



THE UNDER SECRETARY OF THE TREASURY
WASHINGTON

January 27, 1941

Dear Marriner:

In accordance with the Secretary's telephone conversation this morning, I am transmitting herewith four copies of the first draft of his proposed statement before the Ways and Means Committee on Wednesday on H. R. 2653. As we will be working on this this evening, I should appreciate it if you could let me have any suggestions or comments you care to make on it before four o'clock.

Sincerely yours,

Under Secretary of the Treasury

Honorable Marriner S. Eccles,
Chairman,
Board of Governors of the
Federal Reserve System,
Washington, D. C.

FEB 12 1941

When I first appeared before you last spring at the time the revenue bill of 1940 was under consideration, the National Defense program then before Congress was less than \$4,000,000,000. I told you that on the basis of that program the balance of the borrowing authority under the general debt limitation of \$45,000,000,000 would be completely exhausted and the working balance of the Treasury would be dangerously depleted early in the calendar year 1941. In view of this situation, Congress provided in the first Revenue Act of 1940 for the issuance of not more than \$4,000,000,000 of short-term obligations to raise funds to finance the National Defense expenditures. The same Act provided additional taxes, most of which were intended to be used to retire within five years any defense obligations issued under this authority. As I reported to you, the provisions of the bill then pending before your Committee were sufficient to meet the situation as it existed at that time.

The balance of borrowing authority on January 1, 1941, was
8
\$827,000,000 under the general limitation, and \$2,764,000,000 under the National Defense limitation. These combined balances provide the

Treasury with borrowing authority sufficient only for the next three months. I am therefore appearing before you today in support of H. R. _____, which provides for the elimination of the partition in the debt limit, raises the debt limit to \$65,000,000,000, provides greater flexibility in our financing operations, and provides that the income from all future issues of Government securities, both direct and indirect, be subject to all Federal taxes.

Because of rapid changes in world conditions, our contemplated National Defense program, according to the 1942 Budget just submitted, has now been increased until it aggregates approximately \$28,500,000,000 in appropriations, contract authorizations, and recommendations. The estimated expenditures/ programs included in this Budget will result in combined deficits for the fiscal years 1941 and 1942 of more than \$15,000,000,000. In view of this enlarged program, I do not believe that it would be advisable to undertake to finance it through the issuance of short-term securities and their retirement out of earmarked taxes within a specified period as contemplated in the first Revenue Act of 1940. Moreover, short-term securities would for the most part be

purchased by banks resulting in a further inflation of deposits. It is highly desirable to avoid such inflation as much as possible and to some extent this can be accomplished by issuing long-term obligations attractive to permanent investors outside of the banking system. It seems clear, therefore, that the provisions of law authorizing the issuance of \$4,000,000,000 of short-term public debt obligations and their retirement within five years out of earmarked taxes should be repealed. The deficit figures just given also clearly indicate that the general debt limitation of \$45,000,000,000 must be increased. It would appear advisable to increase this limit to an amount sufficient to enable the Treasury to meet all of its financing requirements for the next two fiscal years ending June 30, 1942. I believe that the amount fixed in the bill before you is ample for this purpose.

This brings me to another matter of vital importance in connection with the financing of the National Defense program, and that is the tax exemption features of the debt obligations issued by the Federal Government and its agencies. I told you last year that if it were within my power, I would issue National Defense series obligations subject to all

Federal taxes. The discretionary authority of the Treasury to issue securities subject to all Federal taxes is confined to Treasury notes with a maturity of from one to five years. As to all other types of Government securities, the law itself definitely fixes the exemptions from taxation and there is no discretionary authority in any executive office of the Government to vary these exemptions.

Ordinarily, the Treasury would have raised in December 1940 a substantial amount of additional cash and it would have carried out its usual program of refunding, three months in advance, the obligations aggregating \$1,220,000,000 that mature on March 15, 1941. The money market at that time afforded the Treasury an excellent opportunity to refund the large maturities and raise the additional cash needed largely through the sale of long-term bonds. However, anticipating that the Congress would consider the question of tax exemptions in this session, it seemed to me highly desirable that the Treasury make no further offers of long-term tax-exempt securities until the Congress had had an opportunity to consider the question again in the light of the huge defense financing program before us. I decided, therefore, to defer our refunding program and to

meet our immediate cash requirements through the sale of short-term notes, the income from which is subject to all Federal taxes, in order to give this Congress an opportunity to consider the question of eliminating tax-exemptions from Federal securities. I conferred with some members of both the Ways and Means Committee of the House and the Finance Committee of the Senate and explained to them what I had in mind and that in taking these steps it was my hope that Congress would promptly enact legislation which would provide that the income from all future issues of securities of the Federal Government or any of its agencies be made subject to all Federal taxes. I believe that the program explained to them met with their hearty approval. I am sure this Committee appreciates the importance of prompt action in this connection so that the Treasury can take steps to refund the large March 15 maturities in advance of that date.

Section 2 of H. R. _____ amends section 21 of the Second Liberty Bond Act, as amended, so as to limit the face amount of public debt obligations issued under the authority of that Act to an amount not to

exceed in the aggregate \$65,000,000,000 outstanding at any one time.

This amendment as written will repeal section 21(b) of that Act which authorizes the issuance of \$4,000,000,000 face amount of National Defense notes. As previously explained, this increased limitation will amply cover the Treasury's present anticipated financing requirements for the current and ensuing fiscal years.

Section 3 amends section 22 of the Second Liberty Bond Act so as to broaden the authority under which United States Savings Bonds are issued, in order, first, that the Treasury may issue such bonds with maturities up to twenty years; second, that it may issue Treasury savings certificates with maturities up to ten years, and, third, to give the Secretary control over the amount of new issues of Savings Bonds and of certificates which may be held at any one time by any one person. In addition, this section would authorize the Secretary to issue stamps or provide other means to evidence payments for Savings Bonds and savings certificates, and to provide for the exchange of savings certificates for Savings Bonds. This would permit the Secretary

of the Treasury to carry on a program somewhat similar to the war savings and Treasury savings certificates programs during the World War, programs which provided means for popular participation in the financing of that War through saving small amounts, and at the same time were very effective in raising substantial amounts of funds directly from the investing public. There is ample evidence of a real desire on the part of the American people to do their part and the Treasury is most anxious to reach any individual who desires to invest his savings, however small, with the Government for the purpose of helping to finance the defense program. In this connection, the Treasury intends to offer Government securities of a character which should facilitate and encourage thrift and savings. It is my hope that a substantial part of the defense program for which we have to borrow funds can be financed out of the real savings of the people.

The present law fixes the maximum of Savings Bonds which an individual may acquire in any one year at \$10,000 face amount. There is no authority in the Treasury to increase or decrease this amount to meet changing conditions. This section proposes to give the Secretary of the Treasury

the authority to fix the amounts which may be held by any person at any one time. I believe that such flexibility is most desirable.

Section 4 of the proposed bill provides that all obligations issued after its effective date by the Treasury or any agency or instrumentality of the United States, shall, as to both principal and interest or other gain, be subject to all taxes now or hereafter imposed by the United States. As you know, every administration for the past twenty years has recommended the complete elimination of tax-exempt securities. The bill now before you proposes that the United States Government actually take the first step to eliminate this undesirable feature from our financing by providing that all future Government securities, whether issued by the Treasury under the authority of the Second Liberty Bond Act, or by any corporation, instrumentality, or other agency of the United States under authority of any other act of Congress, shall be subject to all Federal taxes. Under this bill, the owners of these securities would pay Federal income taxes on income from that source and thus help finance the present National Defense or any future program of the Federal Government.

Section 5 of the proposed bill terminates certain obsolete authority to issue debt obligations which the Treasury does not need and which, therefore, might as well be repealed and eliminated from the statute books. The debt limitation fixed by Section 21, as amended by this bill, will then be all inclusive. It also repeals section 301 of Title III of the first Revenue Act of 1940, which sets up a special fund to consist of earmarked taxes for the retirement of any obligations issued under the National Defense debt limitation of \$4,000,000,000. As previously pointed out, this section constitutes an undesirable restriction on public debt financing at a time when the greatest freedom of action is essential. I urge its elimination.

Section 6 contains the usual saving clause to protect the rights of the holders of any obligations now outstanding and already issued under the authority of the laws affected by this bill.

I am sure the members of this Committee appreciate that it will soon be necessary for the Treasury to raise additional funds for its own account and also for the Reconstruction Finance Corporation to meet

expenditures under the enlarged National Defense program now under way
and that prompt passage of this measure will greatly facilitate the
handling of our problems.

draft -1-25-41