, in discussing it with anybody.

H.M.Jr: Harry, not only won't I claim too much because I'm not sure myself - I mean sure in the sense of just what it's going to do, see? There seems to be something that happens when you put gold to work. I don't know; something does seem to happen.

Now, you read back through the history, and here we've got more gold than ever was discovered in any of these periods when there were big gold discoveries, and with the result - effect that happened. And here this tremendous increase in gold occurs and we don't let it go to work.

Now, in my explanation - Gaston's got to think over whether we just want to hand it out with no explanation or with an explanation. Whatever it is, it'll be very carefully done. And one of the things I thought Archie would say is that by doing this, then it gives the world a much clearer opportunity to tell as to the desterilized gold - what is going to Europe, what is staying here; and separates the newly-mined gold - no longer clouds that the way it does now. I mean our sterilization fund will then be simply gold coming from the rest of the world and leaving America's own gold out. The way it is now you've got ....

White: We have an objection to that distinction which you will have an opportunity to listen to before you make up your mind.

H.M.Jr: Well, I'll have plenty of time. And I'm going to have people come down. And if I'm going to do it, I'm going to do it Saturday. I'm not going to fool around, because I don't think it is important enough to fool around with for more than a week.

White: In the precaution that I had, I didn't have in mind the public. I know you'd be more cautious than that. I had in mind those with whom you might talk outside of the Treasury.

H.M.Jr: Well, the only people you've been instructed to talk to ....

White: I know.

H.M.Jr: ... under Mr. Taylor's guidance, is the Federal Reserve. Now, after all - let's see. And then we'll go on again tomorrow and give you a chance to talk business to me at 9:30. You people come back tomorrow.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE February 7, 1938

TO Secretary Morgenthau

FROM Mr. Haas

Subject: Proposal to cease sterilizing -- for the time being -- newly mined domestic gold (amounting to about $15 million a month).

Conclusions:

(1) The mechanical effects of the step are too unimportant to be a significant factor in the decision.

(2) On psychological grounds opinions will differ as to the net effect of such a step. The most important single advantage appears to be the one you indicated, namely, that it might be useful as a trial balloon (i.e., if the reaction is satisfactory more will be forthcoming.)

(3) On principle a distinction between newly mined and imported gold can be justified and separate treatment of each type of acquisition is not necessarily inconsistent. (See last paragraph of memorandum.)

Presumed disadvantages and advantages:

Disadvantages

Mechanical:

1. Additions to the excess reserves of $15 million a month at a time when the excess reserves are being increased (as a consequence of the recession) adds slightly to the danger of future inflation without serving to increase investment or private expenditures.

Advantages

Mechanical:

1. It will increase the Treasury cash by $75 million by the end of the fiscal year.

2. It will add to the excess reserves and thereby slightly ease the money market and possibly increase investment.

Secretary Morgenthau - 2

Disadvantages (continued)

Psychological:

1. Apt to give rise to the criticism that the Treasury misunderstands monetary management in that it appears to believe a $15 million a month reduction in its inactive gold is going to have significant effects on the business situation.

2. If the Treasury considers it advisable at this time to stop sterilizing $15 million of gold a month, why doesn't it desterilize larger amounts. Either the Treasury is in error in assuming that desterilization will have beneficial effects or it is in error in not doing it on a sufficient scale to be significant.

3. The step will revive the now dormant interest in gold. The less said about gold the better.

4. If the Treasury is to take any monetary action at all it should be forceful and substantial and not create the impression of timidity.

Advantages (continued)

Psychological:

1. It may have some merit as a trial balloon. Public reaction to the step will throw additional light on the merits of desterilizing a large sum.

2. In the face of criticism of the sterilization policy sterilization of inflowing gold can be somewhat more easily defended than sterilization of newly mined domestic gold.

3. The step would emphasize the recognition that instruments of monetary control should be flexible and not automatic in character. Discontinuance of the sterilization may be called for now; resumption may be called for at some time in the future. Reversal of operation is exactly what is to be expected in the proper use of any instrument of control when conditions call for such reversal.

4. May be regarded in some quarters as a step in a program of aggressive monetary measures designed to check the recession.

The following two possible psychological effects would be regarded in some quarters as a disadvantage and in other quarters as an advantage:

1. It may be regarded as another indication that the administration intends to resort to a program of monetary "inflation" as a means of checking the recession.

2. In recent weeks some talk of possible further depreciation of the dollar has appeared. Any desterilization step taken now may be regarded as another straw pointing in that direction.

Secretary Morgenthau - 3

Justification in principle of distinction between newly mined domestic and imported gold.

When the inactive account was created two of the three reasons advanced as a justification for sterilizing gold were:

1. That inflows of gold during 1935 and 1936 reflected in large part inflows of capital which might suddenly be withdrawn with possible adverse repercussions on the domestic economy.

2. The Federal Reserve Board in its planned operations could not know in advance how much excess reserves it would have to deal with because it could not know how much gold was going to be imported or exported. Sterilizing all gold would remove that source of uncertainty.

Neither of these two reasons apply to newly mined domestic gold; acquisitions of newly mined gold do not result from or reflect inflows of foreign capital, and the approximate rate of newly mined domestic gold can be foretold with sufficient accuracy. Sterilization of newly mined domestic gold would have to rest solely on the third reason - namely, its effect on excess reserves. Though it may be claimed that this third reason is adequate even now, yet it may be possible to justify in principle cessation of sterilization of newly acquired gold, while continuing to sterilize imported gold without being necessarily inconsistent.

It should possibly be emphasized, however, that the less made of the difference between newly mined domestic gold and imported gold -- in press conferences or public statements -- the more effective will the step be as a trial balloon.

Prepared by
Mr. Seltzer, Mr. Murphy

MENT

TION

DATE
February 7, 1938

TO Secretary Morgenthau

FROM Mr. Haas

Subject: Pros and cons of proposal to have the Treasury use $500 millions of gold in the Inactive Fund to purchase Government securities from the Federal Reserve banks

I. From the Treasury's Standpoint

1. Assuming that no increase in member bank reserves is now desired by deliberate Treasury or Reserve Board action, the obvious motive and principal merit of the subject proposal would be to reduce the interest-bearing public debt without increasing member bank reserves.

2. If the securities sold to the Treasury constituted a cross section of the Reserve banks' open-market portfolio, the annual interest expense of the Treasury would be reduced by not far from $8 millions.

3. Within its limited scope, the subject proposal, by shifting the cost of the sterilization program to the Reserve banks, would result in a more accurate portrayal of the ordinary interest costs of the Government, and of the size of the public debt, for the sterilization program was adopted and is being maintained essentially as a matter of central banking policy. In other words, to the extent of the $500 millions involved, the subject proposal would have the effect of restoring the traditional policy of central banks, whereunder the undesirable effects upon bank reserves of gold inflows are avoided by open-market sales of securities.

Even if the resulting impairment of the earnings of the Reserve banks was such as to require an annual Government subsidy to these banks, it would appear to be far better to pay this subsidy directly than to do it indirectly through a process that involves inflating the public debt by a capital sum equal to some 62 times the amount of the annual subsidy that would be involved.

Secretary Morgenthau - 2

4. The proposed use of $500 millions of sterilized gold would in no way reduce the amount of gold that could be exported without straining the domestic credit structure. The total monetary gold stock of the United States would remain unchanged at about $12.8 billions.

As of December 8, 1937, the Federal Reserve banks held $9,122 millions of gold certificates and $321 millions of other reserves as compared with aggregate minimum legal requirements of only $4,351 millions; leaving free reserves of $5,092 millions, of which all but $321 millions consisted of gold certificates. The subject transaction would increase these free reserves by $500 millions and would reduce the Inactive Gold Account of the Treasury by the same amount.

When gold exports take place through the Inactive Account, the Treasury is reimbursed by deposits in American banks. The Treasury can use these deposits to purchase Government securities or to allow maturing issues to run off, thereby almost instantaneously restoring to commercial banks the reserves lost through gold exports. So long as any part of the Inactive Account remains, this procedure can continue to be followed.

If the Inactive Account is reduced by the purchase of Government securities from the Federal Reserve banks, that Account will naturally be exhausted by gold outflows sooner than would otherwise be the case. But the Federal Reserve banks could then be expected to negative the effects upon member bank reserves of further gold outflows, if such action were deemed desirable, by open-market purchases of securities. The extent of the Reserve banks' ability to conduct such operations is super-abundant at the present time and would be increased if $500 millions of the additional gold certificates were transferred to them by the Treasury.

It may also be noted that member bank reserve requirements could be reduced to their original levels, if necessary, thereby freeing about $3 billions of member bank reserves now backed entirely by gold.

Finally, there would remain $1,800+ millions of gold in the Stabilization Fund, a large part of which could be used as a substitute for Federal Reserve open-market purchases, if desired.

5. The emergency resources of the Treasury would not be significantly affected by the proposed transaction. In the very unlikely event that the Treasury found itself confronted by sudden large cash needs and extremely unfavorable market conditions for the sale of new securities, the Treasury would be able to use

(1) The remaining $700+ millions in the Inactive Gold Account;

(2) The $1,800+ millions in the Stabilization Fund;

(3) Some $900 millions of silver certificates against the cost value of $423 millions of silver bullion against which no silver certificates are now outstanding; and

(4) Up to $3,000 millions of Thomas currency.

In addition, the Federal Reserve banks could be expected in such an emergency to purchase large quantities of Government securities in the open market, and this would tend to have the effect of creating a market demand for additional Government securities.

6. From the Treasury's standpoint, assuming that the determination of the level of excess reserves is to be the function exclusively of the Reserve officials, the only objection against the proposed transaction is that it might be publicly interpreted as smacking of trickiness or sleight-of-hand.

II. From the Standpoint of the Reserve Banks

1. The proposed action would reduce the earning assets of the Federal Reserve banks by $500 millions. If the securities sold constituted a cross section of the open-market portfolio, the annual earnings of the Reserve banks would be reduced by not far from $8 millions, or by about 20 percent of the System's present income from its open-market portfolio. This reduction would be equal to nearly all of the Federal Reserve banks aggregate current net earnings in 1936, which amounted to just over $8 millions.

2. If the Reserve banks attempted to offset this loss in earnings by shifting their remaining holdings into long-term issues, they would sacrifice a considerable measure of flexibility in their control of the money market. Some amount of such shifting, however, could be safely undertaken.

3. If they attempted to offset the loss by increasing the size of their open-market portfolio, they would be increasing member bank reserves in roughly commensurate measure -- which is precisely what the subject proposal is designed in part to avoid.

4. The sale of $500 millions of Governments to the Treasury without a corresponding increase in their open-market portfolio would reduce the power of the Reserve banks to absorb excess reserves in the future.

5. The Reserve banks would gain no practical advantage whatever from an increase of $500 millions in their holdings of gold certificates. They already possess (December 8, 1937) gold certificates amounting to $9,122 millions, and other reserve cash of $321 millions. This is far in excess of the required reserves of $4,351 millions against their combined note and deposit liabilities.

The present power of the Reserve banks to use Government securities instead of commercial paper as collateral for Federal Reserve notes expires on June 30, 1939*. Until then, at least, and thereafter if the law is extended, the Federal Reserve banks, without adding another dollar to their reserves, will be in a position to purchase or discount between $12,730 millions and $14,549 millions of additional securities without violating the existing reserve requirements -- the precise limits of the present possible expansion depending upon the proportion of notes and deposits involved in the expansion.

6. Apart from the recognition that the sterilization program is essentially a matter of central banking policy, the cost of which should properly be borne by the Reserve banks, there is only one other consideration that might conceivably induce the Reserve officials to be receptive to

* Federal Reserve notes must be secured by a minimum of 40 percent in gold. The remaining 60 percent may consist of gold and/or commercial paper; except, as noted above, that Government securities may be substituted for commercial paper until June 30, 1939.

the subject proposal. This consideration is that the Treasury might otherwise spend the $500 millions directly, either for debt retirement or other purposes, over the objections of the Reserve officials, and thereby increase excess reserves by roughly the same amount. The Reserve officials might well be willing to take a chance on this contingency, however, because they could, in that event, fare no worse than under the subject proposal. They could negative the effect of the Treasury action by selling or allowing to run off some $500 millions of their holdings of Government securities.

III. Conclusion

The subject proposal would appear to be entirely favorable to the Treasury. Its advantages to the Reserve System, considered as a separate entity, are not apparent. From a general public standpoint, it would appear to be entirely equitable and justifiable.

Prepared by Mr. Daggit
Reviewed by: Miss Michener,
Mr. Murphy, Mr. O'Donnell,
Mr. White and Mr. Haas.

DATE February 7, 1938

TO Secretary Morgenthau

FROM Mr. Haas

Subject: Review of the business situation.

The gradual improvement in business activity which has been under way since the beginning of the year showed signs of interruption in the statistics for last week, and for the current week a setback seems likely in the New York Times business index. Retail sales, steel output, carloadings, and automobile production have shared in the reaction, and lower levels of stock and commodity prices have contributed to a less optimistic feeling generally than was in evidence a few weeks ago.

We find no reason for believing that the present reaction indicates a further extension of the general decline. On the contrary, the same underlying influences which brought about the January upturn are apparently still favorable and tending to improve. While the current setback is such as can be expected from time to time in any improving business trend, it indicates that the recovery in business which we expect this year may be somewhat slower in getting under way than we had earlier anticipated.

The present situation

The New York Times business index was unchanged at 82.3 for the week ended January 29. Increases in the seasonally adjusted indexes of steel production, cotton mill activity, lumber production, and electric power production, were offset by declines in the indexes of automobile production and carloadings. The Times index for the current week will probably be lower, since steel output and automobile production have been on lower schedules.

Department store sales declined somewhat during the last week of January, according to Federal Reserve Board data, whereas an increase was shown in the corresponding week last year. The sales of 217 reporting stores were reduced to $24,795,000 as compared with $25,875,000 for the previous week, and were 9.3 percent below those for the previous year. The January monthly index of department store sales, in dollar volume, will be about 91, as compared with 93 in January last year. In physical volume the sales for the month will be larger than in January of last year, and probably comparable with those at the recovery peak in February, 1937.

The steel situation

The operating schedules of steel mills were lower this week, on an average, though some districts showed increases. For the industry as a whole, operations were reduced to 30.5 percent of capacity, as compared with 32.7 percent last week. Unfavorable developments during the week were a drop in the volume of new orders reported by the U. S. Steel Corporation, and reduced output by the previously well-maintained farm implement industry.

To follow current developments in the various steel districts, we have prepared the attached chart, showing for each district the rate of operations by weeks, the trend of steel scrap prices, and the deviation of the operating rate in each district from the general average. During the current week the poorest showing has been made by the Buffalo district, where operations have been curtailed because of insufficient new orders. This district normally gets a considerable volume of orders from the automobile industry. Operations are also slightly lower in the Chicago, Cleveland, and Youngstown districts, but have been well maintained in the important Pittsburgh district and at Wheeling. The Wheeling district and the Birmingham district have shown relatively the greatest improvement in recent months.

Steel scrap prices have recently been reduced sharply in the Birmingham district, although quotations there have apparently been largely nominal. They are also slightly lower in the Chicago district. In most districts, however, scrap prices have been well maintained. A continued heavy export demand is reported in the trade to have provided a strong support to the scrap market.

Inventories of semi-finished and finished steel in the hands of the industry at the beginning of 1938 were about 7½ percent lower than a year earlier, according to reports to the American Metal Market from a group of large steel companies.

The outlook for the industry during the next few months depends to a considerable extent upon the spring outlook for the automobile industry. Progress in clearing up the used car situation is reported this week from several sections, following extensive sales promotion efforts by factories and dealers jointly, and by general price markdowns. The improvement in used car sales reported from various sections of the country at a time of seasonal inactivity suggests that consumer incomes available for automobile buying are not as low as new-car registrations would indicate.

The price situation

A further decline in commodity prices this week appears somewhat unfavorable, although it is noticeable that the weakness has not been general but has been confined largely to a few commodities. Hides, steers, steel scrap, cocoa, tallow, rosin and print cloth, in the order named, showed the largest losses among the spot commodities. The Dow-Jones index of futures prices has held steady, and Reuters index of British prices has steadied after reaching a new low last week.

Barring any new deflationary monetary influence, we see no reason for expecting any material further decline in commodity prices. We believe it significant that commodities are no longer leading the declines in the stock market as they did last fall, but have recently been showing greater steadiness. This is particularly true of the important speculative commodities included in the Dow-Jones futures index. A continued good export demand provides a supporting influence for such commodities as cotton, wheat, and steel scrap.

Stock prices have declined slightly further this week, but without attracting any important volume of liquidation. On several occasions during the past few months the three groups of the Dow-Jones index have approached the lows established on October 18, but while these lows have been penetrated slightly, effective support on each occasion has been met at that level.

Odd-lot buying has been the mainstay of the stock market since the beginning of the decline last August. Since that time, according to S.E.C. reports, odd-lot purchasers have increased their holdings by about 7,000,000 shares. By far the larger part of this buying has apparently been for cash. Purchasers have so far shown no tendency to reduce their holdings either on declines or on rallies, but have steadily increased them. Such buying has without doubt contributed to the steadiness of the stock market during the past several months in the face of a declining business trend.

The textile outlook

Cotton mill activity during the week ended January 29 showed slightly more than the normal seasonal improvement, though for the month as a whole there is some doubt that mill activity on a seasonally-adjusted basis will equal the December level. Another substantial pickup in cotton textile buying is expected in the trade within the next few weeks. Converters in the cotton trade are reported to be facing actual shortages as a result of months of curtailed operations, while clothing inventories in the hands of merchants have been depleted by continued heavy retail sales.

Activity in the wool industry, which during December showed a contra-seasonal improvement following a severe contraction during the preceding months, is not expected to show much further improvement until March, when buying for the next fall and winter seasons will get under way. Unfilled orders on the books of the leading woolen goods manufacturer on December 31 were only 50 percent of those a year earlier, while new orders received during January were only 11 percent of those received in January last year, when the buying movement was near its peak. The production rate, however, has dropped correspondingly, the F.R.B. index of wool production in December of 1937 showing a reduction to 56 as compared with 140 in December 1936.

Rayon producers are predicting that yarn output will be back approximately to capacity levels by the end of the month, owing to the sharp improvement in sales since recent price adjustments. Estimates of January production and deliveries have been revised upward because of the heavy sales volume.

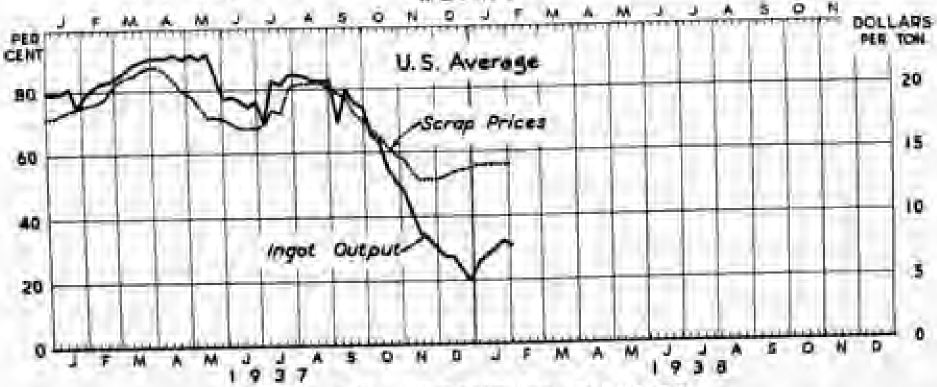
Some business series continue relatively high

Various data suggest that the general level of business activity may not be so depressed as indexes of industrial production would indicate. Carloadings during January were higher than in the corresponding month of 1935, when the F.R.B. index stood at 91, and not much below those in 1936 when the index stood at 98. Electric power production during January, on the basis of past relationships, would suggest an F.R.B. index around 100, after making allowance for the rising trend of electricity production. The January level of retail sales, as previously mentioned, will be close to that of January 1937. These data suggest that the current F.R.B. index, as a measure of general business activity, may be unduly depressed by the steep decline which has occurred in the output of the durable goods industries.

STEEL OUTPUT AND SCRAP PRICES

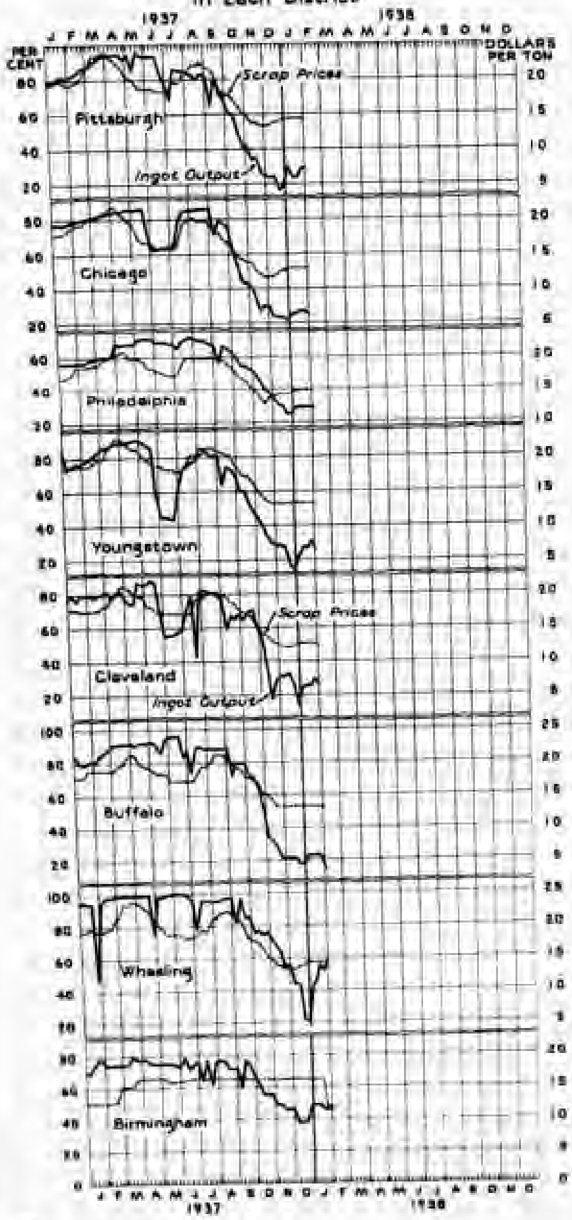
Ingot Output in Percent Capacity

WEEKLY

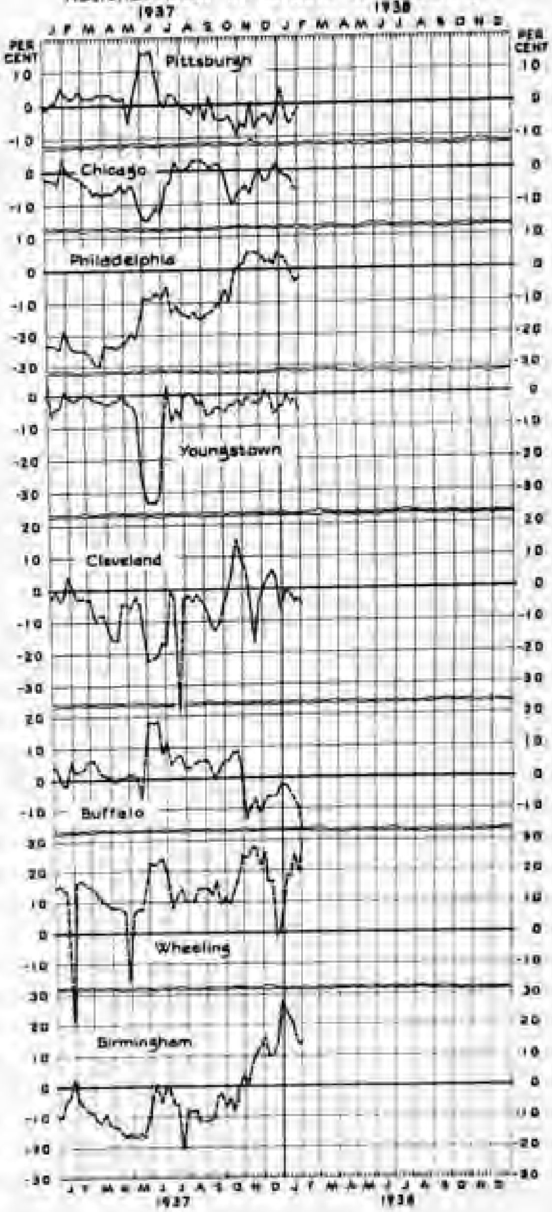


PRINCIPAL PRODUCING DISTRICTS

Ingot Output and Scrap Prices in Each District



Difference Between District Rates and National Rate in Percent of Capacity



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

Prepared by Mr. Daggit
Reviewed by: Miss Michener,
Mr. Murphy, Mr. O'Donnell, Mr.
...te, and Mr. Haas.

DATE Feb. 7, 1938

TO Secretary Morgenthau

FROM Mr. Haas

Subject: The situation in the woolen industry.

Conclusions

Heavy overproduction of woolen goods during 1935 and again during late 1936 and the first half of 1937, resulted in excessive inventories of finished goods last summer, which brought on a severe curtailment of production beginning in July. The seasonally-adjusted F.R.B. index of production for the woolen industry, which had risen to 140 in December 1936, dropped to 51 in November 1937.

This sharp decline in production, together with successful clearance sales and the marking down of prices, has aided materially in reducing inventories of clothing and other woolen goods. As a consequence, activity in the woolen industry rose somewhat in December, contrary to the trend in most industries. No material upturn in production seems in prospect during the next few months, however, since (1) stocks of woolen goods in retail channels continue large in comparison with a year ago; (2) new orders currently being placed with manufacturers are in light volume; and (3) the opinion is generally held in the textile trade that activity in the woolen industry will not pick up much before March, when buying for the fall and winter season will get under way.

Conditions leading to the present situation

The woolen industry is characterized by rapid and wide fluctuations in output resulting from (1) the chain of intermediate stages between the spinning of the yarn and the final sale of the finished clothing; (2) buying and selling policies followed by the different sections of the trade, which favor alternate periods of overproduction and underproduction; (3) an excessive plant capacity dating back to the overexpansion of the World War years.

We show in the attached chart the wide swings in production from 1932 through 1937 in comparison with the more stable movements of an estimated index of "basic demand" for wool products. The production index increased from a low of 37 in May 1932 to a high of 124 in July of the following year, dropped back to 38 in 1934 and rose to 131 in 1935. A peak of 140, the highest on record back to 1919, was reached in December 1936.

In comparison, the estimated "basic demand" shows a gradual rise through this period, in line with the improvement in real incomes of consumers, with but moderate changes in the index from month to month. The production of woolen goods has been below the estimated demand for six months or longer, reaching apparently an even greater degree of underproduction than at the turning points in 1932 and 1934.

The principal factor responsible for the excessive production which came to an end in 1937 was a steady rise in raw wool prices that began early in 1935. This led to rising prices for woolen goods, and to heavy speculative buying in the various sections of the industry. A severe decline in wool prices in 1937 ended the speculative boom, and resulted in enormous inventory losses. The American Woolen Company, the leading factor in the industry, reports a net loss of $1,855,000 for the year as a whole, which compares with a profit of $3,394,000 in the first half-year. Inventory losses of the company in 1937 amounted to $4,023,000.

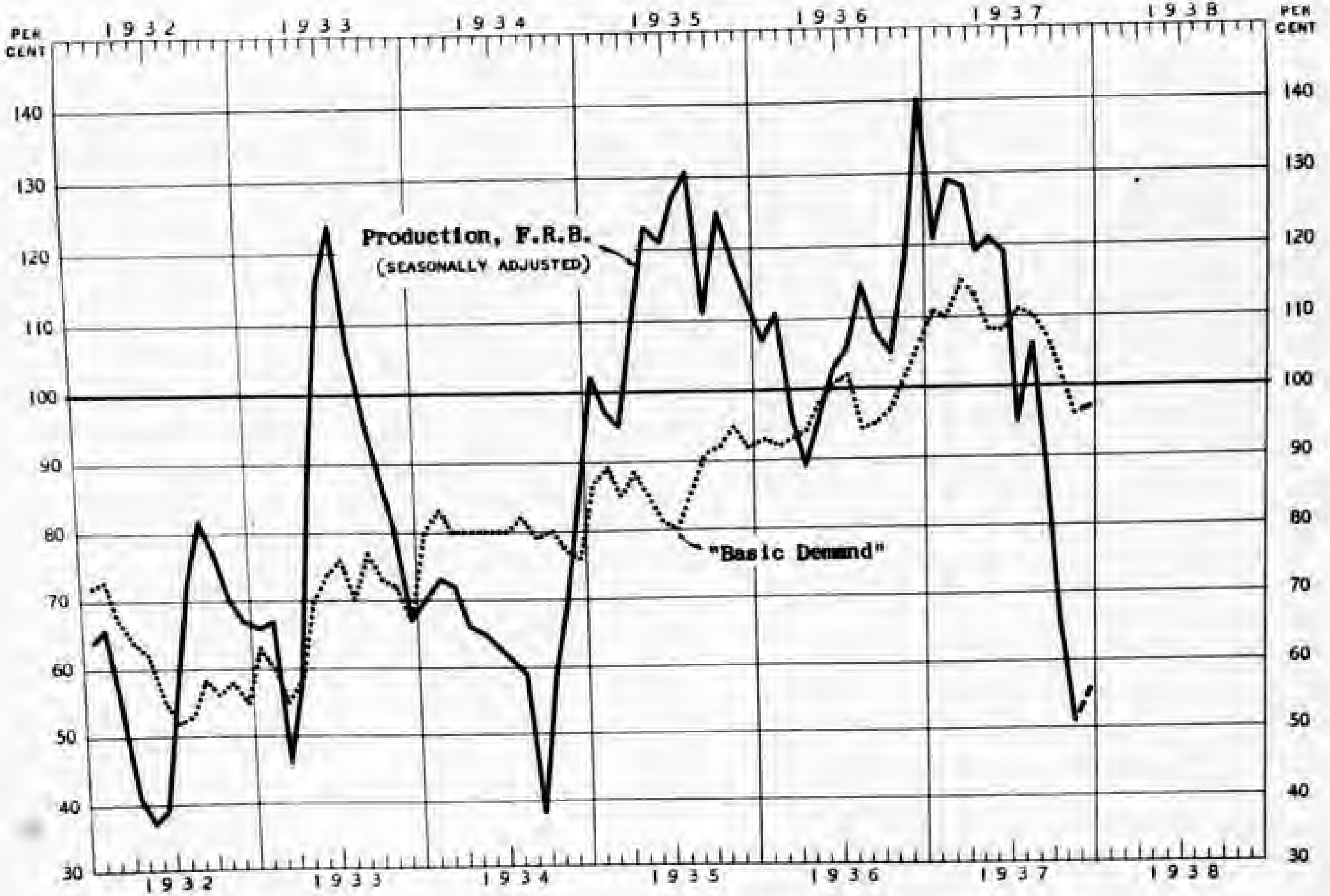
The present situation

Despite the fact that production curtailment has gone far toward correcting the overproduction situation, the experiences of the past year have made new buyers overly cautious. The American Woolen Company reports unfilled orders on December 31, 1937, as 50 percent less than at the end of 1936. During January 1938, new orders received by this company were approximately 11 percent of those received during the same month of the previous year, when speculative buying was near its peak.

Trade reports indicate that while stocks of wool clothing in retail establishments are still large in comparison with last year, they have been reduced substantially in recent weeks by successful clearance sales and by the marking down of prices. The inventories of the American Woolen Company at the end of the year had been reduced to $22,067,000, as compared with $33,567,000 at the end of 1936 and $30,533,000 at the end of 1935.

A reduction in inventories throughout the wool trade, together with the small volume of new business that has been booked to date, should place the industry in a favorable position for improvement during 1938. Some tendency in this direction was seen during December, when the F.R.B. adjusted index of woolen goods production rose to 56 as compared with 51 in November. No real improvement is expected by the trade, however, until about March, when new buying for the fall and winter season is expected to come into the market.

WOOL MANUFACTURES PRODUCTION AND BASIC DEMAND
1923-'25 = 100



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

C - 164

February 7, 1938

For the Secretary:

I have noted down some of the points most commonly made for and against bank holding companies. They may be of interest to you.

Upm

There was widespread discussion in 1892 of a proposal for group banking. The general opinion of bankers and others at that time was that the proposal would be unacceptable because of its "trust" or "monopoly" character.

In 1911 the National City Bank of New York engaged in an abortive attempt at group banking. The National City Company acquired substantial holdings in a number of banks scattered throughout the country. Solicitor General Lehman ruled that this was contrary to the spirit, at least, of the statute which prohibited banks from holding stocks of other banks. The National City Company liquidated its holdings.

In 1911 Secretary MacVeagh in his annual report asked for legislation to prevent either a national or a state bank from holding stock in any other bank and wanted legislation "so explicit that its spirit as well as its letter would be enforced."

In 1911 President Taft in his special message to Congress asked for legislation assuring "the individuality and independence of each bank."

SOME CONSIDERATIONS AGAINST BANK HOLDING COMPANIES

1. They constitute an evasion of the statutory prohibitions against interlocking bank directorates.
2. They constitute an evasion of statutory prohibitions on branch banking.
3. They constitute an evasion of statutory prohibitions against ownership of bank stocks by other banks.
4. Prior to the repeal of the requirements for double liability on bank stock, they constituted, in some cases at least, an evasion of that statutory requirement.
5. They present manipulative possibilities of promotional character, some of which have been transformed into actualities.
6. They make possible an undesirable type of shifting of funds from bank to bank within the group.
7. They thrive on the existence of a speculative fever.
8. They make bank provisions and examination difficult.
9. They may develop into elaborate and intricate structural organizations.
10. They do not reach the weakest element of our banking structure--the very small banks.

SOME CONSIDERATIONS IN FAVOR OF BANK HOLDING COMPANIES

1. They provide a concentration of bank resources.
2. They make possible a higher type of bank management.
3. They give a greater diversification to bank investments and loans.
4. They permit bank operation at lower costs.
5. They make for fewer losses in bank operations.
6. They provide more varied services for customers.
7. They give a mobility to bank credit within the group area.
8. Shareholders have a safer and more marketable investment.
9. They make possible local financing of businesses which become units of national chains.
10. They give to group areas an independence from New York financial interests.
11. They are the rural equivalent of urban bank mergers.

February 7, 1938.
3:48 p.m.

H.M.Jr: Hello.

Operator: Aubrey Williams. Go ahead.

H.M.Jr: Hello.

Aubrey Williams: Hello, Mr. Secretary.

H.M.Jr: How are you?

W: All right, sir.

H.M.Jr: I got -

W: I wonder when I could see you.

H.M.Jr: Well now, let's just see.

W: Got - you know, it's - I got word from the President to go right together with you on discussing what probable moves that he ought to make in this thing.

H.M.Jr: Yes. Well, now, how about three o'clock tomorrow afternoon?

W: Well, that's a little bit bad because the Youth Administration people are going to meet with the President at four.

H.M.Jr: All right. Make it in the morning.

W: Well that would be better for me.

H.M.Jr: How about eleven?

W: That would be grand.

H.M.Jr: Now that's all right, provided Bell can come. If you don't hear from me - I'll - if you don't hear from me at eleven o'clock tomorrow.

W: All right. Thanks very much.

H.M.Jr: Thank you.

February 7, 1938.
4:27 p.m.

H.M.Jr: Hello.

Operator: Jesse Jones.

H.M.Jr: Hello.

Jesse Jones: Hello, Henry.

H.M.Jr: How are you Jesse?

J: Pretty good. How are you?

H.M.Jr: Oh, fair.

J: Well, that's about all I am. I wanted to see you as soon as I could.

H.M.Jr: All right.

J: Convenient for you to -

H.M.Jr: All right. Do you want to do it in the morning or the afternoon, tomorrow?

J: Well.

H.M.Jr: Which is better for you?

J: I believe that - if it's - if it's just as convenient to you in the morning, it would suit me better.

H.M.Jr: All right. How about ten thirty?

J: That'll suit me fine.

H.M.Jr: Do you want anybody here in particular?

J: Well, Wayne and Bell, if you want him, I don't know.

H.M.Jr: Fine. All right. Wayne and Bell will be here at ten thirty, plus the Honorable Jesse Jones.

J: All right. Fine Henry.

February 7, 1938.

H.M.Jr: Hello.

Operator: Dr. Riefler is on his way between the office and his residence.

H.M.Jr: All right. Well, then you'd better try it again after the press conference.

O: All right.

Wynn Riefler: Hello.

H.M.Jr: Wynn Riefler.

R: Yes.

H.M.Jr: Morgenthau.

R: Yes. I called up Stuart.

H.M.Jr: Yes.

R: And Warren. And they would like very much to come down, preferably at the end of the week.

H.M.Jr: Uh-huh.

R: Is that all right?

H.M.Jr: Well how much toward the end?

R: What?

H.M.Jr: How near the end?

R: Well, they've got some people coming from out of town, and I think after Thursday.

H.M.Jr: Well, supposing we say Friday?

R: Friday. Good.

H.M.Jr: Ten thirty?

R: In the morning.

H.M.Jr: In the morning.

R: All right.

H.M.Jr: You - you won't be coming with them, will you?

R: Well, what they wanted was very much that I should.

H.M.Jr: Yes.

R: And they'd like some chance to know what it's all about, that they can talk it over before they get ready. I thought it was just general.

H.M.Jr: I think they'll have to sort of leave it as general.

R: Uh-huh.

H.M.Jr: See? And I was just thinking - tell you what let's do a little bit differently - I may have some others here. Let's say ten o'clock Friday morning. If they come in they could do it earlier - If they come in on the nine, they could come out - they could be there at nine-thirty, couldn't they?

R: Yes.

H.M.Jr: Let's say nine-thirty, Friday morning, at my house.

R: Nine-thirty at your house.

H.M.Jr: That's - you know where it is?

R: Yes.

H.M.Jr: 2211 -

R: Yes.

H.M.Jr: 30th.

R: 2211 - 30th.

H.M.Jr: Nine-thirty Friday morning at the house.

R: All right.

H.M.Jr: O.K.

R: I'll be there too.

H.M.Jr: And you'll be there too.

R: All right.

H.M.Jr: Thank you.

R: Good.

TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Monday, February 7, 1938.
2/4/38

Press Service
No. 12-43

Secretary Morgenthau announced today that United States Savings Bonds of a maturity value of $133,000,000 were sold during January, the largest amount sold in any month since these bonds were first offered on March 1, 1935. The maturity value of the sales exceeded that of January, 1937, by approximately $3,000,000. The greatly increased sales noted at the beginning ~~of each~~ year have been due to the fact that many investors buy Savings Bonds on an annual basis and generally make their purchases within the first month of the year.

Up to January 31, 1938, 5,200,000 Savings Bonds of a maturity value of $1,501,000,000 had been bought by more than 1,250,000 individual investors. The majority of the registered owners are small investors who are buying the bonds out of income. Purchases by individuals represent approximately 85 per cent of the bonds sold. Of the remaining 15 per cent, 9 per cent was purchased by banks and trust companies, 3 per cent by corporations, and approximately 3 per cent by associations.

A Savings Bond may be redeemed at any time after 60 days from its issue date, but less than 6 per cent of the bonds sold have been redeemed.

An average of 130,000 investors are buying Savings Bonds each month, a large proportion of whom are repeat purchasers. Many thousands are undertaking a plan of systematic saving through the regular purchase of the bonds each week, or at other intervals.

Recently a questionnaire was forwarded to the owners of Savings Bonds, and to date several hundred thousand replies have been received. Preliminary examination of the replies indicates that most purchases are made to provide funds for education of children, for retirement funds, or to set up a reserve for emergencies. Among the features of the bonds most frequently influencing their purchase are safety, the constant availability of the funds and the fact that Savings Bonds increase 33-1/3 per cent in value if held for 10 years. The redemption feature, which eliminates any chance of loss to the investor, appeals to all purchasers.

The $100 bond unit is the most popular denomination and has accounted for 30.38 per cent of the number of the bonds sold. The $25 unit ranks next with 23.71 per cent of sales. The $50 unit is next with a sale of 18.49 per cent. The $1,000 unit follows with 18.19 per cent; while the $500 unit accounts for 9.23 per cent.

Yearly sales to December 31, 1937, by States, are presented in the attached tabulation.

UNITED STATES SAVINGS BONDS SALES IN EACH YEAR

States	1935	1936	1937	Total.
Alabama	1,381,100	3,228,450	5,146,725	9,756,275
Arizona	576,925	1,126,825	1,882,675	3,586,425
Arkansas	1,928,450	3,583,175	4,433,150	9,944,775
California	10,003,400	19,225,625	32,177,525	61,406,550
Colorado	3,231,125	6,689,700	9,937,375	19,858,100
Connecticut ...	1,102,050	2,508,675	4,389,050	7,999,775
Delaware	139,150	429,700	657,275	1,226,125
Florida	2,768,450	4,510,750	6,427,025	13,706,225
Georgia	2,526,750	4,678,250	6,188,925	13,393,925
Idaho	785,450	1,299,600	2,123,150	4,208,200
Illinois	34,664,075	48,167,575	70,801,650	143,633,300
Indiana	10,182,750	15,689,150	21,780,400	47,652,300
Iowa	14,808,875	21,001,350	25,735,175	61,545,400
Kansas	11,112,275	14,613,850	17,906,575	43,632,700
Kentucky	3,945,600	5,489,750	8,511,950	17,947,300
Louisiana	1,902,825	3,877,350	5,831,825	11,612,000
Maine	1,019,900	1,722,075	3,103,775	5,845,750
Maryland	2,071,525	5,706,650	7,774,300	15,552,475
Massachusetts .	4,746,075	8,213,625	15,670,550	28,630,250
Michigan	11,310,275	19,291,700	28,660,150	59,262,125
Minnesota	12,235,475	21,493,175	31,851,250	65,579,900
Mississippi ...	1,790,350	3,579,250	4,917,900	10,287,500
Missouri	15,237,325	20,496,875	25,108,875	60,843,075
Montana	2,679,475	4,809,925	6,164,700	13,654,100
Nebraska	7,250,050	11,359,500	13,673,525	33,283,075
Nevada	325,750	616,950	716,475	1,659,175
New Hampshire .	600,225	881,975	1,372,100	2,854,300
New Jersey	3,931,750	8,618,400	16,945,225	28,495,375
New Mexico	544,450	1,080,475	1,566,700	3,291,625
New York	18,922,875	31,275,600	53,822,575	104,021,050
North Carolina	3,643,950	5,356,525	7,701,875	16,702,350
North Dakota ..	2,741,350	3,636,375	4,545,775	10,923,500
Ohio	17,918,525	31,899,100	36,965,625	79,783,250
Oklahoma	4,473,250	7,703,550	11,111,075	23,288,175
Oregon	3,359,725	5,745,075	7,133,000	16,227,500
Pennsylvania ..	13,375,000	25,386,950	43,735,400	82,500,350
Rhode Island ..	617,125	795,075	1,857,975	3,270,175
South Carolina	1,413,925	2,511,175	3,231,700	7,156,800
South Dakota ..	2,113,975	3,364,975	4,209,350	9,688,300
Tennessee	2,977,850	4,566,450	6,481,075	14,025,375
Texas	10,742,475	17,280,050	25,970,325	53,992,850
Utah	749,025	1,263,825	1,497,400	3,510,250
Vermont	424,125	915,725	1,416,350	[illegible]759,200
Virginia	3,046,300	5,392,625	7,743,575	16,182,500
Washington	4,180,225	7,728,550	11,134,475	23,043,250
West Virginia .	3,439,000	4,323,775	6,101,400	13,864,175
Wisconsin	9,534,650	16,196,850	22,663,050	48,395,350
Wyoming	637,125	1,215,300	2,002,650	3,855,075
Dist. of Col...	9,508,375	24,712,175	9,015,600	43,236,150
Sub Total	268,720,725	458,263,375	648,690,125	1,375,674,225
Possessions ...	301,600	836,550	1,146,025	2,286,975
Foreign		190,950	1,313,375	1,512,325
Grand Totals ..	269,022,325	459,300,075	651,150,325	1,379,473,525