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Investment Bankers Association

of America

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Annual Address of President Francis E. Frothingham —Finds Business Hesitant Because of Restrictions —Declares Our Constitutional System and Free Capitalism Interdependent—I. B. A. Not to Become Voluntary Association Under Maloney Act

"There is definite need for a halt if the capitalistic system and our democratic institutions are to endure," said Francis E. Frothingham of Coffin & Burr, Boston, in his address as President of the Investment Bankers Association of America, at the opening session of its annual convention at White Sulphur Springs, W. Va., on Oct. 26. "There is need for a surcease from uncertainty and fear," Mr. Frothingham continued, "if the profits are again to be made, that alone can provide investment funds." "Fortunately," he went on to say, "there are signs of a growing realization that government and business must be more mutually cooperative and realistic. It is high time that this should be so, as a proof of our ability to function under a democratic form of government." Earlier in his remarks Mr. Frothingham indicated it as his belief that "our constitutional system and free capitalism are interdependent." Mr. Frothingham during the course of his address also said:

When everyone was apparently making money, and there was work for all, everything was well. Only when the collapse came did serious shortcomings in the business structure make themselves generally apparent. It was not a failure of a capital system, but a misuse of it. No one would dream of discontinuing that incredibly useful bit of business machinery, the limited liability company, merely because it has been misused. So, also, with the private capitalistic system of individual initiative. But a situation had arisen such that the public interest demanded that something be done to restore the Government to its rightful position of the rule making body. But has it not overdone its job?

Indicating at the conclusion of his address that the Investment Bankers Association has "decided not to become a voluntary association under the Maloney Act, but to remain free and independent to take such position on questions as they arise," Mr. Frothingham added that the I. B. A. "will always do what it can to aid the capital markets, and to help eradicate the abuses that have crept into the capital system." His address follows in full:

The extraordinarily difficult times in which we are living accentuate the peculiar responsibility of the investment banker to society and to our national economy, and in what I have to say I shall endeavor to point out that responsibility as I see it, in the hope that our Association may not be laggard in meeting it. During the past year, in which I have been privileged to be the President of this Association, the sense of that responsibility has been growing on me, and I want to transmit something of my feeling about it if I can. To me the problem is much more than a merely domestic one, so I will ask you to bear with me if I seem at first to go somewhat afield.

Each year of the 26 years of life of this Association has held its problem for us, which were met as best they could be under the circumstances But with the perspective of a quarter of a century we can see that for many years our problems were of a more or less routine kind, or were seemingly so, and that they were met rather in the stride of business. We too little realized that their shadows lay down a path that was to lead us into confused and dangerous places. We walked, as it were, blindfolded, lacking the far-sighted imagination that discloses the future. When I say we, I mean not along this Association, but all business. The few that sensed the on-coming storm could not wake others to see that the brooding calm was ominous. So most of us did not foresee the catastrophe of 1929. Thereafter world forces, long germinating in the social midst of the world, and which were set in active motion by the World War, were released with eruptive violence, as happens periodically in the history of man.

It is well to try to weight those forces, for they are of great concern to us. We should realize that the welling urge of peoples today, paradoxical as it sounds in a world full of more mechanical contrivances for their comfort, pleasures and intercommunication than the world has ever before known, is for security in life, security in old age, security against the hazards of existence, hazards that in some unaccountable way seem to have multiplied with the opportunities that invention has provided. They seem willing to barter way the liberty, personal freedom, even their souls, to the authority that apparently offers them security. They are oblivious to the truth of Ben Franklin's remark that—

"They who give up essential liberty to obtain a little temporary safety deserve neither liberty nor safety."

But this mass urge is a most important aspect of the social revolution going on through the world, the true meaning of which for us in this country has the deepest significance.

In Europe, republics have given way to dictatorships; in Asia, imperialism is on the march; in the United States a rapid and threatening centralization of government is on its way. We have somehow become a world of enemies, in thought and action. The strains under which society is trying to function are terrific. Should it happen that the fabric of peace before long breaks, as I fear it will, what will follow may set back civilization for years to come. Long and threatening shadows are being cast across the future—for all peoples in all countries. The dictatorial and imperialistic nations offer small contribution to world peace. How can economic systems based on the support of millions in uinform by the sweat of other millions under the lash of dictators, toiling to pile up munitions of war; how can the thesis that the State is all, that minorities have no rights, that the dictator is the sole mouthpiece for all, contain anything but the ultimate degradation of society, anything to enoble or advance it?

The acuteness of the strain of the past few weeks has been temporarily eased, but at what expense of more principle. The mutual incompatibilities between the dictatorial and the democratic principle of government remain unaltered, and it is difficult to see how real peace on this earth can come until the issue is finally joined. But the point for us to note is that democracy is on the defensive against the dictators' assumptions of omniscience, for its very liberties open it to the insidiousness of the propaganda of disturbing forces.

But I did not wish to imply, in referring to the centralization of government, that the purposes of the New Deal are the same as those of the dictatorships, for they belong in quite a different category. The aim of the one is aggrandizement, the suppression of independent thought and action by terrorism, the expression of national power through force of arms; of the other the aspiration has rather been to correct abuses that had grown up in the too rapid growth and increase in wealth of a free nation. The one is destructive, the other constructive. But curiously enough, in things so different, an underlying prompting in each is the same,

i.e., the urge of the less privileged for security. In the dictatorial countries the proletariat endeavored to take control, for its own security, of the sources of production, and then, as must always be the case with mob action, one man had to lead, and dictate to, the mob, for the proletariat has not within itself the capacity to manage. In this country, dissatisfaction with things as they were and the same underlying urge for security on the part of the less privileged has speeded up a centralization of government. But with us, as distinct from the continental countries where individual freedom was little known, our people had grown up in an atmosphere of personal liberty that they drew in with the air they breathed. That was the American contribution, out of the centuries of Anglo Saxon struggle for personal rights. I mention this great difference because it seems vital to the issues before us. In this atmosphere of freedom we are likely to forget, in the search for security, that security and freedom are are incompatibles. All of one means little of the other, broadly speaking. The concern for us is lest the efforts hereto eliminate abuses, to protect and give security to the under-privileged, may not take the course of laws and regulations apparently desirable in themselves, so numerous, so intricate, so contradictory, so insinuating into all private affairs, as to bring free democratic processes to a standstill. What we need to observe is that these regulatory steps automatically and inevitably become increasingly authoritative, tend increasingly to brook no interferences, and become increasingly indifferent to means in the attainment of ends, so that public morality suffers, and a society degenerates. Therein lies the concern felt about the New Deal, i.e., that it may after all go the way of the dictatorships, and centralize too great authority in Washington. Over centralization of authority sooner or later means that the personal rights of the individual are sacrificed.

While pointing out this tendency, because I sincerely believe it exists and that its initial steps have assumed in this country a reality that is gravely disturbing, it is at the same time necessary to recognize that changes in methods of government are inevitable in a world that will not remain static, and that we would not have remain so if it could. With the growth of population and of an industrial economy certain increases in centralization of authority was of course inevitable. As James Truslow Adams has said:

"Our entire history shows a steadily increasing concentration of power in Washington."

But the reason the issue is now so acute is that this concentration of authority has in the past few years progressed at such a pace that the shadow of its meaning is now discernible to all as it lies across the future. Instrumentalities of government have been set up that are well night self perpetuating, and authority in Washington is brooking less an less of interference. We cannot be indifferent to the implications.

We must of course recognize that government is a series of compromises. Good government is the happy balance between contending ideas. So it behooves us all to see that the scales do not thud down heavily on one side, and that the checks and balances of our constitutional method be not chipped away in the heyday and exictement of striving for Utopia.

It is here perhaps a fair question to ask if this country is playing its part in demonstrating the virtues of democratic forms. A free, constitutionally governed democratic country, if it would influence the peoples of other lands who are under the controls of dictatorships, or are wavering in their faith in democratic forms, should present a front of peace, security and smooth working and successful business. If the United States cannot give such a demonstration it offers no helping hand to those in the morass of authoritarianism. My own feeling is that we are not making the contribution to world difficulties that we should or that the peoples of the world have a right to expect of our democracy. The number of our unemployed remains great; the number being succored by Government is appaling; our debt and the unbalance of National budget mount threateningly; our business burdened by complicated taxes and increased costs, shows less and less of profit; our Government competes with its citizens; our National morale is at a low ebb; and our people are divided in hostile camps. Yet no voice is raised to dignify labor, to arouse people high and low to a sense of their individual responsibility to the collective whole. Rather are people being taught to turn to Government for their every need, to demand the rights of indolence, so that the non-worker is cared for by the worker. All this should not be a product of the democratic method. If it is inevitable that it should be, then democracy and the rights of free men must give way to collectivism in some form or other. Democracy must prove its political capacity if it is to be copied as a method of government.

In what I have been saying I have endeavored to draw a picture, however inadequate, in order to place this Association in the context of today's events, as I interpret them, for the place this Association occupies, small and ineffective as it may seem at first glance, yet seems to me to be fraught with possibilities of social service of the first order. The next step draws us immediately into this current of events.

The system of finance which is a part of the blood stream that has nourished the growth of our democracy is called the "Capitalistic System," a term that unfortunately carries with it an unjustified stigma, an inference somehow of sinister aggrandizement. The term, as a matter of fact, means nothing more than a recognition of the rights of private

possession, and the incentive of a profit motive under the private control of capital. This incentive to personal effort has in this new country developed a nation with a measure of wealth and happiness greater and more widely diffused, despite existing inequalities, than the world has before seen. This growth drew the attention of the world to the spendor of its realities. Yet there are those who decry this free capital system and would destroy it. Of course we cannot deny that it has faults and that it has been abused. But what instrumentalities of human invention have not. The things this capital system has done for us, the things that can be accomplished under it should stimulate us to make it work. It can be maltreated out of existence, but there is no other system now in sight that has so stimulated private initiative, the incentive of every man to work and win and to enjoy that most precious of human rights, i.e., individually to own.

Now this capitalistic system is inextricably interwoven with our democratic processes. But if State Capitalism supersedes it, a system under which the State provides all the funds for man's activities, and collects all the income, we would then have the collectivist State with its arbitrary and dominating controls, a regime which is the antithesis of democratic processes, and in which those processes could not exist. Some may want such a centralized system. I do not believe the great majority do. It is for us as a people to recognize the drift in that direction and to offset it if we want to. If we would preserve our capitalistic system and so our democratic forms we must make it work; we must by demonstration show that it can work. Only we must remember, as Mr. George Sokolsky has so wisely said while expressing his belief in our capitalistic system, that if private capitalism does not maintain a high standard of living, and does not provide physical comforts, and does not provide a large measure of human freedom, then capitalism does not justify itself and will not continue. The thing for us to recognize is that both democracy and the free capital system are on the defensive.

And now we have reached this Association, and the part that it should and can play in this complicated and disturbing picture. As I believe, our constitutional system and free capitalism are interdependent. The investment bank has been and should be one of the essential elements in the functioning of the capital system. The investment banker has been instrumental in raising from the wealth of the people the great part of the funds that have been demanded by their productive activities and that have made the United States the powerful, rich nation it is. That is a service of so vital a character that it places on the investment banker an almost crushing responsibility. If the threatening dislocation of our system, that I have envisaged, become realities, the investment banker must share the responsibility. To my thinking, though, it is not a question of sharing the responsibility for defeat; it is a call to every investment banker, large or small, alone or in association with others, so to act and build that his will be a constructive contribution to a bettered administration of the free capital system so that it can do the things in the public interest that it is capable of doing. It bears repetition to say that the success of the free capital system means the continuance and success of our democratic form of government, and that that success in turn strengthens the democratically-minded people of the world to meet and to resist successfully the dictatorial principle. I cannot feel that this is a fantastic responsibility that I have placed on the investment banker. Others also share it with him, but he cannot escape his share.

The investment banker should do his utmost to correct and do away with the abuses, often subtle and difficult to see, that have crept into our capitalistic system. Fortunately we are both stimulated in the effort and aided in its accomplishment by the passage a few years ago of the two Securities Acts and by the creation of a Securities and Exchange Commission, set up to administer them. These laws have corrective purposes that are far-reaching and important. No one, least of all the Commissioners themselves, believes these laws or their administration are perfect. The corrections envisioned under them should be by a gradual, evolutionary process, and the laws themselves will need amendments for their more efficient functioning. The danger on the one side is that correctives may be too rapidly sought, and, on the other, that attempts be made to thwart the corrective purpose.

The fundamental purpose of these laws is to correct abuses in the capital machinery that work against the public interest. We in the investment banking business can have no quarrel with that objective; it should be the aim and objective of everything we do. No one more than we should want a well employed, contented, happy, prosperous country, and we know that that cannot be had when chicanery and fraud are unrestrained. We should do all we can to root out malpractice wherever it appears. This has been the constant effort of our Association. We welcome these laws and this Commission to help us raise the level of this mighty business of bringing capital to capital's need.

But the correction of abuses in the business of buying and selling securities is not all that we are interested in, for there are good practices to be protected, as well as bad ones to be eradicated in all business. And also, outside of fraudulent and manipulative practices, there is a field of malpractices, or at least of unfortunate practices, in the conduct of business, to which we cannot be indifferent. Such, for instance, are unfair competitive practices, over-extension of controls of one sort and another, an indifference to the rights of the public, to the rights and welfare of labor, an inadequate sense of inner responsibility to outer contacts that makes or breaks those relationships to a consuming public on which good business depends—practices that have no inherent fraudulent intent, but which nevertheless may assume proportions that bring business into ill repute. For in our increasingly complicated existence an increasing number of businesses are affected with a public interest. While of course such problems are not perhaps directly ours, they are yet of general concern to us, because we cannot be indifferent to the ways in which and the purposes for which funds that we raise are used. I would merely point out that our field of effort and responsibility is not a limited, closely pocketed one, but should be of the broadest, and that our opportunity to aid in the valid constructive use of the capitalistic system is great because we are in contact with all business in one way or another. We are in position to aid in the development of capital structures that will best meet the needs of particular businesses. We should caution against the erection of a financial structure so complicated and so top heavy that it is bound some time to collapse; and we should be unwilling to supply funds for purposes which we believe to be inimical to the social welfare. We owe a saner counsel to those who would borrow, and to those who would invest, a wiser resistance to practices that are unsound. We have learned from the experiences that are now upon us that fixed debt is an underlying cause of our troubles, and that the issue of senior securities has by no means always given to the investor the protection to which he was properly entitled. But there is no need to expand on this, for we all are sensitive to our responsibilities. Suffice it to say that we should have the courage to bring to earth what should and ought to be in the realm of finance.

There will at time undoubtedly be sincere differences of opinion both among ourselves and as between this Association and regulatory and law-making authorities in regard to particular abuses, their extent or importance, or as to the best method of meeting them, but if each side is considerate and respectful of the other's point of view, realizing that the objective of each ought to be the same, a meeting ground can usually be found. The members of our Association, on the one hand, must always have in mind that the business of buying and selling of securities is enormous and country-wide, and that the sources of information of the authorities and the breadth of their responsibilities are entitled to the greatest respect and consideration. On the other hand, we in the business are closer to its daily problems, and may sense with greater clearness the unfortunate reactions of particular rulings or suggested laws, so that we may feel obliged to press points of view that may oppose those of State or Federal bodies. Only we hope that such opposition may be accepted with the sincerity in which it is made. I trust this Association will never be led into opposition for mere opposition's sake; any position taken must never be oblivious to our responsibilities to the public. We in the investment banking business are middlemen, and as such we must give an abundant and valuable service to the community if we would survive. That does not preclude us from taking a stand in our own interest, and we will often do that, the proof being on us, in such case, to show that what is in our interest is not ipso facto against that of the public. I am convinced, too, that what is in the long run in the interest of the public welfare will also react favorably on the profitable conduct of our business.

Let me give two illustrations of what I mean by sincere differences of opinion that were important matters of concern to us during the past year. As you know, the Maloney Act was recently passed with the pur-

pose of regulating over-the-counter markets. From the beginning we recognized the desirability of such regulation and supported the idea of a voluntary association for the purpose. The whole code effort to develop rules of fair practice under the NRA, the outgrowth of which has led to this Act, was the work of this Association. In conferences with the Securities and Exchange Commissioners and Senator Maloney we recognized that self-regulation as we had envisioned it was out of the question. Nevertheless, I urged the advantages of a legalized association under an Act of Congress to work with the Commission on this task, even if the bill was not entirely satisfactory, for it seemed wiser to cooperate and to adjust the differences as we went along, than to refuse cooperation. That view our Board of Governors consistently upheld. The point deserves emphasis. We worked for a good bill, not against a bill. We used every effort to work in harmony with the Commission.

When finally negotiations with the Commission could get no further, our Board of Governors agreed with out special committee that the acceptance of three items particularly would be helpful in obtaining the support of the industry and in forming national associations, and that they should be pressed before Congress. These had to do primarily with questions of penalties. This was one of those cases where through a self-interest was involved, there was no sacrifice of the public interest. There could be no objection to the imposition of full penalties for willful, deliberate violations, but we did feel that where only minor unintentional or unimportant derelictions were involved, such facts should be recognized. We felt particularly with regard to the drastic penalty of rescission, that it should not be invoked except when fraudulent intent was involved. Otherwise rescission might work great and unnecessary injustice to individual houses, whose reputation and capital might be seriously impaired, with corresponding injury rather than gain to the public.

After effort made by our membership to explain to Senators and Representatives what the meaning of our contentions was, and after hearings before committees of Senate and House, and these positions also being pressed by other independently created groups, the bill was finally passed with the more important of our suggestions substantially met. What we did was sincerely done by sincere men.

Another illustration is the Barkley, or Trust Indenture Bill. The American Bankers Association, through its committee, had withdrawn its objections to the bill, because certain amendments proposed by it affecting the bankers' position as trustee had been accepted. Nevertheless, certain important banks sent out a statement urging opposition to the bill on several grounds. We opposed the bill before the appropriate subcommittee of the House. In this case Congress adjourned without finally taking up the bill. Here, again, were fundamental differences of opinion, though as before, there was no desire whatever to avoid corrections of real abuses that had crept into this business. We did feel, however, that the definitions in the bill as to what involved collusive interests were so limiting and precise that they would in practice often be hampering rather than helpful, as well as in themselves not practically preventing the practices condemned. But especially were we concerned by the injection in permement legislation of the "approval" theory of regulation, and we felt also that the bill as a whole threatened a serious and unecessary slowing down of the normal processes of the capital markets, when every urge was rather for freeing them. The Securities Acts are based on the "full disclosure" theory, a sound theory designed to put investors on notice in advance of an offering. But this bill took a long step into a new application of regulatory theory, in setting up the Commission as an "approval" body, substituting its judgment for that of both borrower and lender. Though it might be argued that "approval" in this case was somewhat circumscribed, yet the principle once accepted, there could in the end be no limit to its application. In the bill as written the Commission is made a party to the writing of important parts of the indenture contract, while at the same time it is exonerated of any responsibility for the quality of the resulting security. In over a score of instances could the Commission determine provisions of every indenture affected, guided only by its uncontrolled judgment of what it thinks is "in the public interest and the interest of investors." Mr. Allen C. Throop, General Counsel for the Commission, speaking before the Annual Convention of the National Association of Securities Commissioners in October of last year, said:

"I have already referred to the disclosure theory upon which the Federal Securities Acts are based. . . . Our Commission, as you know, is without discretion to pass upon the quality of the security which is offered to the public, its function being limited to requiring the adequate disclosure of facts essential to the exercise of intelligent investment judgment. This limitation, proper as it is, makes it urgent that the States exercise constant vigilance to cope with many of these vices which the Federal process does not reach."

Here, again, I would emphasize that our efforts were not to defeat the passage of any bill, but only to give opportunity for a further consideration of the form it should take.

I might also mention the fact that the Chairman of our Federal Taxation Committee ably presented arguments before congressional committees last year as to why this Association thought the capital gains and the undistributed profits taxes were not only based on unsound theory but were definitely harmful to business beyond any useful purpose they served as a means of raising revenue.

But enough has been said to indicate the responsive attitude of this Association to the correction of malpractices and abuses in the business of issuing and dealing in securities. This Association has no hide bound conceptions. It is uncontrolled by any inner group or any particular interests. There is no continuous place on its Board of Governors for anyone. The qualifications for its membership rest on what is perhaps a unique fact among associations that in the daily conduct of our operations we are continually doing business with one another and repeatedly forming groups on a partnership basis. Not one of the many committees appointed during the past year but has represented the country as a whole, and been beyond the possibility of domination, either by any special interests or by any section of the country. The Association seeks advice from its members the country over, from those with broad and those with limited experience, and selects its course with such wisdom as it has. It desires and wishes to serve the public interest, but it can only do so by arguing its positions, and by carrying its convictions, when necessary, to the halls of legislatures, whose members are there to weight the arguments of the citizens they represent.

This brings me to a most important aspect of the capital situation and of our place in it. Broadly speaking, there has for some time been no flow of new capital, the capital that employs men. From an average of $5,000,000,000 of new capital raised annually in 1924 to 1929, this has fallen to only $500,000,000, or to 1-10th, for 1932 to 1937. There has, however, been a large amount of refunding, made possible by an artificially maintained low rate money market, which, while having a disturbing influence on security markets, has only substituted new money for old. But there is still little demand for new capital.

The reason for this turn about needs searching. There must be some fundamentally disturbing factor or factors. Certainly there is no lack of willingness on the part of investment bankers, many of whom have been for some time conducting a non-profit or a losing business, to put their funds to work. But investment bankers cannot operate, as it were, in a vacuum. By that I mean that industry cannot be forced to borrow, nor can available funds be forced into investment. With all the good will in the world, investment bankers alone cannot make the capital system function. Its functioning is a result and not a cause. To make it work there must be both willing sellers and willing buyers. The question is, why has not business set its productive machinery in motion? In the first place, are we not perhaps assuming too much in expecting business to snap back where it used to be and to go on increasing from there? Is that not an unreasonable expectation? Is it not more likely that the accelerating production of the past was too rapid to be sustained? Also, it was perhaps in too large part based on the major activities of subduing a new country, such, for instance, as the expansion of railroad mileage, which have now largely ceased. Then, too, a factor that is now working against rapid business recovery is that we have too much aided former international customers to provide for themselves rather than to buy from us, as a result of our sales to them of goods and services, a business which temporarily added to our earlier prosperity. The doors of international trade need to be reopened.

But even if these corrections of our anticipations of business recovery are made, business still lags beyond all justification. The reason, I believe, for the long continued stagnation of business and for this vacuum in which the investment business is struggling to be useful and effective, is to be found in the simple fact that the impetus back of business is of human origin. The legal entity, the corporation, is in itself a dead thing. Human

effort along can give it life. The human being engages in his activities with eagerness and zest, he builds and spends and takes commitments for futures only when he is confident of a relative permanence of the conditions surrounding him. And he looks to government for those conditions of stability. That statement is made with no desire to shift responsibility, but I think it must be the fair conclusion of an impartial examination of human nature and of the facts.

After the strains, both financial and mental, of a long depression, during which Government has been trying to meet the situation with varying degrees of success and failure, we have all become supersentive perhaps, and our nerves too much on edge, with governmental efforts that have been too many and too confused to keep up with. Business is in fullest sympathy with efforts to correct abuses and to balance the productive forces of our national activities. It wants to see labor employed and protected. Business wants a contented, happy, prosperous people, and it needs just that for the successful conduct of its efforts. We are all anxious to cooperate with Government to that end. But when all that is said, and said in the utmost sincerity, business still feels the gravest concern and hesitancy to venture, in the atmosphere of restrictions and penalties that confront it. While recognizing and applauding the awakening of the National conscience to many important needs, yet thoughtful people, view, for instance, with concern, the continuing growth of the public debt and the budget deficit and the constant use of deficit financing; the political and human implications in the administration of relief; the constant making of grants, loans and subsidies of public funds; the increase of bureaucratic controls; and the denial of the use of the mails and other instrumentalities of interstate commerce, as well as the imposition of taxes, for purposes foreign to any implications of the use of these authorities when originally delegated to the central Government.

But no better statement of the fears and concerns of business has been made than in this quotation from the testimony of Mr. Baruch in Washington early this year. After stating that there was ample financial credit to support a great business activity, he said:

"The single missing element is a feeling of security—a belief that money can be spent or invested without confiscation of reasonable profits by inordinate taxation; that American assets will not again be subject to some great arbitrary change in the value of money; that there are to be no further disturbing assaults on business either by some statutory change in the existing business pattern or a general governmental hostility or governmental competitive invasion of existing fields of private enterprise."

There is now, I realize, a sense of relief from the fear of imminent war, and the spending program of the Government is having its effect on a general improvement of business, but people are deeply, and I think fairly, concerned with the fear that these are but passing symptoms and that the day of reckoning is still to be met. As I have said, we all applaud waking the public conscience to the need of the major correctives envisioned, but we fear that the means to the goal is proving disastrous. There is definite need for a halt if the capitalistic system and our democratic institutions are to endure; there is need for a surcease from uncertainty and fear if the profits are again to be made, that alone can provide investment funds. Fortunately there are signs of a growing realization that government and business must be more mutually cooperative and realistic. It is high time that this should be so, as a proof of our ability to function under a democratic form of government.

There is another side to this picture. Government and the people found themselves up against a control by business, and a power of business that was becoming unendurable. When everyone was apparently making money, and there was work for all, everything was well. Only when the collapse came did serious shortcomings in the business structure make themselves generally apparent. It was not a failure of a capital system, but a misuse of it. No one would dream of discontinuing that incredibly useful bit of business machinery, the limited liability company, merely because it has been misused. So, also, with the private capitalistic system of individual initiative. But a situation had arisen such that the public interest demanded that something be done to restore the Government to its rightful position of the rule making body. But has it not overdone its job? As President Roosevelt himself said about a year ago:

"There can be no stability for peace either within nations or between nations except under laws and moral standards adhered to by all."

And now for a final return to our Association. Many issues have been before us during the past year, and many will tax our best thought during the coming year. The question of whether or not banks shall be readmitted to underwriting will need attention. There was so much of wishful thinking over the sufficiency of investment banking capital that I asked the Brookings Institution if it would make an ex parte study of the sufficiency of available capital, and of investment demands. This report should be available for consideration before the next session of Congress. We have worked out a plan under which the municipal section of our business, as distinct from the corporate section, is set up as an autonomous division of the Association. A Muncipal Division Council of seven, has been authorized by the Board of Governors, with independent power to act in matters of interest to the municipal business, provided only that it may not speak for the Association as such unless so authorized by the Board of Governors. This is a real step forward, and coupled with the efficient services of Dudley Smith, our Municipal Secretary, puts this Division in a position to handle its affairs efficiently and effectively. Also, much thought and time have been put on the questions of revising our constitution and of modifying some of the methods of election of governors and officers, all of which will be reported on later by the appropriate committee. Questions of segregation, of separating underwriter and dealer, of amendments to the Securities Acts and of modification of details of administration of the Acts will continue before us. As I have said, our best thought will be demanded. Never was the need of a large membership and a strong Association greater than now.

But no mention of the activities of the Association is complete without stressing the work of our Field Secretary, Arthur G. Davis, in connection with the highly important problems of State legislation. It has been my good fortune to have first-hand contact with the estimation in which Mr. Davis is held by the State Commissioners, and I cannot refrain from expressing, on behalf of the Association, our feeling of obligation to him. And I want to thank, also, everyone in the office force in Chicago, not only for their patience with me during the past year, but for their loyalty to the work of the Association. Both David Dillman and our efficient Executive Vice-President have had particular reason to be patient with me. But back of all the loyal support and friendship of the rank and file of the Association is the inspiration to its President and officers.

Finally let me say that this Association has, with great wisdom, I believe, though in full and complete sympathy with its principles, decided not to become a voluntary association under the Maloney Act, but to remain free and independent to take such position on questions as they arise that generally concern our business, as may seem in its good judgment suitable. This Association will always do what it can to aid the capital markets, and to help to eradicate the abuses that have crept into the capitalistic system, so that that system may continue to function as a great and useful agency of human progress in a democratic State. To that end we pledge our full cooperation to the Securities and Exchange Commission and to every other governmental agency to accomplish results beneficial to our country.

J. P. Wenchel of Internal Revenue Bureau Supports Federal Government's Proposal to End Tax Exemption Privileges as to State and Local Obligations

Speaking in support of the Federal Government's proposal to end tax exemption privileges in the case of municipal and local obligations, John Philip Wenchel, Chief Counsel of the Bureau of Internal Revenue, stated before the convention of the Investment Bankers Association on Oct. 26, "that there is respected legal opinion, with which I most heartily concur, that there are numerous grounds upon which the Supreme Court may validly base a holding that a statute such as the President's message recommends is within the limits of the Constitution. It may be noted here that President Roosevelt's recommendations were contained in his message to Congress on April 25 last, referred to in the "Chronicle of April 30, page 2777.

Mr. Wenchel declared that "it seems that economists generally have regarded tax-exemption privileges as wholly unsound in principle and inconsistent with any rational system of graduated rates of income taxation." Mr. Wenchel further said:

It is extremely important that our economy have an adequate supply of "risk" or "enterprise" capital. There is at the present time no shortage of senior capital but there is an acute shortage of risk capital. The most promising source of risk capital is the savings of individuals in high income brackets, but the policy of extending tax exemption to public securities attracts much of this capital instead to a practically riskless field which might much better be filled by the savings of persons less able to afford to take a chance. If the tax exemption privileges were eliminated from future issues of public securities, we might expect, over the next generation, a gradual transfer to use as risk capital of a large proportion of the proceeds of such securities now held by individuals in the upper income brackets. Thus, it would appear that the effect of the existence of tax exempt bonds upon the business life of the country is decidedly bad.

The statement is made by Mr. Wenchel that little can be added to the "report of the study which the Department of Justice had made on the history of the Sixteenth Amendment." He likewise stated:

The report demonstrates that the basic idea behind the movement for the income tax was that the Federal Revenue system, heavily weighted with consumption taxes and so greatly at variance with the principle of ability to pay, should be modified by the introduction of an income tax which would permit wealth to pay taxes equal to its ability . . . "The object was to impose a portion of the tax burden on the income of 'wealth' or invested capital. There was no suggestion that any type of income should be considered immune."

Mr. Wenchel in his final comments on the subject said that "without destroying the ability of the respective governments to carry on their functions, the Court has already sanctioned taxes which place burdens upon them equal to any possible burden resulting from the proposed legislation." Objection to the proposal to end exemption of municipal and local securities was voiced at the convention by David M. Wood, whose address will be found in another item in this issue. The following is Mr. Wenchel's address:

Much has been said during the past 100 years about the so-called implied reciprocal immunities doctrine. Notwithstanding this, the topic has not been exhausted. The doctrine has been said to exempt from taxation by the Federal government the interest upon State and local obligations and the compensation paid State and local officers and employees and to exempt from taxation by States and municipalities the interest upon Federal obligations and compensation paid Federal officers and employees.

The practical effects of these exemptions have been such to have caused several of the Presidents in recent years to urge their abolition. So also, respective Secretaries of the Treasury (1) under successive administrations have recommended action to end tax exemption privileges for the reasons that they are economically unsound and, from a governmental aspect, unnecessary. The efforts to end these exemptions culminated in the President's message to the Congress of April 25, 1938, recommending the taxation of interest on future issues of Federal, State and local obligations and compensation paid State and local officers and employees and the giving of Congressional consent to the taxation by the States and localities of interest on future issues of Federal obligations and the compensation paid Federal officers and employees.

This recommendation has stimulated so much discussion of the legal aspects of the problem, in which I, as well as many others, have taken a part, that I feel that it would be repetitious for me again to enter into a protracted analysis.

Suffice it to say that there is respected legal opinion, with which I most heartily concur, that there are numerous grounds upon which the Supreme Court may validly base a holding that a statute such as the President's message recommends is within the limits of the Constitution.(2) I shall indicate a few of these grounds presently. I should like at this time to indicate some of the evil economic consequences of continuing the exemption privilege.

It seems that economists generally have regarded tax-exemption privileges as wholly unsound in principle and inconsistent with any rational system of graduated rates of income taxation. In addition, there is a considerable amount of public indignation against continuation of the privileges. There is, of course, opposition to the President's proposal. Part of this opposition is, however, from persons who should not be found in the ranks of the objectors. They can be there only because of a misunderstanding of the nature and effect of the proposal. As for them, a full and impartial examination of the proposition should serve to clear up any such misunderstanding. However, efforts at persuasion and arguments that should convince the unbiased will not generally put a halt to the opposition of others—those who do not want to lose the special privileges which they now enjoy.

These special privileges are of considerable importance, as is demonstrated by the example of the taxpayer who has an income of $100,000 and who, in addition, owns a tax-exempt bond bearing interest at the rate of 3% per annum. To him this bond yields the equivalent of more than 7% on a taxable bond. In other words, a taxable bond paying to him a little more than 7% will, after deducting Federal income tax, have a net yield of not more than 3%. In cases of taxpayers having net incomes in excess of this amount, the value of the exemption increases proportionately with the increase in surtax rates. This privilege, which is of such value to the individual taxpayer, does not, however, produce a reduction in the interest rate payable by the government issuing the bond in any way proportionate to the amount of savings resulting to the taxpayer. Statistical analysis proves that under present day conditions, tax exemption results in a large excess of revenue loss over possible interest saving.

Other countries have Federal systems which may be compared with ours, but in none is such an immunity recognized. For example, in Canada no immunity is accorded income from obligations or offices of either the Dominion or the provinces.(3) Nor is any such immunity now recognized under the Australian Constitution.(4) The American precedents first influenced the earlier cases, but these cases were reconsidered and expressly overruled in 1920.(5) The experience in Canada and Australia has shown that reciprocal taxation instead of reciprocal immunity has in no way interfered with the maintenance of their Federal systems of government. Such taxation has not burdened the borrowing power of their Federal or local governments, which are able, even without any tax-exemption privilege to market their obligations at lower yields than can be obtained from the highest grade industrial securities with which they compete in the money market.(6)

It must also be borne in mind that to the extent to which tax exemption lowers the yield of securities enjoying it, they are made less attractive to prospective purchasers unable to benefit by the tax exemption privilege or unable to benefit by it to an extent equal to the lower yield. The classes of prospective purchasers to whom public securities are thus made *less* rather than *more* attractive by virtue of their tax exemption characteristics include individuals in the lower income brackets, tax exempt institutions and most financial corporations. To the extent that public securities are held by these classes of investors and their yield is lowered because of their tax exemption privileges, these holders suffer a loss of income for which they receive no corresponding value. The loss of income thus suffered by these classes, together with the net fiscal loss of the government arising from the existence of tax-exempt securities, accrues to wealthy individuals who beneifit by the tax exemption privilege much more than it costs them.

This result is particularly unjust since a large proportion of these holders purchase these securities, whether they wish to secure tax exemption or not, either because of legal requirements or because other characteristics of these securities make them desirable. The transfer of income brought about in this manner is almost entirely a transfer from persons in the lower brackets to those in the higher brackets. If the future issues of public securities should be made fully taxable, we should expect that a much larger proportion than is now the case would be held by individuals in the lower income brackets, tax-exempt institutions and financial corporations, and that the investment experience of these classes of investors, comprising or acting as trustees for the bulk of all savers, would be substantially improved.

It is extremely important that our economy have an adequate supply of "risk" or "enterprise" capital. There is at the present time no shortage of

senior capital but there is an acute shortage of risk capital. The most promising source of risk capital is the savings of individuals in high income brackets, but the policy of extending tax exemption to public securities attracts much of this capital instead to a practically riskless field which might much better be filled by the savings of persons less able to afford to take a chance. If the tax exemption privileges were eliminated from future issues of public securities, we might expect, over the next generation, a gradual transfer to use as risk capital of a large proportion of the proceeds of such securities now held by individuals in the upper income brackets. Thus, it would appear that the effect of the existence of tax exempt bonds upon the business life of the country is decidedly bad. This conclusion seems to be shared by the recent report of the Twentieth Century Fund, as summarized by the press, as well as by analysts generally.

I come now to a brief discussion of the legal aspects of the problem. At the outset, I shall merely mention that viewed in the light of the court's traditional attitude, and more particularly its present-day critical attitude toward constitutional doctrine, it would appear that the court would welcome the opportunity to reexamine the broad outlines of the implied immunities doctrine. All of those factors which in other recent cases impelled reexamination and restatement of the doctrines there involved are present in connection with the instant case.(7) This would seem to demonstrate that the court might be willing to adopt some sound ground, or grounds, for actually abrogating or restating the doctrine in question, in a case which presented the occasion so to do. I attempted to analyze the case material and to indicate the possible grounds for restatement or abrogation in an address which I made last May before the Federal Bar Association.(8) I pointed out that there is no good reason why the language of the Sixteenth Amendment should not be held to mean exactly what it says. And if historical background is resorted to, it is apparent that what the amendment says is what was actually intended.

I also pointed out that the validity of the proposed legislation is not dependant upon any departure from the holding of the court in McCulloch v. Maryland.(9) to the effect that a State may not tax a national bank since it is a means of the Federal government. Although the tax in that case was clearly invalid as a discriminatory one, Chief Justice Marshall chose the occasion to sound a warning against State taxation of Federal instrumentalities. What he envisioned is revealed by the context of his opinion. He took numerous occasions to point out that in respect to the powers granted under the Constitution to the National Government that government is supreme, and the States must yield where the paramount rights of the National Government are involved. It seems never to have occurred to the Chief Justice that his theory of the power to tax as the equivalent of the power to destroy might be distorted and seized upon as a basis for denying the power of the National Government to tax the people and the institutions of the State. This is illustrated by his opinion in which he said: "But the two cases are not on the same reason. The people of all the States have created the general government, and have conferred upon it the general power of taxation. The people of all the States, and the States themselves, are represented in Congress, and, by their representatives, exercise this power. When they tax the chartered institutions of the States, they tax their constituents; and these taxes must be uniform. But, when a State taxes the operations of the Government of the United States it acts upon institutions created, not by their own constituuents but by people of whom they claim no control. . . . The difference is that which always exists, and always must exist, between the action of the whole on a part, and the action of a part on the whole—between the laws of a government declared to be supreme, and those of a government which, when in opposition to those laws, is not supreme."

Moreover, the danger of discrimination which induced the Chief Justice to enunciate the doctrine that "the power to tax is the power to destroy" is now adequately checked by the Fourteenth Amendment which would prevent discriminatory taxation against a Federal instrumentality by the States, or any taxation which tended to destroy it. Nevertheless, as it is not proposed to run athwart the doctrine of the McCulloch case, the President's proposed legislation would expressly consent to the taxation by the States of the compensation of Federal officers and employees and the interest on Federal obligations.(10)

That Collector v. Day,(11) holding that the Federal government cannot levy an income tax upon the salary of a certain State official, was not a necessary corollary of McCulloch v. Maryland and that the full import of the McCulloch case may rest upon a sounder foundation that Collector v. Day is openly recognized in the recent case of Helvering v. Gerhardt (12)

It is not necessary, however, to rely upon the inherent weakness of the reasoning of the majority opinion in Collector v. Day to support the proposed legislation. It seems probable that a net income tax would not be regarded as a burden upon State government when imposed without discrimination against the State government in favor of the Federal government.

Little can be added to the excellent and exhaustive report of the study which the Department of Justice has made on the history of the Sixteenth Amendment. It is a real contribution. I recommend to those interested the chapters dealing with the agitation for the income tax, the Congressional history of the Amendment and the history of the ratification of the Amendment. The report demonstrates that the basic idea behind the movement for the income tax was that the Federal revenue system, heavily weighted with consumption taxes and so greatly at variance with the principle of ability to pay, should be modified by the introduction of an income tax, which would permit wealth to pay taxes equal to its ability. "The movement was as broad as its subject and the evils sought to be remedied. There was no exception, exemption, or limitation express or implied. The object was to impose a portion of the tax burden on the income of 'wealth' or invested capital. There was no suggestion that any type of income should be considered immune."(13) The report shows that there was a preponderance of conviction that power was being conferred to tax interest from State and local bonds and the salaries of State and local officers and employees.

In the early stages of development of the law on this subject, statements appearing in decisions of the court indicate that any burden on a sovereign no matter how slight, which arose by reason of a tax levied by the sovereign, was considered to be a partial destruction of and a hindrance of the other sovereign's powers.(14) However, the rigid application of the doctrine threatened to destroy the power to tax. As the realization grew that the immunities doctrine created an unjust distribution of the tax burden, several tests were used in applying the "burden" theory and it was held that to hamper or threaten destruction of a sovereign the burden involved must be "real, not imaginary; substantial, not negligible."(15) Further qualifications of the doctrine were introduced from time to time,(16) until finally in Helvering v. Gerhardt (17) the court said that one of the guiding principles of limitation for holding the tax immunity of State instrumentalities to its proper function is the principle which "forbids recognition of immunity when the burden on the State is so speculative and uncertain that if allowed it would restrict the Federal taxing power without affording any corresponding tangible protection to the State government." This principle, said Mr. Justic Stone, is "exemplified by those cases where the tax laid upon individuals affects the State only as the burden is passed on to it by the taxpayer." Under the decisions, it seems that the court has confined the burden theory so that today the only tax which might be inhibited is one which actually threatens to destroy, namely, a discriminatory tax, or one which is regulatory or prohibitory in its effect. Without destroying the ability of the respective governments to carry on their functions, the court has already sanctioned taxes which place burdens upon them equal to any possible burden resulting from the proposed legislation.(18) More recent decisions have indicated a tendency to modernize the theory of burdens along lines supporting the constitutionality of the proposed legislation. In conclusion, it is unnecessary to dwell upon the fact that maintenance of tax revenues is a matter of imperative importance to the States and the nation. Professor Walton H. Hamilton, of Yale University Law School, sums up the matter in a rather droll way. He says: "Citizens of the United States are not to be deprived of their inherent right to contribute to the support of their Federal government just because an unkind fate has made them officials of a State,"(19) and I may add—or holders of State obligations.

Footnotes

(1) Carter Glass, Treasury, Annual Reports, 1919, Finance, p. 24; Andrew W. Mellon, Secretary of the Treasury, Annual Report, Fiscal Year Ending June 30, 1925; Henry Morgenthau Jr., Secretary of the Treasury, (1937) Hearings before Subcommittee of Senate Committee on the Judiciary on S. J. Res. 5 and 154.

(2) See (1938) "Taxation of Government Bondholders and Employees," a study made by the Department of Justice; Alden L. Powell, (1936) "National Taxation of State Instrumentalities," U. of Il. L. Bull., Vol. XXXIV, No. 8: J. P. Wenchel, Legal Aspects of Tax Exempt Privileges, Address before Federal Bar Association

(1938) 83 Cong. Rec., No. 107; Knollenberg, The Supreme Court and Tax-Exempt Income, Harpers, Oct., 1938, p. 538-546; and many others.
(3) Bank of Toronto v. Lambe, (1887) 12 App. Cas. 575; Forbes v. Attorney General for Manitoba, (1937) 53 Times L. Rep. 211; The Judges v. Attorney General for Saskatchewan, (1937) 53 Times L. Rep. 464.
(4) Webb. v. Outtrim, (1907) App. Cas. 81; Amalgamated Society of Engineers v. Adelaide Steamship Co., (1920) 28 C. L. R. 129.
(5) D'Emden v. Pedder, (1904) 1 C. L. R. 91; Flint v. Webb, (1907) 4 C. L. R. 1178; Baxter v. Commissioners of Taxation, (1907) 4 C. L. R. 1087; contra, Amalgamated Society of Engineers v. Adelaide Steamship Co., supra note 3.
(6) Hearings, Subcommittee of the Committee on the Judiciary, U. S. Senate, 75th Congress, 1st Session, re S. J. Res. 5 and 154, pp. 8-9.
(7) J. P. Wenchel, "The Federal Taxation of State and Local Bonds—The Federal Point of View," Address before National Tax Association, Oct. 24, 1938.
(8) J. P. Wenchel, Legal Aspects of Tax Exempt Privileges, Address before Bar Association, supra note 2.
(9) (1819) 4 Wheat. (U. S.) 316.
(10 Such consent is valid. Sydney A. Gutkin, Taxing Tax-Immune Income, (1938) 26 Calif. L. Rev. 579.
(11) (1870) 11 Wall. (U. S.) 113.
(12) (1938) 304 U. S. 405, rehearing denied Oct. 10, 1938.
(13) Taxation of Government Bondholders and Employees, supra note 2, at p. 133.
(14) Weston v. Charleston, (1829) 2 Pet. 449; Dobbins v. Erie County, (1842) 16 Pet. 435; Collector v. Day, supra note 8.
(15) Willcuts v. Bunn, (1931) 282 U. S. 216.
(16) Burden required to be "immediate or direct" and not "remote," Tirrell v. Johnson, 293 U. S. 533; and a tax burden which interfered with another sovereign had to interfere in a "substantial manner." James v. Dravo Contracting Co., (1937) 302 U. S. 134; Taber v. Indian Territory Co., (1937) 300 U. S. 1; Trinity Farm Co. v. Grosjean, (1934) 291 U. S. 466; General Construction Co. v. Fisher, (1935) 295 U. S. 715; Alward v. Johnson, (1931) 282 U. S. 509.
(17) Supra note 12.
(18) James v. Dravo Contracting Co., supra note 16; Flint v. Stone Tracy Co., (1910) 220 U. S. 107; Helvering v. Mountain Producers Corp., (1938) 58 Sup. Ct. 623; Greiner v. Lewellyn, (1922) 258 U. S. 384; Plummer v. Coler, (1900) 178 U. S. 115.
(19) (1938) 1 National Lawyers Guild Quarterly 287, 293.

Concern Evinced by Investors Over Proposal of Federal Government to Levy Taxes on Income from State and Municipal Bonds—Regarded as Threatened Invasion of State Rights Says David M. Wood

The fact that investors have become upset as a result of the proposal of the Federal Government to levy taxes on the income derived from State and municipal bonds was pointed out in an address by David M. Wood, of Thomson, Wood & Hoffman of New York, at the annual convention of the Investment Bankers Association on Oct. 26. Because of their concern he said some of the States have organized a Nation-wide Association "to protect themselves against this threatened invasion of their sovereign rights." According to Mr. Wood, "the Department of Justice now contends that the Sixteenth Amendment must be interpreted as a new grant of taxing power . . . and that it conferred upon the Federal Government power to levy taxes upon subjects which previously were not within the scope of its taxing power." Mr. Wood argues that the States "are not, and never were within the scope of the taxing power of Congress, for the same reason that an Ambassador, accredited by a foreign country to this country, is not subject to such taxing power." He further asserts that under the Department of Justice interpretation of the Sixteenth Amendment "the Federal Government would be in a position completely to control the finances of the States and of their municipalities, and through the exercise of this power no State would be able to exercise any of its reserved powers, without the approval of the Federal Government." He further declared that "the independent judiciaries, State and Federal, which have been so carefully set up, could be destroyed over night."

The same subject was discussed at the convention by J. P. Wenchel, of the Bureau of Internal Revenue, and his remarks are given elsewhere in these columns. The address of Mr. Wood follows:

Investors throughout the country have become somewhat upset regarding the proposal of the Federal Government to levy taxes upon the income derived from State and municipal bonds. Indeed, the States themselves have become so concerned about it that they have organized a nation-wide association, which, I am informed, has been joined by 40 States, to protect themselves against this threatened invasion of their sovereign rights. This concern would seem to be justified, for the President of the United States, in a message to Congress, has suggested that Congress should enact a statute levying taxes upon the income derived from State and municipal bonds thereafter issued, and the Department of Justice has prepared and published an elaborate brief purporting to sustain the constitutionality of such legislation. The investors are disturbed because they fear that, notwithstanding the assuarances of the Federal Goverment that it is proposed to levy such taxes only upon the income derived from bonds thereafter issued, it actually proposes, or will, in the not far distant future, propose, to tax the income derived from State and municipal bonds now outstanding. Whether there is any justification for this lack of confidence in the assurances of the Government is a question upon which there may be a difference of opinion, but that such lack of confidence exists can hardly be disputed. The investor is convinced that if the power of Congress to levy taxes upon the income derived from future issues of State and municipal bonds, were once established, some argument to justify the taxation of income, derived from bonds now outstanding, would soon be advanced.

The States are concerned about the proposal because they see in it an encroachment upon the rights of the States, which would have very far-reaching consequences. Its initial effect would, no doubt, be to increase slightly the revenues of the Federal Government, but would do so at the expense of the local taxpayer. The Federal tax would be reflected in higher interest rates upon the bonds, issued by the States and their municipalities, and this increase in the interest rate would result in increasing the tax burden of citizens of the States and municipalities issuing the bonds. But the problem has still more serious consequences for the States, to which I will refer later.

The question is frequently asked, what provision of the Federal Constitution deprives Congress of the power to tax the income derived from State and municipal bonds? There is no express declaration to that effect in the Constitution, but the taxing power of any government only extends to properties and persons subject to its jurisdiction. The authors of the Constitution created a federated republic, composed originally, of 13 sovereign States. To the National Government the States delegated certain powers and reserved all other powers to themselves, or to the people. It was never intended to make the States completely subordinate to the United States. The States reserved to themselves all the attributes of sovereignty which they did not delegate to the Federal Government. Consequently the States and their instrumentalities of government were never subject to the taxing jurisdiction of the United States.

On the other hand the United States was not intended to be subordinate to the States, and, accordingly, the Supreme Court of the United States held, very early in the history of this country, that the United States and its instrumentalities of government were not subject to the taxing jurisdiction of the States. From the time the Supreme Court of the United States decided the famous case of McCulloch v. Maryland, down to the present time, this system of dual sovereignties has been recognized by the courts, and the courts have held that the States cannot tax the United States or any of its instrumentalities or bond issues, and, conversely, the Federal Government cannot tax the States or any of their instrumentalities or bond issues. The reason bond issues are included in the exemption is because they are merely the evidence of the exercise of a sovereign power of government—the contracting power, and to levy a tax upon the bonds is, in effect, to tax the power itself.

In 1894 Congress enacted an income tax law. The constitutionality of that law was questioned in the case of Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429; 158 U. S. 601. The Supreme Court held the act unconstitutional. That decision resulted in the adoption of the Sixteenth Amendment to the Federal Constitution. The Amendment reads as follows:

The Congress shall have power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Since the ratification of the amendment, the courts have steadily declared that its sole effect is to permit Congress to levy an income tax, free from the requirement of an apportionment of the levy among the States according to their populations, determined by the last Federal Census, and that it was not intended to extend the taxing power of Congress to new or previously excepted subjects. Conforming to these decisions, the Supreme Court of the United States held, in the case of National Life Insurance Co. v. United States, 277 U. S. 508, that, notwithstanding the Sixteenth Amendment, a tax upon the income derived from State and municipal bonds is unconstitutional. In effect, the Court has held that the Sixteenth Amendment must be read in connection with the entire Constitution and that it was not intended as a new grant of power, which might be exercised by Congress without regard to the other provisions of the Constitution in which it was incorporated but was intended merely to avoid the necessity of apportioning an income tax among the States according to their populations, as the Constitution had previously required. This interpretation of the Sixteenth Amendment has been steadily adhered to by the Supreme Court of the United States, in many decisions, since it was first called upon to construe the Sixteenth Amendment.

The Department of Justice now contends that the Sixteenth Amendment must be interpreted as a new grant of taxing power, not subject to constitutional limitations theretofore imposed upon the taxing power, and that it conferred upon the Federal Government power to levy taxes upon subjects, which previously, were not within the scope of its taxing power. It is admitted that the courts have consistently held that this is not a correct interpretation of the amendment, but it is contended that these decisions are erroneous and were rendered without a consideration of all of the facts. Let us, therefore, examine the facts.

Prior to the ratification of the Sixteenth Amendment, Congress, unquestionably, possessed the power to levy an income tax. This taxing power was plenary and embraced all conceivable forms of income taxes, but the Federal Constitution contained two important limitations upon its exercise. One was that direct taxes must be apportioned among the States in proportion to their population, determined by the last Federal Census, and the other was, that taxes other than direct taxes, must be lieved uniformly throughout the United States. This latter limitation did not preclude the possibility of classification of persons and properties for taxation, but merely required geographical uniformity of the tax levied upon any class of property or persons.

What then, was the necessity for the enactment of the Sixteenth Amendment? The reason was, the Supreme Court had held in the case of Pollock v. Farmers' Loan & Trust Co., that a tax levied upon the income derived from real estate or personal property, was a direct tax which required apportionment among the States, as the Constitution required. In fact, the court held three things in the Pollock case:

(1) That a tax levied upon incomes derived from businesses, professions, &c , was not a direct tax and might be levied by Congress without an apportionment, but, of course, subject to the other constitutional limitation, that it be levied uniformly throughout the country;
(2) That a tax levied upon incomes derived from real or personal property was a direct tax, which was subject to the requirement of apportionment; and
(3) That under no circumstances, whether the tax was apportioned or levied uniformly throughout the country, could a tax be levied upon the income derived from State and municipal bonds

Because this decision rendered impracticable the levy of a tax upon incomes derived from invested capital, President Taft recommended to Congress the enactment of a constitutional amendment to authorize the levy of an income tax, free from the requirement of apportionment. The Amendment was passed by both branches of Congress with comparatively little debate, and at no time prior to its passage was it suggested by any member of Congress that it would permit the levy of taxes upon the income derived from State and municipal bonds. All of the debate indicates that what the members of the House and Senate had in mind, was that there were large incomes derived from invested capital, the taxation of which was practically impossible, under the existing Constitution. Thus we find members of Congress referring to the enormous investment of Andrew Carnegie in bonds of the United States Steel Corp., and the large income, which he derived from that investment, free from all Federal taxation. It was not until Governor Hughes of New York expressed the view that the language of the Amendment was such as to confer upon Congress the power to tax State and municipal bonds, that we find any consideration given to this very important point.

Thereupon, this question was greatly agitated in the public press, and it resulted in Senator Borah delivering a speech from the floor of the Senate, in which with great ability, he analyzed that the amendment would not have the effect which Governor Hughes feared. Senator Bailey said that he had voted for the amendment, believing that it would have no such effect, and Senator Brown, who had introduced the amendment, stated on the floor of the Senate and elsewhere in public speeches, that he did not concur in Governor Hughes's fears. Elihu Root, then Senator from New York, expressed a similar opinion, and a careful search of the "Congressional Record" fails to disclose any opinion to the contrary expressed on the floor of the House or Senate by any member of Congress.

Several public men of the time shared Governor Hughes's fears, but many others of equal prominence differed with him, and many text-writers denied that the amendment had any such effect. Among these was Professor Seligman of Columbia University, a noted authority upon the subject of taxation.

Summarizing the facts we find that while the Amendment was pending before the States, no member of Congress appears to have stated upon the floor of either House, that the amendment, in his opinion, would authorize the taxation of the income derived from State or municipal bonds, but that among public offcials, lawyers and text-writers, there was a difference of opinion upon the subject.

In determining what was the purpose of Congress and of the people of the States, in proposing and ratifying the amendment, it is necessary to consider not only the difficulty which was proposed to be remedied by the amendment, but what would be the consequences of various interpretations of the Amendment. The Department of Justice contends that the Amendment is free from ambiguity, and, therefore, there is no room for interpretation; that the words "from whatever source derived" mean exactly what they say and authorize Congress to tax the income of any person, corporation or other entity. But a moment's reflection will show that there are certain incomes, which, obviously, were not intended to be included within its scope—that there are certain inherent limitations upon the scope of this so-called unambiguous language. Obviously, Congree could tax incomes under this Amendment only if the person to whom the income accrued, or the property or business from which the income was derived, was subject to the jurisdiction of the United States. It certainly would not be contended that it gave Congress the power to levy taxes upon salaries and incomes wholly without the jurisdiction of the United States. Would it be contended that Congress could levy a tax upon the income earned by a foreigner prior to the time he came to this country and became a naturalized citizen? Was it intended to authorize Congress to levy a tax upon the income of a foreign visitor? Was it intended to apply to the salary of an Ambassador accredited to this country by a foreign government? In short, the Amendment is subject to the implied limitation that Congress can levy taxes only upon persons, properties and business subject to its taxing jurisdiction.

But the States have never been subject to the taxing jurisdiction of Congress. The States are independent sovereignties. In Ohio Life Insurance & Trust Co. v. DeBolt, 16 How. 230, the Supreme Court of the United States said:

"It will be admitted on all hands that with the exception of the power surrendered by the Constitution of the United States, the people of the several States are absolutely and unconditionally sovereign within their respective territories."

This has been constantly reiterated by the Supreme Court of the United States. It is because a State is sovereign, that it may not be sued without its consent. However inconvenient it may now seem to the National Government, the obstinate facts are, that the Constitution of the United States did not create a highly centralized national government, but, on the contrary, created a Federal union of sovereign States and delegated to the National Government certain powers only. Those powers which were not delegated to the Federal Government, in the language of the Constitution itself, "are reserved to the States respectively, or to the people." To say that a sovereign is a subject of taxation by another sovereign is a contradiction of terms. The authors of the Constitution of the United States would have been amazed at the assertion of any such power on the part of the Federal Government.

The States, therefore, are not, and never were, within the scope of the taxing power of Congress, for the same reason that an Ambassador, accredited by a foreign country to this country, is not subject to such taxing power. The Ambassador is the representative of his sovereign, and international law has always recognized, for that reason, the immunity of an Ambassador from control by the country to which he is accredited, whether through the exercise of the taxing power, or otherwise. The States are themselves sovereignties, and likewise are not subjects of taxation by the Federal Government. Prior to the ratification of the Sixteenth Amendment, the Supreme Court of the United States had held Congress possessed no power to tax the States or the instrumentalities through which they exercise their sovereign powers, not because there was any express declaration to that effect in the Federal Constitution, but because such taxation was incompatible with the system of dual sovereignties which the Constitution established. The Sixteenth Amendment made no change in this situation, and it must be construed merely as authorizing Congress to levy an income tax, without the necessity of an apportionment, upon such subjects of taxation as are within the taxing jurisdiction of Congress.

If the contention of the Department of Justice is correct and the Sixteenth Amendment amounts to a new grant of taxing power not subject to the limitations imposed by other provisions of the Constitution, it has some very curious results, which it is difficult to believe Congress could have intended. None of these consequences was discussed or even hinted at in the debate upon the adoption of the joint resolution proposing the amendment, and the consequences of such an interpretation of the Amendment are so far-reaching and so destructive of the system of government which the Constitution established, that it is hard to believe that, had Congress intended them, it would have passed the amendment with so little debate. A consideration of the consequences of this interpretation of the Amendment is, therefore, in order, as it may throw considerable light upon the intention of Congress and of the people in proposing and ratifying the amendment.

The Supreme Court held, in the Pollock case, that a tax levied upon the income derived from real or personal property was a direct tax, consequently, subject to the rule of apportionment. If the Sixteenth Amendment, however, be considered as a grant of a new power to Congress, then it authorizes a levy of a direct tax without the necessity for apportioning it among the States. At the same time it is not subject to the rule of uniformity, as that rule does not apply to direct taxes. It is, therefore, subject to no limitation. Under that interpretation of the Sixteenth Amendment, Congress would possess the power to levy a tax upon incomes derived from invested property subject neither to the rule of apportionment, nor to the rule of uniformity. The result would be that Congress would possess the power to levy income taxes of this character at different rates in the different States. It could tax incomes, derived from invested property, at one rate in New York, and in Nevada, at another rate. This was pointed out by Chief Justice White in an opinion rendered for a unanimous Court in Brushaber v. Union Pacific RR., 240 U. S. 1, at page 12.

The power to tax is the power to destroy. Chief Justice Marshall so declared more than 100 years ago, and it is a generally accepted truth. It is true that some Judges in dicta, notably Justice Holmes, have disputed this proposition, usually in dissenting opinions, but even Justice Holmes in writing the opinion for the Court, in St. Louis Poster Co. v. United States, 249 U. S. 272, declared that a municipality could exercise its taxing power to tax bill boards out of existence. In fact the taxing power has been used by the States, and even by Congress on more than one occasion, for the purpose of destruction. Under the Department of Justice's interpretation of the Sixteenth Amendment, therefore, it would be possible for Congress to tax out of existence invested capital throughout the entire country, or, there being no limitations upon the exercise of the taxing power, which it contends was vested in Congress by the Sixteenth Amendment, to select the States in which invested capital should be taxed out of existence. Can we believe that Congress, in proposing the Sixteenth Amendment, or the people in ratifying it, contemplated anything of the sort?

Moreover, if the Sixteenth Amendment is such a new grant of power, and the words "from whatever source derived" were not intended merely to dispose of the difficulty presented by the decision of the Supreme Court in the Pollock case, but are to be construed as extending the taxing power of Congress to subjects of taxation not theretofore within the scope of the Federal taxing power, then it follows that Congress may tax the income of the States, or of their municipalities. The Department of Justice apparently takes that very position. The interpretation for which the Department contends, forces one inevitably to that conclusion, because the States and their municipalities have incomes and under that interpretation of the the effect of the Sixteenth Amendment, the origin of the incomes, or the persons possessing them, is immaterial. Under that interpretation of the Sixteenth Amendment, the governmental or sovereign capacity of the taxpayer is likewise immaterial, for the moment it is admitted that the character of the States or of their municipalities has any bearing upon the validity of the tax, the whole argument made to sustain the interpretation contended for, breaks down completely. It is for that very reason that the Department has gone to such pains in an attempt to demonstrate that all of the decisions of the Supreme Court of the United States, prior to the Sixteenth Amendment, denying Congress the power to tax the States, or their instrumentalities, are erroneous. It was forced to take such a position, for it was realized that its contentions regarding the interpretation of the Sixteenth Amendment were otherwise untenable.

Moreover, under the interpretation of the Sixteenth Amendment, asserted by the Department of Justice, Congress would possess the power to levy taxes upon the incomes of all judicial officers of the Federal Government and of the States. These officers might be classified as a class of taxpayers, and rates of taxation assessed upon their incomes different from those assessed upon other classes of taxpayers. Congress has for many years classified taxpayers for income tax purposes, and has assessed against certain classes rates of taxation differing from those assessed against other classses of taxpayers, and this power has been sustained by the courts. It would be within the power of Congress, therefore, to so exercise the taxing power against judicial officers of the country, as to make them subservient to Congress, and what is even more dangerous, when Congress is dominated by the Executive, to make the Judiciary subservient to the Executive branch of the Federal Government.

This interpretation of the Sixteenth Amendment, would result in conferring upon Congress a power which could be used not only to destroy the States, but also to destroy the independence of the Judiciary. States which did not conform to the will of the Federal Government, could be forced into line by the levy, in those States, of taxes upon the incomes of its citizens at higher rates than those levied upon citizens of States which were subservient to the Federal Government, and if that were not sufficient, discriminatory taxes might be levied upon their bonds and upon the bonds of their municipalities, or even upon their tax revenues, until they came to terms. The Federal Government would be in a position completely to control the finances of the States and of their municipalities, and through the exercise of this power no State would be able to exercise any of its reserved powers, without the approval of the Federal Government. The States would become as completely subject to the control of the Federal Government, as a county is now subject to control by the State which created it. The States would cease to be sovereignties and would become mere geographical subdivisions, existing at the will and for the convenience of the Federal Government.

The independent judiciaries, State and Federal, which have been so carefully set up, could be destroyed over night. The authors of the Constitution were well aware that no judiciary can be independent when its compensation is subject to diminishment by either the Legislative or Executive branch of the Federal Government. For that reason, Article III, Section 1 of the Federal Constitution carefully provided that the compensation of judges should "not be diminished during their continuance in office." Can anyone believe that the people of this country in ratifying the Sixteenth Amendment intended such a revolutionary change in the structure of the American Government?

The conclusions, which the Dapartment of Justice seems to have reached, regarding the effect of the Sixteenth Amendment, seem to be due to a failure to realize that the Amendment, upon its ratification, became a part of the existing Constitution and must be read in connection with that entire document. That is exactly what the Supreme Court of the United States has done in interpreting the Amendment in the various cases which have come before it since its ratification. It was obliged to hold, for instance, that the intent of Congress and the people in proposing and ratifying the Amendment, was merely to transfer taxes upon income derived from invested property, from the class of direct taxes to the class of excises,

so as to subject these taxes to the rule of uniformity applicable to excises, and thus avoid the absurdity of assuming that it was intended to confer upon Congress a power to levy income taxes at different rates in different States. Similarly, the Court has held that the Amendment is subject to the constitutional prohibition against reducing compensation of a judicial officer during his term of office, and, for the same reasons, it has held that the Amendment did not confer upon Congress the power to tax incomes derived from State and municipal bonds. In short, the Court has held that neither Congress, nor the people, intended by the ratification of an obscurely worded Amendment, to destroy limitations upon the powers of the Federal Government, which are expressly provided for in the Constitution, or necessarily implied, and which are essential for the preservation of the very form of government which the Constitution was intended to establish.

The Constitution provided for an indestructible union of indestructible States. Whenever the people decide to change that form of government, they can do so, by amending the Constitution, but the amendment will have to so provide expressly, for no court will be justified in assuming the people intended a revolutionary change in the structure of government, unless their intention was unmistakably expressed. No court would be justified in assuming the people intended to abandon fundamental concepts upon which the United States was founded, because, in an amendment relating to taxation, is to be found the obscure phrase "from whatever source derived."

Before I. B. A., Francis A. Bonner, Discussing Maloney Act and Over-Counter Market Sees No Reason Why Latter Should Not Be as Well Established a Market as That of Other Exchanges

"There is no reason why with the organization, standardization of general principles, efficiency, the over-the-counter market should not be in every sense as well established a market as that of the other exchanges," said Francis A. Bonner, of Blair, Bonner & Co. of Chicago, and temporarily adviser of the Securities and Exchange Commission, in discussing before the Investment Bankers Association Convention "The Over-the-Counter Market and the Maloney Act." "Improvement of practices, establishment of the over-the-counter market on a firmer basis, increase in public confidence alone are worth to all of us, in assurance of a more stable and lasting business, more than this effort will ever cost," he said. "Is there any reason," he added, "why, with adequate reliable quotations, an over-the-counter security should not be as welcome collateral at the bank as one listed"? Putting the question "what is the drift in Washington"? Mr. Bonner said:

For answer, need we go further than the subject of today's forum? I ask you to imagine Congress, three or four years ago, passing an act designed to enable the investment banking business to cooperate with Government in the management of its own affairs. It is an expression of confidence which has few, if any, precedents in legislative history. It is a confidence which was not easily won, but which has been and I hope and believe will be well deserved.

Declaring that "we stand at the threshold of a great opportunity," Mr. Bonner noted that "to succeed in achieving it calls for statesmanship. Statesmanship on the part of Government," he observed, "in understanding and appreciation of the size, nature and difficulty of the task before us," and "statesmanship on the part of ourselves in realization of the necessity of give and take." He added:

Those of us who are large must remember the fears of the small, that they may be dominated by those who do not understand and appreciate their problems. Those of us who are small must remember that there are similar fears on the part of the large, that they may be dominated by the numerically greater small, who do not understand and appreciate their problems. There must be give and take, checks and balances, unity of purpose, for the sake of the whole.

At the beginning of his address Mr. Bonner said that "though sitting for the time being on the Government side of the table, . . . I am trying to look at this problem from the business side as one among you." The address of Mr. Bonner follows:

It is nothing new to be here with you today. Some of the pleasantest memories of my life are centered in this spot, at gatherings such as this. It is a new experience, however, to be here as your guest, and I wish to express to all of you my sincere thanks.

Things have changed somewhat, perhaps, when (if I may appropriate the title for a moment) a government official appears before you wearing a gold button. Whether this sets a record I do not know. So far as I am concerned it sets a record. This being in the securities business and in the government at one and the same time is likewise a novel experience; one that I can assure you is not without its worries. In the work which lies ahead, there must be reconciliation of many points of view within the industry and the plan that is evolved may not completely satisfy everyone. My share in the task of reconciliation may put me in the middle, and the fellow in the middle is often the target for both sides. It is worth whatever risk there is, if such effort is of help in finding a solution.

Though sitting for the time being on the government side of the table, I ask you to believe that in the little I have to say here I am trying to look at this from the business side, as one among you, still trying to cope with the problems of the securities business.

The subject before us today is the oldest in the history of this Association. It is in fact the corner-stone. Permit me to read to you the first paragraph of the first page of the first Annual Report covering the first convention of the I. B. A.:

Six months ago the Investors Bankers Association of America was in an embryonic state, conceived only in the minds of a few investment bankers in this country. The conception of the organizers was given nation-wide publicity on Aug. 8, 1912, when in New York City a meeting of investment bankers was held for the purpose of organization. This gathering was significant for the diversity of its make-up, including representatives from investment houses in all part of America; it gave to the public its first assurance of an association, constituted purely of investment bankers, *organized primarily to improve the standard of those engaged in investment banking and for the general protection of the investing public.*

The very history of securities legislation in this country is written by the Legislation Committee reports of this Association year by year since 1912. It is a history of which this Association can well be proud. It is a history which, I believe, is unexcelled by that of any other business. In that same first Year Book, in the section on "Legislative Action" this appears:

The need of legislative action to correct existing ills in the investment field was given particular emphasis throughout the convention.

Throughout its history the Association's policy in meeting this need has been consistently one and the same. As early as 1913, its second year, that policy was announced, as follows:

The Committee is in sympathy with any fair and practical statute . . . which will protect investors against fraud . . . but against the enactment of such laws, the enforcement of which would practically destroy the legitimate business of responsible investment bankers . . . and hamper the flow of capital to industry.

The method of effectuating that policy underwent radical change as time went on. The early Blue Sky Laws were crude. They were written without adequate study of all the problems involved. It was decided that they should be directly and vigorously opposed, and injunctions were obtained. In 1913 the Committee stated:

Your counsel and committee believe that these laws are unconstitutional and that these injunctions will be made permanent.

The fight was pressed through the courts and by 1916 six Federal decisions, rendered by 14 Federal judges, had held typical Blue Sky Acts invalid.

Early in 1917, however, the Supreme Court of the United States held the laws of Michigan, South Dakota and Ohio to be constitutional. At once the Association's report called on members to cooperate with State officials, to make the growing array of laws and regulations more workable. But it was not until 1922 that the new philosophy became clearly defined. The Denison Bill had been introduced in Congress, with drastic provisions

which in effect enacted into Federal law the myriad and conflicting details of all the State laws. Conferences were undertaken with the State Commissioners to try to bring order out of such chaos. In reporting on one phase of that work a member of the Special Committee states:

I think that in those four days there was more accomplished in bringing to the Securities Commissioners the viewpoint of the Investment Bankers Association of America and bringing to the members of the Investment Bankers Association of America the view point of the Commissioners than has been accomplished in the fight we have had with them covering a period of 10 years to my knowledge.

Successive reports refer to the growing friendly relationship with the States, until in 1926 the Committee's chairman says:

There has been enough continuity both in personnel and thought of our Committees having to deal with this subject to gain a considerable amount of *understanding* of the position in which the commissioners of the various States are placed and a great amount of *sympathy* with their point of view. It is believed also that contact with the Commissioners has given them for the most part an *understanding* of our problems.

The round table method was here, the only satisfactory method of settling the common problems of government and business. It has been marked by great accomplishments on the part of the Association toward improvement in laws and business practices. To cite only one example, by 1929 the Legislation Committee reported that "today 16 States have (blue sky) laws representing approximate uniformity of one type or another, a vast advance over the seemingly hopeless confusion which existed a few years ago." The round table method has persisted since, with one lamented exception, in the early 30's. But the round table method is back again. I have often wished since I have been in Washington that every dealer in the country could have the same opportunity to see from the inside how earnestly those charged with the administration and enforcement of the Federal securities laws, which so vitally affect our business, are approaching a multitude of problems and seeking practical advice in finding the right answers. After some years of experience looking at government from the standpoint of our business I have recently had a chance to look at our business from the standpoint of government, and the guide posts do not seem greatly shifted. The same kind of topic lies on the center of the table, and it seems to make not much difference which chair one happens to be sitting in.

The question often is asked: "What is the drift in Washington?" For answer need we go further than the subject of today's forum? I ask you to imagine Congress, three or four years ago, passing an act designed to enable the investment banking business to cooperate with government in the management of its own affairs. It is an expression of confidence which has few, if any, precedents in legislative history. It is a confidence which was not easily won, but which has been and I hope and believe will be well deserved. The investment banking business can well be proud of the way in which, under the leadership of this Association, it united to produce its code. It was a purely ethical code, concerned principally with questions of sound and decent practices, and as such, differed from many others. The National Recovery Administration looked upon it as one of the best, if not *the* best, of all the codes. The business stood behind it and during its short life, though far from perfect, it worked well.

But after all, there was some legal compulsion in the code. It may be said we *had* to have one. At least as great a tribute to our business has been the way in which, with only a thread of morality to hold them together, so large a part of it has carried on since the death of the code, to preserve the progress which they believed had been made in the improvement of business practices, and to work out some means of perpetuating it. One cannot pick up an underwriting or syndicate agreement today that does not contain important features brought in by the code and never abandoned.

Recently some of us have had the privilege of meeting with dealers in a number of cities, to discuss this new legislation. The spirit is still the same. It has been inspiring to see the wholehearted response of dealers everywhere as soon as they have better understood what it is all about.

What we are here today to discuss is thus the fruit of 26 years of gradual progress. More directly it is the outcome of a steady, consistent chain of events over the past three or four years. One need but cite the almost unanimous vote of registered dealers under the code, after the Supreme Court acted, in favor of holding together to work out a permanent plan, and agreeing to pay assessments to make it possible. The 1938 amendments to the Securities Exchange Act did not just pop out of a hat, but were the outcome of three or four years of concentrated study and effort on the part of our business.

It has been a hard won road and is far from finished. It is not the time, perhaps, to indulge in visions, but one cannot refrain. What we are facing here is no Sunday school picnic, with a set of papers to pack in our basket and go about our play. Nor is it an old ladies' sewing circle, to adopt a set of rules, gossip about our neighbors, and catch them in the act. The fundamental purpose of this effort must and should always be to make our business better and cleaner and keep it so. But if we go no further than that we have not fully realized our opportunity and there may be doubt whether the project will endure. A feeling of righteousness alone, however important, is not enough. There must be more concrete results, yielding measurable value to membership.

Unless out of this is forged a sounder, healthier, more virile over-the-counter market, enabling all of us better to provide a fundamental service to the national economy, on a lasting basis, we have failed in our full opportunity. The whole history of the investment banking business, since the beginnings of this Association, has been building up to what is before us today. That is a commanding fact which we must not overlook. It means the chance for us now to carry further that growth in popular esteem which has marked our business over the past five years, and to build and keep for the over-the-counter market a place commensurate with its importance in our economy. This is the market which not only provides new capital for our industry, but also in very great part cares for the securities representing that capital afterward. There is no reason why with organization, standardization of general principles, efficiency, the over-the-counter market should not be in every sense as well established a market as that of the exchanges. Securities of some types, to my mind, belong to one market; those of other types belong to the other; and if we get our house in order and keep it so, there is infinitely more promise that we may better care for, even retain, those which belong to ours.

Improvement of practices, establishment of the over-the-counter market on a firmer basis, increase in public confidence, alone are worth to all of us, in assurance of a more stable and lasting business, more than this effort will ever cost. Is there any reason why with adequate, reliable quotations, an over-the counter security should not be as welcome collateral at the bank as one listed? Is there not opportunity for substantial savings to all of us in shipping, insurance, and other expenses through establishment of clearing houses? Costs, of course, must be always a vital factor, but could not some of these efforts in fact be self-sustaining? One can imagine many other possibilities, working to the benefit of both the public and ourselves in the daily conduct of our business. But much of this is for the future, as we go carefully along and gain in experience.

We stand at the threshold of a great opportunity. To succeed in achieving it calls for statesmanship. Statesmanship on the part of government, in understanding and appreciation of the size, nature and difficulty of the task before us. What in effect we are trying to do is to set up an organization which it has taken the stock exchanges 146 years to achieve. The task is to set up for the over-the-counter market an orderly, well organized exchange, for we may call it that, with a floor 3,000 miles long and almost as wide, with a membership (and I speak advisedly) in part untutored in even the rudiments of age-old common law or the primer of sound practice in the conduct of their own daily business. In large part our initial task is educational. To succeed there must be appreciation that an infant must creep before it walks and walk before it runs. I am hopeful therefore that on the part of government there may be patience and adequate time to attack a ponderous job, and no expectation that a warrior shall spring full grown from the brow of Zeus.

Statesmanship on the part of ourselves, in realization of the necessity of give and take. No problem of such complexity can be worked out entirely as any *one* of us may wish it. We must remember the vital fact that Congress has done perhaps an unprecedented thing in removing restrictions of the anti-trust laws from this effort. Safeguards therefore have had to be erected. We must remember that what we tackle is a national industry problem and not that of any group large or small within it. In this there must be no east versus west, or north versus south. Those of us who are large must remember the fears of the small, that they may be dominated by those who do not understand and appreciate their problems. Those of us who are small must remember that there are similar fears on the part of the large, that they may be dominated by the numerically greater small,

who do not understand and appreciate *their* problems. There must be give and take, checks and balances, unity of purpose, for the sake of the whole.

Some have criticised, perhaps some still do, the kind of regulation envisioned here, in view of the Commission's supervisory powers. Yet they could hardly have expected repeal of the Securities Exchange Act as it relates to our business, and that is what an unsupervised form would have represented. Let us be realistic. We have an opportunity here to set up our rules of business conduct under a system of business penalties—far preferable, is it not, to Commission regulations covering the same field, enforceable through criminal penalties. The process, I think you will find, is parallel to the governmental supervision now existing over the stock exchanges. Governmental controls, moreover, must provide the essential safeguards to prevent discriminatory, monopolistic, or other unfair tendencies.

Let us not be over-optimistic. We have a real task before us. It will not be easy sailing. There may be breakers ahead. But if we appreciate our job and do it well, we shall have accomplished something and set up an example of cooperation between government and business, the consequence of which for the good of ourselves, the benefit of our national economy, and the welfare of the public, may well be great.

Commissioner Mathews of SEC Discusses Before I. B. A. Maloney Act Program Incident to Formation of Over-Counter National Association

The question as to the future course of action under the Maloney Act (placed on the statute books during the year) of the investment bankers, the over-the-counter brokers and dealers, and the Securities and Exchange Commission was brought before the convention of the Investment Bankers Association by George C. Mathews, a member of the Commission, who reviewed on Oct. 28 certain aspects of the legislation, as to which he said that there has been widespread misunderstanding with respect to its objectives. His address also dealt with the question as to "what sort of organizations should be created to carry out the purposes of the Act, and in what manner they should be brought into existence." "I have suggested," he said, "the probability of a strong National organization," and he added a national organization, "need not preclude a scheme of local administration, or the formation of local affiliated associations." He likewise said.

The Investment Bankers Conference, to which the vast majority of your members belong and which was formed in the hope and anticipation of legislation such as that which we are discussing, would be compelled substantially to alter and supplement its rules and forms of procedure before it could qualify for registration. Moreover, if a strong national association is to be formed, it is sincerely to be hoped that there will be included within its membership a far larger proportion of the brokers and dealers in the country than are at the present time enrolled in the Investment Bankers Conference, Inc. I know of no other organizations of firms of brokers and dealers within the general securities field which might be considered truly national in scope.

In full we give herewith the address of Mr. Mathews:

In addressing this convention last year on certain aspects of the work of our Commission, I urged at some length the importance to investors and to the national economy of the creation of an axis of active cooperation between those engaged in the securities business and those charged with its regulation. I attempted to point out the clear interest of the investment bankers, dealers, and brokers of the country and of the SEC in developing a plan for coordinated action which would have as its two principal objectives enforcement of law with a minimum of interference with the normal processes of business and the establishment and maintenance of high professional standards of conduct and competence. Today I think there are few who do not recognize the essential validity of that concept. It is now very generally understood that as a matter of practical business operation, as well as of realistic governmental administration, such cooperation is well-nigh indispensable if we are both promptly and effectively to unite the technical skill and experience of the industry with the strength and prestige of Government for the elimination of both illegal and unprofessional practices injurious alike to investors, the vast majority of brokers and dealers and the public generally. Last year I was able at best to speak in general terms of a possible method whereby such cooperation could be effectuated and could only deal abstractly with the benefits which might be conferred and the burdens eliminated through the adoption of a sound program. Since that time, as you all know, enabling legislation, in the form of the Maloney Act, has been placed upon the statute books to the end that your industry as appropriately organized may, subject to the Congressional directives, assume as important a role in the conduct of its own affairs as it has the will to undertake and as its natural genius will permit. It is the future course of action, under this legislation, of the investment bankers, the over-the-counter brokers and dealers of the country, and of our Commission which we are here to discuss today.

Misunderstanding has been so widespread with respect to the objectives and substance of the Maloney Act that I wish to review briefly certain aspects of its legislative history. You may recall that there has been continuing consultation for four years between representatives of your industry and our Commission looking toward the development of a cooperative scheme of regulation. One of the most important groups with which we conferred was the Investment Bankers Code Committee, organized under the National Industrial Recovery Act, a majority of the members of which were nominated by the then President of the Investment Bankers Association of America. With the invalidation by the Supreme Court of the N. I. R. A., this Committee voluntarily remained in existence, with the encouragement of our Commission, for purposes of continued consultation and in order to attempt to evolve some formula which would salvage what was believed by them to have been the strong and desirable features of the Investment Bankers code. This group, as you know, inaugurated the Investment Bankers Conference, Inc., an organization which succeeded in holding an entirely voluntary membership of more than half of the firms and individuals who had been assenters to the code. Conversations between representatives of that organization and of the Commission on many problems relating to the industry have continued down to the present time. Numerous conferences were held with them, as well as with representatives of your Association, prior to the enactment of the Maloney bill. This sequence of events has led some people to believe erroneously that Maloney Act represents an attempt to revive the N. I. R. A. or at least to create something founded upon the same legal concept. Nothing could be further from the fact. The Maloney Act represents a direct development of the principles embodied in the Securities Exchange Act of 1934 with reference to national securities exchanges. It, in fact, is patterned as closely after the earlier legislation as was deemed to be possible in view of the differences which exist between exchange markets and over-the-counter markets and the desire of those who framed the Act to provide for an entirely voluntary program.

Under the N. I. R. A., the code, once it had been approved by the President, became the law of the land with respect to transactions in or affecting interstate commerce. Everyone conducting an investment banking business, as defined in the code, was bound by its provisions, irrespective of whether he assented thereto. A non-assentor, however, was deprived of business preferences within the trade, such as syndicate participations and dealers concessions. Any violation of the provisions of the code rendered the violator liable to injunction or posecution. And in the case of a registered investment banker, violations were punishable by the Code committee which was empowered to impose fines, and to suspend or cancel registration. From any such action by the code committee an aggrieved party might appeal to the Administrator. No machinery, however, was provided in the N. I. R. A. for judicial review of such proceedings.

In definite contrast to the N. I. R. A. and the code is the form of organization provided for in the Maloney Act. No broker or dealer is deprived of the use of the mails or of the channels of interstate commerce should he fail to join some registered securities association. Nor is a broker or dealer bound by the rules of an association of which he is not a member. The Act provides for the punishment by associations of members who disobey their rules and for the exclusion of brokers and dealers for specified offenses. This power is, however, carefully safeguarded by provisions for review by the

Commission either on application or on its own motion and under the Securities Exchange Act of 1934 appeal lies to the courts from such determination as the Commission may make. Likewise, there are provisions in the Act designed to provide safeguards against monopolies and monopolistic practices and to protect a free, open, and competitive market.

Before this audience it is obviously unnecessary to review the provisions of the Maloney Act in detail, particularly since we shall be glad at a later period in this forum to attempt to answer any questions which you may have on this subject. I, however, do wish to lay emphasis upon the flexibility of the provisions of the Act which are designed to permit forms of organization suitable to the differing needs of the financial communities throughout the country and of the various types of business being conducted within the board framework of our over-the-counter securities markets. Likewise, it may be well to remaind you that the cooperative program envisioned in the Act must of necessity be an evolutionary one. Ideally, the industry should eventually play the predominant role in its own regulation and development along sound economic and social lines. It should in the largest possible measure achieve that ideal under democratic institutions which Josiah Royce described as the forestalling of restraint by self-restraint. As spokesmen for the Commission repeatedly have said, it is sincerely to be hoped that the ultimate role of the Commission will be a residual one in which its energies may be principally directed toward dealing with that submarginal element known to all industries which in the absence of coercion refuses to abide by either moral or legal standards. Admittedly, the fulfillment of this ideal requires time. Many ancient premises must be reviewed and much of an educational nature needs to be accomplished. Mutual understanding and confidence must be cemented not only between the Government and the securities business but also among the various elements within that business. All of these things were taken into account in the drafting of the Act. It was provided that certain definite conditions must be met in the rules and form of organization of an association before it could be registered, but ample latitude was allowed for the continuing development of such an association in the direction of the objectives sought to be achieved by the Securities Exchange Act of 1934. Furthermore, the Act is clearly predicated upon the assumption that the vast majority of individuals and firms engaged in transacting business in securities are honest and honorable. In that assumption we steadfastly believe. On any other premise a cooperative program, such as that provided for in the Act, would be absurd.

I have one other historical comment to make with respect to the Maloney Act. This concerns the discussions which took place at the hearings before the committees of Congress and in conferences between our Commission and representatives of the Investment Bankers Association and of the Investment Bankers Conference. As a result of those discussions many changes of both form and substance were made in the Act as originally drafted. I think it is safe to say that no piece of regulatory legislation in the field of securities has ever been enacted in this country with respect to which there was such substantial agreement between the governmental authorities and the representatives of the industry to be regulated. This fact augurs well for the future success of our common project.

We now come to the questions of what sort of organizations should be created to carry out the purposes of the Act and in what manner they should be brought into existence. So far as I know, no existing organization of brokers and dealers would qualify for registration in precisely its present form. It is my understanding that your association has elected to retain its present characteristics and to continue to exercise its traditional functions. It, therefore, does not intend to apply for registration. As I indicated to you last year, there is a useful place for such an organization, one of the functions of which is in a spirit of candid advocacy to represent and make articulate the attitude and desires of a restricted membership, without pretense of impartiality, but with a firm intention to keep its partisanship intelligent and realistic, not merely blind. The Investment Bankers Conference, to which the vast majority of your members belong and which was formed in the hope and anticipation of legislation such as that which we are discussing, would be compelled substantially to alter and supplement its rules and forms of procedure before it could qualify for registration. Moreover, if a strong national association is to be formed, it is sincerely to be hoped that there will be included within its membership a far larger proportion of the borkers and dealers in the country than are at the present time enrolled in the Investment Bankers Conference, Inc. I know of no other organizations of firms of brokers and dealers within the general securities field which might be considered truly national in scope.

These facts having been recognized by the governing bodies of the Investment Bankers Association and the Investment Bankers Conference, an undertaking was launched through the agency of a joint committee, the purpose of which was to prepare a plan of organization for an association suitable for registration. Mr. Starkweather and Mr. Ford have already told your of the work which has been carried on by this joint committee. They, of course, have been performing an essential task since a great deal of initiative and effort is required on the part of the industry to produce a plan for submission to the Commission, and to the firms throughout the country, for approval. Appropriate members of the staff of the Commission have been made available to consult and cooperate with the joint committee and its counsel in the interest of expedition. When a draft of a plan suitable for submission to the Commission has been completed, it is anticipated that it will be circulated as widely as possible throughout the trade in order that the Commission and the Committee may have the benefit of the criticisms and suggestions of as many brokers and dealers as possible and to the end that no individual or group within the industry need feel that an opportunity has been lacking for a full and free expression of his or its views, or for determining, alone or in concert with others in the business, which of the courses of action available under the Act he desires to follow.

Although such general national association as may become registered will in all probability be new and different from any organization presently in existence it is hoped that it will nevertheless represent a logical extension of much that has already been accomplished and that as the result of a natural evolution there will not be lost the results of the years of thought and labor which have already been expended upon this general program.

I have suggested the probability of a strong national organization becoming registered and such, we have been told today, has been the plan of the Joint Committee. This result is, I think, desirable. I have stated it freely to large numbers of people in the business with whom I have met in recent weeks. It should be made clear that this expression of a personal opinion does not reflect a desire, either of the Commission or of myself, to determine the course which the industry shall take. It is entitled only to such consideration as it may merit as an opinion. Neither the Commission nor anyone connected with it wants to direct your course except to the extent that the statute makes it our duty to do so.

The types of organization which may be adopted are provided for in the Act. If any organization meets the legal standards the Commission has no right to refuse it registration and certainly it has no wish or intention to assume any function not delegated to it by the Maloney Act.

The important thing is that the people in the industry have an opportunity to become informed prior to making a choice as to their course.

A national association, of course, need not preclude a scheme of local administration or the formation of local affiliated associations in communities in which this type of organization appears desirable or the formation of other national associations meeting the standards of the Act if people in the business decide that organization should proceed along those lines.

Through a strong national association, in my opinion, there can best be achieved substantial uniformity of rules governing business conduct and a reasonable consistency in the administration of such rules. Likewise, such an organization in all probability would provide the best vehicle for securing such degree of uniformity of technical trade practices as may be found to be desirable and the solution of those problems within our trading markets which exist on a national scale. Such an association should also be in a position to create an efficiently functioning mechanism for the arbitration of disputes and the investigation of complaints between firms and individuals in widely separated localities.

I have indicated that, in my opinion, the existence of a strong national association is not incompatible with local administration and I think that a substantial measure of local administration is not only desirable but practically indispensable. It seems only appropriate that complaints relating to the business practices of a dealer in a given community should be heard by an appropriate committee familiar with all the circumstances surrounding the conduct of the securities business in that area, rather than by men conversant only with conditions existing elsewhere in the country. An example might be a controversy involving the reasonableness of a profit or a commission, since the rules of a registered association must provide safe-

guards against unreasonable charges. Clearly what is a reasonable profit or commission must be judged in the light of all the surrounding circumstances. An unfamiliarity with local conditions might well disqualify one who undertook to act as arbitrator or judge.

In conclusion, I should like to stress, first, the safeguards contained in the statute against the domination of such association or associations as may be formed by any group within the industry. No aspect of the legislation received more careful consideration at the hands of Congress or of the SEC than that relating to the firm establishment and maintenance of a truly representative form of Government and the protection of individuals and minorities. It is the clear duty of our Commission to exercise the greatest vigilance in assuring compliance with this Congressional mandate.

Finally, I wish to re-emphasize the evolutionary character of the program provided for in the Act. To be sure various fundamental standards must be met as conditions precedent to the registration of an association with the Commission. Rules of the association must contain the required safeguards. They must furthermore be designed to effectuate the purposes of the Act. Likewise, the form of organization and the character of its membership must be acceptable. It, however, is not anticipated that the great potentiality of this plan for cooperative regulation will be realized in its entirety from the outset. A firm foundation must be created upon which to build and it is our hope, as I am sure it is yours, that the work of construction will continue through the years until there shall finally have been erected a professional edifice commensurate with the importance of the investment banking and over-the-counter securities businesses in our national economy.

"Situation in Which Industry Finds Itself" Discussed by F. C. Crawford Before I. B. A.—Says Future Course Lies in "Going Back to Work and Forcing Production"—Industry Accepts Challenge and Capital Must Also, He Says

A portrayal of a picture of American industry was presented at the annual convention of the Investment Bankers Association by F. C. Crawford, President of Thompson Products, Inc., as to which he said "it is not a battle between capital and labor." "It is simply every day human nature expressing itself in a *free* land. America," he said, "longs for prosperity." He described the present situation in which industry finds itself as "a political depression" and observed that "industry and banking have been sitting idle, waiting for the old American way of the free, unobstructive production to come back by itself. It never will," he said, and added, "we have had the 'cart before the horse'." He went on to say: "Our future course lies in going back to work, forcing production to the limit regardless of all regulation and obstruction until we produce enough wealth to start building a new degree of prosperity. . . . If we are successful, we will see America turn from left to right, tend to become conservative, to understand the old American way, to remove obstacles so that full prosperity may follow. Industry," he said, "accepts the challenge capital must also accept the challenge." Mr. Crawford spoke extemporaneously, but the following as to his remarks, is made available:

Introduction

I propose to tell a simple story of industry as seen by the industrialist. It is a period of great confusion. Each observer looks through glasses of different color. I represent growing, expanding industry, perhaps the kind badly needed by America. Small industry—yet there is no difference between small industry and large industry except the decimal point. America's road to prosperity lies in the expansion of growing industry. I divide my talk into three major parts:

PART I—A Picture of American Industry.

PART II—The Picture of American Industry against the background of American life.

PART III—What to do about it.

I want to portray in graphic manner a picture of American industry. It is not a battle between capital and labor. It is not a cruel invention of 60 families for greed. It is simply every day human nature expressing itself in a *free* land. I will picture industry as a large triangle:

(1) At the top corner I place the American market—130 million American people—all of us. This market is inexhaustible. Any saturation point is inconceivable. The demands of this market upon industry are: more products, better products, cheaper products—the natural human demand of any good buyer.

(2) At the lower lefthand corner I put capital—labor of the past that has been saved. Capital buys the tools of production. All of us who save or have insurance policies, or own any property are part of capital. The demands of capital upon industry are: give us reasonable security and a reasonable return for risk. These are natural human demands.

(3) At the lower righthand corner I place labor—all of us—130 million Americans. The demands of labor are: higher wages and shorter hours These are natural human demands of every person who works. Please observe the three conflicting demands upon the business triangle, each in itself a natural demand yet, apparently, irreconcilable. The market wants more for less money. Labor wants more money for less work. Capital wants security and more return.

(4) In the business triangle there is fourth element—management. Picture management as a figure in the center of the triangle. Management finds itself in an awful spot. It must reconcile the conflicting but natural human demands of the three corners. I can show these by asking you to imagine a rope to the neck of management and the end in the hands of the market. Whenever market buys it yanks the rope demanding more for less money. Capital holds a rope attached to the manager's left leg and pulls it as it demands security and return. Labor holds a rope attached to the manager's right leg and pulls it constantly demanding more money for less work.

Please observe, the market is enormous; reserves of capital are enormous; supplies of labor are enormous; and all these must wait until management, which is scarce, goes into the triangle to reconcile the demands from the corners.

Who is management? Not the smartest—not the genius—just a plain man willing to pay the price and meet the great demands of American industry. His reactions, again, are simply human nature expressing itself. For self-preservation he must find a way to reconcile the conflicting demands from the corners of the triangle. He must be a visionary dreaming of new products and methods. He must be a realist, facing the cold facts of the profit and loss statement. Above all, he must understand human nature and human behavior. To him the science of economics is just the study of human reactions.

Many people follow my picture to this point. Many think at this point that someone tosses in a fixed amount of money and the triangle becomes a poker game, believing that if one shall win, another must lose. This is not so.

The triangle of business is a device for producing wealth, creating something that did not exist before. To illustrate my point, let us consider an umbrella factory with one workman, Joe. Joe goes to work, produces one umbrella in one hour's time and demands $1.00 wages. The manager takes his umbrella to market. He finally finds a buyer who will pay $1.00 for the umbrella but complains that the price is too high. Management returns with the dollar, pays Joe for his work. There is nothing for capital. The business merely breaks even. Under great pressure from the market for a lower price, from capital for return, and from Joe for a raise, (and for his preservation), management schemes to find a better way to make umbrellas. A stool is provided so that Joe will not get so tired. A conveyor saves him time. A motor turns his machine. Other ingenious tools of production are created to speed the process of production. Now Joe returns to work. In one hour he produces two umbrellas. Management takes them to market, gives the buyer the lower price of 75 cents which brings ready buyers, and returns with $1.50. He makes Joe happy with a 25 cent raise and has 25 cents left, a dividend for capital. $1.50 has grown where only $1.00 existed before. Wealth has been created. Natural human demands have been met. All are happy, the standard of living has been raised. Management is successful. American industry, therefore, is no poker game but a wealth producing device.

A definition: Wealth is produced by application of labor to the ingenious devices of production conceived by management and paid for by capital.

Observations from Our Business Triangle

(1) The American industrial system, called capitalism, is not a system at all. It is every day human nature expressing itself in a free land. There is no mystery to it. It was not invented by 60 families in collusion with the bankers. Sweep it all aside, and in a free land, exactly the same thing will come back—naturally.

(2) Industry is not a poker game. It is a way of producing wealth which did not exist before.

(3) From the nature of industry, it is a good healthy tug of war between natural human demands. It cannot be made into a Sunday school, a charitable institution, nor an old man's home.

(4) The business triangle tends to balance the demands made upon it. In the long run, under freedom, the forces will balance each other.

(5) It works. This American industrial way of life has produced extraordinary accomplishment in the past 50 years—the world's highest standard of living, the most rapid creation of wealth, the highest wage scales, the lowest costs. It is a paradox of industry that as the buyer pays less, capital and labor get more.

(6) There are no classes in the American system. All of us are market. All of us are capital. All of us are labor. All of us are making the three conflicting demands upon industry.

(7) The essence of this system is a steady flow of new capital into the triangle to buy the new tools of production which will keep up the process.

(8) I call this the American way because nowhere on earth has this triangle in industry been free to function as it has here. Of European ways we want none. Go to market with your market basket anywhere in the world. You can fill it in America with one-half the labor that you can fill it in any other land.

PART II

I will try to fit the picture of American industry against the whole background of American life.

There are three groups of human activity.

(a) 1. *Social*, including religious, educational activities, &c.

2. *Political*, including all forms of government, municipal, State, Federal.

3. *Commercial*, including industry, commerce, agricultural, banking, &c.

Please observe that from a material point of view, the social and political groups are overhead, producing nothing material. All material wealth is produced by commercial activities.

(b) Consider the past 50 years. The social group did not reach any outstanding success. The political group did not reach any great success. The commercial group has produced wealth and a standard of living that is the envy of the world; a standard of living more widely distributed than ever before. This has been achieved by the American industrial triangle operating in a free land. During this time a prosperous American remained conservative and followed no "isms."

(c) War brought a great upset of world-wide scope, temporarily. All relationships were disjointed. The commercial world was rebuilt for war. Civilization is founded on credit, and credit on price. War, temporarily, doubled the prices. Governments bid up prices, decreased production and increased consumption. The whole commercial structure was remade at an artificial level.

(d) Peace returned followed by boom, collapse, and depression. This always follows war. There is no mystery about it. The whole artificial structure must collapse to peace price levels.

(e) Collapse resulted. Our people were in distress. In distress they did not turn to the social group for religious or intellectual activities, nor did they turn to the political group to perfect a better political science to prevent war. In distress they turned to the commercial group demanding a return of a material standard of living. If ever the American people should have allowed the business triangle to adjust itself for the production of increased wealth it was then. A prosperous America was conservative. Now an American in economic distress turned from right to left forgetting the old American way.

(f) Strange things began to happen to our triangle of industry. The social and political groups—overhead, non-producing groups—pour criticism upon American industry. The preacher, the teacher, the politician had much to say. Distrust, class hatred, abuse, are spread by those non-producing groups upon the American industrial group, and American people in distress, turning to the left, listened to this criticism.

(g) Then follows an avalanche of reform. Politicians take charge. Increased taxes and other things hinder the natural functioning of our triangle of industry. Special privileges are created—all contrary to the best interests of 130 million American people. Under the name New Deal a rabble-rouser diet a thousand years old, is offered our people. People forget how America produced her wealth.

So, today industry strives to adjust itself to the mass of inconsistencies and restricting regulations that hamper the natural processes of production. Over the industrialist hangs threats of fine, punishment in jail, injunction, triple damages, contempt of court, &c. This is the situation in which industry finds itself.

PART III

What to Do About It

America longs for prosperity. This is a political depression. Unless the causes are removed it will remain a depression or at best we will attain only a half measure of prosperity.

Two roads lie ahead:

(1) If the American people can understand the American way and remove political causes, the greatest prosperity dreamed of will quickly result. There will be two jobs for every man. The industrial triangle will pour forth wealth for all. I hope the American people will follow this first road. It is the duty of every citizen to spread the story of The American Way so that the American people will understand it. Each must go out and tell the story to the man in the street, on the farm and in the factory. However, it is unlikely that we will follow the first road. Never have people in distress turned from the left back to the right. Then, what is the second road?

(2) If the people fail to understand and do not remove the political causes of depression, it is still possible to attain a degree of prosperity even though only half of what it might be. This is our second road. We must unite to attain the very highest degree of prosperity possible, under existing conditions.

We have forgotten that only prosperous America will be a conservative America. We have forgotten that only economic distress ever made America turn to the left. We have forgotten that only continued distress can keep America on the left. Industry and banking have been sitting idle, waiting for the old American way of free, unobstructive production to come back by itself. It never will. We have had the "cart before the horse."

Our future lies in going back to work, forcing production to the limit regardless of all regulation and obstruction until we produce enough wealth to start building a new degree of prosperity. As we push this degree of prosperity higher, America will turn from her "isms" just as fast as distress leaves the land. If we are successful, we will see America turn from left to right, tend to become conservative, to understand the old American way, to remove obstacles so that full prosperity may follow. This is our second road.

Industry accepts the challenge, renews faith in itself, surveys its obstacles, forgets criticism and undertakes to produce this higher standard of living. Industry cannot do it alone.

Capital must also accept the challenge. It must again provide a steady flow of capital esssential to industrial success. This is more necessary than ever before. The factories of America are half obsolete; go back to your workshops, capital. Forget criticism. Renew your faith in American industry. Overcome obstacles. Invent new ways to keep this flow of capital to industry. If laws hinder—get them changed. Tear up your old rule books. Forget your old methods. Focus your attention on the quality of management which is all that counts today. Back it to the limit with a steady flow of capital and we will bring about that measure of prosperity that will bring back a conservative America. *This is your challenge.*

Let me read excerpts from some editorials:

The Government has exerted all its powers to cripple the man of business. The people are taxed on everything that is nameable—yet expenditures are greater than income. There is no end to the extravagance of Congress.

This Administration is a continued series of strange events, infringement upon the Constitution, executive inter-meddling, de-rangement of the currency, executive usurpation of power, a violation of public faith, loss of confidence, enormous increase of public expenditures.

The financial condition of the country is enough to scare the average business man to death.

Those editorials were written in 1837 and 1893.

America will go forward—regardless.

Possibilities for Investment Banking "As Great as Ever" Says Prof. Marcus Nadler in Discussing Economic Situation Before I. B. A.—Notes That When Government Ceases to Supply New Securities Demand for Other Securities Will Increase—Problem of Managed Currency

"An analysis of the present economic situation of the United States reveals that the possibilities for investment banking in the country are as great as ever" said Marcus Nadler, Professor of Finance at New York University, speaking before the convention of the I. B. A. on Oct. 29, on the subject of "Some Problems Confronting Investment Banking." "Obsolescence of industrial plant and equipment is widespread in spite of the progress that has been made in the past few years," Prof. Nadler stated, and he told the bankers that "billions of dollars could be spent to increase the efficiency of American industry." "This in turn," he continued, "requires capital which cannot all be obtained through term loans, but will be obtained through the sale of securities in the open market." He also made the statement that "if one looks into the more distant future one can even see a revival of international lending in the United States." "Whether financial institutions or individuals are the chief buyers of securities makes very little difference to the economic development of the country," Prof. Nadler contended. From his address we also quote:

I personally am not for the present concerned about the huge public debt of the United States Government. It is, however, obvious to every thinking person that even the Government cannot go on indefinitely with deficits of billions of dollars each year. An improvement in business undoubtedly will bring about an increase in revenues and a decrease in relief expenditures of the Government, thereby decreasing its demands for new funds. The moment the Government ceases to supply new securities to the market, the demand for other securities will immediately increase. The outlook for business in the United States is favorable.

In the view of Prof. Nadler "the chief problem that confronts us all is under what economic and political system we are to live in the future." "The task of the investment banker in the United States is" he asserted "the same as that of the average citizen—to oppose with all the means at his disposal the foreign ideologies, be they of the Left or of the Right, from entering this country. Totalitarian governments have come to power on unrealizable promises. In totalitarian countries not only is business regimented but the entire economic, cultural and social life is under the sway of the government." "The task then of the investment banker" he added, "as well of the average man in the United States, is to see to it that we do not sell our heritage for a mess of pottage or even for $30 each Thursday." He continued: "if we preserve our form of government . . . there is every indication that the country will overcome its present difficulties, solve its problems and soon resume its economic growth."

A portion of Prof. Nadler's address had to do with "Managed Currency," and in his comments thereon he said, "tinkering with the currency has solved no economic problem. On the contrary, it has created new problems, the solution of which must be found before the world at large can return to more normal currency conditions." In full, we give his address as follows:

Economic Progress and Risk

It cannot be too often repeated that banking and credit institutions are primarily handmaidens to industry and trade organized for the purpose of facilitating production and distribution. Any change in the principles on which business rests or any change in the methods of doing business is therefore bound to have an effect on the financial institutions of the country. The money and capital markets of a country reflect not only the status of economic development, the degree of business activity and the policies of the Government but also the mood of the people. The activities of the investment banker whose function it is to bring those in need of capital in contact with those who wish to invest their savings are affected by these conditions. The business of the investment bankers, is cyclical in character; it is active in a period of prosperity and sluggish in a period of depression, and depends primarily upon the demand for capital by corporations, governments and political subdivisions. In a period of rapid economic development when new forms of transportation and communications are established, when the industrial growth of the country is rapid, investment banking is of necessity active, for the capital and savings of the country must be mobilized through the various channels in order to finance the new projects. Under such conditions some of the securities offered for sale to the public are bound to be speculative in character and to contain what is generally termed a business man's risk.

Speculation or the taking of risks goes hand in hand with economic progress. It is true that individual investors may suffer losses, but the country as a whole is bound to gain from the investment represented by new means of transportation, utilities or new factories. On the other hand, in a period when the industrial development of a country slows down, not only does the demand for capital decrese but the investor becomes more conservative, being primarily interested in safety of principal rather than in return or chances of appreciation. Securities then sought by the investor are seasoned Triple A bonds and he frowns upon anything that carries with it an element of risk.

Once such an investment policy on the part of investors becomes permanent, the economic growth of the country is slowed down. This was witnessed in France before the World War. Investors were primarily interested in the purchase of Triple A securities and, in their search for safety, the French investors placed their savings either in the obligations of their own government and, because of lack of suitable securities at home, in the obligations of allied governments which they then considered excellent credit risks. Anything with a high coupon rate was frowned upon as speculative in character. The conservative character of the French investor before the war was reflected in the slow economic development of France. In spite of its great wealth, the economic growth of the country was not as rapid as that of some of the neighboring states which had less capital at their disposal.

At present investors in the United States have adopted a very cautious attitude. Triple A securities are in great demand, whereas all other types of bonds to which there is an element of risk attached are neglected. High taxation, particularly in the upper brackets, has increased the desire for tax-exempt securities. Many a large investor under present conditions finds that he is much better off by buying a 2% tax-exempt security than an obligation yielding 5% or 6%. Restrictions imposed on the issue of new securities and the cost involved in the registration of securities further tend to reduce the supply of securities of medium-sized corporations. May one not raise the question whether this attitude is permanent and if so what effect it will have on the further economic growth of the country. If investors throughout the land, large or small, refrain from purchasing the unseasoned securities of a young industry and refuse to take a businessman's risk, where will new industries obtain needed capital and would not such a development (slow down) the economic progress of the country?

The problem before the investment banker caused by these develpoments will depend primarily on whether this is a permanent trend or merely a temporary situation. If the present developments should represent a definite trend, then it is obvious that the future economic growth of the country will be much slower than in the past; that the capital market will be less active and that the business of the investment banker will be reduced. It is, however, possible, and I share this view, that the present situation is merely a reaction from one of the greatest economic and financial depressions of the world and that sooner or later the rapid pace of economic progress which prevailed prior to 1930 will be resumed. If this is the case then obviously the outlook for the investment banker is entirely different.

Contraction in the Number of Investors

Closely connected with this problem is another change which has taken place in recent years—namely, the contraction in the number of investors in the country. During the 1920's the number of investors in the United States was very large. At the present time the number of individual investors has materially decreased and the principal buyers of securities are the financial institutions—the commercial banks, insurance companies and savings banks. This, however, is a situation not dissimilar to the one existing before the war. Commercial banks which up to a few years ago considered the making of commercial loans to industry and trade their prime function have become primarily investing institutions. Not only is the total amount of securities held by the member banks greater than the total amount of loans, but also the earnings of many banks today depend more on income derived from securities than interest on loans. The changed postition of all member banks becomes clear from a comparison of their earning assets in 1938 with those of 1928. Whereas in 1928 loans formed 53.9% of the assets of all member banks, in 1938 they were reduced to 27.4%. During the same period the percentage of securities including Government obligations to total assets increased from 23.9% to 37.7%.

The securities which banks purchase at the present time are primarily Government obligations issued through the Federal Reserve banks without the aid of investment banking institutions (eliminating, of course, the dealers in Government bonds). As conditions are at present one may assume that more and more obligations outstanding will rest on the credit of the Government. The interest bearing direct debt of the Government on Sept. 30, 1938, amounted to $37,850,000,000 as compared with $17,318,000,000 in June, 1928. The indirect or guaranteed debt of the Government amounts to $5,034,000,000. Urban and rural mortgages already rest to a large extent on Government credit, and who knows whether before many years are over, the obligations of the railroads will not be in the same position? The Government does its own financing without the assistance of the investment bankers. The more the Government enters the field of financing, private enterprise, the less the possibility for securities being offered through investment banking channels.

The insurance companies in recent years have also become large buyers of securities and the same applies to the savings banks. The type of securities which these institutions may buy is restricted to high-grade obligations so that Government obligations form a considerable portion of their holdings. This, too, has further reduced the demand for securities considered as a good businessman's investment. The investment banker today is therefore confronted with the problem whether the securities offered by him are suitable for institutional investors such as banks, savings banks, and insurance companies. Any security not suitable for institutional investors is difficult to distribute.

Capital loans: Hand in hand with the reduction in the number of investors and the growing importance of banks and insurance companies as investors, is the increased tendency on the part of these institutions to make capital loans. While in the past American banks have made loans which for all practical purposes could be considered as long-term loans, yet they were treated on the same basis as loans based on self-liquidating transactions. At the present time, however, the granting of capital loans is assuming proportions unheard of before. Insurance companies unable to find suitable investments and banks unable to find an outlet for their idle funds through the granting of short-term commercial loans, are beginning to make capital or term loans in increasing amounts. Often capital loans take the place of securities which otherwise would have been sold in the open market. A

times capital loans are made for the purpose of retiring outstanding bonds or preferred stock yielding a higher rate of interest or a higher fixed rate of dividend. The making of capital loans is only in its infancy and if present money market conditions continue for any length of time, more and more capital loans will be made by banks and insurance companies.

The change in bank examination procedure recently instituted by the Comptroller of the Currency is bound to stimulate the granting of capital loans. Whereas heretofore examiners laid emphasis primarily on the liquid character of loans, at the present time emphasis is laid on the ability of the borrower to repay. This in turn may induce a number of banks to engage in long-term loans which they would not previously have made because of fear of being criticized by the examining authorities.

The change in the eligibility provisions of the Federal Reserve Act under which almost any asset considered as sound by the Reserve authorities becomes eligible for discount, may also work toward increasing the volume of capital loans. To this should be added the fact that earnings of the banks have shown a tendency downward and that the pressure for earnings is causing an increase in the volume of term loans made by banks. This in turn may reduce the volume of new securities offered in the open market.

Since insurance companies and banks in the making of capital loans seek the best risks available and are charging rates of interest unprecedented in the history of the country, the question arises as to what effect this may have on the volume of capital issued in the market, and on the investment possibilities of the smaller institutions. If the volume of high-grade bonds offered in the market and of those already outstanding is reduced, how will the small banks scattered throughout the country meet their investment requirements, unless they are driven more and more into the field of government securities, which as stated before are sold without the aid of investment banking institutions.

The making of capital loans in large amounts by banks and insurance companies is a problem of far-reaching importance and may affect not only the capital market but also the role which banks and insurance companies play in the economic life of the country. For the investment banker to close his eyes to these developments would mean to neglect a trend which may materially influence his business in the future.

Managed Currency and Investment Banking

Managed currency is generally confused with the process of tinkering with the currency. To most people the term connotes the abandonment of the gold standard and the attempt of a government to influence the international quotation of its currency. On careful analysis of the subject, however, one will find that this part of managed currency plays but a very minor role. In the United States the dollar has been fixed at a relationship to gold since Jan. 31, 1934. The currencies of all leading countries have remained fairly stable in relationship to one another, with the exception of the brief periods of great crisis. By now it has been fully realized that mere tinkering with the currency can have but little influence on business conditions or on commodity prices. Since under present conditions the devaluation of the currency by any major country is invariably followed by similar action on the part of other countries, devaluation has ceased to be a factor of any importance in managed currency. Tinkering with the currency has solved no economic problem. On the contrary, it has created new problems, the solution of which must be found before the world at large can return to more normal currency conditions.

Generally speaking, managed currency means the utilization of the monetary and fiscal powers of a government for the purpose of influencing business conditions at home. Under it money and banking evolved for the purpose of facilitating the production and the exchange of goods cease to be the handmaidens of industry and trade and become instruments for executing the economic, fiscal and social policies of the government. Whether this change will be for the ultimate good or ill of the countries involved will depend not only on the mechanism of management but also upon the skill, wisdom and far-sightedness of the money managers. In addition managed currency, to be effective, requires not merely greater control by the government and the central bank over the money market, but also a finely knitted money market mechanism, a well coordinated banking system and close cooperation between the government, the central bank and the banking and financial institutions. Its effectiveness also depends largely upon a certain degree of cooperation between business and the government and between capital and labor. Without these prerequisites the efforts of the government to influence business conditions through monetary means merely leads to a glut in the money market, and abnormally low rates of return on gilt-edge bonds, notably of a short-term maturity.

For the purpose of the present discussion, I shall concern myself primarily with the control of the government over the money and capital markets because this has a definite bearing on investment banking. While this control by the government is not of as great importance to the investment banker as to the commercial banker, yet managed currency contains many phases which have a decided influence on the investment banking business.

Low Money Rate Policy: One of the principal foundations on which managed currency rests is the low money rate policy. Partly this was adopted in an effort to influence business conditions; partly it was undertaken in order to enable the government to finance its huge deficits at a low cost; and partly it was carried out for the purpose of enabling corporations to refund outstanding obligations carrying a higher coupon rate and to borrow at a low rate of interest.

The powers of the money managers over the money market are very great. Through the raising and lowering reserve requirements, through the sterilization and desterilization of gold, through the powers vested in the President by the Thomas amendment, and through the open-market operations and other powers of the Federal Reserve authorities, the money managers are in a position to keep money rates indefinitely low or to bring about an abrupt change at almost any time that seems desirable to them. The latter phase, in my opinion, may present a serious problem to the investment banker. In a period of low money rates the investment banker will endeavor to originate new securities or to carry out conversion operations of securities already outstanding. The rate of interest which he will fix on the new issues as well as their price will depend entirely on existing money market conditions. However, almost overnight the Board of Governors may change its credit policies and thereby completely change the outlook for the money market. Under such circumstances the investment banker who has made a definite commitment to underwrite security issues may find that the coupon rate is too low or the price too high. If the commitment is fixed, the investment banker will be forced either to carry the securities until a change in the money market has taken place or to sell the securities at a loss. That this is no mere idle threat was clearly seen in 1937. At the end of 1936 the Board of Governors announced that it would raise reserve requirements in two stages to the limit permitted by law. At the same time, the Treasury announced that it would sterilize all incoming as well as newly domestic mined gold. The banks which in February, 1937, had excess reserve balances of about $2,152,000,000 found them by the end of August, 1937, reduced to $750,000,000 and some of the New York banks were faced with a shortage of required reserves. The sharp break in prices of government securities was a clear indication that money rates might undergo a change and the entire capital market reflected the changed policy of the Board.

While the investment banker must always bear in mind that money rates may change almost overnight if so desired by the monetary authorities, yet for the immediate future there seems to be no danger of a rapid change in interest rates. It is doubtful whether the Board of Governors will change its policy as precipitously as during the past two years. In spite of the improvement in business that has taken place commodity prices, particularly those of farm products, are considered by the Board to be too low. The volume of bank loans has hardly shown any increase and one may assume that in the future the Board of Governors will be much more cautious before adopting any credit restrictive measures. While the immediate outlook is on the whole for unchanged money rates, yet the changed conditions in the money market and the increased powers of the monetary authorities over the market are factors which the investment banker must consider.

Effects of Low Money Rates: A continued policy of low money rates is a mixed blessing. While it may for the time being accelerate the volume of conversion operations and the issuance of new high grade bonds, it is bound in the long run to have adverse effects on the investment market. A continued low money rate policy reduces the saving power of those who ordinarily are large investors, be they individuals or institutions. Since the yield on high grade corporate bonds is not much higher than that on government obligations a number of investors will choose government bonds or other tax exempt securities. Furthermore, many investors believing that the present low rates of interest cannot be maintained indefinitely prefer either to invest their funds temporarily in short time obligations or keep them idle. This has created a wide discrepancy between the yield of short term and long term obligations and at the same time has caused short term interest rates to fall to an unprecedented low level.

The present low money rate policy must be regarded as an invisible tax on holders of high grade bonds as well as on savings depositors and insurance policy holders. What effect a continued low money rate policy will have on the savings habits of individuals is difficult to foretell.

The existence of huge excess reserve balances, of low money rates and of an unbalanced budget raises the question of inflation. The fear of inflation may have an adverse effect on the bond market and may prevent investors from placing their funds in fixed income bearing securities. The fact should also not be overlooked that once inflation sets in in the United States, it would have serious economic as well as social consequences. While for the time being the danger of inflation in the sense of a sharp rise of commodity prices, seems to be remote, yet in view of the conditions in the money market and the continued deficit of the Government, the potential danger must not be overlooked. The question of inflation therefore is another problem confronting the investment banker which deserves his careful attention.

Control over the Flow of Credit and Capital: Managed currency, however, implies more than merely a control over the volume and cost of credit. It also means the ability of the monetary authorities to regulate the flow of credit and capital into channels desired by the Government and to prevent the flow of capital and credit from entering channels not considered desirable by the monetary authorities. The Securities and Exchange Act gave the Board of Governors increased powers over the flow of credit into the securities market. Through its power to fix margin requirements for brokers and banks and to influence the amount of securities which an individual bank may buy, the Reserve Board is in a position to regulate the flow of bank credit into the security markets. These new powers will exercise in the long run a strong influence not only on the secondary distribution but also on the primary origination of securities.

The argument invariably presented by those who favor the control of the Government over the flow of capital is briefly as follows: The productive capacity of the country is great. What is needed is more consumption and less production of capital goods. In order to prevent overproduction it is the duty of the Government to see to it that more funds flow into channels of consumption and less into producers' goods. The undistributed profits tax, now greatly modified, was an effort in this direction. The high income taxes in the upper brackets represent another effort to divert into consumption the capital which ordinarily would have gone into producers' goods.

The efforts of governments to control the flow of capital are evident not only in the United States but also in a number of other countries, including Great Britain. To facilitate the control of capital a number of financial institutions have been established in the United States with the aid of Government funds. The Government already is the dominating factor in the mortgage field, urban as well as rural. The RFC is making loans which ordinarily would have been made at least in part by banks or would be financed through investment banking channels. Now there is a demand that the Government establish industrial mortgage banks for the purpose of providing long-term capital to those industries which have no ready access to the capital market or which cannot obtain capital loans. If this should take place it is obvious that the field of operations of the investment banker would be further narrowed.

The investment banker in contrast to the Government is not in a position to regulate the flow of capital. After all, he is merely a merchant in securities, but in contrast to the ordinary merchant he is not in a position through advertising or otherwise to educate or influence the tastes of his customers. If the investing public refuses to purchase anything but the highest grade of securities there is little that the investment banker can do. If the Government wishes to direct the flow of capital into housing, but the investing public refuses to purchase mortgage bonds, unless indirectly guaranteed by the Government, the banker is helpless. Similarly, if because of the construction of public utilities by municipalities with the aid of Government loans or subsidies, the outlook for the privately owned utilities deteriorates and investors refuse to buy their obligations or equities, the investment banker can do little to remedy the situation. In the past the investment banker acted often in the role of the entrepreneur and took the initiative in the construction of railways, factories, and in the merging of enterprises. Today this function is largely gone.

Managed currency, as already in operation in the United States and elsewhere, raises a problem of the utmost importance to the investment banker. If the Government is to direct the flow of capital it can be done either through new legislation, which will prevent the flow of capital into certain channels or through the establishment of new financail agencies by the Government which will divert the flow of capital into channels desired by it. These agencies operating with the credit of the Government or whose obligations rest on the credit of the Government are in a position to direct capital into enterprises which because of their lack of profitability, could not attract private capital. In either case the influence of the investment banker is bound to decline and the role of the Government is bound to grow.

The Outlook

From what has been said so far, one may reach the conclusion that I am pessimistic about the outlook for the investment banking business. However, stating the problem squarely does not mean a pessimistic conclusion. I, for one, cannot believe that the United States has already reached the saturation point in its economic progress. I am convinced that the standard of living in the United States is bound to increase and this implies the introduction of new machinery, of new labor-saving devices, which means the flotation of new securities by corporations. A higher standard of living can be achieved only when the efficiency of labor is high, which makes possible high wages and low prices.

An analysis of the present economic situation of the United States reveals that the possibilities for investment banking in the country are as great as ever. Obsolescence of industrial plant and equipment is widespread in spite of the progress that has been made in the past few years. Billions of dollars could be spent to increase the efficienct of American industry. This in turn requires capital which cannot all be obtained through term loans but will be obtained through the sale of securities in the open market. The public utilities are bound to expand. During 1937 a large number of our utilities operated practically at capacity. A further increase in business activity is bound to cause an expansion of utility plants and equipment. This too will require new capital obtained through the open market. The railroads have been a negligible factor in the capital market for quite some time. However, sooner or later the railroads will appear in the capital market to finance the replacement of equipment. The inventive genius of the American people has not come to an end. New inventions will be made, new industries will be established which will at least in part be financed with capital obtained in the open market. Even if one assumes that the Government will play a much greater role in the future in guiding the flow of capital into channels desired by it, and even though more and more obligations will rest on the credit of the Government which are sold by the Government directly without the aid of investment bankers, yet the demand for capital in the United States is bound to increase.

If one looks into the more distant future one can even see a revival of international lending in the United States. The world at large, as recently events have shown, is sick of wars, and the efforts to establish more peaceful conditions have met with the instant applause of all nations, democratic as well as those laboring under totalitarian governments. The United States has nearly $14,000,000,000 of gold and more gold is bound to come here. In the peaceful reconstruction of the world the United States will inevitably play an important role. Remote as this may seem at the present time, a changed political aspect in the world will also change the economic aspect and may lead to a revival of the international capital market.

Whether financial institutions or individuals are the chief buyers of securities makes very little difference to the economic development of the country. It is impossible to visualize the United States with a constant annual deficit of billions of dollars. I personally am not for the present concerned about the huge public debt of the United States Government. It is however, obvious to every thinking person that even the Government cannot go on indefinitely with deficits of billions of dollars each year. An improvement in business undoubtedly will bring about an increase in revenues and a decrease in relief expenditures of the Government, thereby decreasing its demands for new funds. The moment the Government ceases to supply new securities to the market, the demand for other securities will immediately increase. The outlook for business in the United States is favorable. Building activity has already started. Gradually capital, labor and the Government are realizing that their best interests are served through cooperation. In spite of the serious problems confronting the investment banker the outlook is favorable.

The Program for the Future: The question may be asked what should or what can the investment banker do to revive the capital market, to restore prosperity, and to raise the standard of living and increase the happiness of the American people. After all his field is limited and restricted by law. He cannot compete with the Government and he cannot swim against the tide. On careful analysis, however, one will find that the problems which confront the investment banker confront the nation as a whole and are of greater importance than merely the question of how much capital should be issued each year and under what conditions.

The chief problem that confronts us all is under what economic and political system we are to live in the future. If the trend is toward a totalitarian state which at present is making such rapid headway in the various European countries and on other continents, then the influence of the Government is bound to increase and many functions now performed by private enterprise will be performed by the Government. The investment banker in the totalitarian state is merely an instrument in the hands of the government. But this applies not only to this business but to banking in general. The totalitarian government in order to exist must have not only complete control over all international financial transactions of the country but also control over the volume and flow of credit and capital. If the trend is toward a totalitarian state, then the outlook is dark not only for the investment banker but for private business in general.

If, on the other hand, this country is to live under a democratic and capitalistic system, modified to be sure to meet the trends of the times and purified of iniquities that may exist, as we all expect it will, then the economic future of this country is bright indeed. Economic and social progress in the United States has hardly begun. There is no end to the progress that can be made in the United States. In spite of the high taxation and in spite of what many may call waste during the past few years the saving capacity of the country is still great. True savings represent the ability of a country to produce more than it consumes. Both the productive and consumption capacity of the country are far from their peak and there is still a long road to travel until this maximum has been reached, if it ever will be reached.

The task of the investment banker in the United States, therefore, is the same as that of the average citizen—to oppose with all the means at his disposal the foreign ideologies, be they of the Left or of the Right, from entering this country. Totalitarian governments have come to power on unrealizable promises. In totalitarian countries not only is business regimented but the entire economic, cultural and social life is under the sway of the government. It has the power not only to dictate to the individual where to work, what to read, what radio program to listen to, how to worship his Maker, but also to regulate his eating habits and how to spend his leisure time. But in spite of all this regimentation and the huge sacrifices made by the public, the standard of living of the people has not risen and even the most superficial comparison between the totalitarian states, be they of the Right or of the Left, with the democratic countries even with poor economic resources, will indicate that the standard of living, to say nothing of human happiness of the latter is greater than in the former. The task, then, of the investment banker as well as of the average man in the United States is to see to it that we do not sell our heritage for a mess of pottage or even for $30 each Thursday.

Each country is bound to go through a period of rapid growth and of contraction. The present period of contraction seems to be about over. In spite of the increased demand on the part of many people for support pensions and subsidies from the Government, I do not believe that the fibre of the American people has weakened. If we preserve our form of government and don't listen to the sirens from right and left, there is every indication that the country will overcome its present difficulties, solve its problems, and soon resume its economic growth. In this the investment banker necessarily will play as important a role as he played in the past.

Implications of Recent Legislation Discussed by Roscoe Pound Before I. B. A. Convention—Sees Excessive Zeal to Regulate by Rule—Cites Administrative Absolutism as Involving Taking Away of Legal Security of Liberty and Property

Roscoe Pound, former Dean of the Harvard Law School, finds that the zeal today "to regulate by rules is carried as far in one direction as zeal to leave everything unregulated was carried half a century ago." Addressing the Investment Bankers Association convention on Oct. 29 on "Some Implications of Recent Tendencies in Legislation," he said "regulation has become a fetish, as freedom from regulation was in the last century." He went on to say:

Both regulation and freedom from regulation are means toward ends. Neither is something intrinsically, absolutely good, to be carried to its potential limits for its own sake. Neither is something intrinsically absolutely bad to be utterly done away with. But the outcome of excessive regulation must be a bureaucratic control of business, presupposing it incompetent to conduct itself, directed toward an ultimate condemning of buseness not merely to regulation but to abolition.

Referring to "a type of recent legislation growing continually in volume and importance," and which he said "threatens to supersede the law over substantially its whole domain," Dean Pound stated, in part:

This type and the administrative absolutism on which is seems to depend for its functioning, and the super-administrators and super-men executives which it presupposes, come within by field of study. It is to this type and what it implies that I am inviting your attention. . . .

The implication, the presupposition of administrative absolutism, is that of every form of autocracy. Indeed, administrative bureaus and officials rather than courts have been the agents of government by autocrats wherever there has been personal as contrasted with constitutional government. . . . The administration bureau rules by right of postulated omnicompetence. It presupposed a lack of competence on the part of the rest of the community to manage their own affairs, or else that there is no such thing as their own affairs. . . . The corollary of the proposition that men are not competent to manage the details of their private affairs is that they are not competent to manage public affairs. In the end administrative absolutism must stand upon a political absolutism.

Dean Pound's address follows:

Forty years ago a speaker on such an occasion, when he was called on to speak of American institutions, at once struck a note of resounding

eulogy. As the last step in a long course of evolution of free institutions, ours were the best that man had known. We could look upon them with just pride as the culmination of enlightened progress of a free people. Thirty years ago the note had changed. A speaker on such an occasion felt bound to aggressive criticism of some details, while glorifying the principles of our institutions. He felt bound to single out certain of the details for vigorous attack and then to follow with an exposition of some single specific remedy, to be put in force at once at the next session of the legislature—very likely with the detailed draft of the necessary bill added in an appendix. This bill was guaranteed to set everything right by its intrinsic force and wisdom. Twenty years ago the note had changed once more. The speaker who conformed to the fashion of that time felt bound to utter a high and solemn note of warning. Our institutions were not only sound in principle, as we had always believed them to be; their details, in which those principles were realized, were precious possessions committed to our care to be zealously preserved from every form of question, from every project which threatened alteration or abrogation. They were beset with dangers. Heretical teachers, newcomers imbued with wrong ideas derived from the institutions of other lands, and agitators at home were undermining them. Alien ideas were being propagated. Un-American ideas were being taught, and writings were in circulation from which they were acquiring a wide currency. If these doctrines, subversive of American ideals, American political principles and American institutions were suffered to be disseminated, if they were not thoroughly stamped out, the destruction of our institutions would carry down with them all civilization in a general wreck.

Today something of all this may still be heard at times according to the occasion. But we have for the most part ceased to be alarmed about our institutions or to care what may happen to them. The dominant fashionable note just now is one of change. Everything has changed. All that we had learned in five generations of political and economic and legal experience has become obsolete. The inventive skill, the resourcefulness in business device on which we had prided ourselves, as ceased to be significant. If we are still to adhere to democracy, we must preserve democracy by building all our institutions anew. The very nature of our people, if not indeed of all mankind, has changed. What had been deemed virtues are but discarded Victorian inhibitions. What had been thought individual rights are but outmoded claims which can no longer be admitted. What had been regarded as constitutional guaranties are at most pious exhortations. They had often been misused by reactionary judges who took seriously what were mere verbal formulas, not to be accorded a fictitious weight because they happened to be announced in the text of the Constitution or to have been supposedly settled by a long course of judicial decision. Mere words, wherever they may be found, are not to be allowed to stand in the way of administrative leadership toward new goals.

Perhaps this fashion may in time prove to have been as transient as were its forerunners. But I am not here to urge return to any of those fashions of the past. Nor am I here to spread the gospel of some new fashion. I am not here to urge a return to the economic ideas of the last century nor to call for repeal of the laws which have been put upon our statute book in the past 40 years. I am not presenting some ambitious plan to remedy all the abuses of our political and economic life by a great act of legislation to be introduced in the appropriate legislative body next January. I am not here obeying a call to prophesy or to warn. But much less am I inclined to admit that in the present decade in the twinkling of an eye we were all changed; that there was over night a complete breach of historical continuity; that all need of constitutional guarantees and checks and balances suddenly ceased and an era of enlightened executive administrative omnicompetence supervened out of a clear sky. What I shall essay is a more humble role of diagnostician. I shall ask what are the implications, or perhaps better, what are the presuppositions, of recent legislation, State and Federal, which reflects in action the fashionable mode of thought of the moment as to economic, political and legal institutions.

Certain ideas had been developed in our polity through experience developed by reason and reason tested by experience. One of the chief of these ideas was the idea of balance. No doubt this is a hard idea to keep in mind in an age of rush and hurry and manifold distractions. Anyone other than a skilled juggler finds it difficult to keep two balls in the air continuously at the same time. On the same principle it is difficult to keep in mind more than one idea at a time. Yet to understand our Government one must do this. Indeed, this idea of balance is inseparable from a well-ordered society. At least in the English-speaking world we must have a balance between stability and change, between the general security and the individual life, between society and the individual, between regimented cooperation and free individual initiative and activity, between Nation and State, between State and neighborhood, between legislative and executive and judiciary. It was the need of such balances, in the bad political and economic conditions following the Revolution, which compelled the drawing up and adoption of the Constitution. It is the achievement of these balances which has made it possible to govern a whole continent by one political organization for a century and a half, marked by expansion in area and in population beyond what the framers could have conceived, by internal conflict and civil war, and by profound changes both in the make-up of the population and in social and economic conditions.

It is a mistake to think of balance as an obsolete idea of the eighteenth century. It is a mistake to think it something belonging only to a past era of small, simple things. The bigger, the more complex a society, the more and more complex the relations of groups and associations calling for a weighing and valuing of their claims, the more complicated becomes the task of adjusting their conflicting and overlapping interests and clashing activities. Hence men are driven to an omnicompetent state, to a superman leader, to an administrative absolutism unless they can maintain a system of balance. Otherwise there is an anarchy of struggling interests in which the offhand adjustments for the time being take the form of giving in to the more ruthless or more insistent or more unreasonable.

It is no more possible to cure all the ills which are incident to the conduct of business in a big country, in an age of big things, in a complex social and economic order, by a regime of complete administrative regulation than by one of complete legislation, covering all the details of conduct with detailed rules, or by one of complete absence of regulation and unrestrained private individual initiative.

Another idea which had held a chief place in the polity of English-speaking peoples was that one will was not to be subjected arbitrarily to the will of another. More specifically the idea was that no one was to be subject to arbitrary action of those who wielded the power of politically organized society. As the great preacher of the Pilgrims put it, we were to be with one another, not over one another. This was the idea behind our bills of rights and behind the doctrine our legal historians have been calling "the supremacy of the law"; a doctrine once thought to be the birthright of the American but now sneered at frequently by young lawyers newly appointed to give counsel to administrative bureaus and imbued with the idea of the supremacy of the bureau.

Still another idea which had governed our polity was distribution rather than centralization of the powers of government. This was an application of the idea of balance. It was an idea of parceling out of authority among coordinate agencies of government, defining the limits of the power conferred upon each distributee, and keeping each within those limits by rules of law judicially declared and administered. In the last century we thought of this distribution of powers as something involved in the very idea of freedom. Today it is scouted as something belonging to the slow going days of the past and is disappearing before a tendency to give bureaus and boards and commissions all the powers of government without limitation or reservation.

All of these ideas run back to a fundamental idea of freedom or liberty, an idea which has not merely ceased to be entertained in advanced and self-styled liberal circles but has become distinctly unfashionable if not wholly repudiated. Cicero said we were slaves of the law in order that we might be free. Today we are to be the slaves of administrative officials in order that we may preserve democracy by committing demos to the rule of unchecked or merely self-checked discretion. The giving up of what had been the basic ideas of our polity and of the fundamental idea on which they rested, if indeed we mean consciously and seriously to give them up, is so radical a departure as to justify the new faith in the gospel of change. The shifting from an idea of a free people to one of a people divided into two classes, one of tribute payers and one of pensioners of a regime of bureaus controlled ultimately and absolutely by one exalted ruler, quite justifies those who hold that a new era is at hand and that the break with our past is complete and irrevocable.

Undoubtedly, in common with the rest of the world, we in the United States carried the idea of liberty and its corollaries much too far in the latter part of the last century and in the immediate past. The conception of having everyone free to do as he liked with no more restraint than was essential to enable other men to do as they liked, so far as these two could be reconciled by a universal law was excellently adapted to the pioneer conditions of our formative era. Carried to an extreme, as the one thing to be regarded in an urban industrial society, it obviously left interests of the first moment unprovided for or inadequately provided for. So, too, we carried too far the idea of checks upon the exercise of governmental authority and overworked the machinery of judicial review of governmental action with reference to constitutional limitations. When I came to the bar in 1890 almost every item of executive or administrative action as a matter of course encountered an injunction. But a reaction had begun a decade before. About 1880 there are signs of a shifting of the judicial view as to what is exclusively judicial, and at the end of that decade the setting up of the Interstate Commerce Commission marks the beginning of a rise of administrative justice which has gone on by leaps and bounds in the twentieth century, and especially in the current decade. This reaction was inevitable. But Spencer tells us that action and reaction are equal and in opposite directions, and that general philosophical proposition has been demonstrated abundantly in the present connection. As we were going much too far in one direction 50 years ago, we feel bound to go too far to the same extent in the opposite direction today.

From the idea that all things will inevitably work themselves out by experience, and that planning and creative lawmaking are futile, an idea generally received in that latter part of the nineteenth century, we have been going to the other extreme of an idea that nothing will work out by experience but that all things must of necessity be planned by legal or political or economic or social super-experts and cannot with safety be left to any but a governmental process of trial and error. From an idea of the individual as a self-sufficient economic unit, we have been swinging to the opposite extreme of an idea of the complete interdependence of individuals, to be promoted by dependence upon the National Government. The old doctrine of the king as father of this country has been newly interpreted. The Government is thought of as an anxious mother directing the nurse to go upstairs and see what Tommy is doing and tell him not to do it. From an extreme of jealousy of administration and hampering of it by judicial scrutiny and tying up of every important administrative act by injunction, we have been going to a no less extreme confidence in administrative agencies. Almost every activity has been put under the control of some one of them, and that control tends constantly to increase, to be relieved of legal limitations, and to be freed from effective judicial review. Along with this there has sprung up a growing belief in administration as something above and beyond law, as something good in itself to be cultivated for its own sake; a type of doctrine which I have been calling administrative absolutism.

Behind this doctrine of administrative absolutism is Karl Marx's doctrine of the disappearance of law. As Marx saw it, law will disappear with the abolition of private property. The legal ordering of society results from the division of society into classes—that is, into those who exploit and those who are exploited. It is no more than a device of those who exploit

to keep those whom they exploit in subjection. Hence when classes disappear in a communist organization of society, law, too, will came to an end. "Communism," says a Russian exponent of this doctrine, "means the triumph of socialism over law, for law will wholly disappear with the abolition of classes and their opposing interests." The conditions that have made for the development of law in social relations are created by capitalism.

In the Constitution, liberty and property are coupled in one guarantee, the guarantee of due process of law; and behind that guarantee is law—the Constitution as the supreme law of the land. The Marxian doctrine which rejects law rejects it because it secures liberty and property, neither of which belong in the communist polity. The rejection of liberty by the exponents of administrative absolutism is avowed. The rejection of property goes with it in effect, whether avowed or not. In the words of a German publicist, an exponent of extreme ideas of authority, words adopted by a Russian exponent of the communist polity as it stood before the recent shift toward the right, in the ideal State there is to be no law and but one rule of law, namely, that there are no laws but only administrative ordinances and orders.

At bottom, then, administrative absolutism involves taking away the legal security of liberty and property. But while it is taking its time to reach the goal toward which it moves, certain other implications or presuppositions require consideration. One upon which its adherents lay much stress is the assumption of administrative expertness. The business man, the industrialist, the judge are all blunderer. They are to be subjected to enlightened guidance of an expert, either a board or bureau of experts or an expert employed by a board or bureau. Thus the conduct of enterprises will conform to an enlightened public interest as revealed to the expert by the nature of his office. For it is to be noted that the expertness is a purely *ex officio* expertness. The administrative official or agent is not appointed because he is an expert. He is an expert because he has been appointed to be one. We are told continually that we must look at the problems of administration realistically and that the failure of courts to take a realistic view is the justification of putting administrative determinations beyond the reach of judicial review. But if we look at the realities of administration and adjudication, there is not, there has never been, there is not likely to be any such uniform guarantee of the training of administrative officials and their agents and subordinates for their tasks as there is in the case of judges taken from the bar. At the battle of Balaclava, Lord Cardigan held that he was qualified to command a brigade of cavalry in battle because, although he had only a barrack yard experience, he held, in the days when commissions were purchasable, the Queen's commission as a general. The famous charge of the Light Brigade was not the only mistake of an *ex officio* expert on that occasion.

Again, administrative absolutism presupposes that administrative boards and commissions and agencies can be trusted to determine rights without the checks which obtain in the judicial process. It presupposes that fair, objective, reasoned administrative determinations are assured by the administrative hunch or expertness, without any of the checks which operate to assure fairness and objectivity and reason in judicial decision. It is assumed that the courts, with all the checks of law, of training of the judges, of public records of what is done, of review of the action of the single judge by a bench of judges, and of professional and academic scrutiny and criticism of what they do, cannot be expected to and are inherently unable to reach objective results. For a leading exponent of administrative absolutism, who now holds a high administrative office, with *jus vitae necisque* over private enterprise, is likewise in the science of law an exponent of a doctrine of psychological determinism. He has asserted, in effect, that every item of the judicial process is shaped wholly and inexorably by the psychological determinants of the individual judge. These determinants are largely undiscoverable and hence judicial action is only in appearance and in pretence uniform and predictable. Such a theory of law in the hands of an official empowered to apply law of his own making in his own way speaks for itself. But it is another presupposition of administrative absolutism that a reasonable adjustment of relations and regulation of conduct may be attained by putting the guiding and regulating agency in the position of a party to controversial situations, like the man who intervenes in a brawl, not to stop the fight but to go in and take part in it on the side of one of the combatants. Many examples might be cited. But one familiar to you is the Securities and Exchange Commission becoming a party to all important reorganizations, as provided in the Lea bill.

When lawyers show themselves skeptical as to the possibilities of administrative absolutism under our polity they are commonly told that they are seeking to exclude all discretion from the process of determining rights and adjusting relations and regulating conduct, and are seeking return to an old idea of governing all things by rigid rules, mechanically applied, which was given up long ago. But everything depends upon what is meant by "discretion." The lawyer things of a discretion held by law to the limits of the rule which commits some judicial action to the judge's personal sense of what is right. He thinks of what he calls a judicial, as distinguished from a personal discretion, a discretion governed by principles. He thinks of a discretion subject to be reviewed in case of abuse, and so held in check by knowledge that if a genuine judgment is not exercised in a reasonable way the action under the guise of discretion will be set aside.

Let me be understood. I am not attacking administration. I am seeking to understand the implications and presuppositions of the administrative absolution toward which so much of recent legislation is tending. Administration must play a large part in any polity under the social and economic conditions of today. It would be idle to argue for any such restrictions of the administrative process as prevailed with us in the last half of the nineteenth century. The demands of an expanding law of public utilities, the requirements of modern social legislation, which called for speedy and sure enforcement and especially for inspection and supervision, and the need of guidance of enterprise before and at the crisis of choice of paths or devices, instead of requiring a guess as to the legally permissible course and judging of the correctness of the guess after the event—all these things brought about a rapid and in some connections extreme development of administrative agencies. They helped to produce the chaotic condition of boards and tribunals and agencies with different powers, subject to different modes of review, relieved of review in varying degrees; some with almost judicial traditions, at the other extreme some with no traditions and growing disinclination to hear both sides if possible to avoid it; some with powers of legislation, administration, and adjudication so far as it is possible to confer them and get by the courts; some with power and practice of acting as an investigating and accusing body, of advocacy at the hearings before themselves, with adjudication upon their own accusations, and of executing their own decrees—in short, the welter from which many scholars, under the influence of ideas imported from Europe, seek escape through administrative absolutism. But no such drastic departure from our constitutional institutions is needed to bring about what administrative agencies were needed to achieve. Our judicial organization was set up for pioneer communities in which little or no administration was needed. Our legal procedure, inherited from eighteenth-century England, and adapted to the rural, agricultural America of our formative era, was not at once equal to the task of applying our traditional doctrine of the supremacy of the law to rapidly multiplying new administrative agencies. Not a little friction and waste resulted while administrative agencies were finding themselves and the courts were struggling to apply constitutional and legal limitations under an inadequate organization and procedure.

But, we shall be told, why not take a realistic view? These administrative agencies are with us, they are busy at work on every side. They have far more control over actual human relations and actual conduct of enterprise than the courts. They are tending to be the paramount agency of social control in our polity just as they are emphatically the paramount agency in Continental Europe. Why not acknowledge this and give up kicking against the pricks? To the lawyer the reasons for standing out against the tide of administrative absolutism are to be found not only in the presuppositions of the regime but in certain characteristics which, as he reads the reports of cases in which courts in every part of the English-speaking world have been called on to review administrative action, seem to be universal.

One of these characteristics is a bureaucratic disregard of the maxim "hear the other side." Even when the statute setting up an administrative agency expressly requires a hearing it has happened frequently that the bureau or commission has acted without any hearing of interested parties and without any real findings of fact. This tendency has appeared in England and in Australia as well as with us. Again, there has been both with us and an England a marked tendency to decide on the basis of matters not before the administrative tribunal; to act on evidence not produced, or on secret reports of inspectors or examiners with no guarantee of a complete or impartial inspection or examination. There has even been a tendency to act on second-hand statements of general repute, opinion and gossip, sometimes traceable to preparation in advance by one of the parties, without opportunity to the party adversely affected to cross-examine the sources of opinion. This sort of thing is especially manifest in connection with a tendency to make determinations on the basis of pre-formed opinions and prejudices. A bureau easily comes to consider the administrative determining function one of acting rather than of deciding. It easily comes to apply to the determining function the methods of the directing function. Administrative agencies are peculiarly subject to political pressure and thus tend to do what "will get by" at the expense of the law. Where they have rule-making powers, they operate under none of the checks that obtain in the case of legislative law-making. There is as like as not no notice to the affected parties till the rule is made. When there is a hearing it is not unlikely to be merely to comply in form with statutory requirements, the rule having been prapered before the hearing instead of growing out of it. It has even happened that a prosecution for violation of an administrative rule has gone to the highest court of the land before it was discovered that the rule on which the administrative agency called for prosecution had no existence. Moreover, administrative rule-making, as was brought out more than once under administrative enforcement of the National Prohibition Act, has a tendency to the making of arbitrary rules for bureau convenience at the expense of important interests.

But what most troubles the lawyer is the union of rule-making, investigation, advocacy, and adjudication in one bureau and not infrequently in practice in one person. This is supposed to be required for efficiency. There was much experience of this under prohibition. The zeal to get results at whatever cost was not the least of the features of that regime that brought the administration of the law into disrepute and disfavor. The same phenomenon may be seen in the parole boards in more than one jurisdiction. The inability of those interested to find out what the rules are or what rules are the basis of action, the large powers confided to the boards and the arbitrary exercise of them have brought on violent prison outbreaks more than once and in more than one jurisdiction.

Another feature of administrative absolutism which troubles the lawyer is the exercise of jurisdiction by deputies. Administrative determination of appeals from the action of administrative subordinates is frequently a one-man review, it may even be a review by a secretary of the official with reviewing jurisdiction, or a rubber stamp review of the action of subordinates by those subordinates themselves. Judicial review is review by a bench of judges and there is no such thing as a judge exercising his reviewing authority in any other way than in person.

I have spoken of administrative determinations. But when we turn to administrative guidance, the primary function of administration, we find phenomena which are equally disturbing. One is a tendency to force theories upon those subject to administrative regulation. Those who for the time being shape the policies of administrative bureaus compel indirectly by denial of the facilities of the mails or of interstate commerce a molding of the conduct of enterprises or of business to the patterns fashionable for the moment with the "experts" of the bureau—often doctrinaire theories with no experience behind them. In the same way legislation may impose punitive taxation to enforce a theory upon enterprise where acceptance of it would not be compelled directly. How far this may go is illustrated by the Maloney bill in which it is proposed to license all corporations that can be reached under the powers of the Federal Government. That this would subject every corporation of much consequence to regulation by a national as well as a State master is obvious. That much regulation is indicated for many situations in corporate management is clear enough. But subjection of corporate business to bureau control, under the conditions of today means subjection substantially of all business to such control, since all businesses of much significance transcend State lines. To commit the whole business of the country to the control of a bureau at Washington, in view of the tendency of administrative bureaus to disregard jurisdictional limits, to seek to extend continually the sphere of their action, and to push their regulatory powers to the limit, is something that should give us pause. Is there anything in experience of bureaucratic management to indicate that it will prove better than a legally controlled private management? But in a widely held current view as to legislation and administration, experience in our past is an irrelevant consideration.

What needs to be thought of in connection with bureau control of all business and legislative indirect control by punitive taxation is the implication that there is need of remodeling the social order at once and that it is the task of the Federal Government to carry out this remodeling. If we are sure of this the question still remains whether the details of the task are wisely committed to subordinates in administrative bureaus instead of being formulated directly by legislative law-making. For as the legislative setting up of administrative agencies goes on, there is want of any consistent system of regulation. Indeed, the tendency to administrative absolutism leads to such want of system. From that standpoint there is no objection to requiring practices of private business to which govern-

ment business competition is not subjected. When regulation is simply the application of arbitrary will, without the check of constitutional or legal limitations judicially enforced, the Government may demand that business recognize and adhere to what are pronounced fair business practices, while it violates them all as it may choose. It may insist, for example, upon a theory of "full disclosure" as applied to private business operations and yet adopt practices in contravention of that theory. It may compete with private business without being subject to legal rules or standards of fair competition. That the presupposition of all this is that private business is something which is to disappear in the administrative remodeling of the social order does not disturb the advocate of administrative absolutism. But are the American people prepared to admit that presupposition? Much could be overlooked in the necessarily crude beginnings of administration in a land where it had been unknown on any large scale. But administrative regulation is now old enough in the United States to know what it is doing and why it is doing it.

The *bete noir* of the proponents of administrative absolutism is judicial review enforcing the constitutional guarantee of due process of law. There is constant pressure by administrative bureaus upon legislative bodies to tie down review so as to make it practically ineffective or to do away with it altogether. As the latter course is not constitutionally admissible, the plan of the moment is to evade the Constitution by making an apparent concession to it in setting up an administrative appellate tribunal permitting administration to review itself. The purpose of administrative bureaus are too high for judicial consideration according to the narrow standards of the law. The methods of carrying out those purposes must be determined by the purposes themselves and not tide down by such legalistic ideas as hearing both sides, acting upon evidence, or basing determinations on definite findings of fact. Without effective provisions for a record as the basis of review the review by an administrative appellate court cannot achieve the purposes of review as a check upon administrative action. If the tribunal is to be a real court, it will be no more acceptable to the advocates of administrative absolutism than the ordinary courts, and it will merely multiply courts in a time of judicial organization calling for unification and simplification rather than for adding new tribunals. If it is not to be a real court, the whole purpose of review of administrative action is given up.

Moreover, we must note that we are coming to administrative dictation, to bureau dictation, in place of the regulation and guidance with which we started. Take, for instance, the Barkley bill with its "approval theory" as compared with the "full disclosure" theory of the law establishing the Securities and Exchange Commission. Excessive administrative rule-making, not merely sanctioned but invited by legislation, takes the place of the excessive legislative law-making so much complained of a generation ago. If the time of what was called the "rain of law," the idea was that the words "Be it enacted" justified every thing that followed. Legislative over-prescribing of detail, of which the New York Code of Civil Procedure, running to over 3,000 sections, was the classical example, has been given up. But its place has been taken by administrative rule-making after the same pattern, and legislation goes on giving the widest powers of such delegated law-making. You will think at once of the detailed provisions in both the Lea and the Barkley bills in which there is an attempt, through elaborate definitions, to eliminate all improper or collusive relations with the matters to be determined. Such definitions have never succeeded in achieving the results expected of them. Nor are such methods in themselves preventive. Administrative rule-making on this model is very common.

Today zeal to regulate by rules is carried as far in one direction as zeal to leave everything unregulated was carried half a century ago. Regulation has become fetish as freedom from regulation was in the last century. Both regulation and freedom from regulation are means toward ends. Neither is something intrinsically absolutely good, to be carried to its potential limits for its own sake. Neither is something intrinsically absolutely bad, to be utterly done away with. But the outcome of excessive regulation must be a bureaucratic control of business, presupposing it incompetent to conduct itself, directed toward an ultimate condemning of business not merely to regulation but to abolition.

It is not mere toryism to protest against institutional waste. It is as reprehensible as any form of irreparable waste. To look only at our own country, the deprofessionalizing of the professions, on the basis of doctrinaire false democracy, which went on at the beginning of the nineteenth century, was a bit of needless waste which we only began to repair after a hundred years, but which has bad results in the administration of justice today in every large city in the land. The complete decentralization of banking under Andrew Jackson was another bit of waste, which has given us banking crises at regular intervals, while in the rest of the world the banks stand firm under economic depressions. After 100 years this waste is far from repaired. Schemes for remaking the social order by substituting State capitalism for the free capitalistic system of the past, whether consciously planned or unconsciously involved in the drift of administrative absolutism and bureau dictatorship, are likely to do no more than bring about like institutional waste. Economic institutions are not the least important of the institutions of civilized society.

My field is law. The recent legislation which appeals to me for study is that which has to do with the adjustment of human relations and ordering of human conduct which had been supposed to be the domain of the law. With another type of recent legislation, which involves piling up of a huge public debt with no apparent limit and no provision for paying it, with reckless expenditure, subsidies, lavish distribution of the proceeds of taxation through all manner of projects whereby a permanent body of dependents on public employment is created, I have no special competence to speak. But a type of recent legislation, growing continually in volume and importance, threatens to supersede the law over substantially its whole domain. This type, and the administrative absolutism on which it seems to depend for its functioning, and the super-administrators and super-men executives which it presupposes come within my field of study. It is to this type and what it implies that I am inviting your attention.

It is a common device of the adherents and proponents of administrative absolutism to set up a straw man, label it with the name of those who question their doctrines, and proceed vigorously to belabor that straw man. If one challenges administrative justice, administrative law-making, administrative investigation, administrative advocacy before itself, and administrative dictation of its theories for the moment, concentrated in one bureau or one man, he is a reactionary. He does not believe in any regulation of the conduct of enterprises. He seeks to return to the regime of *laissez faire*. He would hamper administration by subjecting it to the legal and judicial straitjacket which was imposed on it 50 years ago. A modern, simple, speedy, inexpensive mode of judicial review of administrative determination and rule-making, along lines now well understood in the reform of legal procedure which has gone on steadily for the past 30 years, would preserve the substance of the guarantees of the Constitution, and leave administration free to do its real work within constitutional limits. There is nothing reactionary in such a proposition. It is in the line of progress of our administrative law upon American principles.

The implication, the presupposition of administrative absolutism is that of every form of autocracy. Indeed, administrative bureaus and officials rather than courts have been the agents of government by autocrats wherever there has been personal as contrasted with constitutional government. The Roman emperor was set up as a god. Who could presume to match his wisdom against that of a god? The autocratic king of the seventeenth and eighteenth centuries centralized monarchs ruled by divine right. What were individual rights against right derived from God? The administrative bureau rules by right of postulated omnicompetence. It presupposed a lack of competence on the part of the rest of the community to manage their own affairs, or else that there is no such thing as their own affairs. What is individual experience or intelligence or resource to match against the omnicompetence of an administrative bureau (and the delegated omnicompetence of one of its clerks or inspectors or investigators) chartered to do what it likes in each case looked upon as unique? To complete the regime there is needed only a Duce or Fuhrer or super-man head administrator to direct all of these sub-supermen in a common path. The corollary of the proposition that men are not competent to manage the details of their private affairs is that they are not competent to manage public affairs. In the end administrative absolutism must stand upon a political absolutism.

Jean C. Witter, Following Election as President of Investment Bankers Association, Pledges Assistance in Establishment of Over-Counter Regulation —Says Aim Is to Work with SEC and All Regulatory Bodies

At the concluding session of its annual convention, on Oct. 29, at White Sulphur Springs, the members of the Investment Bankers Association of America elected Jean C. Witter, of Dean Witter & Co., San Francisco, as President for the coming year, succeeding Francis E. Frothingham, of Coffin & Burr, Inc., Boston. Mr. Witter, with his induction as President, in commenting on the important work ahead of the Association, declared that "our number one job is to revive the investment banking business . . . for the benefit of everyone in the country." "Since a resumption of new capital financing," he said, "is so close to the crux of our biggest national problem, everyone must be interested in seeing that there is new financing." The first item which he proposed for the Association's 1938-39 schedule was cooperation with the Securities and Exchange Commission "in carrying out the objectives of the securities legislation it is obliged to administer." As to other matters of vital importance warranting the Association's attention Mr. Witter cited Federal taxation, railroad legislation, &c. His address follows:

Mr. Frothingham, Ladies and Gentlemen of the Convention:

I am grateful for the friendship and confidence you have evidenced in electing me to this high office. It is a great honor and privilege to be your President. I am also keenly aware of the obligations and responsibilities the position involves, and I will do my best to justify your confidence. I plan to make Investment Bankers Association affairs my first order of business, and am prepared to dedicate the next year of my life to its activities and to the welfare of the investment banking business. An active year is anticipated, but an interesting and pleasant one.

In undertaking this difficult assignment I have the good fortune of being supported by a splendid Board of Governors. The spirit of helpfulness and cooperation which characterizes our entire membership was recently impressed upon me. When I asked various Governors and other outstanding men in our Association to serve as chairmen of our national committees, I did not have a single declination. This wholehearted response clearly indicates the serious attitude our members have toward the work of this Association.

It was in the fall of 1922, at the convention at Del Monte, Calif., that I first became interested in the I. B. A., and for two reasons: One, its fine objectives and high standard of ethics; the other, the friendly relationships among its members. Many friendships started then have continued through the years.

Seventeen men devoted to the I .B. A. have served as Presidents since that time. Each of them, in turn, has done his full part of handling current problems before the Association, and all have helped to develop a friendliness among our members which I am sure does not exist to such a high degree in any other industry.

And now I should like to comment briefly on our program for next year. The Association has important work ahead of it. We have a great opportunity to make this Association more useful and valuable not only to its membership but to the country. We aim to make it serve the interests of the entire investment banking business to the utmost. Only a few of the score of objectives can be touched upon.

Our number one job is to revive the investment banking business, not alone for the benefit of us in the business, but for the benefit of everyone in the country—the working man, the farmer, the business man, the man on relief. New financing is the forerunner of new jobs and the cure of unemployment, which is certainly the number one national problem.

Let us be realistic about this. Since a resumption of new capital financing is so close to the crux of our biggest national problem, everyone must be interested in seeing that there is new financing. It might be well, therefore, to make sure that we are not working at cross purposes with others who are just as eager as we are to get the machinery of new financing started.

Particularly we must see that we are not at cross purposes with the Securities and Exchange Commission. We aim to work with all regulatory bodies, both State and Federal, to the end that the public may be fully protected and with the least possible inconvenience and cost. This is a common objective. Only as to the best method of accomplishing this can there be any difference of opinion, and by frank discussion and exchange of views much can be gained. We all want "full disclosure" and "fair practice."

We have pledged every assistance in the establishment of over-the-counter market regulation. From its very inception as "The Code of Fair Competition for Investment Bankers," under the National Recovery Administration, to its present form as the Maloney Amendments to the Securities Exchange Act of 1934, the principle of self-regulation has always had the support of this Association.

So I should like to put down as the first item of our schedule for 1938-39: Work with the SEC in carrying out the objectives of the securities legislation it is obligated to administer.

Other matters of vital importance to our membership which warrant our earnest attention include segregation, over-the-counter rules, Federal taxation, private placement, railroad legislation, intermediate credit banks, investment company legislation, trust indenture and reorganization legislation and "ratings" as a criterion of the eligibility of bonds for bank investment. Many of them bear directly on this problem of reopening the capital market.

Some of these problems will be assigned to special committees. Many of them will be referred to a new committee to be known as the Federal Legislation Committee. John K. Starkweather of New York will be the Chairman of this committee. Arthur G. Davis, of our staff, who has worked so capably on our State legislative matters for so many years, will actively assist Mr. Starkweather and his committee.

The number two job is to explain the investment banking business to the American people. The investment banking business and the people in the business have been greatly misunderstood and maligned. I think there is a great opportunity for the Association to place our business on such a high plane that it will command the respect of every thinking person in the country. All that is needed is to make the function of the business clear and to point out how indispensable the business is to the country in providing (a) capital to growing industries; (b) investments for institutions and investors alike; (c) employment for labor through the expenditure of capital thus provided. The renewal of activities of the investment banking business means the elimination of countless thousands from relief payrolls.

As to public relations and Group activities, we have extensive plans for providing our membership with a better understanding of the work of our Association, both nationally and in the Groups. It has always been my feeling that every member of the I. B. A. has been getting a lot of his money through the Groups alone; in fact, that the work of the Group legislation committees, in itself, is value received for annual dues. Splendid goodwill exists between our Association and State officers and legislators. This cordial relationship we prize highly. I am sure that no single firm or individual could have attained it working alone.

During the ensuing year our Education Committee plans to extend its activities markedly. The committee, headed by Francis F. Patton of Chicago, includes the chairmen of our 18 Group Education Committees and five experts of public relations, appointed from among our members. Assisting Mr. Patton and his committee will be David Dillman, our Educational Director.

Our magazine, "Investment Banking," under the editorship of Mr. Dillman, has been greatly improved. Messrs. Patton and Dillman have full leeway to improve it further. Supplementing the magazine, their plans call for a "President's Letter," to be issued as occasion warrants, to keep our members currently informed as to what is going on.

It is of first importance that our membership be well informed, but we also intend to include the public in our educational program. To accomplish this our National Education Committee will develop articles and speeches for use by our Group Education Committee in reaching back into the country through the press and through speakers appearing before educational groups, luncheon clubs and other gatherings in the small as well as the larger communities. With the drive and direction of the National Education Committee, it is felt that our 18 Group Education Committees, with speakers from the ranks of our own membership, can do more toward developing a public understanding of our business than would be accomplished by the employment of a dozen professional speakers.

Emmett F. Connely of Detroit, who is to be Chairman of our Group Chairmen's Committee, will play a leading part in developing our program with the Groups.

Mr. Connely, Mr. Patton, John S. Clark of Cleveland, who is to be Chairman of our Municipal Securities Committee, Jay N. Whipple of Chicago, Chairman of our State Legislation Committee, and I, together with members of our staff, plan to make Group visits. Prior to the visits definite plans for forums, gatherings and other activities will be programmed. In this manner our membership can become familiar with the objectives of the National Association and, in turn, we can learn directly of Group problems, and through full discussion help to work them out. These visits are intended to give the President and his staff better first-hand acquaintance with the membership and their problems and lay the foundation for a more complete understanding among ourselves and with the public.

The phrase "spending other people's money" is familiar to all of us. It is true that our Association is spending its members' money and, therefore, that economy should be the watchword. The I. B. A. should be run just as economically as one would run his own business. Certain substantial economies have already been accomplished. In addition, we are not going to employ an expensive assistant to the President, as has been authorized. Instead, the committee chairmen and I, making full use of the I. B. A. staff, and with your help and cooperation, will undertake to do everything that a new paid man could do. Furthermore, I am also a believer in full disclosure, and while our Year Book discloses the income and expenditures of the Association, I plan, through the President's Letter, to bring this information directly to the attention of each member so that all may know what our expenses are in detail.

I have one wish to express before concluding these remarks. Having had my first contact with the Investment Bankers Association at Del Monte, it would make me very happy to pass this gavel to my successor at that same delightful place. It is, therefore, my hope that the Place of Convention Committee will today, at the first meeting of the new Board, recommend Del Monte, Calif., for our 1939 convention. I look forward to welcoming you there a year hence. Meantime, you can reach me at the San Francisco or New York office of our firm, and I will welcome hearing from each of you at any time on any subject.

One of the most pleasant acts I am privileged to perform, and the first officially, is to express to you, Mr. Frothingham, our profound gratitude for the untiring and devoted service you have rendered the Investment Bankers Association during a period when strength of character was indispensable. Every one of us who has worked with you admires and respects your unswerving, high-minded attitude toward all matters concerning the public interest. I hope that this Past President's badge will always serve to remind you that investment bankers feel deeply indebted to you for the faithful service you have so ably performed.

Really Forgotten Man "Inarticulate Railroad Investor," Says Report of Railroad Securities Committee of I. B. A. Under Chairmanship of Edward H. Leslie—As Solution of Railroad Problem Advocates Law Which Would Make Railway Express Agency Truck Subsidiary for All Carriers—Also Favors Contracts with Shippers on "Agreed Charge" Basis—More Effective Organization of Security Holders Urged

In its report dealing with the railroad problem, the Railroad Securities Committee of the Investment Bankers Association suggested several proposals to remedy the present predicament of the railroads in outlining "legislative measures which appear most desirable," as the basis for discussion when Congress convenes. The committee, of which its Chairman is Edward H. Leslie of Wood, Struthers, & Co., New York, suggested as a remedy for the disintegration of the rate structure that the railroads of this country be permitted to adopt a rule of rate making which, it says, has been in successful operation in France, Australia and England, and has been approved by Canada with certain modifications. This theory of rate making, says the report, is usually referred to as the "agreed charge" and "in principle consists simply of a special rate granted by the carrier in return for a specified amount of the shipper's business."

With respect to truck competition, the report points out that problems incident thereto "can be solved only in part by coordinating truck with rail service." The Railway Express Service, the report notes, "is a logical development in truck and railroad coordination," and the committee asked, "What more logical development than that the railroads use the Railway Express Agency as the nucleus for owning and operating all their various trucking services."

It added that "the drafting of a law which would make the Railway Express Agency the truck subsidiary for all of the carriers is a thought deserving of the most careful consideration." The report went on to say:

A start in this direction might be made by giving the Railway Express Agency, or its present interstate trucking subsidiary, Railway Express Motor Transport, Inc., a certificate of public convenience and necessity to operate in interstate commerce in all parts of the country. A development of this kind would be of far-reaching importance, for not only would it give the railroads a greater degree of flexibility and many additional time schedules, but it should restore much of their lost traffic.

As to the bringing about of a more effective organization of security holders was also proposed by the committee, which made the statement that "the really forgotten man is obviously the inarticulate railroad investor," the report added:

There are at the present time three organizations whose purpose is to look after the interests of railroad security holders. These organizations are all relatively young, so have made little progress as yet in building up their memberships. One of these groups is attempting to organize on a national basis; another is attempting to organize into State and county groups, while a third represents those who are interested in the transportation problem as a whole. These three organizations may overlap to a certain extent, but if they obtain sufficient investors' support they would form a strong "resistance" body to offset the aggressive tactics of the pressure groups discussed above."

The report follows:

In considering the railroad problem, which is most emphatically still with us, let us forget for the moment the disastrous possibilities of the threatened strike of the railroad employees and return to the situation which existed last spring. At that time the critical position of the railroads and the consequences of the extreme poverty of this key industry to our whole economy had already become generally realized, and it was therefore, expected that the special investigation made by three members of the Interstate Commerce Commission for the President would result in remedying some of the causes responsible for the plight of the railroads. However, a last-minute legislative jam in Congress prevented any progress on this vital problem at that session. Notwithstanding a noticeable improvement in their earnings in the last month or two, legislation along certain definite lines is still most urgent, and the subject will almost certainly be on the coming Congressional agenda. This report, therefore, will attempt to discuss several legislative measures which appear most desirable in the hope that they may serve as the basis for useful discussion when Congress next convenes. While a number of legislative proposals are discussed, attention will be focused mainly on two suggestions which, if enacted into law, might go far in solving one of the most difficult problems of the railroads; namely, motor carrier competition.

Before discussing new laws, we must first agree on the causes of the present predicament of the railroads. Several volumes could be written to cover the whole situation, but without much doubt the problem of greatest concern to the railroads at the moment is their lack of traffic; and, of course, the problem of paramount importance to American industry at present is precisely the same—lack of business. In other words, we are still in a serious depression. Obviously, the passing overnight of a few laws affecting the railroads will not correct the business depression, and until the current slump is overcome the railroad industry, like many other businesses, will have to struggle to make ends meet. However, certain unfavorable long-term difficulties have been gradually stifling the railroad industry, and it is these which might be corrected, at least in part, through legislation. Let us refer to them in the following order:

1. Freight rates as a whole have shown, with one or two exceptions, a consecutive downward trend since the Transportation Act of 1920.
2. The trend of railroad traffic, in comparison with the total volume of production and consumption of the country, indicates conclusively that the railroads are moving continually a smaller proportion of the country's total traffic.
3. Railroad costs, particularly wages and taxes, have obsorbed an increasingly larger proportion of gross revenues.

These problems have been expressed in the simplest terms possible; but a discussion of them immediately reveals their many complex ramifications.

Declining Freight Rates

The rate-making structure of the country is necessarily most intricate, and it is not surprising that it is the subject of endless controversy. Nevertheless, like many complicated mechanisms of our economic structure, it works rather well on the whole when the natural balances and checks are permitted to work; but herein lies the difficulty. The final control over

freight rates has, for a number of years, rested very largely in the hands of the ICC, and it is one of the greatest complaints of the railroads that this important function of management has been largely taken away from them, and they wish, insofar as it is consistent with public policy, to have the right once more to place a value on the price of their services, the only product which they have to sell.

The present rule of rate-making was adopted in 1933, and is known as Section 15-a of the Interstate Commerce Act. It instructs the Commission in setting rates to "give due consideration, among other factors, *to the effect of rates on the movement of traffic*, to the need, in the public interest, of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable the carriers, under honest, economical, and efficient management, to provide such service." (Italics Committee's.)

This rate-making rule is a complete revision of the old Section 15-a of the Transportation Act of 1920, and it was supposed to be an important improvement, but railroad management feels that under the Commission's interpretation of this law in most cases decided since 1933, it has given undue weight to the provision italicized above and only secondary weight to the need of the carriers for adequate revenues. To decide the effects of a rate change on traffic movement is largely a matter of judgment, and the roads feel that since the responsibility is primarily theirs, the ICC should not substitute its opinions for that of management, but should concentrate its investigations more on the discriminatory characteristics of proposed rate changes. This, the carriers feel, would still give the public adequate protection because rail traffic has, for a number of years, been highly competitive, and this, in the long run, determines whether a rate is too high or too low.

Specifically, railroad management feels very strongly that there should be such a revision of Section 15-a as will direct the Commission to consider the revenue needs of the railroads as of major importance, and they suggest the use of a rate base equated to one of the several valuations completed by the ICC under the old La Follette Valuation Act. The railroads, as a whole, would undoubtedly be quite happy if they could average a fair return on a valuation published a year ago by the ICC. The figures showed as follows:

Original cost	$21,965,701,000
Original cost less depreciation	15,817,380,000
Lands, &c., and working capital	2,635,675,000

Adding to the "original cost less depreciation" the lands and working capital gives a total of $18,453,055,000.

The Commission pointed out that whereas at the inception of its valuation work the available records did not contain complete data of the monies actually expended for property, so that it was necessary to employ the method of "estimate" based on the so-called "1914 unit prices," the passage of time had rectified much of the difficulty and the above figures were actual costs as to 70% of the total.

It is evident, therefore, that the total sum above-mentioned—$18,453,055,000—is a substantially accurate measure of the money spent for railroad properties up to Dec. 31, 1936, that being the date of the report.

It may be noted in passing that this sum is almost exactly the same as that of the par value of railroad securities outstanding in the hands of the public at the same date.

The Commission at the same time reported the "reproduction cost" of the same properties which, with depreciation deducted and lands and working capital added, was appreciably larger than the sum of original cost—viz., $20,693,951,422.

It is their hope that a law can be drawn to give the railroads the cumulative right to a fair return on their property, for they feel this would enable common sense flexibility in making rate revisions. In other words, the railroads feel that in periods of rising prosperity rates should be advanced with increases in the general price level and that the reserves thus earned in such years would avoid the doubtful expediency of attempting to raise freight rates in periods of depression when such action usually results in reducing the flow of traffic and places an additional burden on industry when it is least able to withstand it. This proposed rate revision would not contain the unworkable provision of the recapture clause of the old Transportation Act of 1920.

A law covering these points can probably be framed, but it would still not ensure the efficient administration of the law unless the Interstate Commerce Commission adopts a more cooperative attitude toward the carriers than it has shown in the present crisis. The premature elimination of the "surcharges" and its many delays in handling Ex Parte 115 and 123, not to mention the unsatisfactory disposition of the eastern passenger rate case, have unquestionably intensified the present railroad difficulties.

Even assuming the passage of such a law, and favorable interpretation of it from the viewpoint of the carriers, there would still remain the demoralizing effects on the rate structure of the growing competition with motor carriers. A logical way to protect the rate structures of the carriers from this competition is to permit them, with as few restrictions as are necessary, to safeguard the public interest, to own their own trucks, and this whole subject of truck competition will be discussed in succeeding pages. Another remedy for this disintegration of the rate structure may be to permit the railroads of this country to adopt a rule of rate-making which has been in successful operation in France, Australia and England. The latter country adopted this change in 1933, and Canada has recently approved an importation of this new practice of rate-making with certain modifications. It is now a part of The Transport Act of 1938, and it is expected that it will shortly be put into operation.

The details of this Act, as it was passed in Canada, are contained in an appendix to this report, [this we omit—Ed.] but the following is a brief explanation of it. This new theory of rate-making is usually referred to as the "agreed charge," and in principle consists simply of a special rate granted by the carrier in return for a specified amount of the shipper's business. As previously mentioned, it is an inspiration which comes from Great Britain, and is an atte ipt by the Government to provide some protection for the railroads against highway traffic which is, and probably must be, largely unregulated. (The latter statement is applicable also to this country regardless of the Motor Carrier Act of 1935). The Canadian authorities have been convinced that it does not increase the means of competition between the railroads themselves, which would be undesirable, for there is, obviously, too much competition in that direction already. This contract may provide for the shipment of the whole or a specified portion of the goods of the shipper, and it may specify the time during which the charge shall remain. The charge must be approved by the regulatory authorities, which, of course, in this country would be the Interstate Commerce Commission, before it becomes effective. The charge would be filed with the Commission, which could only approve the rate after public hearings, and the rate would remain open to public inspection.

To understand how the "agreed charge" is expected to work out in Canada, the following is quoted from the Railway Association of Canada's official brief:

"Let us now consider the second branch of the bill's proposal, the agreed charge. An agreed charge is simply a rate, embodied in a contract between shipper and carrier. The contract may provide for the whole or a specified portion of all the goods of the shipper and it may specify the time during which the charge shall remain. The charge must be approved by the Board of Transport before it becomes effective; it must be filed with that Board, its approval in the event of objection is after a public hearing, and it remains open to public inspection.

"Now there is nothing in the Railway Act which prevents a railway from negotiating with a shipper for his entire business. But a rate so accepted must be made a public rate and open to all shippers alike. The other shipers are then in a position to take advantage of that special rate when it suits their purpose to do so and to seek other carriers when lower rates may be available to them. Arrangements of this kind are made in the ordinary run of railway administration; the practice is of long standing; and the effective operation of the proposed legislation is to validate that arrangement with the individual shipper to the exclusion of all others who are not prepared to accept the rate on similar conditions. The agreed charge is universally practised by water and truck carriers; it is an essential part of their traffic mechanics: from the standpoint of fairness, equality and economics, why should the railways be denied the same right?

"No sound reason has as yet been suggested. What we hear are expressions of vague apprehensions and fears on the part of shippers and competing carriers that (a) the small shipper will be sacrificed to the large shipper and (b) that the device will be used as an instrument not to promote legitimate competitive action but to destroy competitors.

"Let us consider these in their order. At the present time what is the position of the small shipper as against his large competitor? The very fact of his existence shows that he is prepared to compete on the basis of existing services. But how is he protected in the unregulated services? He is not protected at all; he is subject to the same discrimination by secret arrangements that oppressed him before the regulation of railways. Under the Railway Act he is in exactly the same position as his competitor as to the rates which his shipments will carry. What will his position under an agreed charge be? Precisely the same. The essential terms of the Railway Act dealing with unjust discrimination have been incorporated in this bill verbatim; and as under that act no change in a rate can be made which will unjustly affect the existing competitive relations between the shippers, so here, under similar conditions, an agreed charge is bound by the same limitations and restrictions. It cannot, therefore, be emphasized too strongly that the actual relative competitive position of a small dealer towards his larger competitor will not be affected adversely by an agreed charge if he is willing to submit to the same terms as his competitor.

"Then there is the fear of destroying competitors. This is really a plea for a preferred position. From 1903 to this moment, notwithstanding the freedom of action allowed railways in respect of competitive rates, what competing bodies have been destroyed by the action of the railways? The latter have always had advantages in respect of the field and periods of operation over all other forms and have always been in a position to meet the rates of competitors; but these competitors remain: why have they not been destroyed? The answer is that the railway agencies are responsible bodies that have vast interest in this country; their administration must be based on sound economic policies; they must justify competitive action by the net results; they cannot go beyond the actual competitive pressure without producing discriminatory effects in the commercial field which would effect the whole rate structure; they are quasi-public organizations subject to the over-riding public control of a governmental body: and both the internal administration and the external control negative the use of railway power to a purely destructive end. And what is the nature of the competition which now presents itself? Is it conceivable that any action by the railways, much less that approved by the Board of Transport, could work destruction to such a resilient agency as water carriage? These individual units possess little of the inherent weaknesses of railways: they have a flexibility both in respect of cost and mobility, and an economy in operation which exclude the possiblity of eliminating them from the public service by any competition.

"Moreover, the vast unregulated carriage must also be taken into account here. The activities that have struck the deadly blow at railways have been those of public and private automobile trucks. The extent to which the carriage of commodities has been taken over by them is a matter of common knowledge.

"Not only is highway transport unregulated but it is not today carrying its legitimate charges and to that extent is the beneficiary of public assistance. The trucks have extended their operations into fields which in our opinion are legitimately open to the railways and against these and like public and private competitors the railways declared they must be given greater freedom of action.

"But let us consider the safeguards with which the bill surrounds the agreed charge. There are many of them. There is first the necessary approval of the Board of Transport. For this the Board is to have regard to the effect of the charge (a) on the net revenue of the carrier and (b) on the business of any shipper who objects to the charge. That approval is to be given only after interested parties who desire it have been heard, and specific permission is given to any carrier under the Act to be heard. There is no more serious concern of the railways than that of their net revenues and this deterrent is the surest safeguard against improvident arrangements. Their past history in competitive rates is a conslusive answer to the suggestion that they would even propose such arrangements.

"There is next the requirement as to unjust discrimination. An agreed charge must contemplate a possible adverse effect on commercial interests anywhere within the competitive area and the carrier must be prepared to remove that discrimination by an extension of the basis of the charge to those so affected. In this respect the situation is precisely the same as under the Railway Act. No agreed charge can unjustly affect the actual commercial relationships existing at the time it is proposed. The charge in fact is a matter only between carriers: in a commercial aspect, it concerns them and them alone.

"There is next the prohibition against the approval of an agreed charge if the Board should consider that the object to be secured 'can, having regard to all the circumstances, be adequately secured by means of a special or competitive tariff of tolls under the Railway Act or this Act.' This is a provision to restrict the use of the agreed charge to circumstances which modern conditions have placed beyond the control of those long established methods contemplated and approved by the Railway Act. That new conditions should call forth new measures to deal with them is obvious and this the bill, by its provisions, under the safeguard mentioned, recognizes.

"Finally, there is Section 37. Here is a specific provision to preserve to Canadian business life the services of every agency of carriage which are in the national interest. What more fundamental safeguard could surround the agreed charge as a protection against its unfair use. What more could any such undertaking ask for? Every legitimate interest and function is here made a matter of public concern and, by means of a public determination, the national interest as paramount is to be served. What greater shield could be thrown around essential enteprise it is difficult to imagine.

"Similar causes have produced like transportation problems in other lands and the study of solutions has dictated similar remedies. In England, the agreed charges have been in effect for five years: in France for a lesser period, and they have lately been authorized in Australia. Their special merit is that while they offer no obstacle to the competitive determination of rates on the cost of service basis, they furnish a flexibility in rate mechanics which is necessary to full, equal and beneficial competitive functioning.

"The railways submit, therefore, that:

"The provision of an agreed charge is of vital importance to the railways, as well as to the other forms of transport, to enable them to meet the competing services of other agencies and to determine the boundaries of the legitimate field of each regulated and unregulated service. It is dictated by the new factors in modern carriage and unless it is granted the railways shall be permanently handicapped in their effeorts to obtain their proper share of the transportation business of Canada."

The congestion on our highways, exaggerated to a large extent by the truck, is a problem affecting the lives and safety of well over 25,000,000 private automobile owners in this country; while, on the other hand, the railroads are geared physically to move nearly twice their present volume of traffic. If a new system of rate-making which seems to offer adequate safeguards to protect the public could restore to the railroads a large volume of the traffic which has been taken away by their competitors, due, at least to an important extent, to the inflexibility of our rate-making mechanism, there would seem to be many advantages to the public as a whole.

While we are still on the subject of freight rates, there appears to be little opposition to the repeal of the so-called "land grant rates." Although the amount of net revenues involved is, on casual appraisal, rather small, the carriers claim that the competitive influence on the rate structure of

carriers which, theoretically, do not have to comply results in substantial losses in revenues.

The Pettengill Bill, to eliminate a number of important restrictions under the so-called "long-and-short-haul clause" of the Interstate Commerce Act, should once again be revived, and thus restore further control over rate-making to the carriers.

The report down to this point has attempted to discuss some of the reasons why freight rates have shown a continuous decline to a level that gives the shipper advantages considerably in his favor over those of shippers all over the world. It does not seem to be asking too much for legislation along the lines suggested in the foregoing which might correct the trend in freight rates which has played a most important part in bringing the railroads to their present crisis.

Declining Trend of Railroad Traffic

The frequent downward adjustments of freight rates have not succeeded in returning to the railroads their former share of the total traffic of the country; and, without being too statistical, a few of the important reasons may be summarized as follows:

1. Registration of motor trucks, tractors, trailers and semi-trailers has increased from 215,000 in 1916 to 5,275,281 in 1937;

2. Petroleum transported by pipe line has increased from 75,942,511 tons in 1931 to 147,373,335 tons in 1937, while originated oil tonnage of the railroads dropped from 50,057,918 tons in 1 931 to 42,556,545 in 1937;

3. Amount of coal consumed by fuel stations of electric power industry to produce a kilowatt hour dropped from 3.47 pounds in 1916 to 1.43 pounds in 1937;

4. Interstate pipeline transportation of natural gas increased from 149,792,000,000 cubic feet in 1921 to 574,343,000,000 in 1937;

5. Production of electricity by water power, with attendant displacement of coal, a major rail traffic item, increased from 14,578,000,000 kilowatt hours in 1931 to 43,702,000,000 in 1937;

6. Registration of passenger automobiles increased from 3,297,996 in 1916 to 25,449,924 in 1937, during which period the revenue passenger miles of the railroads, after reaching a peak of 46,848,668,000 in 1920, dropped to 24,655,414,000 in 1937;

7. Domestic airplane traffic increased from 4,258,771 miles flown in 1926 to 66,071,507 miles in 1937 when the airlines received gross revenues from passengers of $26,690,000 and income from mail transportation of $12,-100,147;

8. Receipts by motor trucks of livestock at principal markets increase from 6,779,502 head in 1926 to 24,159,415 in 1937 and the latter figure represents 52.05% of all receipts while the railroads handled 47.95% of the traffic; and,

9. Commerce on rivers, canals and connecting channels in the United States increased from 116,300,000 tons in 1921 to 276,263,926 in 1936.

(The figures above were taken from data prepared by the A. A. R.)

The tremendous diversion of traffic brought about by certain of these developments obviously cannot be remedied by the enactment of a few simple laws, but at least something may be done about the increasing competition of motor vehicles, which is of major importance.*

Truck Competition

This type of competition provides a flexibility and special type of service which the railroads have had great difficulty in meeting as they are handicapped today. It is obvious that, from the viewpoint of public policy, the country is unquestionably entitled to whatever advantages are obtainable through the use of motor carrier services, and regulation of the trucks provided under the Motor Carrier Act of 1935 cannot unfairly handicap that industry for the benefit of the railroads. On the other hand, the very essence of the problem indicates that coordination of highway with rail transportation is a logical development and, therefore, in the long run, would best serve the public interest. The Motor Carrier Act of 1935 was an important step toward permitting the railroads to acquire their own truck lines and coordinate them with their rail services, and a number of important railroads are now operating fleets of trucks. Already their short experience has proved conclusively the many ways in which the use of the highways by a carrier fits into the regular operation of its rail services and gives the shipper a flexibility and dependability of service not provided by either form of transportation by itself. It is unfortunate, however, that the law as it is being interpreted by Division 5 of the Interstate Commerce Commission, prevents the railroads from operating these trucks in service beyond their own lines or operating in a manner that is competitive with their own rail operations.

The Union Pacific, Chicago, Burlington & Quincy and the Chicago & North Western Railroads were recently prevented from acquiring control of the Union Transfer Co. It was their intention to use this agency as the nucleus for developing a complete and comprehensive trucking system sufficient in scope to bring about full coordination of rail and truck facilities in the general territory served by these roads. In his concurring opinion refusing to permit this acquisition, Commissioner Eastman stated as follows:

"It appears that the three railroads by no means intend to confine the use of the trucking company to coordinated service in connection with their own operations. They propose to operate it to its own best advantage as a motor carrier in service which is strictly competitive with rail operations as well as in coordinated service. In fact they could hardly do otherwise in justice to each other as stockholders. It is also to be observed that they propose this undertaking as merely the first step in a much broader enterprise of similar character to be established by acquisition of other trucking companies.

"I am not satisfied that in the present stage of motor carrier development such an undertaking is consistent with the public interest. It is true that we have power to prevent a motor carrier so controlled from being used to the damage of independent competitors through the establishment of unduly low rates: and it is also true that any damage which might come from superior service can hardly be regarded as contrary to the public interest. Nevertheless a large motor carrier backed by the financial resources of three great railroads and by their influence with shippers presents possibilities of unfair competition which it would be difficult to guard against. The penetration of territory served by other railroads is also to be considered.

"The time may ultimately come for a considerable degree of union between these rival branches of the transportation industry, but I am not persuaded that it has yet come. For the present, therefore, I believe that the emphasis should be on the establishment of coordinated truck-rail service rather than on the domination by railroad companies of trucking operations per se."

This appears to be a restriction which the public interest hardly demands; in fact, a trucking combination with such responsible financial interests behind it could, it seems, give the shipper an improved brand of trucking service in that territory. This action of the Commission prevents the railroads from satisfying some of the chief complaints of the shippers against the railroads. There are many types of goods which require less packing when shipped by truck; there are articles of mixed class ratings, or commodity groups; shipments to meet emergency conditions where trucks are faster; many articles of unusual shapes or sizes which require special service or are liable to special charges; many types of goods which, if sent by rail, require special packing to prevent pilferage (cigars, for instance); shipments which must be forwarded or received at irregular hours; goods which can be shipped in sufficient quantity to claim truckload rates, but not carload rates: and goods to be shipped c.o.d.

A survey was recently made which indicated substantial use of trucks for carrying dry goods, hosiery and underwear, men's and women's clothing, cotton piece goods, iron and steel articles, toys and games, knit goods, carpets and rugs, candy and chocolate coating, chewing gum, agricultural implements, bicycles, sleds, hardware and cutlery, radio sets, electric storage batteries, machinery, tools, groceries and provisions, paper and paper products, chemical products, composition floor coverings, paints, varnishes, shellac and putty, cigars, cigarettes and tobacco, steel sash, shelving and doors, electric lighting fixtures, oil-burning equipment, electric refrigerators, fresh meats, cement, brick, ores, fuel oil, milk and cream, butter and eggs, auto and truck tires, stoves and ranges, automobiles, drugs and medicines, soap, woodenware, crockery and glassware.

Such problems can be solved only in part by coordinating truck with rail service, and it is difficult to see why a railroad owning a fleet of trucks could be construed as operating against the public interest when it makes complete use of its facilities even though this involves it in competition with other truck owners. Accordingly, it appears desirable that the railroads should be permitted to own and operate their trucks with fewer restrictions as to the routes over which they may operate and as to the character of their services.

Aside from hauling commodities a longer distance, which does not seem to be the essence of the situation, the railroads have a similar problem in the handling of express shipments. The railway express service is a logical development in truck and railroad coordination, and it seems that the public is adequately protected against certain semi-monopolistic characteristics of this organization on the one hand, and have been provided with a very reliable service on the other. What more logical development than that the railroads use the Railway Express Agency as the nucleus for owning and operating all their various trucking services.

Former Coordinator Eastman, as a result of his survey of the l. c. l. merchandise traffic of the railroads, felt quite emphatically that this traffic should be handled collectively on a nationwide basis, and his committee suggested that this service should be pooled in the hands of two competing railroad-owned merchandise agencies, each national in scope, of comparable strength, and operated by independent management. While Mr. Eastman realized that extension of the facilities of the Railway Express Agency for this purpose might establish a dangerous precedent in nationalization, yet when the advantages and disadvantages were weighed it was his conclusion that the railroads should immediately, and even as a matter of compulsion, form one, or, if necessary for competitive reasons, two or three such agencies. Although many of the railroads agree in principle that such an organization should be created, other railroad executives prefer to develop their own trucking subsidiaries. Since it was the conclusion of the Coordinator's experts that the roads could save in the neighborhood of $100,000,000 a year by adopting his committee's plan, it would appear that the duplication of facilities that would result from building up a number of organizations would be a luxury that the railroads could hardly afford under present-day conditions.

If there is really danger of government ownership of the railroads, and many authorities have said it was inevitable, the managements should reconcile their differences and as soon as possible come to some definite conclusions on unifying their trucking operations.

The drafting of a law which would make the Railway Express Agency the truck subsidiary for all of the carriers is a thought deserving of the most careful consideration. A start in this direction might be made by giving the Railway Express Agency, or its present interstate trucking subsidiary, Railway Express Motor Transport, Inc., a certificate of public convenience and necessity to operate in interstate commerce in all parts of the country. A development of this kind would be of far-reaching importance, for, not only would it give the railroads a greater degree of flexibility and many additional time schedules, but it should restore much of their lost traffic.

Consolidation

If we refer back to the list of reasons why the railroads have not held their own in the field of transportation, it is quite obvious that the more extensive use of trucks by the carriers is not a cure-all for the problem. Most of these difficulties support the belief that there are too many railroads, and consolidation immediately suggests itself as a remedy. Indeed this has been officially recognized ever since the Transportation Act of 1920 as the ultimate solution of many of the difficulties of the railroads. It is well known that the Transportation Act of 1920 endeavored to promote consolidation of the railroads into a limited number of systems, and under the authority of that Act the Commission did prepare a so-called "final plan" for consolidating the railroads of the country into about 20 systems. Little or no progress has been made in bringing about consolidation under these fixed rules, and the reasons for this were outlined by former Coordinator Eastman, as follows:

1. Consummation is dependent wholly upon the voluntary action of the carriers. No matter how good a plan may be, it can only be made effective to the extent that it is to their liking.

2. Independent carriers have in general found it impossible to effect consolidations by mutual agreement, subject to the approval of the Commission. The prevailing method is for one carrier to acquire a controling interest in the stock of another, or for some agency to acquire such interests in the stocks of both, prior to arranging for a consolidation or other unification. Such operations drive up the price of stock which is being acquired, often to unwarranted levels, and usually involve a diversion of railroad cash which could better be used for other purposes. The results are particularly unsound when borrowed money is used to acquire these stock equities.

3. Even if a consolidation be arranged and finally approved by the Commission, considerable amounts of cash will now usually be necessary to take care of dissenting minority interests. The inability of the railroads to obtain cash during the depression has halted progress in consolidations and unifications.

4. It is very difficult, if not impossible, to devise a plan which conforms to the elaborate specifications of the Act, and any plan can only meet these specifications temporarily, owing to continual change in underlying industrial and financial conditions.

5. The rapid development of competition with the railroads from other forms of transportation has made the emphasis in the Act upon the preservation of railroad competition unnecessary in the public interest.

Mr. Eastman presented a draft of legislation which, in his opinion would correct most of these weaknesses. His proposed legislation would eliminate the present final consolidation plan and give the Commission authority to approve any unification which it finds will promote the public interest. It would also give the Commission authority, through resort to the power of eminent domain, to require a unification, where it is sought by at least one carrier, on proof that such a merger would be in the public interest. It would further provide for consummation of mergers by exchange of securities on a fair and equitable basis without the use of cash.

There appears to be a great deal of merit in the coordinator's views on this subject. Indeed it appears that little or no progress toward consolidation will be made unless there is some compulsion under governmental authority. Aside from the difficulties previously outlined, there could be

* Since it is a primary intention of this report to focus attention on ways and means to enable the carriers to solve the problem of highway competition, there is danger that the reader may underestimate the present position of the railroads in the whole transportation industry. In order to correct any possible misunderstanding in this direction, it seems hardly necessary to point out that the railroads are estimated to move from four to five times as much traffic as is handled by the motor trucks at the present time; nor does it seem likely that, from this point on, this relative position of the railroads is likely to change materially, except over a considerable period of time.

mentioned the divergent personal interests of the guiding officials of the carriers, which alone is sufficient to make any great progress in consolidation virtually impossible.

The Wage Problem and the Working Rules

It is unnecessary here to discuss, in detail, the critical financial situation of the railroad industry. The thousands of miles in receivership, the billions of dollars of railroad bonds in default, and the inability of the carriers to do their part in stemming the ravages of the current depression through purchasing much needed materials and supplies, are all matters of common knowledge, but it is perhaps not so well known that railroad wages, if we exclude part-time employees, are higher today on either an hourly or annual basis than at any time in the history of the railroads. Meanwhile, the carriers have been forced to drop from their payrolls nearly 40% of the employees who were in service in 1929. This report will make no attempt to discuss whether these wages are too high or too low in relation to the work performed, but it believes that attention should be called to the inconsistencies and inequalities governing the manner of payment of a large proportion of those employed. We refer to what is known in the parlance of the railroad employees themselves as the so-called "featherbedding" rules. The Interstate Commerce Commission describes it as "time paid for but not worked." Few railroad executives are willing to discuss this subject publicly, apparently for fear of union retaliation, and the unions are apparently unwilling to air cases involving such payments in the courts as certain of them would hardly stand the spotlight of publicity.

This so-called "featherbedding," the term applied in railroad circles to the contracts under which engineers, conductors and certain other workers receive pay for work not done, is an old practice and, at the outset, was apparently a perfectly legitimate way of evening out inequalities that were at the time unavoidable in railroad employment. But in recent years, due to the great speeding up of railroad service, both passenger and freight, many of these working rules are entirely obsolete, and, according to the figures of the Interstate Commerce Commission, are now an additional wage burden on the railroad industry of well over $100,000,000 a year.

The basis of payment of the so-called "running crafts" is very largely a day's pay for eight hours' work, or for 100 miles' run. It originated at a time when eight hours' service, or 100 miles' run, were reasonably comparable. Now, however, the rule applies to the engineer or other workers on a train that today might do 400 miles in six or seven hours. For this run such work would now receive four days' wages. Any number of instances might be given to illustrate the effects of such discrimination not only on the railroads, but to large bodies of railroad employees themselves. This is only part of the story, for in addition to the rule basing pay on the antiquated speed of 12½ miles an hour, there are many restrictions having to do with the separation of different kinds of work. Just how one of these rules works was recently explained by one of the larger railroad systems, as follows:

"A machinist, removing a steam gauge for test would be required to have a sheet metal worker disconnect the steam gauge pipe. In the removal of an electric generator from a locomotive three different mechanics could claim a portion of the work—an electrician to disconnect wiring, a sheet metal worker to disconnect steam and exhaust pipes and a machinist to remove the generator. The entire job could be done by one man in 30 to 40 minutes; in fact, in some instances more time is lost waiting for mechanics to get on the job to do their portion of the work than would be required to perform the actual work."

A rule which costs the roads millions is that which prevents road crews from doing any kind of switching service at terminals. This one item is reported to cost the Chicago & North Western RR in the neighborhood of $300,000 a year. The Lehigh Valley, under a decision of the Railroad Adjustment Board, gave to a small number of workers on the Lehigh Valley RR. a payment estimated at $241,000 in April, 1937, for which very little work was performed. An award amounting to about $600,000 was made against the "Rock Island" in a somewhat similar case.

Numerous incidents of a similar nature could be recited; and the layman immediately wonders why the railroads submit to this form of sabotage. The explanation appears to be that decisions of the Railroad Labor Board are theoretically, final, the carriers having no right of appeal to the courts; and, since hearings before the Board rarely come to the attention of the public, the railroads never have had the opportunity of placing their cases before the high courts. Theoretically, the railroads might force the Brotherhoods to appeal to the courts by refusing to obey the decisions of the Board; but since it appears that the unoins do not want to resort to the courts, they merely take a strike vote. Certain rail executives admit flatly that they dare not risk a strike not only because of the stoppage of traffic, but because they fear damages to their property with attendant loss of life. Not all railroad executives are willing to submit to this condition so mildly; in fact, the President of a Western railroad, in his 1937 report to stockholders, said, in part:

"When conditions now existing on the railroads are brought into the open the public will quicky discern the injustices and demand a change.

"The public might go even further now and inquire why the managements had let the present wasteful conditions continue unchallenged for so long a time."

The railroads, in their legislative program which they expect to submit to the coming Congress, have explained their side of this case, with an attempt to remedy the difficulties as follows:

"In the administration of the Railway Labor Act and particularly those portions which deal with the work of the Adjustment Boards, many difficulties have been encountered, producing delay and unsatisfactory results.

"A fundamental weakness of the present law is the temporary character of the referees, who are employed on a per diem basis for particular cases. The referee does not sit and hear the testimony but is called in only in the event of a deadlock of the Board. No record of the evidence is made, either for submission to the referee or for any other purpose, and the parties are not even permitted to appear before him.

"Another fundamental weakness is that no provision is made for court review at the instance of the railroad, and the only provision referring to court review is that which contemplates suits by the employees for the enforcement of awards. Experience has shown that the employees refuse to take awards in their favor to the courts, as contemplated by the statute, but prefer to enforce them through threats of strike.

"Experience has indicated that a limitation should be put upon the time within which claims can be presented. In practically all similar laws there are appropriate statutes of limitation.

"There has been a growing disposition on the part of certain referees to consider questions of discipline pure and simple, having nothing to do with the proper interpretation of rules.

"To remedy these situations, it is recommended that Section 3 of the Railway Labor Act, creating the National Board of Adjustment, be amended."

Any amendment to the Railway Labor Act which would relieve the railroads from this great handicap under which they operate is most desirable. But, on the other hand, when burdensome working rules expire, it appears that railroad executives in duty to their stockholders should negotiate new agreements that are more equitable and in conformance with modern operating conditions. The excuse which railroads give, that the unions will retaliate and push "make-work" legislation at Washington, such as the 70-Car Train Bill and the Six-Hour Day, does not seem to be a fair answer to the problem.

Taxes

The railroads are one of the largest taxpayers of the country, and this burden grows year after year. If the railroads could at least avoid taxation on their obsolete properties, the savings would be most important; and if the regulatory bodies would cooperate with the railroads in speeding up the abandonment of obsolete or little used facilities, largely superseded by truck operation, it would also be most beneficial. But the unsatisfactory record of annual abandonments, perhaps explained by the reasoning used by the Interstate Commerce Commission in a recent important case, indicates little ground for optimism in this direction. We refer to the decision of the ICC preventing a group of Western roads from acquiring the more useful properties of the Minneapolis & St. Louis RR. and abandoning its unproductive mileage. Probably the best commentary on this decision to prevent abandonment of several hundred miles of outmoded mileage is the one dissenting opinion of the Commission, expressed by Commissioner Meyer. It is so much to the point that appears worth while quoting in detail, as follows:

"This proceeding is illustrative of a national problem of staggering proportions, which some of the parties have completely ignored.

"The dismissal of these applications only postpones the day of reckoning. It avoids certain present losses, but it makes more certain greater losses in the future. For the Minneapolis & St. Louis RR. it compels the prompt choice of one of two alternatives, foreclosure sale or reorganization with or without a sale after fifteen years of failure to reorganize. Both alternatives, with the same problems of abandonment and future operation of segments, will later again confront the property. Barring basic changes in the status of our railroads, the country as a whole probably faces the greatest railroad salvaging operations of all time. The case of the Minneapolis & St. Louis is only one of many.

"During the last 15 years the mileage of all-year highways in the five States in which the Minneapolis & St. Louis operates has been increased by nearly 46,000 miles. The mileage of highways of all classes is many times that. During the five years ended with 1936 the registration of trucks in these same five States increased by nearly 62,000. (In Illinois buses are included with trucks.) These trucks were purchased and registered for use on highways which were not created merely to lie there as slabs of concrete or asphalt. It is this process of steady encroachment of the highway which has been progressively breaking the backs of the railroads. In spite of the excess of transportation facilities in Minneapolis & St. Louis territory, which has existed for some years, that excess has been steadily increased.

"Looking at this country as it stands today, I do not believe it can yet get along without the railroads, ignoring for the present questions of National defense. If that is true it follows that to have railroads we must preserve them. For years this Commission has pointed out to communities in many parts of the country, in connection with applications for abandonment, that it was for them to decide in the first instance whether they could afford both railroad and highway transportation; and if not, which agency they elected to retain. But a railroad which is not given enough traffic to live must be abandoned, no matter how essential its continued operation may be for industries on its line or in the territory it serves. It is only by authorizing abandonments where public gains out-weigh private losses that the most essential railroad mileage of the country can be preserved.

"It is not for the Commission to say which instrumentality of transportation the public shall patronize. The people who buy transportation decide that. To a great extent they have already decided against the railroad so far as a large part of their transportation is concerned. They have given it to the highways and now they must take the consequences of their choice. If those who are using the highways for profit are now paying their fair share of taxes and other charges for such use, a still greater proportion of existing railroad mileage is doomed, for the simple reason that, in the face of present highway operations, many thousnads of miles of railroad cannot be sustained by the proportion of available traffic still given to them. Even though economic recovery should hereafter be speedy, it is not probable that enough traffic will develop during the next decade to sustain the present railroad and highway capacity, not to speak of the constant additions to the latter.

"The Commission does not finally decide upon what basis the competitive struggle among the various agencies of transportation—railroads, highways, waterways, pipe lines, airways—shall be conducted. It would be an abuse of power to attempt to do it by means of arbitrary rate levels or differentials; and private as well as contract trucks can be resorted to. The State legislatures and the Congress alone can determine the basis upon which this competitive struggle shall be conducted. If the prevailing basis should be found to be the permanent basis, the future of our railroads is dark. This is so without reference to droughts and other disasters. What I am discussing is not caused by disasters of that character. Information compiled by the Federal Coordinator of Transportation may be sufficient for Congress and State legislatures to decide whether or not the raging competitive warfare is now being waged upon a basis of substantial equality in public burdens among the combatants. If it is, there is nothing further to do but to await the outcome concerning which there can be little doubt. The fittest should survive.

"It is well known that Congress has made it our duty to preserve as far as possible the inherent advantages of the different kinds of transportation and to coordinate their respective functions. We have no authority to distribute tonnage among the rival agencies. If we had, we might not find enough to go around.

"The general plan presented by the instant applications is primarily an attempt on the part of the railroads operating in that territory partially to readjust themselves to the changes which the highway has wrought. The Minneapolis & St. Louis was a problem long before the depression and droughts. Our records show that every community now served by the Minneapolis & St. Louis is also served by one or more common carrier highway operators, not to speak of contract and private carriers. Every community on the segments proposed to be abandoned would still have common carrier service after abandonment of rail operation. These many little communities scattered along more than 300 miles of railroad have a total population of less than 3,000.

"By coordinating the railroad and highway transportation, substituting the highway for the railroad to the extent necessary, the people living in Minneapolis & St. Louis territory will be assured of better transportation service in the future than they may receive as a result of the denial of these applications. It may well be that certain details of the proposed arrangements should be modified but in view of the conclusions reached in the report it is not necessary to discuss the subject now. The applications before us represent a process or method which is essentially constructive, in spite of the unavoidable incidental destruction. This process will force itself upon many localities throughout the country as it has here because existing conditions compel it. In my opinion there is no other way out of the present railroad situation than to rearrange much of the remaining railroad mileage and to coordinate its operation within itself and with other agencies, especially with the highway. The unavoidable property losses accompanying rail and highway readjutsments must be regretted and should be held at a minimum, but there is no way to escape them entirely. Not a single modern highway has been created without benefitting certain owners of property and damaging others. Few railroads can be abandoned without injury to some citizens. The loss of railroad employment can generally not be offset by gains in employment connected with the highway; yet a reduced number of railroad jobs is surely to be preferred over no railroad jobs. It would be most unsound to attempt to keep railroad mileage in operation purely for the jobs it would perpetuate and when public convenience and necessity no longer requires its operation.

"The country at large may not fully realize what it is facing in the field of transportation and all that is connected with it. What is said here so briefly is intended both as a small contribution to general public thought on the subject and as a public notice of what in my judgment the country is up against. To be warranted in drawing a contrary picture would be a pleasanter undertaking.

"I am well aware that certain facts which I have stated, especially those regarding highway mileage and truck registration are not in this record, voluminous as it is. However, they are facts of common knowledge available to all in publications of highway commissions, in publications of the motor trade and in our files. If thought necessary, they could be stipulated into the instant record and probably no one would object to such a stipulation. The record is seriously defective without them. Neither does this record show by what methods the recent marked increase in traffic of the Minneapolis & St. Louis, which has been given such wide and persistent publicity

was brought about. Such increase in traffic, explained or unexplained, when other railroads in the territory have been losing, is of no significance in the consideration of the basic problem before us."

Whether or not it is possible to write a law speeding up abandonment of obsolete mileage is debatable, but some attempt should be made to establish principles that would guide the Commission toward this objective. Possibly, however, a better remedy lies in the reorganization of the Interstate Commerce Commission along the lines suggested in the Splawn-Eastman-Mahaffie report and previously recommended by Coordinator Eastman. From the data appearing in the Splawn report, and in reports of the former Coordinator, there is much to support the belief that the Commission, as it is organized today, is not suited for the purpose of promoting the future interests of the railroad industry along the difficult path before it, since its methods and organization were designed very largely for regulatory work, requiring quasi-judicial procedure. It is the belief of Mr. Eastman and his two associates that "planning and promotion" are separate and distinct from "regulation" and can be separately pursued without interference. The Splawn report summarizes the method of remedying this condition as follows:

"That a body of three members, to be known as the Federal Transportation Authority, be created for a period of two years, with power in the President to extend its life to five years, for the purpose of planning, encouraging, and promoting action by railroad companies with a view to eliminating the waste caused by the fact that the railroad system of the nation is owned and operated by a large number of independent companies. Such action would include consolidation or other unification of companies and 'coordination,' this being described as 'cooperation in a common interest at particular places or with respect to particular matters,' such as the pooling of traffic or unified terminal operations.

"In aid of this program, it is proposed to amend section 5 of the Interstate Commerce Act to broaden greatly the powers of the Commission with respect to the pooling or division of railroad earnings or traffic, to eliminate the so-called 'consolidation plan,' and to permit the Commission to approve whatever unifications it finds will promote the public interest. The Authority is given power to intervene in such proceedings, and upon its petition the Commission is also given power to require 'coordinations', not covered by Section 5. No provision is recommended for the compulsion of consolidations, but the Authority is directed to report through the Commission to the President and Congress, if it finds that such compulsion is necessary or desirable, and to submit a draft of appropriate legislation.

"The Authority is also directed to investigate the relative economy, and fitness in other respects, of rail carriers, motor carriers, and water carriers for transportation service, or any class thereof, in order that the use of each may be encouraged for purposes for which they are specially fitted, and discouraged for purposes for which they are not well fitted, and their joint and cooperative use be promoted, with a view to abating wasteful and destructive competition. In the event that further legislation directed to this end is found to be necessary or desirable, the Authority is directed to report accordingly. It is also directed to report upon the extent to which the three forms of transportation are supported, directly or indirectly by the use of government funds, and to report the facts in regard to this matter and any changes in government policy with respect thereto which it deems desirable."

It may be important that Adolph A. Berle's memorandum on "monopoly" to the governmental committee investigating that subject recognized the inability of the Interstate Commerce Commission to fulfill its functions properly under modern conditions. He said as follows:

"It is customary in certain circles to become violently excited at mention of regulation, rather than competition. Much of this proceeds from a lack of ability to distinguish between different kinds of business, and rests on the assumption that competition will produce a balance.

"The sound points of objection seem to be: Regulation is always inherently dangerous; it is often unsound to have government boards making regulations, without assuming responsibility for the results. The decay of the Interstate Commerce Commission is an admirable illustration."

The past record indicates there is much to recommend such a reorganization of the functions of the Interstate Commerce Commission, for, without much doubt, the principal powers of that body as it stands today are negative, while the future demands some guiding authority, aside from that expressed through the executives of the roads themselves, to foster consolidation, coordination and pooling of facilities, not to mention abandonment of obsolete facilities.

The Association of American Railroads was an attempt by the railroads themselves to work out, in their own way, many of these problems, and, while the depression may not have given them a fair opportunity to make much progress, it also appears that the selfish competitive interests of many of the larger and stronger roads will automatically continue to prevent collective action on a large scale toward these desirable objectives in the future.

Organization by Security Holders

The more one studies the railroad problem, the more obvious it becomes that the railroads are really the unfortunate victims of two, and possibly three, strongly entrenched and politically articulate pressure groups. We have the shippers, with their national organizations always ready to oppose any upward revision of freight rates; then, of course, there are the labor organizations whose fundamental purpose is to achieve higher and higher wages. The third group, which is just as effective, although perhaps not organized in the same way collectively, are the local taxing authorities who always insist on their "pound of flesh" from the railroads.

The really forgotten man is, obviously, the inarticulate railroad investor. There are reported to be some two million owners of American railroad securities, and, thus, numerically, they are twice as strong as railroad labor, so that they have some hope in collective action. There are, at the present time, three organizations whose purpose is to look after the interests of railroad security holders. These organizations are all relatively young, so have made little progress as yet in building up their memberships. One of these groups is attempting to organize on a national basis; another is attempting to organize into State and county groups; while a third represents those who are interested in the transportation problem as a whole. These three organizations may overlap to a certain extent, but if they obtain sufficient investors' support they could form a strong "resistance" body to offset the aggressive tactics of the pressure groups discussed above. The American public have always been sincere disciples of the rule of fair play, and honest educational efforts to bring the facts to their attention should do much to combat the annual proposals before State and Federal law-making bodies of bills detrimental to the welfare of the carriers.

Investors have a vital stake in the railroads beyond the dollars invested, for, in many respects, successful private operation of the railroads is perhaps the front line trench between individual initiative and further encroachment of government on private business.

A fairly recent poll was completed by the American Institute of Public Opinion, directed by Dr. Gallup. Because of the excellent record of these polls on different important public questions, its opinions are of more than passing interest. The results show that a sizable majority of the voting public still favors continuation of private ownership; less than one-third want the government to take over the carriers. The chief reason given by the voters for their opposition to government ownership was stated to be "that it would set a dangerous precedent for direct Federal interference in private business." Organization of railroad security holders is most essential for efficient protection of their interests.

Respectively submitted,
RAILROAD SECURITIES COMMITTEE,
Edward H. Leslie, Chairman.

Municipal Securities Committee of I. B. A. Comments on Federal Proposal to Terminate Tax Exemption of State and Municipal Bonds—Regards Matter as One Which Should Be Submitted to States for Determination—Legislative and Other Developments in States

The Municipal Securities Committee of the I. B. A. under the Chairmanship of John S. Linen of the Chase National Bank of New York referred in its report to the question of tax exemption of State and municipal bonds, and to President Roosevelt's message to Congress early this year proposing the termination of such exemption in the case of State and municipal bonds—the issue being the subject of two addresses at the Convention. Mr. Linen's Committee in reiterating its postion, holds that the matter is one "which should in all justice be submitted to the States for their consideration and determination in the form of a constitutional amendment." In large part the report follows:

By way of brief review, the volume of new long-term municipal issues during the 12-month period ending Oct. 1 was, based on compilations made by "The Bond Buyer," but slightly larger than like financing during the preceding 12 months, the difference being about $53,690,000. New short-term financing, however, was substantially heavier during the same period for the past year, exceeding the amount for a year ago by approximately $354,345,000.

Of special interest, we believe, is a review of the municipal market as of the first of each month during the past five years. This information appeared in the Oct. 8 issue of "The Bond Buyer." It is based on its index of yields of bonds of 20 large cities. The tabulation is reprinted here, with the consent of "The Bond Buyer," for the purpose of present perusal and later reference.

	1938	1937	1936	1935	1934
Jan. 1	3.16%	2.62%	3.25%	3.81%	5.48%
Feb. 1	3.07%	2.74%	3.11%	3.61%	4.89%
Mar. 1	3.05%	2.90%	3.04%	3.55%	4.74%
Apr. 1	3.19%	3.15%	3.03%	3.37%	4.56%
May 1	3.08%	3.09%	3.12%	3.39%	4.27%
June 1	3.05%	3.04%	3.00%	3.46%	4.17%
July 1	3.00%	3.06%	2.99%	3.31%	4.01%
Aug. 1	3.01%	2.94%	2.95%	3.25%	4.05%
Sept. 1	2.88%	2.95%	2.91%	3.34%	4.15%
Oct. 1	2.98%	3.05%	2.86%	3.51%	4.21%
Nov. 1	-----	3.15%	2.86%	3.34%	3.94%
Dec. 1	-----	3.17%	2.69%	3.23%	3.89%

* Lowest yield, 2.62%, Jan. 1, 1937. * Highest yield, 5.69%, May 1, 1933.

* All time low yield and all time high yield as reflected by the records compiled by "The Bond Buyer" for its index of yields of bonds of 20 large cities.

Various developments believed of general interest to the municipal field were covered in our interim report of last May. These will not be included here. While there will be references on occasions to some of them, a reading of the interim report in conjunction with this report will be necessary in order to gather a fairly complete review of developments since the last annual report.

Tax Exemption of State and Municipal Bonds

In the interim report there was set forth the concluding statements of President Roosevelt's message to Congress of April 25 on the subject of terminating the tax exemption of these obligations, also that of Federal bonds and all governmental salaries. It will be recalled that the President recommended taxing future issues only. He proposed, however, accomplishing the desired result by statutory enactment.

Your committee, recognizing that this subject involved very definitely certain basic principles of government stated in the above-mentioned report —"While there may be no question as to the desirability of the objective which the President is endeavorng to accomplish, there is, we believe, question as to the advisability of the suggested method of approach. He apparently believed the desired end can be effectively achieved by legislative action. Certain very important phases of the subject appear either to have been overlooked or ignored. We are inclined to believe that an attempt to embrace the States and their subdivisions by legislative action rather than through the medium of a constitutional amendment will cause consternation among them. There are certain basic principles involved which cannot effectively be passed over lightly. The consent of the States would seem to be necessary and the method, in our judgment, should be by constitutional amendment rather than by legislative enactment."

Shortly after the President's message a joint congressional committee was appointed to investigate and study the subject in its various phases and applications including the exemption of securities issued under the authority of the United States, and all governmental salaries along with that of State and municipal securities. It is expected that this committee will submit its findings during the forepart of the coming session of Congress.

During the latter part of June the Department of Justice completed a very extensive study of matters relating to this subject. In connection with this study the Department issued, with other material, a printed booklet embracing "Taxation of Government Bondholders and Employees, The Immunity Rule and the Sixteenth Amendment." The study, we understand, was prepared under the immediate direction of James W. Morris, Assistant Attorney General. Mr. Morris in a letter of transmittal accompanying the report to the General Counsel of the Treasury Department, stated:

"From this study there may be drawn arguments which justify the enactment of the proposed legislation and which should be urged upon the courts if the validity of the legislation were challenged."

Mr. Morris further states, after setting forth these arguments:

"These are strong arguments, but, even if there were greater doubt as to the final solution of these constitutional problems, the legislation recommended by the President would seem to be justified. For only by such legislation can these questions be settled."

The U. S. Supreme Court has expressed itself clearly on more than one occasion with regard to the tax immunity of State and municipal obligations. The decisions of this Court do not appear to support the conclusions of the Assistant Attorney General as expressed above. The latter part of July, Mr. David Wood of the firm of Thomson, Wood & Hoffman, municipal attorneys, in an article with particular reference to the Department of Justice's study and findings, made some very pertinent comments. In concluding Mr. Wood said:

"Considering the study as a whole, it is an able and plausible document, but so far as concerns the taxation of State and municipal bonds it does not stand critical analysis. It throws little new light upon the questions discussed. It is largely a repetition of the arguments of the unsuccessful counsel in the cases heretofore decided by the Supreme Court. In fact it may be characterized as a compilation of these unsuccessful arguments.

"It might be pointed out that, while the authors of the study confine themselves to recommending legislation designed to tax future issues of

State or municipal bonds, it is obvious that, if it be admitted that Congress possesses the power to tax future issues, it also posseses the power to tax outstanding issues. Will any one doubt that if the principle were once established that Congress could tax future issues of State and municipal bonds the next step would be to tax all outstanding issues?

"Tax exemptions or subsidies of any kind are anomalous in a democracy, but when the courts for generations have sustained their validity and billions of dollars have been invested relying upon those decisions, the straightforward, honest method of meeting the situation is by a constitutional amendment.

"If it be contended that a constitutional amendment cannot readily be obtained, that is equivalent to saying that the pople do not desire it, because experience has proved that whenever the people really desire a constitutional amendment it is ratified fairly promptly.

"If the people do not desire the change in the law sufficiently to ratify a constitutional amendment, then an attempt to foist such a change upon them by chicanery or political maniuplation must be condemend by all believers in constitutional government."

Reiterating its position your committee is firmly of the opinion, all phases of the subject considered, that taxation by the Federal Government of the obligations of the States, their political subdivisions and instrumentalities is a matter which should in all justice be submitted to the States for their consideration and determination in the form of a constitutional amendment. The effects, both immediate and future, of legislative enactment without the consent of the States, even though applying only to future issues would, in our opinion, be far-reaching with serious results.

This is a matter which is of interest not only to the municipal bond trade and investment bankers generally, but to all citizens who cherish the liberties and opportunities which we have enjoyed for generations under our constitutional form of government. We should be alert to the fact that to recognize the right of the Federal government to tax States and their political subdivisions by legislative enactment as distinguished from constitutional amendment, is clearly to threaten our dual system of government and greatly increase the powers of a centralized Federal government without the checks and protections that now exist against abuses of such powers.

On May 7, 1920, the Board of Governors of our Association adopted a resolution advocating the adoption of an amendment to the constitution of the United States empowering on the one hand the Federal taxation of the income from future obligations of the States and their political subdivisions and on the other hand the taxation of future obligations of the United States by the States and their political subdivisions, in both cases with proper safeguards limiting such taxation.

The full text of the resolution is appended to this report along with an excerpt from the report of the Committee on Taxation of this Association submitted at the annual convention in October, 1920. We believe the contents of the excerpt will be found of interest not only by way of review, but in the reasoning advanced. The Commitete on Taxation in recommending the resolution above mentioned said:

"Such an amendment would undoubtedly have to give the State governments the right to tax the income from United States Government bonds The suggestion of such an amendment brings to mind the essential difficulties of the problem. If the Federal Government were given unlimited authority to tax the obligations of the States and their political subdivisions, it would be an exceedingly dangerous power to be granted under our form of government. It would be equally dangerous if the States were given unlimited power to tax the instrumentalities of the Federal Government. The whole matter is very much broader than any question of taxation for raising revenue and goes to the very fundamentals of our government system. It has been said wisely that the power to tax is the power to destroy."

In view of comparatively recent developments we now submit to the Board of Governors another resolution in the form appended to this report with our recommendation for its favorable consideration and adoption by the assembled convention.

Information Respecting Tax Exempt Securities

During August of this year the U. S. Treasury Department issued a booklet containing the results of a study it had made of "Securities Exempt from the Federal Income Tax" as of June 30, 1937. This survey evidences an exhaustive examination and compilation of material relating to the subject. It will be found of value to those interested in governmental financing generally as well as the exemption phase of it.

Table 1 appearing in the booklet shows the gross volume of securities, as of June 30, 1937, exempt from the Federal income tax as follows:

Types of Borrowers	*Total*	*Wolly Exempt*	*Partially Exempt*
United States Government	$35,803,000	$15,065,000	$20,738,000
Federal agencies	10,547,000	2,228,000	8,319,000
State and local government	*19,152,000	*19,152,000	--------
Territorial & insular governments.	146,000	146,000	--------
Total	*$65,648,000	*$36,591,000	$29,057,000

* Estimated.

Another table reflects the Department's estimate of holdings of tax exempt securities by various governments, the Federal Reserve banks and by selected classes of investors including individuals, banks, insurance companies, corporations, societies, &c.

We understand that there is presently being prepared a somewhat similar estimate of the amounts of State and municipal bonds held by various classes of investors. This is being done by Mr. Carl Chatters, Executive Director of the Municipal Finance Officers' Association and Mr. A. M. Hillhouse, who up to recently was associated with that organization.

Other studies and compilations are being made. In all there will be a wealth of material available.

U. S. Supreme Court Decision

On May 23, 1938, this Court rendered a decision in the case of Helvering v. Gerhardt, et al. in which it held that the salaries of certain employees of the Port of New York Authority were subject to Federal income taxes.

The Court points out that it has never ruled expressly on the precise question whether the Constitution grants immunity from Federal income tax to the salaries of State employees performing, at the expense of the State, services of the character ordinarily carried on by private citizens. The Court also held that—"When immunity is claimed from a tax laid on private persons, it must clearly appear that the burden upon the State function is actual and substantial, not conjectural."

In conclusion the Court said:

"Expressing no opinion whether a Federal tax may be imposed upon the Port Authority itself with respect to its receipt of income or its other activities, we decide only that the present tax neither precludes nor threatens unreasonably to obstruct any function essential to the continued existence of the State Government. So much of the burden of the tax laid upon respondents' income as may reach the State is but a necessary incident to the coexistence within the same organized government of the two taxing sovereigns, and hence is a burden the existence of which the Constitution presupposes. The immunity, if allowed, would impose to an inadmissible extent a restriction upon the taxing power which the Constitution has granted to the Federal Government."

A petition for rehearings was filed in the Helvering v. Gerhardt case and we understand that Justice Roberts of the U. S. Supreme Court signed a stay pending action of the Court with respect to it. The Court but recently declined to rehear the case.

During the closing days of Congress several bills were introduced intended to relieve the serious effect of retroactive application of the impost on salaries of public employees legalized by the decision. No action was taken with respect to these bills. The matter will probably receive attention when Congress convenes.

Conference on State Defense

Concern among State officials and others respecting possible steps that might be taken by the Federal Government based on the decision of the U. S. Supreme Court, Helvering v. Gerhardt just referred to, resulted in the formation of the Conference on State Defense, a nonpartisan organization. It comprises State Attorney Generals. At present those representing 39 States have joined the Conference.

It has been pointed out by the Conference that the Treasury Department and Attorney General of the United States have contended in recent briefs submitted to the U. S. Supreme Court that the net revenues of State agencies and State instrumentalities are subject to corporate income tax under the revenue laws of the United States, also that the Commissioner of Internal Revenue is attempting to collect over $50,000 directly from the Delaware River Joint Commission for Federal stamp tax on its bonds. This Commission is wholly owned by the States of New Jersey and Pennsylvania.

We are informed that the objectives of the Conference include:

Passage, at the next session of Congress, of legislation prohibiting any retroactive taxation of State and municipal employees who had reason to consider themselves immune prior to the decision in Helvering v. Gerhardt.

The prevention of Federal taxation, either prospectively or retroactively of outstanding securities of States and municipalities, and of State and municipal agencies.

The prevention of Federal taxation of the revenues or income of States and municipalities, and of State and municipal agencies, and the prevention of any direct Federal taxes upon them.

Proper presentation of the State's viewpoint on these issues to the American people and to the Congress of the United States.

Defaults (General Obligations)

In our annual report of last November we commended on the continued improvement in curing defaults which had occurred among the more important municipalities. The figures which we used at the time were those compiled by "The Bond Buyer." Again through the courtesy of that organization we are pleased to report that all of the 58 cities with a population of 25,000 or more (1930 census) which were in default at some time during the depression period, have adjusted their problems and are now current. On the basis of more complete information received during the year, four cities were added to the list bringing the total to 58 as above mentioned.

Of the 18 counties with a population of 100,000 or more (1930 census) but one remained in default a year ago. This was Hillsborough County, Fla., which at that time was contesting the validity of certain obligations. Since then the county has recognized its liability to the holders of these bonds and has offered refunding obligations in exchange therefor. We understand that holders of a large percentage of the oldjobligations have accepted the new bonds but that there are still some holders who decline to do so. We also understand that all other general obligations of the county are now current.

Among the 31 school and other districts having a population of 25,000 or more (1930 census) which were in default, all but 4 had been cured as of a year ago and but 1 remains unsettled at this time.

Information Concerning Emergency Appropriations

Through the courtesy of the United States Treasury Department we have in hand an exceedingly interesting and extensive report, as of June 30 this year, of the financial status of funds and analyses of expenditures under the Emergency Relief Appropriation Acts of 1935, 1936 and 1937 as prepared by the Treasury Department. We understand like information accompanies the report of the President to Congress at the conclusion of each fiscal year.

We call attention to the fact that this report is in hand for the reason that it contains a wealth of information concerning emergency appropriations. It is now at your disposal. From time to time questions arise respecting such expenditures or appropriations in the minds of our members and their customers. We are now in a position to be helpful in such cases and suggest that you place your questions before us. If the answer is not found in the report, we believe we can obtain it from the Treasury Department.

As a matter of interest there is appended to our report a summary [this we omit—Ed.] by States of the emergency expenditures during the fiscal years 1935 to 1938, inclusive, also a classification of these expenditures as to types of work and purposes. We believe this information will be found of interest to our members and others.

Model Legislation

The National Committee on Local Government Finance formed in 1937 to design a model fiscal procedure for units of local government and to translate such design into the form of recommended State laws, has not made as rapid progress as had been hoped, largely because of the difficulty in financing the complete program as outlined. The original plans, it will be remembered, called for a three-year program, the first year to be devoted to designing and drafting and the second and third years to promotion, at a cost of $15,000 a year.

The committee had hoped to raise the entire amount ($45,000) before starting its work. This, however, appears to be impracticable. Many of those interested in the project would like to see the conclusioss of the committee prior to contributing to its support.

Consequently, during the past few months, there has developed a growing conviction among the members of the committee that the work of designing the program and drafting the laws should start immediately. This fall the chairman, after consultation with a number of the members of the committee, authorized the secretary of the League to employ a legal research man and draftsman and start work immediately. This was done and the preliminary work of checking existing statutes, investigating standads available in the form of recommendations from various municipal groups and establishing cooperative relations with other committees whose work overlaps to some degree the work of this committee (the Model City Charter Committee of the National Municipal League, for example) has been begun. . . .

Homestead Exemptions

This form of exemption which came into existence but six years ago has developed to a point where there are now 15 States which have provisions for homestead exemptions in one form or another with the amounts of the exemptions ranging from $500 to $5,000, some with an adjustable basis for arriving at the amount which may be exempted. These States are: Alabama, Arkansas, Florida, Georgia, Iowa, Louisiana, Minnesota, Mississippi, North Carolina, Oklahoma, South Dakota, Texas, Utah, West Virginia, and Wyoming.

Arizona is to vote at the coming election in that State for a provision that will exempt all homes occupied by the owner up to a maximum amount of $5,000

We will not attempt here to outline various problems that are created by these exemptions. Attention is again called, however, to the form of homestated exemption existing in Iowa. This was pointed out by your committee in its interim report of May, 1937. It is unique and at the same time a type which, if a State insists upon having homestead exemptions, may be considered as a model which should not disturb the credit position of its municipalities. It is flexible in amount, with a maximum of $2,500. Taxes are levied against individual property of the various taxing districts in accordance with their needs. A portion of this money is turned over to a Homestead Credit Fund and the amounts available in this fund are used as credits against taxes due from owners of homesteads. Maximum credit against such taxes is limited to 25 mills on the $2,500 of valuation as assessed. No credit is given on that portion of the homestead which exceeds $2,500 in assessed valuation. The number of mills of credit is determined by the amounts available in the Homestead Credit Fund.

During the fore part of this year it was proposed in Congress (S. J. Res. 220) that the Constitution of the United States be amended upon ratification of the proposal by three-fourths of the legislatures of the several States as follows:

"Article ——

"Section 1. The homestead of any head of a family, male or female, or of any citizen having one or more persons dependent on him or her for support, shall be exempted from taxation up to $5,000 of its value when occupied by its owner or by his or her dependents as a homestead, excepting only the tax required to pay State, county, municipal, and district bonded debt applicable to such homesteads and outstanding at the date of ratification of this article.

"Sec. 2. The Congress and the States shall have power to enforce this article by appropriate legislation."

It will be noted from the Article that the exemptions do not apply to taxes required to pay State, county, municipal and district bonded debt outstanding on the date the amendment is ratified.

At a hearing on the resolution before a subcommittee of the Senate Judiciary Committee, Senator Morris Sheppard of Texas, speaking in behalf of the proposal said that in Texas the total of homestead values eligible to benefit by the $3,000 exemption was less than 15% of the total property values assessed for taxation and less than 5% of the total lawfully taxable property in the State. He also said "it has been argued that taxation or non-taxation of homesteads is exclusively a matter for the States to determine. The answer to that is that the American people own all our governments and that we are free at our pleasure to use any or all of them, in due constitutional procedure, to serve the general welfare and to preserve our free institutions. Ratification of this amendment would leave the States free to determine, each for itself, what shall constitute a homestead—acrage of homestead farms, and so forth—and to readjust its internal system of taxation to conform to a national policy of homestead tax exemption. The only limitation fixed in the proposed Federal amendment is establishment of a minimum exemption of $5,000. Any State will be free to fix one higher than $5,000 if its people so desire."

State Court Decisions

We are including only such of these as are believed to be of interest to the trade in general or of specific significance locally.

Alabama—The Supreme Court of this State, in a comparatively recent decision rendered in the case of W. F. Herbert v. T. M. Perry, et al. respecting certain interest-bearing Alabama County non-negotiable warrants payable solely out of the gasoline fund derived monthly from the State, held to the effect that these warrants may be issued without regard to the debt limitation.

Considerable interest developed in certain quarters of the municipal bond trade as a result of this decision. Attention was centered, however, on the point of view presented by Justice Joel Brown of the court who, in a dissenting opinion, held to the effect that the warrants are a debt of the county under the limitation provision of the Constitution. He also pointed out practical considerations involved in allowing counties to contract debts and pledge revenues over which they have no control. The gasoline tax referred to is levied and collected by the State which pays half the proceeds to the counties. For further particulars in this situation see "Investment Banking," issue of Aug. 1, 1938, "Alabama County Warrants."

California—The case Southern Service Co. v. City of Los Angeles determined by the Supreme Court of this State resulted in a ruling that taxes may not be levied in one fiscal year to take care of requirements of any later period. This, if enforced, would mean that bond interest falling due after the end of the fiscal year (June 30) and before the date of the first installment of taxes for the next fiscal year (due in November and delinquent Dec. 5) would be unpaid, unless, of course, other funds were available for transfer or tax anticipation borrowing, where power exists for such borrowing, were resorted to.

It is apparent that the Court did not anticipate such an effect as a rehearing has been granted and we understand also a stay in the effect of the decision. Unless the decision is reversed it is pointed out that a technical hardship will be inflicted upon municipal, county and school finances and that it will be necessary to ask remedial legislation at the coming session of the Legislature. It is also pointed out that the Court in its decision is applying a rule that has preserved California municipalities from the evils of unbalanced budgets and floating debts, further, that the decision was in no wise aimed at curtailing the rights of municipal bondholders. It is believed that a satisfactory solution to the problem will be found before July 1 next.

In Loew's, Inc., v. Byram the State Supreme Court held that a taxpayer is legally entitled to pay other tax items without paying his acquisition and improvement district tax. It is likely that this ruling applies to other district bonds including school districts. The result, however, does not appear to be detrimental. In the case of a small district of little or no merit, such as a poor acquisition and improvement district, it might make it easier to effect a compromise with bondholders but frequently residents of such districts have refrained from paying any taxes whatever. In a good district, such as a school district, there would be no object in paying one tax and not paying another because penalties would accrue and the property would be lost by non-payment of any tax. In fact, school taxes are part of the county tax bill and city taxes for the same property are usually collected separately by different officials and there is apparently no preference in paying either tax.

Illinois—In our report of a year ago attention was called to the passage of the so-called Pre-Adjudication Act which provided for a method of adjudicating tax levies by taxing bodies in Illinois with a population of 500,000 or more, excluding the State. The provisions of the Act applied only to tax levies to be made for the year 1938 and thereafter and were designed to provide that objections to illegal levies should be filed with and passed on by the County Court before taxes were extended and bills made out. In theory if a tax rate were found illegal taxpayers both small and large would share equably in the reduction.

But a few weeks ago the Supreme Court of the State declared the Act unconstitutional on the grounds that it did not provide for adequate notice to taxpayers concerning the levies which the municipalities were asking to have validated. We understand that a rehearing of the case has been requested and that if it is not granted or the decision not changed an attempt will be made to have a new act passed at the coming session of the Legislature in form believed to overcome the Court's objections.

Georgia—In a recent decision of the Supreme Court of this State the Georgia laws authorizing the issuance of revenue bonds by municipalities were validated. While this decision is of considerable importance within the State we understand that there are no issues of any size contemplated at this time.

Michigan—Throug case before the State Supreme Court concerning Paris and Wyoming School District No. 6, Fractional, Kent County, it was hoped that the status of limited tax school bonds would be clarified. Unfortunately the Supreme Court decided largely upon the authority of the Public Debt Commission to approve bond issues and disregarded several important phases more directly affecting the status of limited tax bonds.

Minnesota—The Supreme Court on Oct. 8, 1937, in the case of Bergman v. Village of Golden Valley, held that water main certificates of indebtedness issued under Laws of 1921, Chapter 425 are general obligations although special assessments were levied as required by the law for their payment. The same rule would seem to apply to paving certificates of indebtedness issued under Chapter 65, Laws of 1919 as amended, since the statutes are practically identical. The case is of particular importance as showing that the Court will not necessarily follow the rule it laid down in Judd v. St. Cloud, 1936, 198 Minn. 590, 272 N. W. 577, that "where a municipal corporation by authority of law creates a particular fund with reference to which it contracts, any indebtedness arising on such contract is payable therefrom only."

Montana—On May 31, 1938, the Montana Supreme Court in the case of Rogge v. Petroleum County held that a county may not levy taxes for its Bond Sinking and Interest Fund in an amount substantially in excess of the debt service requirements of the fiscal year for which the levy is made. Where the amount on hand is adequate, no levy can be made. The County Board has no authority to levy taxes to create a fund with which to buy in its outstanding bonds at a discount before their due date.

North Carolina—Debt Limitation: In a case where a county, which had failed to decrease its debt during the previous year, sought to issue bonds to build a high school building without a vote of the people, the Supreme Court of the State, in Halyburton v. Board of Education, 213 N. C. 9, held that such bonds are prohibited unless approved by the people.

Tax Rate Limitation: In a case where a city sought to refund its bonded indebtedness requiring a tax to pay such bonds in excess of the rate allowed by local law at the time of the refunding, though not in excess of the rate allowed at the time the original bonds were issued, the Supreme Court, in Bank v. Bryson City, 213 N. C. 165, held in effect that the old power governs otherwise the taxing power pledged for the original bonds would be decreased. Accordingly, this limitation is not binding with respect to refunding bonds issued to replace those existing when the limitation on tax rates was passed.

Ohio—An important decision was handed down by the Ohio Supreme Court on July 13, 1938. It follows a long line of opinions rendered in favor of bondholders against municipalities which had issued limited tax bonds, particularly special assessment bonds. The present case was brought by the Ohio National Bank of Columbus against the Village of Hudson. The decision is more sweeping than any previous one handed down by the Court. Briefly, the result is, we understand, that all general obligation bonds issued in Ohio prior to Jan. 1, 1931, may now be paid from unlimited taxes, if necessary, despite either the 15 or 10-mill limitations. This decision is based on the fact that in another section of the State constitution, it requires that when bonds are issued "a sufficient tax shall be levied" to pay interest thereon and retire principal at maturity. Previous opinions of the Court had held that bonds issued under a former 15-mill limitation were still entitled to such 15 mills, even though the State Constitution now provided a tax limitation of 10 mills. In general, Squire, Sanders & Dempsey contend that refunding bonds issued prior to such date are also entitled to unlimited taxes, if necessary. The date of Jan. 1, 1931, is used because that was the first time the 15 mill tax limitation was ever written into the State Constitution. Prior to that time, only a statutory limitation was in effect.

During August, 1937, a law was passed authorizing county treasurers to refund in cash all 10% penalties and 8% penalty interest charges paid on delinquent tax payments between June 20, 1930 and Jan. 1, 1937. This measure was known as the Ogrin Act. A test case was instituted and the Supreme Court on May 4, 1938, declared the Act unconstitutional not only because it was discriminatory, but also because it was retroactive. Should the Act have been held valid it is estimated that Cuyahoga County alone would have been obliged to refund over $1,500,000.

South Dakota—In a decision handed down Aug. 10, 1938, in the case of Rice v. City of Watertown it was held that the constitutional debt limits based on value of taxable property of 5% for general purposes, 10% for water and sewers, and 8% for street railways and electric plants are mutually exclusive and debts for any of the various purposes are chargeable only against the particular limit for such purpose. The effect is that a city may incur debts for the several purposes up to a 23% total without regard to the order in which they are incurred. We understand that this interpretation of the constitutional language is in accord with that given to similar language by the courts of Arizona, Missouri, Utah and Washington, and is contrary to that given by the courts of Montana and some other States.

Legislative and Other Developments in the States

This year the Legislatures of but nine States met in regular sessions will 10 others met in one or more special sessions. Concerning matters coming under this heading we will, as was done in connection with State Court decisions, include only such as are believed to be of interest to the trade in general or of special significance locally.

Alabama—While there was no legislative session in this State during the year it is interesting to note the steady progress made by the State in the retirement of its bonded debt. During the calendar year it will have retired a total of $2,800,000 of which close to half was purchased out of excess revenues from income tax collections. The balance of the debt retirement was a result of serial maturities. . . .

Arkansas—At the present time there is a proposed amendment to be voted on by the people of this State at the coming election. As a precautionary measure the language of this amendment is now being reviewed by the Supreme Court in a friendly injunction suit. The revenue provisions of the proposed amendment would pledge Arkansas to maintain highway revenue applicable to the payment of the highway debt at a minimum of $8,985,000 annually. In addition to the pledge of existing levies for the highway fund, the State would also covenant to impose and collect ad valorem, excise or other levies to maintain revenue at the minimum. . . .

In the section devoted to the highway fund, the proposed amendment stipulates that should revenue reach $10,985,000 in any fiscal year, the excess may be used to match Federal highway aid, to finance now construction by the State, or for bond redemption at the Legislature's discretion. . . .

Arizona—At the coming election in this State voters will have the opportunity to express themselves concerning a homestead exemption provision which briefly, provides that all homes occupied by the owner shall be exempted in the maximum amount of $5,000. There appears to be a divided opinion as to whether such exemption would apply to bonds issued prior to the enactment of the proposed amendment.

California—Of interest is the fact that the Nevada Irrigation District in its reorganization provided new bonds containing a provision that their terms may be modified by agreement of 75% of the holders. This provision in a municipal obligation is, of course, very unusual.

At the coming election in this State on Nov. 8 the citizens will have to decide about 25 different propositions of which no fewer than 19 are attempts to amend in one form or another the organic law of the State. Three of the proposals are of marked significance to all interested in municipal financing through their probable ultimate effect, if passed, on the credit position of the State and its various subdivisions.

One of these, known as the Garrison Bond Act, is designed to establish a State-wide basis of revenue bond issuance for all public ownership projects by but a majority vote of the people. We understand that this provision is so drawn as to give no assurance of sound financing in the revenue field. It would probably encourage numerous unsound projects which in time may reflect on the credit position of the respective municipalities.

Another proposal, known as the California Retirement Life Payments Act, has had such wide publicity throughout the country that it is unnecessary to recite here particulars of the plan beyond perhaps stating that the warrants authorized by it have not the support of the taxing power or credit of the State. It is important that attention be called to the fact that these warrants by the terms of the amendment must be accepted by the State and its political subdivisions in payment of taxes, license fees, &c., and in payment of all other debts or obligations due them. This quite obviously would destroy the value of governmental taxing power which is the basis of municipal credit.

Among questions that naturally arise with respect to this plan are whether provisions of it, of sufficiently vital importance, are contrary to the California constitution to the extent that they nullify the whole plan, also whether the warrants would constitute a form of tender considered to be in competition or conflict with U. S. currency, thus raising the point of Federal constitutionality. . . .

Florida—There was no legislative session in this State in 1938. It is nteresting to note, however, that substantial progress has been made during the year in clearin up a great many s tuations through refunding issues principally with present holders. There is, of course, considerably more work to be done along this line but it is primarily with the small municipalities.

Georgia—Last December Gove.nor Rivers of this State signed a measure passed by the Georgia Legislature providing for homestead exemptions in the amount of $2,000. No legislative provision was made to replace the loss of revenues resulting from this exemption.

Kansas—An act was passed at the special session of the Legislature validating, ratifying, approving and confirming all bonds issued prior to the passage of the act and subsequent to July 1, 1933 for the purpose of financing or aiding in the financing of any work, improvement, undertaking or project by any public body in the State. This enactment is important as the validity of some of the bonds previously issued, particularly those issued under acts which might be construed as constituting special legislation were uncertain.

Kentucky—At a special session of the Legislature this year a measure known as The County Debt Commission Act was passed and is now in effect.

The finances of several counties in Kentucky with respect to certain of their outstanding obligations have been in bad shape for some time past. By this Act the Department of Revenue of the State is empowered to investigate the county debt situation and negotiate between county officials and their creditors for an appropriate solution. It should mean a great deal to Kentucky and to the holders of the bonds affected if these situations can be cleared up.

Louisiana—At the regular session of the Legislature there were a number of bills providing for new bonds and proposing constitutional amendments which are to be voted upon by the electorate on Nov. 8. Among the proposed constitutional amendments are several authorizing additional issues.

New Jersey—Among various enactments in this State one of particular interest to municipal dealers and investors is an act signed by the Governor on May 17 1938, amending the law relating to investments by fiduciaries. The new law is very much of an improvement over the one formerly in effect.

New York—Of particular interest at this time are the amendments to the constitution of the State which will be submitted to the people at the approaching general election. Those proposed as a result of the constitutional convention are very extensive. Article VII of Amendment No. 1 deals with "State Finances" and Article VIII with "Local Finances." Both of these Articles are constructive and improve the present laws relating to these subjects. Amendment No. 9 provides for New York City transit unification. This involves excluding from the debt limit of the City of New York $215,000,000. Such bonds if issued would be offered to the public only in part, as many would be exchanged for outstanding obligations of the privately owned companies and a portion would probably also be acquired by special funds of the city. . . .

North Carolina—At a special session of the State Legislature a measure was passed known as the Revenue Bond Act of 1938. It authorizes counties, cities, towns, and sanitary districts to acquire, construct, improve, &c., revenue producing undertakings, to maintain and operate the projects, and further, in anticipation of the collection of the revenues, to issue negotiable bonds payable solely from such revenues.

This act has alrady stimulated issuance of bonds and their sale through the Local Government Commission at Raleigh. Theere is an increasing number being authorized which are yet to be sold. We understand that so far a ready market has awaited the offering of these issues. . . .

Ohio—Deliquent Tax Commission—Effective May 17, 1938, a delinquent tax commission, consisting of nine members, was created to study the delinquent tax situation in the State and to make special recommendations for methods of liquidating these items. Since then the commission has held numerous hearings. This is an involved situation but there are many phases of it which can probably be partly corrected. Apparently a serious effort is being made toward this end. Particular emphasis is being placed upon present foreclosure laws with a possibility of recommendation being made to authorize the sale of tax liens on delinquent parcels.

Authorizing Federal Aid Bonds—An act effective Oct. 19, 1938, permits subdivisions to issue bonds with or without vote to provide money to finance their share of Federal Aid projects. If the bonds are not voted, they may be issued in excess of debt limitations up to the amount of debt of the subdivision as reduced between Oct. 19, 1938, and Dec. 12, 1943. While this appears to be another instance of legislation setting aside previously determined debt limitations, this Act is not of serious consequence, inasmuch as the indirect debt limitation existing by virtue of the tax limitation will prevent issuance of such securities in a great number of instances.

Tennessee—County Highway Bonds Reimbursable in whole or in part by the State: In May, 1937, an act was passed to reorganize the debt structure of the State, containing provisions whereby the State could pay off its Highway Reimbursement obligation to the counties, amounting to about $35,000,000 at that time. While the act made specific provisions as to the means of raising the money by the State, the method of paying the counties and certain details as to how the counties would pay off their Reimbursement bonds were very indefinite, and were left to the State Board of Claims. This Board adopted a policy which presumably will be in effect until Jan. 1, 1939. . . .

Inasmuch as neither the act nor the policy of the Board of Claims are a contractual obligation with the counties or the holders of county Reimbursement bonds, the whole situation is subject to change by the new legislature which convenes in January, 1939. It is generally expected that some changes in the county reimbursement situation will be made. . . .

Texas—Regulations affecting State Banks: The State Banking Commissioner, pursuant to an opinion by the Attorney General, issued certain regulations limiting the amount of bonds of any one issuing municipality, which might be held by the State banks, to 25% of the capital and surplus of any such institution. Another regulation of the Commissioner requires that banks have in their files certain information on each bond held by the bank, such information being substantially that which is usually furnished in a municipal bond circular. . . .

Mr. Norman S. Taber engaged as Advisor and Consultant: In accordance with Senate concurrent resolution of the Legislature the State acting through its Highway Commission, entered into a contract dated Jan. 5, 1938, with Norman S. Taber of the firm of Norman S. Taber & Co., New York. Under the terms of this contract Mr. Taber is to act as financial advisor and consultant to the State Highway Commission and to make a complete study and analysis of county and road district bonded indebtedness and other matters pertaining to the financial affairs of the State and its subdivisions which have bearing on county and road district bonded indebtedness. Mr. Taber is also to formulate a debt reorganization program and make recommendations intended to reduce the annual burden of the present county and road district indebtedness including recommendations for legislation which might be considered necessary to accomplish the purpose. At the writing of this report Mr. Taber's recommendations have not been officially filed.

Municipal Division Council

At the May meeting, the Board of Governors by resolution created the Municipal Division Council to comprise seven members, the Chairman of the Municipal Securities Committee as Chairman and six others actively engaged in the municipal bond business and occupying executive positions with member houses at least a majority of whose security business for the three years preceding the appointment has been in municipal bonds.

Copy of the provisions respecting the Council were distributed to members shortly after the meeting last May. For immediate reference, however, a copy is appended to this report. Creation of this Council and the authority which has been given to it provides greater autonomy for the Municipal Division. It is not intended that the Council supersede the Municipal Securities Committee in any of its established functions. The Council is empowered to authorize actions, pronouncements and appearances by its own members or those selected by it in connection with proposed or actual legislation, rules or regulations, &c., without awaiting authorization by the Board of Governors provided, however, that in any such pronouncements, statements or appearances it shall be stated that the presentation represents the views of the Municipal Division solely unless the Board has authorized that Division to speak for the Association.

Investment Securities for Banks

As of July 1, 1938, there became effective revised investment securitic regulations of the Comptroller of the Currency and revised procedure for bank examinations as agreed upon by the Secretary of the Treasury, the Board of Governors of the Federal Reserve System, the directors of the Federal Deposit Insurance Corporation and the Comptroller of the Currency. They represent very much of an improvement and should be helpful in overcoming certain phases of bank investments which have been found troublesome.

The new regulations of the Comptroller omit any reference to rating manuals. The revised procedure in bank examinations, however, in its definition of Group I securities specifies "general market obligations in the four highest grades and unrated securities of equivalent value." Group II securities includes "general market obligations in grades below the four highest, and unrated securities of equal value."

Provision is made for valuing securities in Group II "at the average market price for 18 months just preceding examination and 50% of the net depreciation will be deducted in computing the net sound capital."

Special Committees

Municipal Ratings—As was stated in the last annual report our Chairman, Mr. Linen, had appointed a special committee comprising Messrs. Henry Hart (Chairman), Rollin G. Andrews, Eugene I. Cowell, Brownlee O. Currey, I. A. Long, Francis Moulton and John Nuveen Jr. to study the matter toward the end of proposing some form or basis of ratings for municipals that may be found to be better suited than the form now generally followed.

Circular Recommendations—Directly following the last annual meeting Mr. Linen, acting in accordance with the resolution passed at that meeting, appointed a special committee to review and study existing municipal circular recommendations toward the end of revising them to cover developments and changed conditions which had since occurred and for the purpose of inducing uniformity in presentations insofar as practicable. . . .

Non-negotiability—In line with our effort to encourage adequate disclosure of all material facts and supplementing the report on General Circular Recommendations for Municipal Securities, it appeared desirable to deal in some appropriate manner with this subject. It is a legal matter and dealers necessarily have to rely on attorneys for the information. With this in mind our Chairman has conferred with several municipal attorneys and has communicated with about 40 others in an effort to arrange for the inclusion of the feature, in some practical form, in their approving opinions.

Respectfully s ibmitted,

MUNICIPAL SECURITIES COMMITTEE

John S. Linen, Chairman

John P. Ballman	John L. Kenower
Cecil A. Burnham	J. Ritchie Kimball
Francis B. Childress	James D. McGee
Randolph P. Compton	George L. Martin
George T. Curley	J M. Maxwell
Rush S. Dickson	Donald O'Neil
Willis E. Doll	Aaron W. Pleasants
F. D. Farrell	James F. Quigg
H. Fred Hageman Jr.	J. Creighton Riepe
Paul C. Harper	J. D. Robinson Jr.
Malvern Hill	Robert O. Shepard
Devereux C. Josephs	Norman D. Weeden

F. W. Willey

Report of Industrial Securities Committee of I. B. A. by Karl Weisheit, Chairman—Total Volume of Industrial Financing for Year to Sept. 30, 1938, Approximately $600,000,000 or Less Than Half That of Preceding Year—Prime Essential for "Brisk New Capital Market" Is Restoration of Confidence in Profit System and in Future Stability of Economic and Political Conditions

Noting that the volume of industrial financing in the year ended Sept. 30, 1938, was approximately $600,000,000 compared with $1,340,000,000 in the year before, the report of the Industrial Securities Committee of the Investment Bankers Association, points out that "the prime essential for a brisk new capital market is the confidence of issuers and investors alike in the future level of profits and more important, in the future stability of economic and political conditions both nation-wide and world-wide." "The partial drying up of the new capital market," the committee observes, "is not a separate phenomenon to be attacked as such; it is a small but important part of a general problem of sweeping proportions, the solution of which is to work for the fundamentals which will restore confidence in the future of the profit system in our economic life." We give the report in full herewith:

The total volume of all industrial financing during the 12 months ended Sept. 30, 1938, was approximately $600,000,000, or less than half of the $1,340,000,000 in the corresponding period a year earlier. Reflecting the alteration in business conditions and outlook from those obtaining in the preceding year, there were but few new common stock issues. Issues for new capital purposes amounted to 82% of the total—a new high in a trend which has been progressing for several years and as such deserving of attention, although the significance of this figure is lessened by the fact that during most of the period business activity and markets were declining sharply and thus tending to reduce possible savings through refundings.

The really important point in the record of industrial financing in the 12 months under review, as we see it, is the sharp curtailment in volume during most of that time which is brought out more clearly when it is realized that more than 70% of the total was done in the last 4 months of the period. It is important, obviously, to investment bankers, but even more so to the country as a whole, for resumption of a heavy flow of money into industry would inevitably be a vital part of a vigorous recovery spiral affecting everyone.

The decline in the volume of financing is illustrative of a truth which is well-known, certainly to investment bankers, but which seems worth some exposition in the hope that it may help to clarify thinking on a matter which has recently been the subject of considerable public discussion. The truth to which we refer is simply that, now that much of the formerly potential refunding has been accomplished, the flow of investment capital in this country depends primarily on the demand for new money by industry for productive purposes and on the simultaneous willingness of investors to supply funds for those same purposes. But it is not enough that there be a need for and a supply of funds at the same time; both the corporation seeking additional money and the investor must be satisfied that the use to which the money is to be put is sound and reasonably likely to result in a fair profit or return. Thus, regardless of idle bank deposits and overflowing institutional treasuries, no financing will materialize if investors are not convinced that Company A, which wants capital badly, will be able to employ it to advantage without excessive risk, nor will there be any financing if Company A, after realistic appraisal of the prospects, should itself have too much doubt of the future profitableness of the venture to dare to undertake it. In other words the prime essential for a brisk new capital market is the confidence of issuers and investors alike in the future level of profits and, more important, in the future stability of economic and political conditions both nation-wide and world-wide. It was lack of such confidence, of which the weak stock market was a partial expression, which was the fundamental cause of the severe curtailment of industrial financing in the year ended last September. And it is significant that in June, July and August, when there was an improvement in sentiment, the volume of new industrial financing was double that in the preceding 8 months.

Now all of this is admittedly elementary, but the aspect which is interesting to us is how investment bankers fit into the picture. It is a commonplace to say that it is in their selfish interest to do everything possible to help stimulate the flow of capital, and that this selfish interest exactly parallels the public interest in the capital market as an integral part of any prolonged recovery movement. The very business life of each of us in this Association is directly dependent on the volume of financing, in large part for new productive purposes, which is being done from month to month. That each investment banker is acutely aware of this is evident from the steady narrowing of underwriting spreads reflecting keen competition for what business could be done.

Granting that we all want a more active new issue market, it is still true that we are merely in the position of an intermediary. Investment bankers can advise with and supply ideas to corporate managments and to investors. At times they can even be persuasive, although not without risk of being charged with putting their own interest above that of the corporation and the investing public. But bankers cannot create new business. That can come, as noted above, only with confidence not only in the general situation but also in specific cases against the background of general conditions. Our function commences only after the demand and supply factors are both present, and consists of bringing the two together. We are charged with the task of judging whether or not there is adequate demand for each individual bit of proposed financing, and we have a public duty to make those decisions correctly. Our own interest, as already pointed out, is to say "yes" whenever possible. It is disappointing to have to say "no," but it is just as much our public duty to make that answer when proposed new issues do not measure up to tests of soundness or seem unsaleable because of lack of demand for securities of their particular nature as it is to make an affirmative answer whenever proper. It is really worse from the point of view of public interest to go ahead with an issue for which there is insufficient demand or for which the issuing corporation insists on too high a price than it is to defer an issue which might ultimately prove to have been marketable. An unsuccessful piece of financing has a positive retarding effect on the future flow of new capital in that it tends to break down existing confidence, to weaken the market for similar securities and to tie up investment banking capital which might otherwise have been available for additional financings.

We as investment bankers can do little to increase the activity of the new capital market. We cannot create demand or supply, nor can we set out deliberately to purchase and hold securities which we are prepared to underwrite. Furthermore, the addition of more public or private financing agencies would not meet the main problem, for investment bankers are already equipped and eager to handle a much greater volume of sound financing than is now being done. Public agencies can, of course, invest huge sums directly in industry, but that raises serious questions of the ultimate effect of such a policy and of the propriety of using public money for the purpose of supplying capital for ventures which bankers and investors consider too risky for financing through the usual private channels. Backing for such projects used to be furnished in large part by wealthy individuals who could afford to assume the heavy risks and who were tempted by the hope of commensurate profits. Extreme income and inheritance taxes have changed all that.

The partial drying-up of the new capital market is not a separate phenomenon to be attacked as such; it is a small but important part of a general problem of sweeping proportions, the solution of which is to work for the fundamentals which will restore confidence in the future of the profit system in our economic life.

Respectfully submitted,

INDUSTRIAL SECURITIES COMMITTEE

Karl Weisheit, *Chairman*

Henry M. Bateman	Arthur E. Kusterer
Paul W. Cleveland	Ranald H. Macdonald Jr.
William R. Daley	R. Verne Mitchell
Paul H. Davis	Joseph D. Murphy
F. Dewey Everett	F. Ward Paine
Albert H. Gordon	William H. Putnam
Clarence L. Harper	Sidney J. Weinberg
Chapman H. Hyams III	Claude W. Wilbide

Note—All figures relating to the volume of industrial financing have been compiled from data published by The Commercial & Financial Chronicle.

Report of Federal Taxation Committee of I. B. A.—Renews Recommendations as to Capital Gains Tax—Finds Modifications Made in Undistributed Profits Tax More Satisfactory Than Those Tentatively Suggested by Association—Further Amendments Sought

Previous recommendations regarding the capital gains tax were renewed by the Federal Taxation Committee of the Investment Bankers Association in its report adopted by the Board of Governors of the Association at its White Sulphur Springs convention on Oct. 27. The report, presented by Chairman James J. Minot Jr. of Jackson & Curtis of Boston, said that "in the opinion of disinterested observers there is a distinct probability that there will be further tax legislation in the coming winter." "We feel," said the Committee, "the capital gains tax should be further amended so it will do more to relieve what might be termed the average investor with an income of say from $5,000 to $25,000." The report follows:

The I. B. A. of America adopted the report of its Federal Taxation Committee on May 10, 1937, which recommended repeal or substantial modification of the tax on undistributed profits. This was reiterated at a meeting of our Association on Nov. 6, 1937, at which time a resolution was also passed advocating the repeal or substantial modification of the undistributed profits tax in a pamphlet which had widespread publicity. Later, specific suggestions for a revised capital gains tax were made.

The attitude of Congress at its last session in its tax legislation proves conclusively there is a real desire to cooperate with business. Modifications made in the undistributed profits tax were in our opinion more satisfactory and accomplished more good than the ones we suggested tentatively. The Act in its final form was distinctly a long step in the right direction. While we still must insist that the entire principle is fundamentally wrong and should at some time be eliminated, nevertheless it seems unwise when more important tnings must attract the attention of Congress to labor the point at this time.

Changes in the capital gains tax showed that Congress is again returning to the principle which governed the treatment of capital gains and losses in the period of 1922-1933. Congress has already offered private investment capital considerably greater incentive than it has had for several years. Again, I think we should commend Congress and particularly the Ways & Means Committee of the House and the Senate Finance Committee for their constructive work in passing the 1938 tax legislation.

In the opinion of disinterested observers there is a distinct probability there will be further tax legislation in the coming winter. We feel the capital gains tax should be further amended so it will do more to relieve what might be termed the average investor with an income of say from $5,000 to $25,000. Our industry is in an enviable position as our recommendations are made from an unselfish point of view in order to encourage a normal flow of new capital into industry.

We suggest again our recommendations regarding the capital gains tax:

1. Capital gains to be placed in a category separate from income; gains and losses to be averaged over a three-year period.
2. The maximum tax to be 20% on capital gains of $1,000,000 and more, the rate being scaled downward from that bracket in about the same ratio as the present surtaxes; the time element to be recognized by the allowance of a credit of 1% against a taxable gain for each month (after an initial 30 days) during which the taxpayer held the asset upon which the gain was realized; this time credit to be limited to a maximum of 50%, the percentage of a gain subject to tax remaining constant after the 51st month.

We have made no attempt to give a factual synopsis of the 1938 tax bill as this has been done many times by other organizations. We do feel definitely that our recommendations carried real weight and that we had a part in helping to secure tax legislation in its present form.

Every member of our Association is urged to talk frequently with his Senators and Congressmen about business problems. In our opinion the great majority will welcome this contact as our business deals with all business and we are the vehicle through which new funds for industry should come. Congress showed their cooperative spirit in the last session and it is up to us to give them all the help we can.

JAMES J. MINOT Jr., Chairman

Harcourt Amory	Wm. M. Marshall
Sherman Asche	Harold C. Payson
F. Malbone Blodget	G. Willing Pepper
Yelverton E. Booker	Charles C. Renshaw
Chauncey P. Colwell	Francis T. Ward
Edward J. Costigan	Pearson Winslow
Joseph T. Johnson	

Report of State Legislation Committee of I. B. A.—Nine States in Regular Session During Year—Securities Laws Amended in Three States—Committee Regards Attitude of Securities Commissioners as Constructive and Helpful

"The attitude of Securities Commissioners toward legitimate investment banking business is definitely constructive and helpful," says the report of the State Legislation Committee of the Investment Bankers Association, headed by Jay N Whipple of Bacon, Whipple & Co. of Chicago. With nine State legislatures in session during the year, three—Kentucky, Massachusetts and Virginia—amended their securities laws, according to the Committee, whose report follows:

Nine State legislatures have been in regular session since our last convention. These States are:

Kentucky	New Jersey
Louisiana	New York
Massachusetts	Rhode Island
Mississippi	South Carolina
Virginia	

Of these, Kentucky, Massachusetts and Virginia amended their securities laws. In New York, two bills of importance were passed, amending certain sections of the Penal Code and relating to broker and dealer transactions in securities.

In a number of States, special sessions of the legislature were held during the year. Most of these, however, related to taxation which will be reported by another committee, or to other subjects of no specific importance to investment bankers. In Ohio, however, at a special session, comprehensive amendments were made to the securities law.

Appended hereto is a summary statement, by States, of amendments to State Securities laws made during the year. Careful consideration should be given to these amended provisions by those interested in the laws of these respective States.

General Trends of Legislation

When securities legislation is by amendments and more or less sporadic, it is not always possible to visualize any general trends. This year, however, there appears to be an observable general trend in certain particulars. The Securities Commissioner of Kentucky, Joseph W. Schneider, in a paper read at the convention of the National Association of Securities Commissioners, at Kansas City, Sept. 20 to 22, so well covered this subject as to justify quoting therefrom. In part, he said:

"Before beginning the discussion of 'Trends' it might be well to remember that it was the abuses which crept into the securities business over a period of years which brought into existence certain definite trends in Blue Sky legislation. It might, in truth, be said that it was the Depression and its consequent financial disasters which threw the spotlight on those abuses and had such a tremendous influence on the thinking and general attitude of legislators and government officials, and which might further be said to be the reflected general consensus of public opinion and public thought. It goes without saying that there was an inflamed public attitude toward everything financial, and it was only natural that the public should think that the blame should be put somewhere, although just where nobody actually knew. It therefore happened that some drastic changes were made in the Blue Sky laws while the public and the legislators and government officials were in this general frame of mind, some of which have worked out to the general good, while some of them proved actually harmful. With the passing of time, however, a better understanding of the real and multiple causes of the Depression has changed that attitude. We now find ourselves back to the place where legislators, government officials, legitimate dealers, and the public actually feel the necessity of being definitely helpful to sound business, and the idea of punishing those who were at one time considered responsible for the Depression and its consequent disasters has disappeared. May we not consider this a trend of no small import?

"One of the first trends, or lack of trends, to which I shall direct your attention is that with respect to the fundamentals of the various State Blue Sky laws. In the early days of Blue Sky legislation there was a lack of any degree of uniformity. Each State, as it adopted this type of legislation, tried to improve on what had gone before, the result being that securities laws have converged into about four general types of laws which might be designated as follows:

"1. Investment Companies Acts
"2. Regulatory Acts
"3. Fraud Acts
"4. Dealer's Registration Acts

"In general, these types of laws have remained during the past several years quite as theretofore enacted. We do find two recent exceptions, however, that of a Southern State which abandoned its 'Investment Companies Act' for the Regulatory type of law and one Eastern State which combined a fraud type of law with the Dealer's Registration or Licensing provision, thus strengthening the requirements as to the information which may be required by the Commissioner and veering that law more toward the Regulatory type. While we find as many as 20 States amending their securities laws in some particular during the year 1937, they have not materially modified the general type of law theretofore in existence.

"Securities are the most technical part of the business world, and politics, tax reforms, and labor reforms are largely responsible for the inertia in which the investment business finds itself today. New issues are few and far between as compared to their heyday prior to the panic of 1929. Therefore, the development of secondary offerings over the past three or four years has presented a problem, particularly to those States having the Regulatory type of law, the solution of which by several States marks an important trend.

"I might cite as one of the lesser trends, but nevertheless a definite trend, the exemption of transactions by registered dealers executed upon customers' orders on any exchange or in the open or counter market, but not the solicitation of such orders. There are, of course, appropriate retrictions coupled with this exemption. In connection with this trend I might say that it is the opinion of some securities commissioners that a dealer should be relieved of any liability for the non-compliance with the securities laws of his State if he is merely acting as agent for his client at his client's request.

"From time to time efforts have been made to clarify provisions of the Blue Sky laws with respect to securities issued pursuant to the reorganization of a given company. One method provides a partial exemption for securities issued pursuant to reorganization, with appropriate restrictions or qualifications, such as when reorganization has been effected through a Federal court under Section 77b of the Bankruptcy Act. Still another method adopted for the sale of reorganization securities is that providing for a hearing upon the plan of reorganization by the Commissioner of Securities of the State in which the reorganization takes place.

"Because the dealer and his agents represent the contact between the issuer of securities and the ultimate purchaser, one of the decided trends with respect to the licensing or registration of dealers and salesmen is that of demanding more information concerning the applicant, the exercising of more rigid supervision over the activities of both, and a more exacting demand for the showing of financial responsibility of dealers.

"One of the definite trends, and one which undoubtedly strikes the fancy of all concerned and is perhaps a bright spot on the picture in this day of regulation and supervision and the multiplicity and duplication of regulation and supervision, and one which will undoubtedly strike a responsive chord on the ears of both issuers of securities and the dealers interested in their offering or sale, is the considerable trend toward coordination of State laws with the Federal Securities Act. This trend is manifested by the practice of permitting the use of the prospectus required under the Federal Act, and some of the States have gone so far as to accept not only the prospectus but a copy of the Federal Registration Statement in lieu of the information otherwise required under their State Blue Sky laws, and while I as Commissioner of Securities in Kentucky have not gone so far, this trend will undoubtedly be a relief to the issuers of securities and the attorneys who prepare their applications for presentation in the several States by way of eliminating some of the so-called governmental red tape.

"A major trend, but one which is not necessarily included in the trend of Blue Sky legislation, and one which has gathered considerable momentum even since our last Convention, is the trend toward the adoption of uniform forms by the several States. This movement had its inception some years ago and the diligent work of Chester R. Montgomery and his Committee on uniformity in giving members of our Association their first uniform forms will, in my opinion, long be remembered as a major achievement of our Association. Since the subject of 'Uniformity' has been discussed at length in previous conventions and will perhaps be dealt with separately during this Convention, no further comment is deemed necessary at this time."

Uniformity and Simplification

Although the subject will be covered more fully by the Uniformity Special Committee, it should be stated here that the movement for greater uniformity and simplicity in the securities laws and the forms for compliance therewith is making slow but definite progress. To illustrate: In Massachusetts and Ohio there were inserted, this year, provisions for the filing of copies of the prospectus or registration statements filed with the Security and Exchange Commission, in lieu of the forms otherwise prescribed by the law for the registration of securities in those States. This obviates the time and expense necessary to the breaking-down of factual statements required by the Federal Act into other specified forms for use by the States.

Administration of Securities Laws

The attitude of Securities Commissioners toward legitimate investment banking business is definitely constructive and helpful. They are fully cognizant of the economic necessity for continuing the flow of capital to industry. They are awake to the dual responsibility of their official position, that of protecting the public against fraud and deceit, and of fostering legitimate business in every practicable and possible way.

On different occasions this committee has called attention to the unfortunate frequent turnover in the personnel of the administrators of these most important laws—the securities laws. Records disclose that the average tenure in office by a Securities Commissioner is but little more than two years. This, of course, is occasioned by the exigencies of our political system and the failure to place such highly specialized administrative positions on the merit system. The success of any securities law, both as to workability and effectiveness, depends almost wholly upon its administration, and administration is dependent upon experience as well as ability. It all too frequently happens that at about the time the requisite experience is acquired, the turn of a political wheel of fortune forces a change. As a consequence, both the investors and legitimate industry are liable to suffer for a time.

Every securities law is revenue producing to the State. This is accomplished through a fee system for qualification of securities or licensing of dealers and salesmen, or both. These fees are paid by issuers seeking public financing or by underwriters and dealers in securities. The sole legal purpose of such fees is to afford an efficient administration of the law producing that revenue. A number of the States, however, derive from the fees under these laws a revenue considerably in excess of that appropriated for the administration and enforcement of the law. Some States have even publicized, with apparent pride, the excess revenue which is turned into the general fund of the treasury and used for other purposes. This, too, has often happened while the administration of the securities law was suffering for lack of sufficient personnel, adequately paid to be inviting to a continuing competent administrative force.

Looking Forward

The year 1939 will be an active one in point of legislation. Five States have already indicated intentions of "bringing up-to-date" their respective securities laws. Securities Commissioners, members of the legislatures and State officials, generally, will welcome constructive suggestions when made in the interest of promoting legitimate industry and the safeguarding of the public interest.

Respectfully submitted,

STATE LEGISLATION COMMITTEE
Jay N. Whipple, Chairman

Edwin O. Baker	John D. Harrison
Marcus L. Baxter	John Inglis
Burle D. Bramhall	Harry W. Kerr
Waller C. Brinker	I. A. Long
James G. Callaway	William A. Simonton
Charles S. Cheston	Leland Speed
John Dane	James D. Van Hooser
Russell K. Dunbar	Charles W. Warterfield
John S. Fleek	Ellicott H. Worthington

Edwin J. Wuensch

As an appendix to its report the State Legislation Committee furnished a summary by States of amendments to State Securities Laws during 1938.

Report of State and Local Taxation Committee of I. B. A.—Of 15 State Legislatures Which Met in 1938 Only Three Adopted New Tax Measures

The fact that "only 15 State Legislatures met in 1938, and of these only three adopted new tax measures," prompts the State and Local Taxation Committee of the I. B. A. to state that "the year 1938 can be classified as a fortunate one for the taxpayers of States and the political subdivisions." It adds that "the many tax laws already on the statute books of the 48 States are an extremely heavy burden on real estate and business generally," and "it would be a cause of great rejoicing to find some State administration which . . . effected sufficient savings to warrant the elimination or reduction of some State and local taxes." Thomas W. Gregory Jr., of Gregory-Eddleman Co., Houston, Tex., is Chairman of the committee, whose report we give herewith:

During the year 1938 there were only nine States that had regular sessions of their Legislatures, although, supplementing these, six additional States held called sessions. Time and space does not permit your committee to detail all changes in the revenue laws of the various States, so we will briefly list, by States, the changes which we consider to be most material.

The Arkansas Legislature met in special session last March, but no tax legislation of consequence was enacted.

The California Legislature met in special session last March, but here again no tax legislation of consequence was enacted.

A special session of the Georgia Legislature met last November and carried through until February of 1938, enacting several measures affecting tax revenue:

1. Homestead exemption was granted on real property up to a $2,000 value.
2. The Income Tax Act was amended in an effort to clarify certain provisions, particularly those relating to definition of a resident, deletion of the minimum tax provisions, and credits allowed certain fiduciaries, and authorizing deduction from gross income of the Federal net income tax paid during the preceding year.
3. Intangible personal property classified for taxation placed a levy of 10c. per $1,000 on all cash deposits in banks on Jan. 1st of each year, a levy of $3 per $1,000 of market value on all bonds, stocks and real estate notes, excepting stocks of Georgia corporations, United States Government bonds, and bonds of the State of Georgia and its political subdivisions. Revenue collected under this Act is allocated as follows: 20% to the State, 40% to the county in which it is collected, and 40% to the city in which it is collected.

The Illinois Legislature, meeting in special session in May, enacted no important tax legislation.

The Kansas Legislature met in special session in February, but no tax legislation of consequence was enacted.

A regular session of the Kentucky Legislature began in January, but passed no new laws affecting taxes.

The Louisiana Legislature met in regular session in May and enacted several revenue laws, the following being the most important:

1. A tax of ½% was levied on the gross receipts of cold storage plants which stored meat or fish.
2. A tax of 20c. per gallon was levied on petroleum solvents.
3. A general retail sales tax was substituted for the luxury tax; this tax aggregated 1% on all retail sales except products sold by the producer.
4. A constitutional amendment relating to the severance tax on mined sulphur was proposed by this Legislature, and will be voted on in November. This proposal reduces the severance tax from $2 to $1.03 per ton.

The regular session of the Massachusetts Legislature, held in January, failed to enact any new tax measures.

The Mississippi Legislature, meeting in regular session in January, passed a Homestead Exemption law allowing freedom from all ad valorem taxes levied by the State or any political subdivision, up to $5,000 of the assessed value. Additional measures were passed to force the State to reimburse the various political subdivisions for the loss of tax revenue occasioned by this Homestead Exemption law, although no new revenue measures were enacted to furnish the State with the money to meet these payments.

The regular session of the New Jersey Legislature, meeting in January, enacted no new revenue measures.

The New York Legislature met in regular session in January, but aside from measures designed to clarify existing tax laws, passed nothing of consequence pertaining to revenue legislation.

Several special sessions of the Ohio Legislature carried on from November, 1937, through June of 1938, but no new tax legislation was enacted.

A regular session of the Rhode Island Legislature met in January, but failed to make any changes in the existing revenue laws of that State.

The South Carolina Legislature, meeting in regular session in January, made no changes in the existing revenue laws of that State.

The regular session of the Virginia Legislature met in January, but failed to enact any new tax legislation.

Constitutional amendments to be voted on in the general election in November are being proposed in a number of States, and many of these proposals, if carried, will mean new homestead exemption laws in some States, such as Arizona and Louisiana; new revenue measures in other States, such as Oregon with its old-age pension plan, and numerous suggested changes in New York.

Two large cities invaded the sales tax field in 1938, Philadelphia enacting an ordinance in March levying a 2% sales tax with exemptions allowed on sales of food, medicines and certain services. New Orleans enacted an ordinance in July levying a general sales tax of 1%, exempting farm products and certain commodities sold by the utilities.

In view of the fact that only 15 State Legislatures met in 1938, and of these only three adopted new tax measures, the year 1938 can be classified as a fortunate one for the taxpayers of States and their political subdivisions. We use the word "fortunate" advisedly, as we readily appreciate the fact that the many tax laws already on the statute books of the 48 States are an extremely heavy burden on real estate and business generally. It would be a cause of great rejoicing to find some State administration which, by economy and good management, effected sufficient savings to warrant the elimination or reduction of some State and local taxes. This hope may not be entirely forlorn, as each year since 1930 the people appear to become a little more tax-conscious and perhaps, by a more intelligent use of the ballot, more capable men, rather than professional politicians, may be placed in public office.

Respectfully submitted,

STATE AND LOCAL TAXATION COMMITTEE,

THOMAS W. GREGORY JR., *Chairman.*

WILLIAM R. BARROW,	MILTON G. HULME,
WINTHROP H. BATTLES,	THOMAS M. JOHNSON,
VIC E. BREEDEN,	JOHN W. NEWEY,
MARION H. CARDWELL,	CHARLES A. PARCELLS,
JOHN S. CLARK,	BERNARD W. SCHARFF,
N. PAUL DELANDER,	A. W. SNYDER,
JOHN W. DENISON,	F. KENNETH STEPHENSON,
WAYNE J. ESTES,	GARFIELD J. TAUSSIG,
JOHN C. HAGAN JR.,	HAROLD D. WRITER,
WM. H. HEMPHILL,	L. P. VAN VOORHIS.

Report of Education Committee of I. B. A. Outlines Activities to Be Included in Telling Public What Investment Bankers Do—Committee's Composition to Be Changed

In the report of the Education Committee of the Investment Bankers Association, presented by the Chairman, Francis F. Patton, of A. G. Becker & Co., Chicago, it is noted that the committee is on the point of inaugurating a program of publicity approved by the Board of Governors at its May meeting. The objective of this program, the report states is "to tell people what investment bankers are and what they do." The report goes on to say:

The methods to be used in its accomplishment, include: Enlisting the participation of the groups in localized educational activities. Utilizing regular Association activities for their publicity value. Generating new activities that warrant publicity and serve to tell our story.

New Type Committee

To implement the program, the education committee is to have a different composition henceforth. Of its 23 members aside from the chairman, 18 will be the men in charge of educational activities in the groups as chairmen of the group education committees, and five, appointed "at large," will be chosen because of technical experience or aptitude for public relations.

Our program proposes to utilize resources available to us at little or no expense. A number of people have suggested the use of such things as a campaign of paid advertising, a motion picture on the subject of investment banking, exhibits at the New York World's Fair and the San Francisco World's Fair, and radio programs. It was the conclusion of the committee, however, that activities of that type are not feasible, because they involve the expenditure of money in sums prohibitive to the business of investment banking with its narrow profit margins. Modest advertising expenditures are inherent in the business. The explanation lies in the contrast between typical underwriting commissions of 2 or 3% and the mark-ups on other types of merchandise from factory to consumer. To make a worth while impression through any kind of paid program, would involve amounts too great either for the Association to bear directly or to be raised by soliciting contributions from members, in the opinion of the committee.

At the same time, the committee has the conviction that more effective results may be obtained through a more consistent use of channels of publicity always open to us, particularly the press and the platform.

Whatever we do in the way of publicity must be justified on the basis of public interest in the activity. Actually, we operate close to the public interest. Every individual has a "pocketbook" interest in investments and we talk his problems when we talk our own. Economists of all stripe have been saying that the cure for depression and unemployment is revival of the capital goods industry, which would come only through a resumption of new financing. Whatever we do to assist in the reopening of the capital market is, consequently, interesting to the readers of publications, to radio listeners, and any other audience. The story must be told interestingly, and we hope that a decentralization of activities will assist in that respect. Identifying locally prominent men with our activities will enhance their news value, get better attention, and avoid any implication of a national program of paid propaganda.

So, in a sense, the ball is being thrown to the groups. The National committee and the Educational Director will, of course, not only assist in every possible way, but intend to take an active part in getting local activities under way and keeping them alive.

At the same time, we hope to be able to utilize national activities by bringing out all the publicity benefits that they afford.

Activities to Be Included

Nationally and in the groups, educational activities are to be directed toward the following:

1. Greater editorial attention in general publications by—
(a) Publicizing current activities
(b) Generating more activities to be publicized
(c) Creating material in special studies, committee reports
(d) Publishing statements on public issues affecting investments
(e) Encouraging members to write and speak for publication
(f) Encouraging members, and corporations, to emphasize the constructive character of specific pieces of financing; for example, the new business and employment to result.

2. *Radio*—Much of the material used for publication is suitable for distribution to radio stations—which are coming to use news-desk technique in compiling news and commentator programs. In addition, there are many opportunities to provide sustaining features on local stations.

3. *Speeches*—Thousands of receptive audiences are provided for speakers on financial subjects. Two types of speakers are required. The big public speaking engagement calls for a prominent figure—an official of the Association or a principal of a member house. The more numerous occasions could be better handled by junior men in member organizations. Each group should have a list of speakers suitable for various occasions. There are reported to be 100,000 forum and discussion groups in the country.

4. *Conventions and Group Meetings*—Should be planned with greater attention to the public interest in them. Many group meetings would receive national attention if publicized.

5. *Washington Appearances*—Generally require the advance preparation of statements or memoranda that should be provided to publications simultaneously with presentation. Even when testimony is given in hearings that are not public, the same arguments can be publicly released without reference to the fact that they were used in Washington.

6. *Constructive Proposals*—To offset any implication that we invariably oppose everything, we should volunteer constructive proposals or commend those of others.

It is essential to the success of our plans that activities be planned in advance and executed according to a definite program to the fullest extent possible. To that end issues should be anticipated, policies regarding them established, and material prepared to support that policy. The education committee last spring suggested that kind of treatment on a number of current issues. It would now like to add the request that special committees be assigned to study "private placings" and "use of 'ratings' to determine the suitability of bonds for banks," in order that we can speak up regarding them. We also made the suggestion last spring, and now repeat it, that standing committees be asked to conduct research projects in their respective fields. We recommend the use of surveys as a fruitful source of publicity material. They should, of course, be conducted on subjects where there is a definite need for facts.

Too often, of course, occasions for publicity are beyond our control, or arise from a necessity to defend ourselves. Defensive publicity is the least effective, and its value declines as it is delayed. Hence, we should answer immediately and undertake to make capital of the occasion. Our plans call for greater attention, however, on the creation of constructive publicity. From that point of view we are appreciative, for instance, of the attention being given at this convention to the currently prominent issue of tax-exemption. That is a good illustration of not being "habitual objectors." The committee urges, again, that attention should be paid to the public relations possibilities of all statements, announcements, resolutions.

Association Publications

On the strength of a year's experience with our Association publication, "Investment Banking," the education committee recommends that it be given more the character of an article magazine, and that its function of keeping members informed on Association affairs be transferred, in part at least, to a less formal medium. To serve this purpose, we recommend that the President of the Association should write to all members at frequent intervals, giving an account of what the Association is doing and outlining the problems confronting it. There are numerous reasons for this suggestion; among, them, the advantage that a "President's Letter" would have over our magazine for speeding up communication of Association news to members. On the other hand, we think that the magazine can serve a better purpose by devoting more attention to instructive articles and to educational material.

An analysis of the editorial content of "Investment Banking" during the last year indicates that it touched upon most of the important issues confronting the business. Greatest attention was given to the "Maloney Over-the-Counter Regulation" subject, on which there were 15 articles. There were six articles on the Securities and Exchange Commission and the legislation it administers, three on State securities laws, 11 on municipal bond subjects. One or more articles were carried on "Use of Ratings," "Private Placing," "Tax Exemption," "Bank Underwriting," "Interest Rate Trends"

"Inflation," "Split Commissions," "Permissive Incorporation," "Investment Counselors."

There were 12 articles dealing with investment banking in a more general way, most of them especially selected with a view of providing instructive material for the junior men in the business to whom the magazine should be directed, in the opinion of the committee. With this purpose in view, authorization was obtained of the Board last spring for offering the magazine on cash subscription of $1 a year to employees of member houses and others not eligible to obtain it under the policy whereby it has been sent, upon request, to principals and executives. To date, 36 annual cash subscriptions have been received unsolicited. The circulation of the magazine currently is 6,003, as follows:

Colleges and public libraries	167
Public officials, private libraries, paid subscriptions (36 at $1 a year), miscellaneous	168
State Securities Commissioners	61
Newspapers and magazines	256
* Selected members of Board and ex-members	92
* Selected group officials	31
Individual executives and partners	3,712
Main and branch offices of members	1,516
	6,003

* Those not otherwise on the list.

On the face of it, the magazine is not reaching the people it should for educational purposes now, altnough we hope to correct this by inducing member houses to enter subscriptions for selected employees.

In Summary

The main features of the program outlined here have already been autnorized by the Board of Governors. We wish to bring up additional specific suggestions, however, as follows:

Appointment of a fact finding committee on the subject of "private placings."

Appointment of a fact finding committee on the subject of "ratings" as the criterion of the suitability of bonds for bank investment.

Respectfully submitted,

EDUCATION COMMITTEE

Francis F. Patton, *Chairman.*

J. Frederick Brown	Clyde L. Paul
Cloud L. Cray	Harry C. Piper
H. H. Dewar	A. Cuthbert Potter
John W. Dietz	Robert C. Webster
Auville Eager	Louis R. Schmertz Jr.
Frederic P. Griffin	H. H. Wagenseller
Augustus Knight	Frank F. Walker
D. I. McLeod	Robert S. Weeks
Galen Miller	Adolph E. Weltner

Report of Special Committee on Uniform Forms of Investment Bankers Association

Some progress during the year in the matter of uniform forms was noted by the Special Committee on Uniform Forms in its report to the Investment Bankers Association convention, in which it said "it is pleasing to note that all concerned now seem to be in accord as to the great value, all around, of as much simplification and uniformity as may be possible." The report of the committee, under the chairmanship of J. Weller Kimball of Glore, Forgan & Co., Chicago, follows:

The Special Committee on Uniform Forms is pleased to report some progress during the year, although not as great progress as may have been hoped for. Prevailing conditions have not been such as to afford the most favorable opportunity toward the further perfection of the substantial progress made during last year. All are familiar with the small number of issues during the first part of the year, of wide distribution and requiring registration in a number of States. This has had the very natural effect of slowing down the active interest as well as the opportunity for suggestions of specific betterment and improvement. State securities commissioners have felt justified in going slowly but surely, accordingly as experience and the rule of trial and correction permitted. Certain things, however, have happened during the year. They are:

Early in the year the Commissioner of Michigan promulgated a very simple form for the registration of securities, under his State law, which were being registered with the Securities and Exchange Commission. This form calls for the submission to the State Commissioner of the simple facts essential to identify the issue to be offered; name, location and nature of the business of the issuer, type of issue, amount of securities to be offered, price, name of underwriters, &c. In addition, there is required duplicate copies of the registration statement filed with the SEC and all amendments thereto, and a copy of the prospectus and all amendments. The applicant is required to stipulate that he will file with the State Commissioner two photostatic copies of any orders of the SEC, including orders of refusal, stop orders, &c., with reference to the registration statement or the securities covered thereby; also to notify the Commission immediately of any stop orders or show cause orders.

To the extent that the volume of business permitted, this form has been undergoing tests and experimentation. Thus far it has worked satisfactorily. Certain provisions of the law make mandatory some inconveniences which may not be obviated unless and until the Legislature sees fit to make slight amendments. These are being studied, and it seems likely appropriate recommendations may be made to the Legislature at its convening early in January. If and when the entire workability of this form may be proven by the tests and wide experience, it will tend to serve as a demonstrated step forward. Other States have been following the progress of this experiment and seem inclined to be willing to follow similar or substantially the same procedure, particularly with respect to securities registration with the SEC on Form A2.

Certain of the States have experimented during the year with the tentative draft of uniform forms promulgated at the 1937 convention of the National Association of Securities Commissioners, while others have been inclined to delay definite action for a further study, feeling (a) that an adoption of these forms might not be entirely satisfactory in the light of the provisions of their existing statutes; and (b) that the process of experimentation might dictate further refinements and improvements toward simplification.

It has been found that several of the States' securities laws will need some amendments to authorize a complete adaptation of the new forms to the statutory requirements. These amendments usually are more or less minor, but essential, nevertheless, and doubtless will be called to the attention of the respective legislators, as opportunity is afforded. But few Legislatures have been in session during the year 1938.

Soon after the announcement of the tentative draft of uniform forms at French Lick Springs in 1937, a group of attorneys, representing a number of the larger underwriting houses of the country, primarily New York, volunteered a study of these tentative draft forms and went over them in great detail in the light of their experiences and their knowledge of the respective securities laws and the difficulty encountered by them when registering a security in a considerable number of States. They made a painstaking report of their research study, which was most excellent indeed. This report is now in the hands of the Committee of the Securities Commissioners, where it is receiving very careful consideration. There is every evidence of a sincere desire to accommodate the forms, as nearly as is practicable or possible and as may be constant with their respective State statutes, to the proposals for the elimination of duplications and other complicated requirements.

The Committee of the National Association of Securities Commissioners made a report of progress at the Commissioners' convention in Kansas City, in September, stressing most of the points outlined above and asking for a continuation of the committee that its work might be further pursued during the year. The committee was continued and was given authority to make such revisions in these tentative drafts as to the committee appeared proper in the light of the experience and study thus far made, and to submit any modifications or revisions to the Commissioners.

It is pleasing to note that all concerned now seem to be in accord as to the great value, all around, of as much simplification and uniformity as may be possible in view of the purposes of the respective laws.

Respectfully submitted,

SPECIAL COMMITTEE ON UNIFORM FORMS,

T. WELLER KIMBALL, *Chairman,*
JOHN D. HARRISON,
COLIS MITCHUM,
GEORGE V. ROTAN,
KELTON E. WHITE.

Report of Foreign Securities Committee of I. B. A.—Institute of International Finance Now an Independent Research Activity

"It is useless to try to look for any one formula to apply to all debt readjustments," said the Foreign Securities Committee of the I. B. A. in its report presented to the annual convention by its Chairman, Carlton P. Fuller of Schroder Rockefeller & Co., Inc., of New York. The report, which was brief, follows:

While it seemed possible at times during the six months since our last report for foreign countries of the highest credit to consider issuing dollar securities, it has been clear that the opportunity, even for refunding, was distinctly limited. Naturally, the grave developments in Europe extinguished for the time being what limited possibilities there might have been.

In the readjustment of outstanding defaulted debts, the bargaining process between the debtor and protective committee continues to occupy much time—the debtor usually arguing from the slogan "capacity to pay," which has a convincing connotation that is often belied by investigation of the facts. Since all nations have a certain "capacity to pay," the crucial point in a debt readjustment is rather the "order of payment" than the "capacity to pay." Each debtor seeks to enlarge the list of "indispensable" services, which even the creditors would agree it must pay before meeting its foreign obligations. A substantial part of the incapacity to pay is due to inserting the increasing expenditures for armament under the heading of "indispensable" services. In the present state of world affairs, the desire of some nations for a certain amount of armament is certainly understandable.

The question of a satisfactory readjustment always comes back to the necessity for bilateral negotiations in an atmosphere composed of "will to pay" on one side and accommodation to present realities on the other. Such discussions have resulted in several acceptable proposals during the past year, and there is reason to hope that more will be forthcoming during the next year.

It is useless to try to look for any one formula to apply to all debt readjustments. The resumption of a reasonable payment in dollars is what interests American bondholders. However, when a debtor is negotiating toward a resumption of dollar payments, it seems to this committee that there could be combined with such an offer, in some instances, the opportunity for bondholders at their own option to convert their dollar bonds into local currency bonds at a fair rate. This will, admittedly, not interest most of the bondholders, but to the extent the offer is accepted, it should improve the market demand for outstanding bonds by interesting buyers who may have use for the local currency, and from the debtor's point of view, it avoids to the same extent the transfer problem.

As reported in "Investment Banking" for June 10, the Board of Governors decided at its spring meeting to discontinue as of Aug. 31, 1938, any contribution to the Institute of International Finance. New York University has announced that it will continue the Institute as an independent research activity of its own to deal with domestic financial problems, as well as the foreign financial problems to which it has been devoted in the past. The Institute has already issued a bulletin on "The Government Bond Market and the Banks," and has projected for the rest of the year nine other bulletins on topics such as "The Gold Problem," "Inflationary Forces in the United States," "Economic Effects of Currency Devaluation." It is believed that the bulletins will continue to be of great interest to members of the Association, who are urged to continue their subscriptions.

Respectfully submitted,

FOREIGN SECURITIES COMMITTEE,

CARLTON P. FULLER, *Chairman.*

Report of Government and Farm Loan Bonds Committee of I. B. A.

The Government and Farm Loan Bonds Committee of the I. B. A. presented in its usual comprehensive form its report dealing with the public debt, the interest-bearing debt, Treasury financing, special issues, &c. Regarding the public debt, we quote as follows from the report:

Public Debt

On Sept. 30, 1938, the total gross debt of the United States Government as reported in the daily Treasury statement of that date amounted to $38,392,725,250, an increase of $1,517,634,419 over the reported total gross debt on Sept. 30, 1937. Of this amount $37,849,982,492 represented

the interest-bearing debt outstanding, while the balance of $542,742,758 consisted of matured and non-interest-bearing debt. The following table reflects the trend in the public debt since the pre-war period:

COMPARATIVE PUBLIC DEBT STATEMENT

	Gross Debt	* Net Balance in General Fund	Gross Debt Less Net Balance in General Fund
Mar. 31, 1917 (pre-war debt)	$1,282,044,346	$74,216,460	$1,207,827,886
Aug. 31, 1919 (highest post-war dt.)	26,596,701,648	1,118,109,535	25,478,592,113
Dec. 31, 1930 (lowest post-war dt.)	16,026,087,087	306,803,320	15,719,283,768
Sept. 30, 1937	36,875,090,831	2,859,661,772	34,015,429,059
Sept. 30, 1938	38,392,725,250	2,978,460,220	35,414,265,030

* This item represents the excess of assets over liabilities in the General Fund as reported in the daily statement of the Treasury. For the year 1937, silver seigniorage of $382,358,918, gold increment of $141,035,834 and the inactive gold fund of $1,208,735,394 are included. For the year 1938, silver seigniorage of $460,353,232 and gold increment of $142,111,999 are included.

In addition to the direct public debt, the Federal credit agencies and corporations had outstanding on Sept. 30, 1938, approximately $5,000,000,000 ($5,000,929,632 on Aug. 31, 1938) of obligations which are guaranteed by the United States Government as to both principal and interest. The aggregate debt, both direct and guaranteed, amounted to approximately $43,392,725,250 on Sept. 30, 1938, compared with $41,543,877,879 as of Sept. 30, 1937.

Robert G. Rouse of the Guaranty Trust Co. of New York is Chairman of the committee.

Report of Group Chairmen's Committee of I. B. A.

Harold E. Wood, reporting as Chairman for the Group Chairmen's Committee of the Investment Bankers Association, said that "in the year just closing, the Group Chairmen's Committee has attempted" in the words of President Frothingham, "to build up the importance of the Group, through increased activities which challenge the attention and support of its members."

"We have sought," said the report, "to revitalize and extend the old routine of luncheon and dinner meetings, and Committee functions. This was particularly true until last spring, when national problems completely overshadowed Group activities, because of the numerous Bills before Congress, vitally affecting our business." In part, the report continued:

An enumeration of the luncheon and dinner meetings, as reported by each Group Chairman, reveals the overwhelming interest in these legislative proposals, enactments, and questions of regulation. For example, W. O. Douglas, Chairman of the Securities and Exchange Commission, spoke at large meetings in San Francisco, Denver, and Seattle, Commissioner Matthews spoke in Cincinnati and Minneapolis, among others; John W. Hanes was the featured speaker at luncheon and (or) dinner meetings, in Chicago, Pittsburgh, Minneapolis, and St. Paul. The Southwestern Group assisted in sponsoring the Convention of the National Security Commissioners of the United States, in Kansas City, this Convention including the Blue Sky officers of the various States. In practically every Group there were many meetings reporting progress and the implications, after final enactment, of the Maloney Bill, with either John Starkweather, some member of his Committee, or Governors of this Association reporting. . . .

Few Legislatures were in session, but the above recital indicates that the various Groups were not idle in matters of vital interest to the business. Another example of such activity is that of the Northern Ohio Group, which cooperated with the Ohio Security Dealers Association and the Southern Ohio Group, to revamp the Blue Sky laws of Ohio. Mr. McDonald, Chairman of the Northern Ohio Group, feels "that the result of last year's work gives us a Blue Sky law that is quite satisfactory."

Several of the Groups have been putting on membership drives. The Central States and the California Groups call particular attention to that in their comments on the year's activities.

At the suggestion of Mr. Frothingham, not only all Group Chairmen, but all members of the Executive Committees of all the Groups, were invited to the Spring Meeting at White Sulphur, and on the opening day of that meeting, May 14, a Forum was held at which many Group activities and problems were discussed. Well over 100 men attended. A letter had been sent out, requesting reports from Groups engaging in particular activities, and asking for a list of subjects to be brought up.

Among the subjects brought up were New York Stock Exchange split commissions; difficulties incident to secondary market operations; public relations, education and publicity; with proposals made that the Groups should plan meetings and Forums on investment problems, to which local business men, University groups, and others, would be invited, that closer contacts with regional SEC officers be made; financial statements; a paid secretary for each Group; the feasibility of employing counsel on retainer; more effective aid to local Better Business Bureaus; custody of securities, and others.

Undoubtedly many of these suggestions are being more fully covered in other Committee reports. Our Committee, to use varying terms, is, in its report of activities, a sounding-board, and a cross-section of ideas and reports of work done by all the members of the Association. Our duty is to see to it that ideas are generated and transmitted throughout our entire system, that we may build "a better, stronger, more useful Association." Therefore, we have made this record of things done, not only for the purpose of keeping the record clean for future reference, but that discussion of ways and means to achieve this object may be stimulated. It is toward this end that we have labored.

Mr. Wood is head of Harold E. Wood & Co. of St. Paul.

Report of Investment Companies Committee of I. B. A. —Suggestion by Representatives of SEC That Committees of Investment Company Managers Be Formed

The Investment Companies Committee of the Investment Bankers Association, of which Earle Bailie of J. & W. Selegman & Co. of New York, is Chairman, stated that a suggestion has been made by representatives of the Securities and Exchange Commission that committees of investment company managers be formed. Under the head "SEC Investment Company Study," Mr. Earle's Committee says:

Nothing of importance has occurred since the spring report. It was expected at that time that public hearings on the Founders Group would be completed shortly. These hearings were interrupted, however, to make place for hearings in New York on matters involving Continental Securities, Burco, Inc., and several other investment companies. The Founders Group hearings have not been resumed to date.

Meanwhile, Part One and Volume I of Part Two of the SEC's report to Congress have been released. They contain a discussion of the origin, scope, and conduct of the study, classification of investment companies for purposes of the study, a brief history of the origin of the investment company movement in this country, and a statistical survey based on recent factual data gathered in the course of the study. It is anticipated that several additional parts of the report will be sent to Congress in the near future. These are likely to contain further statistics, a treatise on the economic significance of investment companies generally, their contribution to the capital markets of the country, abuses alleged to have been discovered in the course of the study, &c. It appears doubtful at the moment that the Commission will be ready to submit its final report and recommendations for legislation to Congress by the end of this year.

Representatives of the Commission have suggested that committees of investment company managers be formed—one representing the ordinary type of management company, the other for companies of the open-end type—for the purpose of discussing with the Commission and its staff the subject of legislation and regulation before any final recommendations are submitted to Congress.

The report continued:

Taxation

The Revenue Act of 1938 continued the special treatment for open-end investment companies, without extending the benefits thereof to companies of the ordinary management type. While capital gains realized by investment companies during the year 1938 are not likely to be large enough to make tax relief imperative, this question continues to be of the utmost importance to investment companies generally, particularly in connection with any legislative recommendations that may be made in this regard by the SEC. Representatives of the Commission were understood last winter to have urged the members of the tax committees of Congress either to abolish special tax treatment accorded to mutual investment companies, or in any case not to extend them, pending the completion by the Commission of its study and submission to Congress of its recommendations. Further delays on the part of the SEC may, therefore, result in a serious handicap to investment company stockholders, particularly if a substantial rise in security prices should occur prior to the time when the inequalities contained in the present tax statute are corrected.

Respectfully submitted,

INVESTMENT COMPANIES COMMITTEE

Earle Bailie, Chairman

Hugh Bullock — Raymond D. McGrath
Chase Donaldson — Colis Mitchum
John M. Hancock — Charles H. Stix

Edwin S. Webster Jr.

Investment Bankers Association to Conduct Essay Competition to Encourage Research Study of Investment Banking

An Investment Bankers Association prize essay competition to encourage research studies of current problems of investment banking has been authorized by the Board of Governors of the Investment Bankers Association, it was announced Oct. 28 at the annual convention. The authorization provided $500 in awards for a single contest as an experiment but the Association contemplates an annual series of awards if the results in this case are worthwhile. The Association's announcement in the matter continued:

Conduct of the competition has been turned over to the Education Committee of which Francis F. Patton, A. G. Becker & Co., Chicago, is Chairman. Its purpose, Mr. Patton said, would be to direct the attention of a greater number of serious students to investment banking as a subject for study and research. "It should also furnish the Education Committee with considerable material to use in its educational work, and it is hoped, provide some valuable permanent additions to the literature on investment banking. It should help to attract desirable young men to the business as a profession," he added.

The committee is to announce details of the competition in the near future. A special committee of members of the Association is to select a list of subjects upon which essays may be written.

A Board of Awards appointed by the President of the Association and to consist of individuals who are not connected with any member of the Association will judge the papers entered in the competition and make the awards.

Resolution of Investment Bankers Association on Elimination of Federal Tax Exemption in Case of State and Municipal Securities—Opposed to Any Method to Permit Reciprocal Taxation Other Than by Constitutional Amendment

On Oct, 29, the Investment Bankers' Association at the closing session of its annual convention adopted the following resolution regarding the proposal for Federal legislation to tax State and municipal securities:

Whereas: Proposal has been made to enact Federal legislation to tax the income from State and municipal securities thereafter issued without first submitting the question to the States and obtaining their consent in the form of a constitutional amendment, and

Whereas: It is officially contended by the Federal administration that the Federal Government now has that power without amendment to the Constitution, and

Whereas: If this contention be enacted into law and judicially sustained the power to tax thereby established might be applied to previously issued and outstanding obligations of States and municipalities and, in the opinion of eminent counsel, might even be asserted and applied to the revenues on which the States and municipalities themselves depend for their existence, and

Whereas: Regardless of present assurances to the contrary, the power to tax if so established might by a future Congress be applied to the detriment of holders of securities purchased in good faith and to the distress or destruction of the States and municipalities themselves.

Now therefore be it resolved by the Investment Bankers Association of America in convention assembled:

First, that attention be directed to resolution adopted by its Board of Governors on May 7, 1920, and standing continuously since then as the expressed policy of the Association as follows:

"It is the sense of this Board that the Investment Bankers Association of America advocate the adoption of an amendment to the Constitution of the United States empowering on the one hand the Federal taxation of the income from future obligations of the States and their political subdivisions and on the other hand the taxation of future obligations of the United States by the States and their political subdivisions, in both cases with proper safeguards limiting such taxation."

Second, that this convention supplement such resolution to include the obligations of instrumentalities and agencies of the States and their political subdivisions on the one hand and the instrumentalities and agencies of the Federal Government on the other hand.

Third, that this convention record itself as opposed to any method for the accomplishment of this purpose other than by constitutional amendment.

Adoption by Governors of I. B. A. of Recommendations of Its Maloney Bill Policy Committee Approving Registration of Investment Bankers Conference, Inc., as National Association for Regulation of Over-Counter Business

The Board of Governors of the Investment Bankers Association adopted on Oct. 28 recommendations of the Association's Maloney Bill Policy Committee, as follows:

(1) That the contemplated registration of the Investment Bankers Conference, Inc., as a national association under the Maloney Amendments be approved.

(2) That the I. B. A. use its best efforts to assist in every possible way in the operation of the Association under the law, and that its members be urged to join and support the registered Association.

(3) That the original registration be accomplished, if possible, with as simple a structure and set of rules as the Securities and Exchange Commission will approve, and that the further development of the new Association's work be left, so far as possible, to the Governing Board of the new Association, working in cooperation with the Commission and the industry.

(4) That the Maloney Bill Policy Committee, having completed the work for which it was appointed, be now discharged, and that the appropriate regular committee of the Association be instructed to confer and advise with the I. B. C. with a view to assisting in its further development.

The members of the committee included:

John K. Starkweather, Starkweather & Co., New York, Chairman.
Emmett F. Connely, First of Michigan Corp., Detroit.
Ben B. Ehrlichman, Drumheller, Ehrlichman Co., Seattle.
Perry E. Hall, Morgan Stanley & Co., Inc., New York.
Chapman H. Hyams 3d, Moore & Hyams, New Orleans.
Devereux C. Josephs, Graham, Parsons & Co., Philadelphia.
T. Weller Kimball, Glore, Forgan & Co., Chicago.
James J. Minot Jr., Jackson & Curtis, Boston.
Francis F. Patton, A. G. Becker & Co., Chicago.
John J. Sullivan, Sullivan & Co., Denver.
Albert E. Van Court, William R. Staats Co., Los Angeles.
Francis T. Ward, Clark, Dodge & Co., New York.
Francis E. Frothingham, Coffin & Burr, Inc., Boston.
Jean C. Witter, Dean Witter & Co., San Francisco.

The recommendations of the I. B. A. Maloney Act Policy Committee were presented to the Board of Governors of the I. B. A. on Oct. 28 by Nevil Ford of the First Boston Corp. of New York; the recommendations were contained in "An Outline of Actions, Deliberations and Findings of the Special Committee on the Maloney Act of Investment Bankers Conference, Inc., and Maloney Act Policy Committee of Investment Bankers Association, Acting as Members of a Joint Committee." Besides Mr. Ford, those presenting the recommendations in behalf of the joint committee were: John K. Starkweather of Starkweather & Co., New York, and Joseph C. Hostetler of Baker, Hostetler & Patterson of Cleveland.

James J. Minot Jr., Vice-President of I. B. A., Looks for Activity in Capital Issue Market

James J. Minot Jr. of Jackson & Curtis, Boston, Vice-President of the Investment Bankers Association, was reported as stating in an interview during the Convention on Oct. 27, that changes earlier this year in Federal tax laws offered private investment capital greater incentive than it has had for several years. He added:

"A pickup in inquiries for new money is reported by many of the Association's members and business will find the investing public's response to its capital needs will be prompt."

The Associated Press advices from White Sulphur Springs, from which the above is quoted, further said, in part:

Mr. Minot's remarks were prompted by an address before the bankers' annual convention by F. C. Crawford, Cleveland industrialist, who exhorted them to "forget criticism; go back to your workshops; invent ways to keep the flow of capital to industry; if laws hinder, get them changed; forget your old methods."

Mr. Minot said he believed the bankers were increasingly adapting themselves to present conditions, and were doing less fretting over complicated Government controls, but he added that Congress in its last session, through changes in the tax laws, had shown a real desire to cooperate with business.

He said the recent pickup in the new issue market had been encouraging, and while the securities brought forth of late had been primarily bonds designed for bank and insurance company investment, he thought 1939 would find a good market for smaller issues of corporation securities appealing to the individual investor. He expressed belief the financing would take the form of bonds convertible into common stock, and described the recent $2,500,000 Carrier Corporation issue as typical of what might be expected.

The Bostonian pointed to the airplane industry as one which probably would do considerable of that type of financing to provide expansion to meet armament orders and needs of growing air travel.

Officers Elected at Annual Convention of Investment Bankers Association

As indicated in another item, Jean C. Witter of Dean Witter & Co., San Francisco, was elected President of the Investment Bankers Association on Oct. 29. The following are the other officers elected for the coming year at the closing session of the convention:

Vice-Presidents—Devereux C. Josephs, Graham, Parsons & Co., Philadelphia; John S. Linen, Chase National Bank of the City of New York, New York; James J. Minot Jr., Jackson & Curtis, Boston; Francis F. Patton, A. G. Becker & Co., Chicago, and Albert E. Van Court, William R. Staats Co., Los Angeles.

Governors—One-year terms expiring in 1939—Brownlee O. Currey, Equitable Securities Corp., Nashville; Francis E. Frothingham, Coffin & Burr, Inc., Boston; John J. McKeon, Charles W. Scranton & Co., New Haven, and Blair A. Phillips, White-Phillips Corp., Davenport. Two-year terms expiring in 1940—Augustus Knight, Bartlett, Knight & Co., Chicago; Robert H. Parsons, Pacific Co. of California, Los Angeles, and Joseph P. Ripley, Brown Harriman & Co., New York. Three-year terms expiring in 1941—Edgar M. Adams, E. M. Adams & Co., Portland, Ore.; C. Prevost Boyce, Stein Bros. & Boyce, Baltimore; F. Dewey Everett, Hornblower & Weeks, New York; Albert H. Gordon, Kidder, Peabody & Co., New York; J. Ludwig Mosle, Mosle & Moreland, Galveston; Julius W. Reinholdt Jr., Reinholdt & Gardner, St. Louis; J. Fleming Settle, J. H. Hilsman & Co., Inc., Atlanta; George F. Spaulding, Northern Trust Co., Chicago; John K. Starkweather, Starkweather & Co., New York; Jay N. Whipple, Bacon, Whipple & Co., Chicago, and Alexander C. Yarnall, Yarnall & Co., Philadelphia.

1939 Convention of I. B. A. to Be Held at Del Monte., Calif., Oct. 9-13

Following the address of the new President of the Investment Bankers Association, Jean C. Witter, in which he expressed the hope that the 1939 Convention of the Association would be held at Del Monte, Calif., it was decided at the meeting just concluded to hold next year's convention at Del Monte from Oct. 9 to 13. In other years the fixing of the date and place for the annual meeting has been determined at the spring meeting of the Association's Board of Governors.

A. S. Embler Elected President of Savings Bank Association of New York State—Action Taken by Delegates at Annual Convention

Albert S. Embler, President of the Walden Savings Bank, Walden, N. Y., was elected President of the Savings Banks Association of the State of New York on the final day of the convention held aboard the Motorship Kungsholm on Oct. 26. The retiring President was Andrew Mills Jr., President of the Dry Dock Savings Institution, New York City. Vice-Presidents of the Association representing the several geographical groups are: Clarles Diebold Jr. of Buffalo, Robert A. McCaull of Auburn, Frank H. Williams of Albany, Robert Louis Hoguet of Manhattan and Richard J. Wulff of Brooklyn. The convention of the Association embraced five business sessions during the six-day cruise and the meetings were devoted exclusively to the discussion of the major problems in which savings bankers are interested.

Regarding the action taken by the convention, an announcement by the Association said:

The convention took affirmative action looking toward the establishment of a cooperative retirement plan for officers and employees; voted to continue its committee investigations in the field of possible new services which savings banks might extend to the public; voted in favor of the development and expansion of an organized research program and indicated its interest in the development of a cooperative radio program to bring to the attention of the public the philosphy and utility of savings banking.

The convention also decided to seek permissive legislation which would allow savings banks to offer small personal loans to the public in areas where that service was needed. The convention endorsed the action of the outgoing president and executive committee in suggesting to the American Bankers Association the possibility of action which would place Federal Savings and Loan Associations, Federal credit unions and similar Federally chartered financial institutions under the supervision of the Comptroller of the Currency.

The subject of Savings Bank Life Insurance was discussed at some length and it was voted unanimously to hold a further meeting within a few weeks at which time it is hoped the banks may reach a final decision as to the most appropriate action in this regard.

Some 450 savings bankers and their guests enjoyed both the business sessions and the recreation afforded by the cruise to Nassau and return.

An item bearing on the six-day cruise convention appeared in our issue of Oct. 22, page 2477.

New York Chapter of Financial Group of Special Libraries Association to Hold First Meeting of Year Nov. 7

The first meeting of the year of the New York Chapter, Financial Group, of the Special Libraries Association will be held on Nov. 7 instead of Nov. 14 as previously announced in our issue of Oct. 29, page 2629. The following speakers will appear on the program:

Elsie Rackstraw, Librarian, Board of Governors of the Federal Reserve System and Chairman, National Financial Group, will give a two-way talk on:

1. Financial Group Plans for the Year
2. Federal Reserve Board Library

Mary Hayes, Librarian, National City Financial Library, will speak on the subject: "Methods and Systems in Use in the National City Financial Library" or, informally, "We Do This."