At the time these papers were prepared United States' control over foreign exchange stemmed from March 6 and 9, 1933, Proclamations of the President. These Proclamations issued by virtue of section 5(b) of the Trading-with-the-Enemy Act (40 Stat. 411), as amended by the Act of March 9, 1933,6/ were still in full force and effect. Because of Japanese violence against American persons and property, the President could have issued a proclamation stating that these events were a continuing threat to the peace of the United States, and that it was his duty to forestall any continued violence which would plunge the United States into war. General Counsel Oliphant drafted not only the proclamation, but also extensive regulations controlling transactions in foreign exchange, transfers of credit, the export of coin, bullion and currency, etc. In the first draft of these regulations the General Counsel employed much of the language which later became basic to all Foreign Funds documents. Article 2(a) of these regulations, for example, was as follows:

> "All of the following are prohibited if they involve funds, credits, or foreign exchange in which Japan, or any national thereof, has a significant interest, direct or indirect:"

The new concept of national displaced the concept of enemy alien, which had been used as the classification under the Trading-with-the-Enemy Act during the first world war. The words "direct or indirect" included all the techniques by which the Germans hoped to camouflage ownership of their United States subsidiaries

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6/ "During time of war or during any other period of national emergency declared by the President, the President may, through any agency that he may designate, or otherwise, investigate, regulate, or prohibit, under such rules and regulations as he may prescribe, by means of license or otherwise any transactions in foreign exchange, transfers of credit between or payments by banking institutions as defined by the President, and export, hoarding, melting, or earmarking of gold or silver coin or bullion or currency by any person within the United States or any place subject to the jurisdiction thereof; ****"

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in the event of war. Even though these initial draft regulations were aimed at Japan, the basic concept which Herman Oliphant conceived was adequate to sustain an exchange control which could have been applied to any country in the world.

Article 5 of his draft provided for a licensing scheme. Under this provision the Federal Reserve Banks wer to serve as administrative sub-divisions of the Treasury for the purpose of taking applications and issuing licenses. United States Mint or Assay Offices were also to be provided with application blanks for distribution to prospective licensees.

Just at the point when the Treasury had everything ready the Japanese Government made adjustment and the international situation eased. The freezing control documents were then relegated to the safe in the Office of the General Counsel, ready at moment's notice for any future contingency. It wasn't long before it developed. The German Government had made demands upon Czechoslovakia in the fall of 1938, asking the return of the Sudetenland to German control. The Czechoslovakian Government at first resisted the German demands in the belief that it would get support from France, England, and possibly the United States. At the time of the Munich crisis and afterwards the Treasury Department redrafted its proposed Executive Order and devised detailed reporting requirements by which the United States Government could determine the extent and location of assets in the United States of such foreign governments (including, of course, Czechoslovakia). The purpose was, of course, to enable Britain and France particularly, to mobilize their financial resources here for use in any struggle which might ensue. The proposed regulations and forms which made it necessary for banks, financial institutions, and other business organizations in the United States to report fully on assets they held directly or indirectly for any foreign national designated

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in the proposed Executive Order, was the key to the exchange control. Although these requirements were not put into force, another basic development had been made in the technique of the ultimate program of Foreign Funds Control.

The Department of State had also been disturbed by the Munich crisis, and especially by German exchange controls which made payments by Germans to Americans subject to the control of the German Government. State had completed a preliminary study of reciprocal economic sanctions which it concluded were available under our laws. After its completion the Secretary of State wrote the Secretary of the Treasury November 17, 1938, as follows:

> "The Treasury is of course fully acquainted with the fact that many governments are now subjecting the payments due to Americans for purchases of goods, yield on investment, proceeds of inheritance, etc., to strict and often discriminatory control. In considering some of these situations it seems to me that we might well be in a more effective position to protect the American interests if there were legislation specifically giving the executive the authority to control payments by Americans. I am told that under certain sections of the Trading-with-the-Enemy Act the executive already possessed some such authority in general terms, but I believe that it would be preferable to have this authority explicitly conveyed for an explicit objective and with public understanding.
>
> "I have had prepared the draft of a possible bill . . . which is receiving the tentative consideration of the Department. I know that this is a matter of great interest to the Treasury Department and furthermore surmised that the application of policy in this field would have to be carried out largely if not primarily under the administrative direction of the Treasury. I therefore request consideration of the policy embodied in this piece of legislation and of the precise terms of this legislation, and would appreciate an expression of your judgment on both as promptly as may be convenient."

The bill which the State Department had drafted was an amendment to the Act of March 9, 1933 (an amendment to the Trading-with-the-Enemy Act of October 6, 1917). It proposed to control payments to foreign countries by requiring such payments to be made to a government controlled institution prior to remittance. It also authorized concomitant regulations to govern the administrative procedure.

In a memorandum which accompanied the proposed draft, State made clear that the legislation was intended only to control payments to foreign countries pursuing policies in the exchange field detrimental to American interests. Treasury, on the other hand, had visualized a "freezing control" which, because of its extensive reporting requirements, was an economic weapon powerful enough to restrain a foreign government bent on aggression, or to quarantine a peripheral war and thus prevent it from involving the United States. What State had proposed constituted only one technique of many embodied in the Oliphant plan. Therefore, the Secretary of the Treasury replied to the Department of State on the following day as follows:7/

> "I shall be glad to respond, as early as the importance of the program permits, to your request for an expression of my judgment on the policy and form of this legislation."

This work was then taken over by newly appointed Acting General Counsel Foley. Under Mr. Foley's direction the State Department bill was redrafted in order to put it on a more sound legal base, and to add sufficient flexibility to permit the Executive branch to deal with the problem by:

(1) Giving the President control over all foreign holdings in this country as well as all American holdings abroad. This gave the government real power to retaliate for discriminatory and unwarranted acts by other countries in this field.

(2) Authorizing the President to enter into agreements with other countries to protect the interest of the United States and its nationals.

In a February 6, 1939 memorandum to the Secretary, Mr. Foley stated that:

> "The act being amended is the Trading-with-the-Enemy Act, which as amended by the Act of March 9, 1933, is the source of

7/ This letter had been prepared by General Counsel Oliphant, who died in January, 1939.

the Treasury's authority in the field of exchange control, etc. Accordingly, if the State Department is going to request any legislation of this kind it is a propitious time for us to get legislation which would be helpful in the general field of international monetary relations. We have, accordingly, redrafted the amendment so as to enable us to cope with problems in this field which we have been considering in the last few years by: (a) making explicit a number of powers about which there is now some doubt and (b) giving us a number of new powers. Thus, as redrafted, the amendments give the Treasury explicit power to:

> "(1) Deal with the 'hot money' situation in various of its aspects. Here we have included the power to obtain full information on foreign holdings of property in this country and American holdings of property abroad, and to regulate and prohibit the bringing of property into the United States as well as the taking of property out of this country.
>
> "(2) Protect our economy in the event of threatened or actual war or other serious economic disturbances here or abroad."

The General Counsel then prepared a letter for the Secretary of the Treasury to send to the Secretary of State, enclosing the Treasury draft as an alternative for the consideration of both Departments. In the letter Secretary Morgenthau stated:

> ". . .the legislation which your department proposes would be even more useful if it were framed a little more flexibly so as to permit the President effectively to deal with other ramifications of the general problem. . . I attach an alternative draft..."8/

In the meantime the Czechoslovakian crisis in Europe was deepening. The Sudetenland, occupied by Hitler a few months before, had not satisfied the German Government. The familiar pattern of German aggression became apparent once again. Consequently, the Treasury reexamined the existing legislation to see what could be done. There was ample statutory authority at that time to:

8/ Letter of February 13, 1939.

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(1) Revoke the general foreign exchange license of November 12, 1934, and reimpose a general foreign exchange control. By the simple expedient of refusing a license the United States Government could halt the withdrawal of Czech balances from this country.

(2) Amend the existing foreign exchange order and general license to require licenses with respect to individual transactions involving Czechoslovakian funds. Banks could be required (according to the Treasury's views) to file detailed reports showing what was held for Czechoslovakian accounts. No transfers of interest of such assets could be made except under the licensing system which still did not exist.

In March of 1939, the German Government trumped up a case against Czechoslovakia, crossed the border, and occupied Prague. Treasury strongly urged immediate imposition of a freezing control. Some doubt was raised as to the legality of the proposed controls and the question was therefore referred to the Justice Department for an informal opinion as to their legality.

The Treasury's proposed Executive order regulating transactions in foreign exchange, and for other purposes, took the form of an amendment to an existing Executive order dated January 15, 1934. The proposed order placed further restrictions upon transactions in foreign exchange, transfers of credit, payments and the export or withdrawal of coin, bullion or currency. There was little question that this phase of the amended order was valid. It followed substantially the language of section 5(b) of the Act of October 6, 1917, as amended. Justice Department lawyers, however, questioned another part of the order. The questioned sections provided for the filing of detailed reports concerning foreign owned assets in the United States. The Treasury argued that these provisions were authorized by section 5(b) for the following reasons:

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(1) The statute authorized the President to "investigate, regulate, or prohibit. . .any transactions in foreign exchange, transfers of credit between or payments by banking institutes as defined by the President and export, hoarding, melting or earmarking of gold or silver coin or bullion or currency." This, the Treasury argued, included the power to require the filing of reports. Such a requirement was contained, the Treasury pointed out, in the Executive order of August 28, 1933, (and its attendant regulations), issued under the statute. These regulations related to the hoarding of gold, and required every person who possessed or owned gold to file reports. The legality of such reports had been sustained in a court decision.9/

(2) The Treasury also maintained that in the event of a war, foreigners or foreign governments holding assets in this country would desire to liquidate or withdraw their assets. Such action, if left unchecked, could have had a disastrous effect on our economic and financial structure. Therefore, regulations which would prohibit damaging manipulation were clearly authorized by the statute. Obviously the government could accomplish this more effectively if it had full information concerning the extent and location of these assets.

(3) Only if the government had adequate information, could it administer any system of foreign exchange control properly and adequately.

(4) Both section 5(b), and its amendment on March 9, 1933 resulted from periods of grave national emergency. Congress had acted speedily in order to combat, in the first case, a world war, and in the second case, a domestic depression. The legislative history of these acts made clear that the President had broad discretion.

9/ United States v. Campbell, (S.D. N.Y. 1933) 5 F. Supp. 156.

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(5) The statute had already been construed very liberally. When the President declared the bank holiday 10/ the act was invoked in a much broader sense than required by the exchange control which the Treasury had devised.

(6) The provisions for filing reports of foreign owned assets were aimed primarily at American business organizations which had custody or control of such assets, and which would have no particular reason for withholding vital information which would help protect a free enterprise economic system.

Two days after the Justice Department recieved the proposed Executive order, the regulations and Mr. Foley's memorandum, the Attorney General dispatched a long memorandum to the President in which he discussed the Treasury's position. The attorney General stated in his letter that:

> "Legal doubt exists only with respect to that provision which requires detailed reporting of foreign owned assets in the United States. It is believed, however, that the order would be upheld even in that respect if issued under conditions of national emergency, the existence of which you should determine. . . the statute does not, in express terms provide for the filing of such reports but I am satisfied that such requirement is sustainable and would be upheld if made during a period of war or national emergency.
>
> * * *
>
> "It must be observed, however, that violations of the statute and orders or regulations issued thereunder are punishable, upon conviction, by fine and imprisonment. Thus, in the final analysis any implication in the statute is to be resolved by the courts. Whether the courts would sustain the implied authority in my opinion would depend upon the nature of the emergency existing. The extent to which public opinion approved the exercise of the power would unquestionably have a bearing upon successful administration of the order."

10/ Proclamations of March 6 and 9, 1933.

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Before the letter was delivered to the President it was shown to General Counsel Foley and the Secretary of the Treasury. In Mr. Foley's memorandum to the Secretary accompanying a copy of the Attorney General's letter he stated:

> "For our purposes the letter in my opinion is satisfactory. In light of the draft which the Attorney General submitted at our meeting yesterday afternoon, it represents a substantial compromise decidedly in our favor."

The Attorney General's opinion was transmitted to the President April 7, 1939. The President then returned the entire file to the Secretary of the Treasury with the following memorandum:

> "This I take it, is the order which will be kept in your safe ready to be signed at any time.
>
> "Please, however, read the opinion of the Attorney General."

Subsequently, the Department of State, for reasons which are not ascertainable from Treasury files, failed to support Treasury's position,11/ despite the fact that definite warning of what the Germans intended to do had been received by telegram from the United States Embassy in Prague shortly after German occupation. The Embassy's telegram stated:

> "Our representative in Prague has received confidential information. The German executives in charge of the affairs of the Czech National Bank intend, within a week, to force the turning over to them of funds on deposit in the United States but owned by residents of Czechoslovakia in which are included American citizens. The total of funds involved is about $600,000. . .The German exchange control does not allow any export of funds. . .suggestion has been made that our government may be willing to consider preventing the transfer of any funds (to Czechoslovakia) unless like transfers are permitted to the United States. . ."

This telegram made it perfectly clear that Germany's discriminatory foreign exchange techniques would now be extended to Czechoslovakia. After having studied

11/ No action in this field was taken until after Germany invaded Denmark and Norway in 1940.

this wire, the Treasury discussed the proposed freezing program with Mr. A. A. Berle, Assistant Secretary of State. Treasury made it clear to Mr. Berle, that the proposed order merely defined methods and provided machinery for a freezing control. The policy determination of whether there should be any action was the only question still to be settled. Treasury indicated that if the Department of State should decide to issue an order further discussion should be held with the Departments of Justice and Treasury. 12/

12/ The staff members of the Office of the General Counsel who worked on these drafts included General Counsel E. H. Foley, now Assistant Secretary; Joseph B. Friedman, now an Assistant General Counsel; John W. Pehle, later Director of the Division of Foreign Funds Control; James Mann, now Special Assistant to the General Counsel and Treasury Representative in Bern; Ansel Luxford, later an Assistant to the Secretary, and Bernard Bernstein, the Assistant General Counsel in charge during this formulative period.