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The following is copy of a letter from Secretary McAdoo to

Senator Pittman;

March 30, 1918.

Honorable Key Pittman,
United States Senate,
Washington, D. C.

My dear Senator:

I have examined the draft of a bill embodying the ideas which have been discussed between us for the utilization of the silver now lying unused in the Treasury of the United States. I venture to recapitulate briefly the purposes to be accomplished by the bill, and the reasons, which, in my judgment, require its enactment.

The annual production of silver has varied in recent years, having fluctuated from 160,000,000 ounces to 226,000,000 ounces per annum according to the estimates of the Director of the Mint. Production for the year 1916 amounted to 156,600,000 ounces, and for the year 1917 is estimated to be approximately 160,000,000 ounces. The decline in production during recent years has been partly due to conditions in Mexico, as the result of which Mexican mines have not been operated to their full capacity. The price of silver has varied from about 48½ cents per fine ounce, at which price it sold during August, 1915, to \$1.18 per fine ounce during September, 1917. Apart from industrial requirements, estimated at about 100,000,000 ounces per annum, silver is used by all nations for subsidiary coinage and by India and other Oriental countries for major coinage. In China uncoined silver circulates as money.

The European War has greatly enlarged the demand for silver. European countries engaged in the conflict have required unusual quantities of silver coins for their armies and for the civil population. Buying power of Oriental countries has been greatly enlarged, and as the importation of commodities has been limited owing to war needs of the belligerents, that buying power has been exercised to acquire silver.

China and India are the two oriental countries that absorb the largest amounts of silver. The products of India are wheat, jute, burlap, etc. The demand for Indian products has been unusual. Jute bagging is used for sugar, grain, and fertilizer bags, also as outside wrappers for cotton and other products. It is also used for trench bags and for packing many articles of military necessity. No article has been found that will serve as a substitute.

The Orient is willing to accept silver in place of gold for commodities furnished by them, and it is to the interest of the United States and its allies that foreign trade balances should, as far as possible, be settled in silver rather than in gold. The gold in this country and in the hands of its allies is needed as a base for the enormous credit structure it is necessary to erect in the process of placing Government loans, and every ounce of silver that can be used in the settlement of foreign balances is so much gained. It is better to settle trade balances by shipping silver, than to make arrangements for stabilizing exchange, where these are possible, as they are not in the Orient, because these exchange arrangements whatever their form, always mean a deferred demand for gold, while the settlement of foreign balances in silver is a definitive settlement, calling for no future adjustments. Further, the unprecedented business activity in this country has caused an unusual demand for silver for subsidiary coinage, the needs of the United States for this purpose during the present year being greater than ever before, amounting as they do, to approximately 21,250,000 ounces.

There are now in the Treasury of the United States approximately 490,000,000 of Standard Silver Dollars, containing approximately 375,000,000 ounces of fine silver. Against these Standard Silver Dollars there are outstanding silver certificates, and so long as these Silver Certificates remain outstanding, a corresponding amount of Silver Dollars must be held for their redemption.

The proposal is now made to borrow from the Treasury, for the purposes stated above, a portion of the silver so held in the Treasury, but only upon the cancellation from time to time of a corresponding amount of outstanding Silver Certificates. The silver having been so borrowed and used, the Secretary of the Treasury is required to re-purchase from time to time at the fixed price of \$1. per fine ounce, an amount of silver equal to the silver so borrowed and used, and to recoin that Silver into Standard Silver Dollars, thus in time replacing in the Treasury the silver so withdrawn. In this way the large mass of silver, which is serving no useful active purpose, now can be made available for a direct war purpose. There is no intention of making any permanent change in the status of the Silver Certificates. The proposition is, in brief, to retire Silver Certificates; to borrow from the Treasury the silver for use for the war purposes above set forth; and then, as silver from time to time in the future comes on the market, to replace the silver so borrowed by purchase in the market at the fixed price of \$1. per fine ounce and to replace the borrowed silver by coining the new silver acquired for that purpose into Standard Silver Dollars. There is no limit of time within which this must be done.

The cost of producing silver, like the cost of producing all other commodities, has greatly increased. Labor is receiving very much higher wages than during normal times. Machinery is more expensive, and the chemicals and other supplies needed in the production of silver are all correspondingly higher in price. The price at which the silver is to be rebought has been fixed in the proposed bill at \$1. per ounce. This price was arrived at after an examination by the Director of the Mint into the cost of producing silver, in a number of different mines, and the Director of the Mint is of the opinion that \$1. per fine ounce under all the conditions at present prevailing is a fair price. The silver released through the retirement of Silver Certificates will be sold by the Secretary of the Treasury for the war purposes stated, at a price that will permit him without loss to rebuy at the price of \$1. an ounce, the silver thus sold.

The proposed measure is unquestionably in the interest of the country as a whole for the prosecution of the war. It proposes no permanent change in our existing currency arrangements. What is proposed is a temporary change, consisting of the active use for war purposes of the silver now lying inert in the Treasury. The bill provides within itself the steps necessary to reverse that position and to replace and recoin the silver.

The arrangement proposed is purely a temporary arrangement and the pressing needs of the United States require, in my opinion, its prompt enactment into law.

Sections 5, 6, 7, and 8 seem to me the best way of dealing with the contraction of the circulating medium which would otherwise be brought about through the cancellation of Silver Certificates. This is accomplished by authorizing an issue of Federal Reserve Bank Notes in small denominations in order to fill the void occasioned by the retirement of Silver Certificates and provides for the prompt retirement of those Federal Reserve Bank Notes as Silver Certificates are from time to time re-issued. There may well be differences of opinion as to the best method of counteracting such contraction. If no method of meeting the contraction be provided, the contraction will be automatically relieved through the issue of legal tender notes in denominations of 1's and 2's. Federal Reserve Notes taking the place of the legal tender notes. This would be perhaps the easiest way of meeting the situation were it not for the fact that Federal Reserve notes are now secured by gold reserve of over 60% and the issue of additional Federal Reserve Notes without a corresponding addition to the gold reserve would reduce the percentage of reserve. Federal Reserve Bank Notes, on the other hand, require a reserve of but 5% and as there is absolutely no reason why a larger reserve for Federal Reserve Bank Notes should be provided, it seems to me unwise to reduce the percentage of reserve under Federal Reserve Notes. My reason for stating that the Federal Reserve Bank Notes, the issue of which is contemplated under the Bill, require no greater reserve than 5% is that those Notes in small denominations will merely take the place in the pockets of the people of the Silver Certificates now carried by them and are thus extremely unlikely to be

presented for redemption. If, and to the extent that they are presented for redemption, it will be a demonstration that these Notes are not needed in the circulation and the means for their prompt retirement is furnished by the deposit as security for these Federal Reserve Bank Notes of short time Certificates of Indebtedness or the One Year Conversion Notes of the United States. Whenever, therefore, these Federal Reserve Bank Notes are presented for redemption, it will only be necessary to let the maturing obligations held against them run off. The popular and well founded feeling against a bond secured currency therefore, does not apply to the present issue, because (1) the issue is strictly temporary in its nature, (2) the security behind the issue automatically provides for the redemption of the issue, (3) no artificial value is given to any long time bonds by the circulation privilege and no vested interest is created in the circulation privilege, which, if created, it might prove burdensome for the Government or the banks to abate.

If the method suggested for dealing with the replacement of the silver certificates that may be retired does not commend itself to you as the best manner of meeting the situation, I should be glad to discuss any modifications that may be thought advisable.

Cordially yours,

(Signed) W. G. McAdoo.

June 5, 1918.

Dear Mr. Kitchin:

Replying to your letter of June 3d, and referring to our recent conference on the question of new revenue legislation, permit me to submit the following for your consideration:

If the present rate of increase in expenditures should continue for six months, the Treasury will actually have to disburse during the fiscal year ending June 30, 1919, approximately \$24,000,000,000.

This estimate is not based merely upon appropriations, nor merely upon estimates made by other Departments as to their probable expenditures, although they have been obtained and considered; it is based upon the actual experience of the Treasury during the past year, which has shown that actual expenditures, exclusive of transactions in the principal of the public debt, have increased at the average rate of \$100,000,000 per month since March, 1917.

You will observe from the enclosed statement (Exhibit A) that in March, 1917, the expenditures were in round figures \$100,000,000. In May, 1916, they were \$1,508,195,000. If there should be no further increase during the coming fiscal year, the cash expenditures upon the May basis would be more than \$18,000,000,000. If, as seems inevitable, the increase in expenditures should continue at the rate of \$100,000,000 per month for the next six months, or until December, 1918, and if thereafter the monthly expenditures should remain stationary until the 30th of June, 1919, the Treasury would have to finance expenditures aggregating \$24,000,000,000 during the fiscal year ending June 30, 1919; or, to put it another way, if the average monthly expenditure should exceed that for the month of May, 1918, by 33 1/3%, we shall spend \$24,000,000,000 in the fiscal year 1919.

In the fiscal year ending June 30, 1918, our cash disbursements will amount to between \$12,500,000,000 and \$13,000,000,000. Of this amount, about one-third will have been raised by taxes and two-thirds by loans, all of which will be represented by long-time obligations, that is, bonds of the First Second and Third Liberty Loans and War Savings Certificates. We shall thus have completed fifteen months of the war with a financial record unequalled, I believe, by that of any other nation.

We cannot wisely contemplate nearly doubling our cash disbursements in the fiscal year 1919 without providing additional revenue. We cannot afford to rely upon \$4,000,000,000 only from taxation, because we shall then have to rely on raising \$20,000,000,000 by loans. This would be a surrender to the policy of high interest rates and inflation, with all the evil consequences which would flow inevitably therefrom, and which would, I firmly believe, bring ultimate disaster to the country. We cannot afford to base our future financing upon the quicksands of inflation or unhealthy credit expansion. If we are to preserve the financial strength of the Nation, we must do sound and safe things, no matter whether they hurt our pockets or involve sacrifices--sacrifices of a relatively insignificant sort as compared with the sacrifices our soldiers and sailors are making to save the life of the Nation. The sound thing to do is unquestionably to increase

taxation, and the increases should be determined upon promptly and made effective at the earliest possible moment.

I doubt seriously if the Government can be financed with only \$4,000,000,000 derived from taxation, because with a tax bill no larger than this, sufficient economies will not be enforced upon the people of America, and without such economies, I see no way in which the great financial operations of the Government can be safely conducted.

On the basis of the present revenue laws, we should have to raise in the fiscal year 1919 \$20,000,000,000 by the sale of Liberty Bonds or by loans of one sort or another. I believe that if we are to preserve the soundness and stability of our financial structure, we should raise by taxation not less than one-third of the estimated expenditures for the fiscal year 1919, or \$8,000,000,000.

There are also certain general considerations bearing upon the problem of taxation which I hope I may be permitted to bring to your attention.

The existing excess profits tax does not always reach war profits. The rates of excess profits taxation are graduated and the maximum is 60%. In Great Britain there is a flat rate of 80% on all war profits. The Government Departments, under great pressure as they are to get necessary war materials and supplies with the utmost expedition, cannot in the nature of things fix their prices nor guard their contracts in such a way as to avoid the possibility of profiteering. The one sure way is to tax away the excessive profits when they have been realized. I do not say this in a spirit of criticism of the corporations or business men of the country who have for the most part loyally supported the Government. In entering into war contracts they take grave risks. They are called upon to make vast expenditures of capital for purposes which may prove unproductive after the war. They are not to be blamed in these circumstances for asking for prices and terms which cover these risks. On the otherhand, when the risk has been liquidated by proper allowances, and the contract has proved profitable, the Government should take back in taxes all profits above a reasonable reward. Under existing law, that does not happen because the tax rates are not high enough and cannot safely be made high enough, since the test now is not how much of the profits are due to the war, but what relation the profits bear to the capital invested. A company with a swollen capital and huge war profits escapes.

Of course, no one objects to reasonable profits; on the contrary, everyone should want, and I am sure does want, business and enterprise to be rewarded with reasonable, or even liberal, profits. Prosperity should be preserved and can be preserved, I believe, on the basis of reasonable profits. The problem of statesmanship is to establish a just relation between necessary taxation and the earning power of the Nation.

This brings me to another consideration of great moment in the Government's financial plans. I hope that it will not be necessary further to increase the interest rate on Government bonds. The number of subscribers to the three Liberty Loans aggregated 30,000,000. The people who subscribed are impatient of those who have not. Various plans have been urged upon me for forcing the people to buy Liberty Bonds. The man of small means who buys a \$100 bond wants his neighbor to do so too. There is a popular demand also for high taxes upon war profits. There is also a popular demand that all the people should contribute to financing the war. There should, therefore, be a substantial increase in the normal income tax rate and a higher tax should be levied upon so-called unearned than on earned incomes. Income derived from Liberty Bonds would be exempt from this taxation and the relation between income from Liberty Bonds and income from other securities would be readjusted without increasing the rate of interest on Liberty Bonds. It would not tax the patriotic purchasers of Liberty Bonds on their holdings, but it would weigh heavily upon the shirkers who have not bought them. It would make the return from Liberty Bonds compare favorably with the return from other securities. It would give the Government's bonds an essential and necessary advantage over those of corporate borrowers and would very greatly decrease the relative advantage which State and municipal bonds now enjoy through the total exemption which they carry. It would produce a gradual readjustment of the situation in the investment markets instead of an abrupt one, as would be the case if the interest rate on Liberty Bonds should be increased.

A normal tax falls upon all alike. Therefore, as I pointed out in my statement before the Ways and Means Committee last summer, there is not the same objection to the exemption from normal income taxes as there is to the exemption from surtaxes. A substantial increase in the normal income tax is the soundest and surest way of stabilizing the price of Government bonds. If we have to increase the interest rate on Government bonds, the increased rate may continue for ten to thirty years and some of the bonds which we have issued will go to great premiums not long after the war is over. If we make the bonds at the present rate more attractive by increasing the normal tax, then the decrease in taxation which will follow the close of the war will automatically adjust the situation. I believe that to stabilize the price of Government bonds by first increasing and subsequently reducing the normal income taxes, from which the holders of these bonds are exempt, is sound finance and sound economics.

There is another feature deserving of consideration. We are asking the people to finance this war and we are offering them an investment paying 4 $\frac{1}{2}$ % interest. The people have responded wonderfully to this appeal. In the last Liberty Loan campaign 17,000,000, approximately, subscribed. There is a widespread feeling that many people who are able to do so, especially those who are making vast profits out of the war, are not doing their part, either in the purchase of Liberty Bonds or in the payment of taxes--that they are investing in corporate stocks and bonds producing high returns instead of in the Bonds of their own Government producing reasonable returns, when the first duty of patriotism and self-protection demands that they shall buy Government bonds for the protection of the Nation in its hour of peril.

There is a natural feeling among the masses of the people that taxation upon incomes and upon war profits should be high enough to bring the return from corporate investments more nearly on a parity with the return from Government bonds; that the Government should not be forced to compete for credit with war industries which are profiting abnormally and which, unless restrained by the exercise of sound and just taxation, will constantly add to the difficulties of the people of the United States in their effort to supply the Government at reasonable interest rates with the credit it needs to fight successfully this war for Liberty.

If I may, without impropriety, offer a suggestion as to the proposed revenue measure, I should recommend:

(1) That one-third of the cash expenditures to be made during the fiscal year ending June 30, 1919, be provided by taxation. According to my estimates, this would involve raising \$8,000,000,000 through taxation.

(2) That a real war profits tax at a high rate be levied upon all war profits. This tax should be super-imposed upon the existing excess profits tax in such a way that the taxpayer should be required to pay whichever tax is the greater. The existing excess profits tax should be amended in certain important particulars so as to remove inequalities.

(3) That there should be a substantial increase in the amount of normal income tax upon so-called unearned incomes. Under existing law earned incomes above certain exemptions are taxed 4% as an income tax and 8% as an excess profits tax, making a total of 12%, while unearned incomes, derived from securities, etc., are taxed only 4%. The 8% tax should be recognized as an income tax and the rate of 12% (4% normal and 8% excess profits) should be retained in respect to earned incomes, while a higher rate than 12% should be imposed on unearned incomes.

(4) That heavy taxation be imposed upon all luxuries.

Sincerely yours,

(Signed) W. G. McAdoo.

Hon. Claude Kitchin,
Chairman, Ways and Means Committee,
House of Representatives.

STATEMENT SHOWING CLASSIFIED DISBURSEMENTS BY MONTHS FROM
MARCH, 1917, TO MAY, 1918, AS PUBLISHED IN DAILY TREASURY STATEMENTS:

	Ordinary	Foreign Loans	Other Special	Total
March, 1917-----	\$ 72,773,903.20	-----	\$27,176,896.12	\$ 99,950,799.32
April, 1917 -----	81,599,598.22	\$200,000,000.00	8,294,354.78	289,893,953.00
May, 1917 -----	114,102,809.68	407,500,000.00	4,962,746.28	526,565,555.96
June, 1917 -----	134,304,040.35	277,500,000.00	919,445.78	412,723,486.13
	<u>402,780,351.45</u>	<u>885,000,000.00</u>	<u>41,353,442.96</u>	<u>1,329,133,794.41</u>
July, 1917 -----	208,299,031.05	452,500,000.00	1,511,814.92	662,310,845.97
August, 1917 -----	277,438,000.64	478,000,000.00	2,019,363.50	757,457,364.14
September, 1917 --	349,013,305.34	396,000,000.00	1,364,980.35	746,378,285.69
October, 1917 ----	462,045,359.94	480,700,000.00	1,623,392.58	944,368,752.52
November, 1917 ---	512,952,035.17	471,929,750.00	1,200,022.36	986,081,807.53
December, 1917 ---	611,297,425.62	492,000,000.00	1,914,433.70	1,105,211,859.32
January, 1918 ----	715,302,039.83	370,200,000.00	4,854,005.86	1,090,356,045.69
February, 1918 ---	675,209,068.43	325,000,000.00	12,477,917.31	1,012,686,985.74
March, 1918 -----	819,955,367.26	317,500,000.00	18,338,441.98	1,155,793,809.24
April, 1918 -----	910,756,758.95	287,500,000.00	17,031,020.28	1,215,287,779.23
May, 1918 -----	1,068,203,026.82	424,000,000.00	15,992,206.83	1,508,195,233.65
	<u>6,610,471,419.05</u>	<u>4,495,329,750.00</u>	<u>78,327,599.67</u>	<u>11,184,128,768.72</u>
Total March 1, 1917, to May 31, 1918 --	<u>7,013,251,770.50</u>	<u>5,380,329,750.00</u>	<u>119,681,042.63</u>	<u>12,513,262,563.13</u>

FEDERAL RESERVE BOARD

WASHINGTON

July 6, 1918.

Dear Sir:

In the Bulletin for April, 1918, the Federal Reserve Board published a statement setting forth the reasons why, in its opinion, a gradual but consistent curtailment of nonessential credits is necessary, and urging the banks and trust companies of the country to do whatever they could in the exercise of a reasonable discretion to restrict credits which are clearly not needed for the prosecution of the war or for the health and necessary comfort of the people.

On June 12, the Secretary of the Treasury addressed a letter to all banks and trust companies, announcing his financial program for the ensuing six months which involves the sale to and through banks of approximately six billion dollars of Treasury certificates of indebtedness, in installments of not less than \$750,000,000 every two weeks between June 25 and the first of November. In this letter each bank and trust company was requested to invest in these certificates an amount equal to approximately $2\frac{1}{2}$ per cent of its gross resources, or a total of 5 per cent for each month. Announcement was made at the same time that there was in contemplation an issue of two billion dollars of certificates of appropriate maturities in anticipation of income and excess profits taxes, for sale more particularly to taxpayers, and that the amount of the regular semimonthly sales of certificates of indebtedness would be reduced in proportion to the extent to which these tax certificates are taken by the public.

The banking institutions have responded most generously to the appeal of the Secretary of the Treasury. Throughout the country they have pledged themselves without hesitation to subscribe to their allotment, and the result of the initial offering which has just been closed—a subscription of \$838,000,000 in response to a request for not less than \$750,000,000—is evidence of the splendid patriotism of those who direct our national and State banking institutions. The Board hopes that succeeding issues will be subscribed as readily and in the same patriotic spirit.

The Federal Reserve Banks will be prepared to place their facilities—directly or indirectly—at the disposal of such subscribing banks as may legitimately need assistance in taking their allotments. The Board, however, feels in duty bound to reiterate that the banks can render a greater service to the country in this connection, not merely by subscribing their allotments and by using the rediscounting facilities of the Federal Reserve Banks in making payments, but by providing the necessary funds for meeting payments for certificates of indebtedness purchased, by employing for this purpose the accretion of new deposits, and by utilizing the funds that may be made available by a judicious curtailment of credits asked for non-essential purposes.

In order to prosecute the war successfully, the Government is compelled to issue obligations to provide for its large expenditures which involve waste and destruction rather than a permanent addition to the national wealth. This process in itself tends to inflation, and contributes to a rapid increase in the price of necessities. Abnormal demands by the Government, unavoidable and necessary in the present circumstances, must be counteracted by greater economy on the part of the civilian population which must decrease, by combined effort, the normal waste incident to domestic life and business pursuits. There is not an unlimited supply of credit or of goods, or of man power. Wherever possible all such resources should be conserved and set aside for the use of the Government. Credit extended for nonessential purposes involves the use of labor, of transportation, of material and reserves which ought to be kept free for the use of the Government. Unrestricted credit involves unnecessary competition with the Government, and needlessly advances prices, besides impeding and delaying Governmental operations.

"Business as usual" and "life as usual" are impossible at a time when the supreme business of the country is war, and can not be approximated without interfering with the work of the Government and inflicting serious harm upon the Nation as a whole. The staying power of the country in this emergency depends upon the extent of its resources in men, goods, and gold. An unnecessary use of credit, a needless recourse to the discounting facilities of the Federal Reserve Banks, weakens proportionately the gold reserve of the United States—the financial backbone of the entire allied group. Whoever wastes the raw material and manufactured products of the country adds to our financial burden by increasing the amount the United States must import from other countries and by decreasing, at the same time, the volume of goods that should be available for export purposes—the best means of paying for the goods acquired from abroad.

Conservation of our commodities and of our gold—preservation of our economic strength—is of the greatest importance in making provision for the period of readjustment which will follow the reestablishment of peace. The country having the largest supply of goods and gold available at the end of the war will find itself in the best strategic position for controlling the markets of the world. The Board wishes to point out, also, that by refraining from buying luxuries, and by restricting the use of necessities to the actual requirements of health and reasonable comfort, we can create a reserve purchasing power which will be of the greatest value in bridging over our industries during the period of reaction and reconstruction which must follow when war industries are transformed into peace industries. An intelligent and prudent use of credit, therefore, will be an important factor in strengthening the national resources during the period of the war, in aiding its successful prosecution, and in maintaining the economic strength of the country for the time of rapidly changing conditions which will come when the war has been won and the millions of men in our armies are returning to the employments of peace.

Thus, by giving your cooperation now in the effort to conserve national resources by the exercise of discriminating judgment in granting credits, you will also do your part in averting the danger of unemployment which is apt

to follow a treaty of peace. The Board appreciates the difficulty of laying down a general rule for defining essentials or the degree in which any enterprise is essential, and requests that its remarks on this subject in the April issue of the Bulletin be read again. The Board can not suggest specific ways in which credit should be conserved or unnecessary expenditures curtailed, as each banker must determine this for himself after conferring with the business men of his community and after a careful study of his local situation. Reasonable discretion should be exercised, and drastic steps calculated to bring about hardships or embarrassments or work injustice should be avoided, but the banks should divert the use of their credit more and more into productive fields, where its employment will result in augmenting the national resources.

Respectfully yours,

A large, stylized handwritten signature in dark ink, likely belonging to the Governor mentioned in the text. The signature is fluid and cursive, with a prominent initial 'G'.

Governor.

To the President
of the Bank or
Trust Company addressed.

6
Washington, D. C.

November 14, 1918.

My dear Senator:

The collapse of our enemies necessitates instant reconsideration of the financial problems before the Government, the most immediate of which is that presented by the new Revenue Bill now before the Finance Committee of the Senate. The prompt enactment of a Revenue Bill is imperative. The existing law is not satisfactory to the country nor to the Treasury. On the other hand, the Revenue Bill which passed the House is more stringent than the changed situation will justify.

In June, in preparing for a long war and an increasing military program, I estimated the expenditures for the fiscal year ending June 30, 1919 at \$24,000,000,000. The expenditures for the first four months of the fiscal year 1919, that is for the months of July, August, September and October, aggregated, according to the Treasury Daily Statement, \$6,635,922,423.72, or within \$365,000,000 of the amount which I anticipated for that period. The saving was apparent rather than real--due to the fact that the improved arrangements which the Treasury was able to make for meeting the requirements of the Army's disbursing officers abroad released funds which had accumulated to their credit and made them available for current expenditures, and also due to certain other adjustments. I have little doubt, therefore, that had the war continued, the expenditures would have reached the amount estimated.

Now, however, there seems every reason to anticipate a large reduction in the Government's expenditures during the balance of the fiscal year. How great that reduction will be, it is impossible at the moment to estimate. Existing contracts will, no doubt, be liquidated to a considerable extent. That process of liquidation might actually result for a time in acceleration of demands upon the Treasury rather than retardation. The pay of the Army and Navy and the expenditures in salaries and wages of the war establishments must continue without material change for months to come. It seems reasonable to suppose that the decrease in the Government's expenditures cannot be at a very rapid rate, if a wise policy of readjustment and transfer of activities from a war to a peace basis is followed.

The United States will be the fortunate possessor of foodstuffs, raw materials and manufactured products of which Europe and the rest of the world are in dire need. Not all of the Allies can fully pay us in gold, for some have little and others none to spare; nor in commodities during the period of reconstruction, for some of them will not so soon be able to resume normal activities; and the United States must be prepared to continue, therefore, to enable the governments of

the Allies, or some of them, to make purchases on credit. I shall promptly ask the Congress for authority to continue to establish such credits and make loans within reasonable limits to these Governments for purposes growing out of the war.

It is of the utmost importance that such foreign loans should be held down to a minimum and as soon as may be, discontinued, and that every reasonable argument should be pressed upon the governments of the Allies to prepare themselves and their people to make payment for their exports from the United States by imports into the United States; that is, in effect, to make cash payment instead of payment by credit. For the period of reconstruction, however, some of the Allies must have working capital in the form of credits to enable them to pay for the imports without which they cannot place themselves and their industries on a peace basis. This is not only the policy which is actuated by a proper desire to be helpful to the governments which, with us, have borne the burden of the war, and to their peoples, but is also the policy of enlightened selfishness. It is to be apprehended that the sudden cessation of the extraordinary demands upon our industry and products, consequent upon the conclusion of the war, may result in sudden reduction of prices and wages and even in unemployment, if we are not prepared to continue to sell on credit to the extent that may be necessary.

These considerations lead me to believe that the Government's expenditures during the fiscal year ending June 30, 1919, may be in the neighborhood of \$18,000,000,000.

I am inclined to recommend a substantial reduction in the amount sought to be raised by the House Bill. Changes have been made or are

in contemplation by the Senate which, taken together with the anticipated elimination of revenue from liquor taxes, would reduce the amount to be raised by the pending Revenue Bill from the \$8,000,000,000 or more provided for in the House Bill and originally suggested by me to some \$6,300,000,000. Further changes may, I think, with safety be made in the Bill with a view to reducing the amount of taxation to \$6,000,000,000 which may be paid in instalments during the calendar year 1919. The excess profits tax rates applicable to the calendar year 1918 should not be greater than those provided for in the existing law of October, 1917, and should be payable only in those cases where such excess profits tax would yield a larger return than the proposed war profits tax. The 60% war profits tax applicable to the calendar year 1918 should be retained.

Contracts have been made during past months in the expectation of a heavy war profits tax. Everyone is agreed that war profits should be taxed. They must be taxed now.

It is time to look ahead to the future of American business and industry. Our tax measures should be so devised as to encourage and stimulate rather than to burden and repress them. I, therefore, recommend the immediate amendment of the pending bill so as to provide that, with the collection of the taxes levied upon war and excess profits for the calendar year 1918 and payable in the year 1919, the war and excess profits taxes shall come to an end, except in so far as may be necessary to subject to these taxes profits which, though arising from contracts entered into during the war period, would, under existing regulations, technically be profits of 1919 and not profits of 1918. I can think of nothing which would do more to encourage industry and enterprise than this measure, carrying with it as it would the assurance that with the cessation of war there will come cessation of taxes on so-called war profits and war excess profits.

It seems wise to provide, with the elimination for the calendar year 1919 of the war and excess profits taxes, for a sufficient revenue from corporation and individual income taxes applicable to the calendar year 1919 to make the total revenue payable during the calendar year 1920 not less than \$4,000,000,000. It is impossible at this time to make a forecast of the aggregate amount which the war debt will have reached by the time war contracts have been liquidated and the reduction of our military forces to a peace basis has been completed. What will be the government's necessities when the period of readjustment is past and the country has fully reached a peace basis cannot now be foretold; but having regard to the interest on the then public debt in excess of the interest to be received from obligations of foreign governments, the necessity of providing from taxes for the gradual retirement of the war debt, and the certain permanent increase in the expenditures of the government over pre-war expenditures, the figure of \$4,000,000,000 suggested seems a very moderate one.

In connection with the revision downward of the pending Revenue Bill, I cannot too strongly urge upon you the necessity, so far as the war and excess profits tax is concerned, of providing necessary safeguards in the form of adequate provisions for amortization, conservative valuation of inventories, and the ascertainment of the minimum incomes which shall be exempted from the tax on lines which will

insure the taxpayer from injustice and avoidable injury. Nor can I overemphasize the importance of determining now the basis of taxation which will apply to the calendar year 1919 as well as to the calendar year 1918. Business and industry and individual initiative and enterprise are entitled to know in advance the basis of taxation upon which all the activities of the Nation must be conducted. Prosperity cannot be maintained if business is kept in uncertainty as to taxation. It is always unfortunate to be compelled to enact a tax bill at the end of the calendar year, with retroactive effect, instead of in advance of the calendar year, which would permit contracts and business arrangements generally to be entered into with certainty as to the burden of taxation to be borne. This is a gross injustice to business and to all forms of enterprise. It is costly also to the people at large, as they are required to pay higher prices for their necessities, because producers, in order to be on the safe side, fix prices on the assumption that taxes may be higher than they subsequently turn out to be. Definiteness and certainty as to the basis of taxation should be given in the pending bill, not alone as to the calendar year 1918, but as to the calendar year 1919. This will enable business and enterprise to proceed with confidence and courage.

Being reasonably assured of a decreasing rather than an increasing scale of expenditure, the Treasury could look forward with composure to the necessity of temporary borrowing against the expected revenue, in addition to such borrowing as may be necessary to meet the excess of current expenditures over revenue. This gives an opportunity in connection with the pending Bill to take measures which heretofore have been impossible because of the increasing scale of expenditures, although inherently very desirable, for the spreading of the payments of income and profits taxes over the entire calendar year instead of requiring them to be made in the first six months, and I suggest that these taxes be made payable in four equal instalments, say, March 15, June 15, September 15 and December 15. This will give great additional relief to taxpayers during the period of readjustment now before us and will initiate a policy which should be to the permanent advantage of the Government. For many years to come the Government's expenditure for interest and other purposes will be vastly increased and that expenditure will be spread over the whole year. It is of the utmost importance that the Government should be in receipt of revenues through the calendar year about evenly proportioned so that it will not be under the necessity of accumulating balances beforehand or borrowing against anticipated revenue receipts when we reach again a peace basis.

To summarize, I venture to recommend:

1. That the pending Revenue Bill be revised with a view to yielding \$6,000,000,000, payable during the calendar year 1919 and not less than \$4,000,000,000 during the calendar year 1920.

2. That income and profits taxes be payable in four equal quarterly instalments, beginning March 15 in each year.
3. That the excess profits tax rates in respect to taxes payable in the year 1919 be not higher than those in the existing law.
4. The amelioration of the provisions with reference to the determination of war and excess profits taxes in respect to the revenue payable in the year 1919 and the elimination of those taxes in respect to revenue payable in 1920, except with respect to profits on contracts negotiated during the war period.
5. That to compensate for any reduction of revenue beyond the desired amounts above indicated, there should be an increase in the corporation and individual income tax levies.

I am sending a copy of this letter to Mr. Kitchin, Chairman of the Ways and Means Committee.

Cordially yours,

(signed) W. G. McADOO.

Hon. F. M. Simmons,
Chairman, Committee on Finance,
United States Senate.

EX-OFFICIO MEMBERS
CARTER GLASS
SECRETARY OF THE TREASURY
CHAIRMAN
JOHN SKELTON WILLIAMS
COMPTROLLER OF THE CURRENCY

FEDERAL RESERVE BOARD

WASHINGTON

W. P. G. HARDING, GOVERNOR
ALBERT STRAUSS, VICE GOVERNOR
ADOLPH C. MILLER
CHARLES S. HAMLIN

J. A. BRODERICK, SECRETARY
W. T. CHAPMAN, ASSISTANT SECRETARY
W. M. IMLAY, FISCAL AGENT

ADDRESS REPLY TO
FEDERAL RESERVE BOARD

November 26, 1918.

X-1288

SUBJECT: Use of Gold Coin for Christmas Presents:

Dear Sir:

The Board has been asked for an expression of its views as to the propriety of using gold coin for Christmas presents. About a year ago the Board issued a statement giving some reasons why, in its opinion, it was not desirable to use gold coin for such purposes. There are still some objections to the use of gold coin for gifts, for we are not yet through with war financing and the problems which grow out of the war and reconstruction will be live ones for many years. There is a world-wide movement to discourage the use of gold coin as a circulating medium upon the ground that gold should be concentrated in the banks as reserve and used in the settlement of balances growing out of international transactions.

New bills can be obtained readily for use as presents, and Liberty Bonds, War Savings Certificates, and United States Thrift Cards can be used in the same way to good advantage. We should continue to encourage habits of thrift and should frown upon extravagance and the wasteful employment of anything which can be diverted to a useful purpose.

Very truly yours,

Governor.

Washington, December 5, 1918.

Dear Mr. Kitchin:-

In my annual report on the State of the Finances for the fiscal year ended June 30, 1918 I called attention to the fact that until certain of the Allied countries could resume their normal activities the United States should be prepared to sell them on credit even after the declaration of peace, foodstuffs, raw materials and manufactured products of which they might be in need, and stated that I should recommend the enactment of legislation extending the authority to establish credits in favor of foreign governments for a reasonable period and within reasonable limits to meet needs growing out of the war.

I enclose herewith the draft of a bill which is designed to confer such authority and recommend its enactment.

Under the existing law credits may be established by the Secretary of the Treasury with the approval of the President, only for the purpose of the National security and defense and the prosecution of the war in favor of governments engaged in war with the enemies of the United States and the authority to establish such credits ceases upon the termination of the war between the United States and the Imperial German Government. If the Draft bill enclosed herewith should be enacted the authority to establish such credits would be continued for the period of one year after the termination of the war, and after December 15, 1918 credits might be established, with the approval of the

President, for purposes growing out of the war and after the termination of the war in favor of the governments of such foreign countries as were previously engaged in war with the enemies of the United States.

The obligations of the Allied Governments which have been acquired by the United States pursuant to existing law are in form payable on demand. Under existing laws the Secretary of the Treasury is authorized to convert all such obligations acquired under the authority of the First Liberty Bond Act or of the Second Liberty Bond Act into "long-time obligations of such foreign governments respectively maturing not later than the bonds of the United States then last issued under the authority of this Act or of said Act approved April twenty-fourth, nineteen hundred and seventeen as the case may be,"

The bonds of the United States issued under the Act of April 24, 1917, the First Liberty Bond Act, mature June 15, 1947 and the bonds last issued under the Act above quoted, the Second Liberty Bond Act mature October 15, 1938. The provisions of Section 2 of the draft bill herewith presented are intended to continue the authority at this time vested in the Secretary of the Treasury in regard to such conversion and to prevent a limitation of such authority in case bonds of the United States should be hereafter issued under the Second Liberty Bond Act bearing a short date of maturity.

The present appropriation for loans to foreign governments in the amount of \$10,000,000,000 is not increased in the draft bill presented to you herewith. It is very difficult to estimate with any degree of accuracy how much of the present appropriation will be required for loans

to meet the war expenditures of the foreign governments, how much will be available for loans for purposes growing out of the war and what will be the requirements of the Governments of the Allies for reconstruction purposes. The date of the termination of the war and the terms of the peace treaty are important factors as well as the extent to which such foreign governments will be able to pay for their requirements in the United States out of the dollar equivalent of our military expenditures abroad, by sales of securities or commodities exported or by the use of private credits. The actual cash advanced to the Allied Governments together with credits dedicated and made effective for specific purposes aggregate \$7,608,693,483.70, while credits established but not yet advanced or made effective for specific purposes amount to \$611,647,218.30 bringing the total of the credits out of which advances have been or may be made up to \$8,220,340,702. After providing say \$279,659,298 additional for outstanding commitments and the continuance of purchases--largely of foodstuffs--for war purposes, the amount of the existing appropriation (\$10,000,000,000) which will be available for use under the draft bill may be roughly estimated at \$1,500,000,000.

I restate the foregoing figures (cents omitted) in tabulated form:

Appropriation for foreign loans	\$10,000,000,000
Cash advances and credits made effective	\$7,608,693,483
Credits established but not yet advanced nor made effective.	611,647,218
Additional requirements for commitments and other war requirements say	<u>279,659,299</u>

\$8,500,000,000

Balance available under draft bill
for purposes growing out of war-say

\$1,500,000,000

The gross needs of the Governments of the Allies from the United States for after the war purposes they have estimated at a much greater total than \$1,500,000,000, but I believe investigation will show a considerable reduction in such estimates. A part of their requirements may be provided by the Treaty of Peace through awards in their favor for reparation either in money or materials; a part will be provided out of the dollar equivalent of our military expenditures abroad and a part it should prove possible for these countries to finance through sales or private credits. A balance, however, is likely to remain which it may be impossible to provide other than by the use of loans from the Government of the United States and the above amount of about \$1,500,000,000 should be sufficient for the purpose.

I cannot feel that victory has been really won in the war if at its conclusion the countries which have side by side with us borne the stress of the conflict are not supplied by some available means with credits to the extent that they may be unable to provide their own finances, so that they may procure in this country the supplies needed for their people and for the reconstruction of their economic life. From the standpoint of enlightened policy, the United States should put itself in position to provide the credits necessary to sell its surplus products until the establishment of normal peace conditions.

The draft bill enclosed merely enlarges the existing powers to make foreign loans, so that within the limits of the present appropriation

and if occasion should arise, the Secretary of the Treasury, with the approval of the President, will be authorized to establish credits after the termination of the war, from which, in the light of conditions as they develop and if it be clearly in the public interest, foreign loans may be made for purposes growing out of the war.

I am sending a copy of this letter to Senator Simmons.

Very truly yours,

(Signed) W. G. McADOO

Hon. Claude Kitchin,
Chairman, Ways and Means Committee,
House of Representatives.

Section 1. That the proviso at the end of Section 2 of the Second Liberty Bond Act as amended by the Third Liberty Bond Act and the Fourth Liberty Bond Act be and hereby is amended so as to read as follows:

"Provided That the authority granted by this section to the Secretary of the Treasury to establish with the approval of the President credits for foreign governments, as aforesaid, shall cease upon the expiration of the period of one year after the termination of the war between the United States and the Imperial German Government; and Provided further That after December 15, 1918, such credits may, with the approval of the President, be established for such purposes growing out of said war as the Secretary of the Treasury shall determine, and after the termination of said war, in favor of the governments of such foreign countries as were previously engaged in war with the enemies of the United States."

Section. 2. The obligations of foreign governments acquired by the Secretary of the Treasury by virtue of the provisions of the First Liberty Bond Act, the Second Liberty Bond Act, the Third Liberty Bond Act, or the Fourth Liberty Bond Act shall mature at such dates as shall be determined by the Secretary of the Treasury; Provided That such obligations acquired by virtue of the provisions of the First Liberty Bond Act or through the conversion of short-time obligations acquired under said Act shall mature not later than June 15, 1947, and all other such obligations of foreign governments shall mature not later than October 15, 1938.

Treasury Department.

For Morning papers, February 11, 1919.

Washington, D. C.,

February 10, 1919.

Dear Mr. Kitchen:

Now that the revenue bill has passed the House I desire, in accordance with the intimation contained in my letter of January 15th to you and my talk with you and Mr. Fordney, to ask the attention of the Ways and Means Committee to the necessity of the immediate enactment of legislation amending the Liberty Bond Acts so as to make possible the funding by a Victory Liberty Loan in the spring of the floating debt which has been incurred and will be incurred up to that time. The Victory Liberty Loan could not be issued successfully, now that hostilities have ceased, within the limitations imposed by existing laws.

After most careful consideration of the matter and after receiving and considering the views of bankers, liberty loan workers and others whose views are most entitled to consideration, very reluctantly I am constrained to say that I cannot wisely determine now in February the terms of the bonds or other obligations which it would be wise to offer for subscription in April when the Liberty Loan campaign should probably begin. At the moment we are in a period of readjustment. To the slackening of industrial and commercial activity incident to the termination of active warfare has been added the usual dullness of the winter season. The necessary and desirable contraction of our credit structure has begun and will be greatly facilitated by the enactment of appropriate legislation

to permit the liquidation of claims arising under informal any contracts, Steps have been taken to break the deadlock which has arisen growing out of the maintenance, nominally at least, of war prices in certain basic industries. Upon the enactment of appropriate legislation to enable the Food Administration to protect the guaranties given by the United States, I am hopeful that it will prove possible to restore the operation of the law of supply and demand with respect to foodstuffs with, as I believe, a consequent reduction in the cost of living. A period of rising prices and of intense industrial activity such as we have experienced during the past four years is always a period of great apparent prosperity, and a period of falling prices and of the contraction of credits is always a period of depression. The retardation of the process of readjustment by artificial means can only increase the evils inherent in the situation. Buying will not begin and activity will not set in until the community at large is satisfied that prices have reached bedrock. I am very hopeful that measures now under discussion may result in the rapid acceleration of the readjustment and I am firmly convinced that if that be done, America has before her a new period of great and growing prosperity. I am even sanguine enough to believe that it is within the range of the possible that so much may have been accomplished on the lines above indicated before the expiration of two months from now that the whole situation will have been changed and that we may look forward to the successful issue of the Victory Liberty Loan on terms which today would seem quite impossible.

Furthermore, merely as a matter of the technique of bond selling,

it would be a fatal mistake to fix the terms of the Loan so long in advance of the offering. The issue would become stale and its attractions would have been discounted long before the Loan Campaign begins. It will be remembered that the Second Liberty Bond Act was approved as late as September 24th and the bonds were offered on October 1st, 1917; that the Third Liberty Bond Act was approved April 4th and the bonds offered on April 6, 1918; and that the supplement to the Fourth Liberty Bond Act was approved September 24th and the bonds offered on September 28th, 1918.

Therefore and in view of the early expiration of the life of the present Congress and the apparent impossibility of convening and organizing the new Congress in time to enact further bond legislation before the Victory Liberty Loan campaign begins, I reluctantly ask greater latitude in the exercise of a sound discretion as to the terms of the Victory Liberty Loan than has been conferred by the Congress in respect to previous loans. I should be only too glad to have the Congress share with me the responsibility of this extraordinarily difficult determination, but, believing that it would be a grave mistake to reach a final determination at this time, I must ask authority to deal with the matter as the situation may develop.

Holding these views, I have ventured to have prepared and I submit to you herewith, a draft of a bill to amend the Liberty Bond Acts and for other purposes. This bill would (1) increase the authorized issue of bonds from twenty billion dollars to twenty-five billion dollars; (2) remove the limitation as to interest rate so far as regards bonds maturing not more than ten years from the date of issue; (3) authorize the issue of not to

exceed ten billion dollars of interest-bearing, non-circulating notes having maturities from one to five years; (4) authorize the issue of bonds and notes payable at a premium; (5) exempt war savings certificates from income surtaxes; (6) confer authority upon the Secretary of the Treasury to determine the exemptions from taxation in respect to future issues of bonds and notes and to enlarge the exemptions of existing Liberty Bonds in the hands of subscribers for new bonds and notes; (7) exempt from income surtaxes and profits taxes all issues of Liberty Bonds and bonds of the War Finance Corporation held abroad; (8) extend the period for conversion of 4% Liberty Bonds on the lines suggested in my letter of January 15th to you; (9) create a $2\frac{1}{2}\%$ cumulative sinking fund for the retirement of the war debt; (10) continue the existing authority for the purchase of obligations of foreign governments after the termination of the war in accordance with the views expressed by Secretary McAdoo by letter and in his testimony before the Ways and Means Committee; and (11) extend the authority of the War Finance Corporation so as to permit it to make loans in aid of our commerce, thus supplementing the aid which may be given by the Treasury on direct loans to foreign governments and in a measure relieving the Treasury of demands for such loans.

I am sure that your Committee will wish to discuss all of these matters fully with me and I shall not burden you at this time with a fuller statement of my views concerning them.

I am sending a copy of this letter to Senator Simmons.

Very truly yours,
(Sgd). Carter Glass.

Enclosure.

Hon. Claude Kitchin,
House of Representatives,
Washington, D.C.

A bill to amend the Liberty Bond Acts and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That Section 1 of the Second Liberty Bond Act as amended in hereby further amended by striking out the figures \$20,000,000,000 and inserting in lieu thereof the figures \$25,000,000,000 and by adding the following clause:

"Any bonds maturing not later than ten years from the date thereof may bear interest at such rate or rates, notwithstanding the limitation hereinbefore contained, and may be made payable at or before maturity at such premium or premiums as the Secretary of the Treasury may prescribe."

Sec. 2. That the Second Liberty Bond Act is hereby amended by adding thereto a new section to read as follows:

"Sec. 18. That in addition to the bonds and certificates of indebtedness and war savings certificates authorized by the Second Liberty Bond Act and amendments thereto, the Secretary of the Treasury is authorized to borrow from time to time on the credit of the United States for the purposes of said Act and amendments thereto and to meet public expenditures authorized by law such sum or sums as in his judgment may be necessary, and to issue therefor notes of the United States at not less than par in such form or forms and subject to such terms and conditions and at such rate or rates of interest as he may prescribe, and each note so issued shall be payable at such time not less than one year nor more than five years from the date of its issue, and may be redeemable before maturity upon such terms and conditions, and may be payable at or before maturity at such premium, and the interest accruing thereon shall be payable at such time or times as the Secretary of the Treasury may prescribe. The sum of such notes outstanding hereunder shall not at any one time exceed in the aggregate \$10,000,000,000. None of

such notes shall bear the circulation privilege. The principal and interest therefore shall be payable in United States gold coin of the present standard of value. The words "bonds" where it appears in Section 8, 9, 10, 14, and 15 of this Act and Section 5200 of the Revised Statutes, but in said sections only, shall be deemed to include notes issued hereunder."

Sec. 3. That notwithstanding the provisions of the Second Liberty Bond Act and of any other Act,

(A) War Savings certificates of the United States heretofore or hereafter issued shall be exempt from taxation as fully and to the same extent as bonds of the United States issued under Section 1 of the First Liberty Bond Act.

(B) Bonds, notes and certificates of indebtedness of the United States of any series hereafter issued shall be exempt from taxation if, and to the extent prescribed by the Secretary of the Treasury in connection with the issue thereof.

(C) Subscribers for any subsequent series of bonds or any series of notes of the United States shall be entitled to additional exemptions from taxation in respect to bonds of the First Liberty Loan converted, the Second Liberty Loan converted and unconverted, the Third Liberty Loan and the Fourth Liberty Loan owned by them if, as and to the extent prescribed by the Secretary of the Treasury in connection with the issue of such subsequent series of bonds or of such series of notes.

(D) Section 3 of the Fourth Liberty Bond Act is hereby amended to read as follows:

"Sec. 3. That, notwithstanding the provisions of the Second Liberty Bond Act and of the War Finance Corporation Act and of any other Act, bonds, notes and certificates of indebtedness of the United States and bonds of the

War Finance Corporation shall, while beneficially owned by a non-resident alien individual, or by a foreign corporation, partnership or association, not engaged in business in the United States, be exempt both as to principal and interest from any and all taxation now or hereafter imposed by the United States, any state or any of the possessions of the United States or by any local taxing authority."

Sec. 4. That the privilege of converting 4% bonds of the First Liberty Loan converted and 4% bonds of the Second Liberty Loan into $4\frac{1}{4}\%$ bonds, which privilege arose on May 9, 1918, and expired on November 9, 1918, may be extended by the Secretary of the Treasury for such period, upon such terms and conditions and subject to such rules and regulations as he may prescribe; Provided, however, that for the purpose of computing the amount of interest payable, bonds presented for conversion under any such extension shall be deemed to be converted on the dates for the payment of the semi-annual interest on the respective bonds so presented for conversion, next succeeding the date of such presentation.

Sec. 5. That at the expiration of one year after the termination of the war, and annually thereafter until all bonds and notes hereinafter referred to shall be retired, the Secretary of the Treasury shall set aside, as a cumulative sinking fund for the retirement of the war debt, such amount as he shall deem necessary under the provisions of this section and the amount so set aside by the Secretary of the Treasury in each such year is hereby appropriated for the purpose of this section to be available until all such bonds and notes are retired. Bonds and notes purchased, redeemed or paid out of the sinking fund shall be cancelled and retired and shall not be reissued. The Secretary of the Treasury shall from time to time, beginning one year

after the termination of the war and continuing until the war debt is retired, purchase for the sinking fund bonds and notes issued under authority of the First Liberty Bond Act, the Second Liberty Bond Act, the Third Liberty Bond Act, the Fourth Liberty Bond Act and this Act, including converted bonds, at such prices and upon such terms and conditions as he may prescribe. The aggregate amount of all such bonds and notes purchased in any sinking fund year shall equal as nearly as may be but shall not exceed $2\frac{1}{2}\%$ of the aggregate amount of such bonds and notes outstanding at the expiration of one year after the termination of the war plan (in the case of any sinking fund year after the first) any amount herein authorized to be expended for such purchases not expended in any previous year or years and an amount equal to the interest on all bonds and notes retired by means of the sinking fund. The sinking fund may be applied to the payment of bonds or notes at maturity or to the redemption thereof before maturity as well as to the purchase thereof. The average cost of the bonds and notes purchased shall not exceed par and accrued interest.

Sec. 6. That the proviso at the end of Section 2 of the Second Liberty Bond Act as amended by the Third Liberty Bond Act and the Fourth Liberty Bond Act is hereby amended to read as follows:

"Provided, That the authority granted by this section to the Secretary of the Treasury to establish credits for foreign governments, as aforesaid, shall cease one year after the termination of the war between the United States and the Imperial German Government: and, Provided further, That, for the purpose of promoting commerce with foreign nations, such credits may, after February 15, 1919, be established by the Secretary of the Treasury, with the approval of the President, to provide for purchases in the United States for export therefrom and for expenditures in the United States in connection with such purchases and for the payment of interest to the United

States; and, Provided further, That after the termination of the war such credits may, with the approval of the President, be established in favor of the Governments of such foreign countries as were previously engaged in war with enemies of the United States."

Sec. 7. That the obligations of foreign governments acquired by the Secretary of the Treasury by virtue of the provisions of the First Liberty Bond Act and the Second Liberty Bond Act and amendments and supplements thereto, shall mature at such dates as shall be determined by the Secretary of the Treasury: Provided, That such obligations acquired by virtue of the provisions of the First Liberty Bond Act or through the conversion of short-time obligations acquired under said Act, shall mature not later than June 15, 1924, and all other such obligations of foreign governments shall mature not later than October 15, 1938.

Sec. 8. That the War Finance Corporation Act is hereby amended by adding to Title I thereof a new section to read as follows:

"Sec. 21. That the Corporation shall be empowered and authorized in order to promote commerce with foreign nations through the extension of credits to make advances upon such terms, not inconsistent with the provisions of this section, for periods not exceeding five years from the respective dates of such advances to any person, firm, corporation or association engaged in the business in the United States of exporting therefrom domestic raw materials, agricultural products, manufactured articles and other commodities to foreign countries or to make advances to any bank, banker or trust company conducting business in the United States which shall have made advances to any such person, firm, corporation or association after this Act shall have taken effect.

"Such advances shall be limited in amount to not more than the market

value of the goods to be exported at the port of shipment and at the time of shipment (as estimated and determined by the Corporation), plus insurance and carrying or transportation charges to the foreign point of destination if and to the extent that such insurance and carrying or transportation charges are payable in the United States to domestic insurers and carriers. Provided, That any such advances to bank, banker or trust company shall not exceed the amount remaining unpaid of the advances made by any such bank, banker or trust company to any such person, firm, corporation or association, and Provided further, That the aggregate of the advances made by the Corporation under this section remaining unpaid shall never at any time exceed the sum of one billion dollars.

"Notwithstanding the limitation of Section 1 of this Act, the advances provided for by this section may be made until the expiration of one year after the termination of the war, the date of such termination to be fixed by proclamation of the President of the United States. All such advances shall be made upon the promissory notes of the borrower, secured in each instance by endorsement, guarantee or otherwise as the Corporation shall deem adequate. The Corporation in its discretion may extend the time of repayment of any such advance through renewals, the substitution of new obligations or otherwise, provided that the time for the repayment of any advance shall not be extended beyond five years from the date on which the same was originally made."

Sec. 9. That the last sentence but one of Section 15 of the War Finance Corporation Act be and is hereby amended to read as follows:

"Beginning twelve months after the termination of the war, the date of such termination to be fixed by a proclamation of the President of the United States, the directors of the Corporation shall proceed to liquidate its

assets and to wind up its affairs, but the directors of the Corporation, in their discretion, may, from time to time, prior to such date, sell and dispose of any securities or other property acquired by the Corporation."

Sec. 10. That the short title of this Act shall be "Fifth Liberty Bond Act."

February 21, 1949.

Dear Sir:

I beg to acknowledge your letter of the 11th instant, enclosing circulars from the Farm Mortgage Bankers Association, which I return herewith as you request. This Association is composed of firms and corporations engaged in the business of making farm loans. They find that the profits of their business have been curtailed by the operation of the Federal Farm Loan System, under which money is loaned to farmers for deserving purposes at a reasonable rate of interest, for a long period of years, and without the exaction of the "bonuses" and commissions which have characterized this business in the past. They have been constant opponents of the System, attacking the security of the loans made by the Federal Land Banks, and threatening to bring legal proceedings to test the constitutionality of the tax exemption feature of the Act. Latterly, they have been conducting an extremely active propaganda looking toward the repeal of the tax exemption. Their object in this is to make it impossible to sell the Farm Loan Bonds issued by the Banks, and thus make it impossible for the Banks to make any Loans.

I should have to write you a very long letter to state and answer their various arguments. Briefly, I may say -

1. The amount of Farm Loan Bonds outstanding in the hands of the public is only about 1/2 of 1% of the amount of Liberty Loan Bonds.

The total principal sum of these Farm Loan Bonds represents less than two months' interest on the outstanding Liberty Loan Bonds. The disparity in amount between the two is so great as to preclude the idea of any appreciable competition in sales.

2. The depreciation in the price of Liberty Loan Bonds is due primarily to the fact that they have to some extent been subscribed for by people who were unable to pay for them, or unable to keep them after they had paid for them, and therefore obliged to sell them. The amount offered for sale has been largely in excess of the demand and in such circumstances depreciation was inevitable. I think that it has not been materially affected by any other cause.

3. Farm Loan Bonds are not, as the Mortgage Bankers imply, the only tax exempt bonds. On the contrary, there are billions of dollars in fully exempt bonds issued by the United States, States and local subdivisions now outstanding. The addition to this great volume of less than \$100,000,000 Farm Loan Bonds is negligible.

4. It is true that every tax exempt bond diminishes the Government's revenue from income tax. The diminution due to the sale of Farm Loan Bonds is slight, because they are comparatively small in amount, and because the assumption of the Mortgage Bankers Association that they are all sold to persons subject to the maximum surtax is an absurdity. As a matter of fact, special precautions are taken to see that they are sold as far as possible in small lots to persons of moderate means.

5. It is true that about \$65,000,000 Farm Loan Bonds have been purchased by the Treasury under the authorization in the amendment of

January 18th, 1918, to the Farm Loan Act, but as these bonds pay $4\frac{1}{2}\%$ interest they yield an annual profit to the Treasury of \$102,500 over the rate paid by the Government on its own bonds. Moreover, the Federal Land Banks have been purchasers of both Government bonds and Treasury certificates of indebtedness, and will be continuous purchasers of bonds. They have also commenced the repayment of the capital originally subscribed by the Government at the time of their incorporation. The first payment of about \$125,000 on this account was made in November last, and there will be a further payment in May next.

For your further information I hand you herewith a copy of a letter written by Secretary Mcadoo to Mr. Kitchen on August 20, 1918.

Hoping that this will give you sufficient material for a satisfactory reply to letters that you may receive on this subject, I am

Very sincerely yours,

(signed) GARTER GLASS.

Enclosures,

August 20, 1918.

Dear Sir:

I have your letter of August 9 asking my views with reference to a proposal to amend the Federal Farm Loan Act of July 17, 1916, so that any bonds hereafter issued under such act shall be issued at the same rate and subject to the same taxation as bonds issued under the Second Liberty Loan Act as amended by the Third Liberty Loan Act.

The credit of the Federal Land Banks is high, but does not equal that of the United States Government, nor is it possible for Federal Land Banks to make an appeal to the patriotism of the people which the United States Government makes in offering its Liberty Bonds.

I have no hesitation in saying that bonds issued under the Farm Loan Act could not be issued at the same rate and subject to the same taxation as bonds issued under the Second Liberty Loan Act, as amended by the Third Liberty Loan Act.

Whether bonds could be issued bearing interest at a higher rate, but subject to the same taxation as Liberty Bonds, I do not know. If the Congress should direct such an experiment, it would be necessary to authorize the Treasury, during the period of the war, to buy and hold such bonds as cannot be sold, so that the functions of this great Farm Loan System shall not be crippled at a time when farm production is of major importance. I do not undertake at this time to express an opinion as to the bonds of the Joint Stock Land Banks which stand on a different footing.

Cordially yours,

(Signed) W. G. McAdoo.

TREASURY DEPARTMENT.

Washington.

February 22, 1919.

INCOME AND PROFITS TAXES DUE MARCH 15, 1919.

Income and profits taxes due March 15, 1919, may be paid in Treasury certificates of indebtedness, Tax Series of 1919, dated August 20, 1918, maturing July 15, 1919, and in Treasury certificates of indebtedness, Series T, dated November 7, 1918, maturing March 15, 1919. No other certificates of indebtedness will be accepted in payment of the taxes due on said date. Certificates of the two series mentioned will be accepted by collectors of internal revenue at par, without interest, when tendered in amounts not in excess of the amount of such taxes due March 15, 1919. They will be so accepted at any time on or before March 15, 1919. If so accepted before March 15, 1919, full interest to March 15, 1919, will be paid in the ordinary course upon presentation of the coupons for such interest when due. Coupons maturing on March 15, 1919, should be detached from certificates of Series T, and coupons maturing on or before March 15, 1919, should be detached from certificates of the Tax Series of 1919, before presentation to the collector, and should be separately presented for payment in the ordinary course when due. Coupons maturing after March 15, 1919, must, however, be attached to certificates of the Tax Series of 1919 and surrendered to the collector with such certificates for cancellation; and collectors will not accept any certificates of the Tax Series of 1919 which have not attached thereto the coupons,

No. 4, maturing May 15, 1919, and No. 5 maturing July 15, 1919.

The procedure above provided will automatically adjust accrued interest in respect of all Treasury certificates of indebtedness used in payment of taxes due March 15, 1919, whether presented on or before said date and no other payment or credit will be allowed or made on account of interest in connection therewith.

In order to avoid unnecessary dislocation of funds, it is of the utmost importance that Treasury certificates of indebtedness of Series T be used by taxpayers to the utmost extent possible in payment of their taxes, in preference to making cash payment of their taxes, and Federal Reserve Banks and collectors of internal revenue should use every effort to induce taxpayers who are the holders of such certificates to make such use of them and to facilitate such use in every manner in their power.

The instructions to collectors dated December 9, 1918 (T. D. 2778), issued by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury, and the instructions to Federal Reserve Banks dated December 9, 1918, issued by the Treasurer of the United States and approved by the Assistant Secretary of the Treasury remain in full force and effect.

The amount of Treasury certificates of Series T, maturing March 15, 1919, now outstanding is nearly \$800,000,000, and the amount of Treasury certificates of the Tax Series of 1919 also available in payment of taxes due March 15, 1919, is upwards of \$30,000,000. In view of this and of the fact that the amount of income and profits taxes due on March 15, 1919, is only one-fourth of the whole amount

of income and profits taxes payable during the calendar year by taxpayers who make their returns upon the basis of the calendar year, there seems to be no reason to anticipate that the amount of taxes paid as of March 15, 1919, will exceed the amount of Treasury certificates maturing on that date plus the current expenditures of the Government during the period of collection of this tax payment. It seems that there will be no unexpended cash proceeds arising from the payment of income and profits taxes on March 15, 1919, and therefore no redeposits will be made; nor will payment of income and profits taxes by credit be permitted.

Collectors of internal revenue will, however, be instructed to deposit checks received on and after March 10, 1919, to and including March 22, 1919, in payment of income and profits taxes, with Federal Reserve Banks, following to that extent substantially the procedure adopted last June. As to this procedure detailed instructions will follow.

R. C. LEFFINGWELL,

Assistant Secretary of the Treasury.

March 31, 1919

The War Finance Corporation will, through its agent, the Federal Reserve Banks and their sub-agent banks all over the United States, open a sale of their first bond issue on Wednesday morning, April 2nd.

Under the statute, the War Finance Corporation would be authorized to-day, on the basis of its paid-in capital stock, to issue bonds in the amount of \$2,100,000,000. At this time, however, in its first issue of bonds, it is putting out only \$200,000,000.

The bonds will be put out in denominations of \$1,000, will be payable in one year, and bear interest at five per cent. per annum. They will be exempt from State taxation and from all local taxation; and will also be exempt from taxation by the United States, with the exception that they will be subject to estate or inheritance taxes, and to surtaxes and excess profits taxes now or hereafter imposed by the United States upon the income or profits of individuals or corporations. But another important tax exemption relating to these bonds is this: That the interest on \$5,000 of these bonds owned by any person will be entirely exempt from all income taxes, surtaxes, excess profits or war profits taxes.

The War Finance Corporation is a corporation of which the United States Government is the sole stockholder and of which the Secretary of the Treasury is the Chairman.

The final legal details with reference to this issue were agreed upon in conference this afternoon between the Attorney General of the United States and Counsel for the War Finance Corporation.

The War Finance Corporation, through its Managing Director, Eugene Meyer, Jr., is sending out the following circular:

\$200,000,000

WAR FINANCE CORPORATION

SERIES "A" 5% GOLD BONDS

Dated April 1, 1919.

Due April 1, 1920.

Coupon bonds in denominations of \$1,000.

Tax Exemptions as described below.

Offered at \$1,000 per bond
and accrued interest.

The War Finance Corporation, a Corporation created by Act of Congress, approved April 5, 1918, as amended, offers, beginning at 10 o'clock a. m. Wednesday, April 2, 1919, under the authority of said Act, with the approval of the Secretary of the Treasury, for subscription at \$1,000 per bond and interest, through the Federal Reserve Banks, as its fiscal agents, coupon bonds, Series "A", of War Finance Corporation in the aggregate principal amount of \$200,000,000. Bonds will be issued in denominations of \$1,000 only, in bearer form, will be dated April 1, 1919, will mature April 1, 1920, and will bear interest from April 1, 1919, at the rate of 5% per annum, payable semi annually on October 1st and April 1st. The principal and interest of the bonds will be payable in United States gold coin of the present standard of value.

The right is reserved to reject any application; to allot less than the amount of bonds applied for; and to close the subscription at any time with or without notice. Payment for bonds allotted may be made at once and must be made within the period fixed in the notice of allotment which will be mailed to the subscriber. Upon payment, Federal Reserve Banks will issue interim receipts pending delivery of the definitive bonds.

Incorporated banks and trust companies and such dealers in investment securities as shall be approved by the Federal Reserve Banks will receive a commission of $\frac{1}{8}$ of 1% of the face amount of any bonds of this issue, when duly paid for, which shall have been allotted to or through such banks, trust companies or dealers. This commission is to be payable in each instance within sixty days after the allotment has been paid for in full.

LEGALITY

Opinions have been given by the Attorney General of the United States and by the General Counsel of the War Finance Corporation that these bonds will constitute valid and binding obligations of the Corporation, and will entitle their holders to the exemptions from taxation as set forth in this circular.

TAX EXEMPTION

In accordance with said Act of Congress, the bonds are exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess profits and war profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, corporations or associations. The interest on an amount of such bonds authorized by said Act, the principal of which does not exceed in the aggregate \$5,000, owned by any individual, partnership, corporation or association, is exempt from the taxes referred to in clause (b).

DISCOUNT AND REDISCOUNT RIGHTS

It is further provided by said Act that Federal Reserve Banks are authorized, subject to the maturity limitations of the Federal Reserve Act and to regulations of the Federal Reserve Board, to discount the direct obligations of member banks, secured by the bonds of the Corporation, and to rediscount eligible paper secured by the bonds and endorsed by a member bank. No such discount or rediscount, however, may be at an interest charge less than 1% per annum above the prevailing rate for eligible commercial paper of corresponding maturity.

SECURITY

The Act creating the Corporation provides that all bonds issued by the Corporation shall have a first and paramount floating charge on all the assets of the Corporation and that the Corporation shall not at any time mortgage or pledge any of its assets. These assets include not only such as may be obtained through the proceeds of sale of these bonds, but also those obtained from funds raised through subscriptions to capital stock. The United States is not liable for the payment of these bonds or the interest upon them.

CAPITALIZATION OF CORPORATION

The total authorized capital stock of the War Finance Corporation is \$500,000,000, all of which shall, under said Act of Congress, be subscribed by the United States of America. To date, \$350,000,000 of the capital stock has been subscribed and paid for, and is now owned by the United States of America; subscription to the remaining \$150,000,000 is subject to call upon the vote of three-fifths of the Board of Directors of the Corporation, with the approval of the Secretary of the Treasury, at such time or times as may be deemed advisable. The Secretary of the Treasury is by law the Chairman of the Board.

The object of the Act creating the Corporation was, as expressed in its title:- "To provide further for the national security and defense, and, for the purpose of assisting in the prosecution of the War, to provide credits for industries and enterprises in the United States necessary or contributory to the prosecution of the War, ***, and for other purposes".

REPORTS

The first annual report of the War Finance Corporation, covering its operations from date of organization to November 30, 1918, inclusive, may be had upon application at the offices of the War Finance Corporation in Washington. The regular quarterly reports as required by said Act of Congress will likewise be supplied on request.

BALANCE SHEET

The balance sheet of the corporation as of March 19, 1919, is attached hereto.

WAR FINANCE CORPORATION

by CARTER GLASS
Chairman.

March 31, 1919.

by EUGENE MEYER JR.
Managing Director.

Approved.

CARTER GLASS
Secretary of the Treasury.

WAR FINANCE CORPORATION

GENERAL BALANCE SHEET, MARCH 19, 1919.

ASSETS

Cash deposited with the Treasurer of the United States and the Federal Reserve Banks	\$13,851,406.43
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LOANS TO:

Banks, Bankers, Trust Companies, and Savings Banks	\$3,912,677.61	
Railroads . . (which includes \$50,000,000.00) (to the Director General of) (Railroads)	116,555,270.00	
Public Utilities	26,781,900.00	
Industrial Corporations	636,652.00	
Cattle Loans	<u>6,790,772.35</u>	154,677,271.96

INVESTMENTS:

United States of America Liberty Loan Bonds .	184,584,518.29
Office Furniture and Equipment	8,671.04
Accrued interest receivable	3,694,519.62
Total	<u>356,816,387.34</u>

LIABILITIES

CAPITAL STOCK--AUTHORIZED BY WAR FINANCE CORPORATION ACT	500,000,000.00	
LESS SUBSCRIPTION BY THE UNITED STATES OF AMERICA, subject to call by the Directors of the Corporation	<u>150,000,000.00</u>	\$350,000,000.00
Earnings	6,780,122.77	
Interest collected in advance	<u>36,264.57</u>	
Total	\$356,816,387.34	

TREASURY DEPARTMENT

WASHINGTON

May 7, 1919.

INCOME AND PROFITS TAXES DUE JUNE 16, 1919.

Income and profits taxes due June 16, 1919, may be paid in Treasury certificates of indebtedness of Tax Series of 1919, dated August 20, 1918, maturing July 15, 1919, Series T 2, dated January 16, 1919, maturing June 17, 1919, and Series T 3, dated March 15, 1919, maturing June 16, 1919. No other certificates of indebtedness will be accepted in payment of the taxes due on said date. Certificates of the three series mentioned will be accepted by collectors of internal revenue at par, without interest, when tendered in amounts not in excess of the amount of such taxes due June 16, 1919. They will be so accepted at any time on or before June 16, 1919. If so accepted before June 16, 1919, full interest to June 16, 1919, will be paid as below stated.

Coupons maturing on June 16, 1919, should be detached from certificates of Series T 3, and coupons maturing on or before May 15, 1919, should be detached from certificates of the Tax Series of 1919, before presentation to the collector, and should be separately presented for payment in the ordinary course when due. Coupons maturing July 15, 1919, must, however, be attached to certificates of the Tax Series of 1919 and surrendered to the collector with such certificates for cancellation; and collectors will not accept any certificates of the Tax Series of 1919 which have not attached thereto the coupon No. 5 maturing July 15, 1919.

Accrued interest on certificates of Series T 2 (which were issued without coupons attached) from January 16, 1919, to June 16, 1919, and accrued

interest on certificates of the Tax Series of 1919 from May 15, 1919 (the last coupon payment date), to June 16, 1919, will be remitted to the taxpayer by the Federal Reserve Bank by check and the collector must furnish to the Federal Reserve Bank the name and address of the taxpayer and the amount and serial numbers of the certificates presented in each case.

The procedure above provided will automatically adjust accrued interest in respect of all Treasury certificates of indebtedness used in payment of taxes due June 16, 1919, whether presented on or before said date and no other payment or credit will be allowed or made on account of interest in connection therewith.

Interest on Treasury certificates accepted in payment of taxes ceases to accrue on (a) the date of the maturity of the certificates, or (b) the date the tax is due - whichever of said dates be earlier. The provisions hereof in relation to the payment of interest to June 16, 1919, do not apply to Treasury certificates of indebtedness accepted in payment of taxes due prior to that date. Any Treasury certificates of indebtedness accepted in payment of taxes becoming due before June 16, 1919, must be dealt with separately, and accrued interest will be paid only to the date the tax was due and upon surrender with the certificates of any coupons maturing subsequent to the date the tax was due. Collectors must specially notify Federal Reserve Banks in each case when Treasury certificates are accepted in payment of taxes becoming due prior to June 16, 1919. The 15th day of June being a Sunday, the Bureau of Internal Revenue has ruled that the taxes which by the terms of the Revenue Bill of 1918 are due on that date become due on June 16th.

In order to avoid unnecessary dislocation of funds, it is of importance that Treasury certificates of indebtedness of the three series mentioned be

used by taxpayers to the utmost extent possible in payment of their taxes, in preference to making cash payment of their taxes, and Federal Reserve Banks and collectors of internal revenue should use every effort to induce taxpayers who are the holders of such certificates to make such use of them and to facilitate such use in every manner in their power.

The instructions to collectors dated December 9, 1918 (T. D. 2778), issued by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury, and the instructions to Federal Reserve Banks dated December 9, 1918, issued by the Treasurer of the United States and approved by the Assistant Secretary of the Treasury, not inconsistent herewith, remain in full force and effect.

There seems to be no reason to anticipate that the amount of taxes paid as of June 16, 1919, will exceed the amount of Treasury certificates maturing on or about that date. It seems that there will be no unexpended cash proceeds arising from the payment of income and profits taxes on June 16, 1919, and therefore no redeposits will be made; nor will payment of income and profits taxes by credit be permitted.

Collectors of internal revenue will, however, be instructed to deposit checks received on and after June 1, 1919, in payment of income and profits taxes, with Federal Reserve Banks and branches, following to that extent substantially the procedure adopted in March. As to this procedure detailed instructions will follow.

R. C. LEFFINGWELL

Assistant Secretary of the Treasury.

LETTER FROM THE SECRETARY OF THE TREASURY TO THE CHAIRMAN OF THE COMMITTEE ON WAYS AND MEANS.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, July 9, 1919.

MY DEAR CONGRESSMAN:

I take pleasure in handing you herewith for your information and that of the Committee on Ways and Means the following statements:

A. Preliminary financial statement of the United States Government for the period from April 6, 1917, to June 30, 1919.

B. Preliminary statement of the public debt on June 30, 1919.

C. Statement showing classified receipts, exclusive of the principal of the public debt, by months, from April 6, 1917, to June 30, 1919, as published in daily Treasury statements.

D. Statement showing classified disbursements, exclusive of the principal of the public debt, by months, from April 6, 1917, to June 30, 1919, as published in daily Treasury statements.

Expenditures in the month of June just ended amounted in round figures to \$809,000,000, or less than for any month since September, 1917.

Expenditures for the fiscal year just ended amounted to \$18,514,000,000.

Expenditures for the war period amounted to \$32,427,000,000, and of these more than \$9,384,000,000, or about 29 per cent, were met out of tax receipts and other revenues than borrowed money, although payment of nearly half of the income and profits taxes for the fiscal year 1919 has not yet been made, such payment being deferred until the fiscal year 1920. In this calculation no deduction is made of expenditures for loans to the Allies, which on June 30 amounted to \$9,102,000,000, or for other investments, such as ships, stock of the War Finance Corporation, bonds of the Federal Land Banks, etc.

If we assume that the expenditures of the Government on a peace basis would have been at the rate of \$1,000,000,000 a year, or for the period under discussion of nearly 27 months would have equaled \$2,250,000,000, then we may estimate the gross cost of the war to June 30, 1919, at \$30,177,000,000.

The gross public debt (without any deduction for loans to the Allies or other investments) amounted on June 30, 1919, to \$25,484,000,000. Of this sum only \$3,634,000,000 was in the form of Treasury certificates, or floating debt. Of such certificates more than \$608,000,000 matured or were redeemed on July 1, 1919, and were paid out of the net balance in the general fund on June 30, 1919, which amounted to \$1,251,000,000. Deducting the certificates last referred to, the floating debt on June 30, 1919, was little more than \$3,000,000,000, which is roughly the estimated amount of the deferred installments of the income and profits taxes for the fiscal year 1919 and of the deferred installments of the Victory Loan subscriptions.

In the announcement given to the press on April 14, 1919, of the terms of the Victory Liberty Loan, I made the following statement with reference to financing the future requirements of the Government:

This will be the last Liberty loan. Although as the remaining war bills are presented further borrowing must be done, I anticipate that the requirements of the Government, in excess of the amount of taxes and other income can, in view of the decreasing scale of expenditure, be readily financed by the issue of Treasury certificates from time to time as heretofore, which may be ultimately refunded by the issue of notes or bonds without the aid of another great popular campaign such as has characterized the Liberty loans.

I confirm the statement above quoted. The decision then taken has been fully sustained by the experience of the past three months. The successful flotation of the Victory Loan and the adjustment of the amount and terms of the issue have resulted, as I hoped they would, in

a strong market at about par for these notes, without the necessity of Government support, and in an improving market for the bonds of the Second, Third, and Fourth Liberty Loans, evidenced not only by the firm market quotations, but by strong undercurrents of investment buying, which give reason for the hope that, with the continuance of favorable general conditions, there will be consistent appreciation in the market prices of these bonds.

I do not now think it will be wise to make any further issues of long-term bonds before the maturity or redemption of the Victory Notes, when there will have been such an interval in Government offerings of all kinds as must inevitably result in marked improvement of the market prices of the existing issues, with corresponding decreases in the interest bases at which they are selling, and consequent assurance that the Government will be able to finance itself for a longer period upon better terms.

It is not possible at this time, when appropriations for the coming year are under consideration by the Congress, when contract claims by and against the United States are still in process of settlement, when demobilization is still incomplete, when the extent of the liability on the wheat guaranty is unascertained, and when the business upon which the income and profits tax receipts in the first half of the calendar year 1920 are to be based is still only half transacted, to make a formal estimate of the receipts and expenditures of the United States during the fiscal year 1920. But so large a part of the war expenditures has been paid or provided for out of taxes and the issue of bonds or notes already sold and so small a part is unfunded that I confidently expect that the Government will be able not only to meet its further temporary requirements for the decreasing scale of expenditure by the sale of Treasury certificates of indebtedness bearing interest at the rate of $4\frac{1}{2}$ per cent or less, but also to fund as many of these as it may be desirable to fund, by the issue of short-term notes, in moderate amounts, at convenient intervals, when market conditions are favorable, and upon terms advantageous to the Government. It will not be desirable to fund all the certificates of indebtedness, for the issue of certificates of indebtedness in anticipation of income and profits tax installments not only furnishes a means of financing the requirements of the Government temporarily upon easy terms, but constitutes an almost necessary financial expedient, to enable the taxpayer to save and to prepare gradually for the great tax payments, and to relieve the banking machinery of the country of the great strain which would be imposed upon it if these tax installments had to be paid on a single day without such preparation.

I need scarcely say to you that the realization of these sanguine expectations is contingent upon the practice of the most rigid economy by the Government and the continuance of ample revenues from taxation. Such a course, accompanied by the practice of sober economy and wise investment by our people and strict avoidance of waste and speculation, will make it possible for the American people to respond to the demands to be made upon them privately for capital and credit by the nations and peoples of Europe—demands which are reinforced by the strongest and most vital ties of sympathy for the Allies, who fought and won the war with us, as well as by the most obvious dictates of self-interest.

I am writing a similar letter to the Hon. Boies Penrose, Chairman of the Committee on Finance.

It has seemed to me only proper at the end of the last fiscal year of the war period to lay these facts and opinions before the Committee on Ways and Means, and the Finance Committee, which bear so large a measure of responsibility for the war-loan legislation; and to make them public also, since they vitally concern the millions of Americans whose purchases of Government securities, and tax payments, made this record of war finance possible.

Very truly yours,

CARTER GLASS,

Secretary.

Hon. JOSEPH W. FORDNEY,

Chairman Committee on Ways and Means, House of Representatives.

A.

Preliminary financial statement of the United States Government for the period from Apr. 6, 1917, to June 30, 1919.

[On the basis of daily Treasury statements.]

RECEIPTS AND DISBURSEMENTS.

Net balance in the general fund Apr. 5, 1917.....	\$92,317,710.27	Disbursements, exclusive of principal of public debt, Apr. 6, 1917, to June 30, 1919.....	\$32,427,469,054.72
Receipts, exclusive of principal of public debt, Apr. 6, 1917, to June 30, 1919.....	9,384,278,708.22	Public debt disbursements, Apr. 6, 1917, to June 30, 1919.....	24,183,034,599.70
Public debt receipts, Apr. 6, 1917, to June 30, 1919.....	48,385,572,063.47	Net balance in the general fund June 30, 1919.....	1,251,664,827.54
Total.....	57,862,168,481.96	Total.....	57,862,168,481.96

PUBLIC DEBT AND EXPENDITURES.

Total disbursements for war period, exclusive of principal of public debt.....	\$32,427,469,054.72	Total gross debt June 30, 1919.....	\$25,484,506,160.05
Total receipts for war period, exclusive of principal of public debt.....	9,384,278,708.22	Total gross debt Apr. 5, 1917.....	1,281,968,696.28
Excess of disbursements over receipts, for war period.....	23,043,190,346.50	Gross debt increase for war period.....	24,202,537,463.77
		Net balance in the general fund June 30, 1919.....	\$1,251,664,827.54
		Net balance in the general fund Apr. 5, 1917.....	92,317,710.27
		Net increase in balance in general fund.....	1,159,347,117.27
		Net debt increase for war period.....	23,043,190,346.50

B.

Preliminary statement of the public debt of the United States Government, June 30, 1919.

[On the basis of daily Treasury statements.]

Bonds:		
Consols of 1930.....	\$599,724,050.00	
Loan of 1925.....	118,489,900.00	
Panama's of 1916-36.....	48,954,180.00	
Panama's of 1918-38.....	25,947,400.00	
Panama's of 1961.....	50,000,000.00	
Conversion bonds.....	28,894,500.00	
Postal savings bonds.....	11,349,960.00	\$883,359,990.00
First Liberty loan.....	1,984,796,730.00	
Second Liberty loan.....	3,566,464,969.00	
Third Liberty loan.....	3,958,560,357.50	
Fourth Liberty loan.....	6,794,504,557.00	16,304,326,613.50
Total bonds.....		17,187,686,603.50
Notes: Victory Liberty loan.....		3,467,840,956.77
Treasury certificates:		
Loan and tax.....	\$3,273,000,000.00	
Pittman Act.....	178,723,000.00	
Special issues.....	182,494,490.00	3,634,217,490.00
War savings certificates (net cash receipts).....		956,023,121.45
Old debt on which interest has ceased.....		2,355,250.26
Noninterest bearing debt.....		236,382,738.07
Total gross debt.....		25,484,506,160.05

C.

Statement showing classified receipts of the United States Government, exclusive of the principal of the public debt, by months, from Apr. 6, 1917, to June 30, 1919, as published in daily Treasury statements.

	Customs.	Income and profits tax.	Miscellaneous internal revenue.	Miscellaneous revenue.	Panama Canal.	Total.
Apr. 6 to 30, 1917.....	\$17,863,547.22	\$24,075,386.24	\$35,387,512.86	\$5,804,920.33	\$314,793.31	\$83,446,159.96
May, 1917.....	28,660,148.60	50,009,778.45	107,601,090.34	11,361,950.32	634,421.46	198,267,389.17
June, 1917.....	18,686,805.14	72,448,261.80	179,775,934.55	14,120,100.17	694,056.30	285,725,167.96
Total Apr. 6 to June 30, 1917.....	65,210,500.96	146,533,426.49	322,764,537.75	31,286,970.82	1,643,271.07	567,438,707.09
July, 1917.....	15,805,120.91	9,478,880.98	50,895,959.22	7,575,979.09	171,687.08	83,927,636.28
August, 1917.....	15,902,255.99	4,248,091.69	43,922,598.77	9,839,107.31	584,477.10	74,496,530.86
September, 1917.....	15,201,388.70	6,026,475.01	41,265,393.95	12,967,317.09	648,787.75	76,109,362.50
October, 1917.....	13,647,946.24	5,987,904.91	50,318,414.27	20,226,866.64	277,158.50	90,458,290.56
November, 1917.....	11,935,389.41	6,720,898.26	81,536,702.42	39,175,579.26	122,208.09	139,490,777.44
December, 1917.....	11,247,214.10	13,725,534.51	61,425,075.62	18,034,677.89	626,568.30	105,059,070.42
January, 1918.....	12,163,216.06	11,428,560.88	61,665,347.96	17,796,189.59	302,895.38	103,356,209.87
February, 1918.....	12,019,441.74	13,200,936.38	59,115,478.32	14,177,234.29	585,348.96	99,098,439.69
March, 1918.....	18,106,373.13	31,424,027.09	89,635,237.66	16,536,309.47	1,047,330.70	156,749,278.05
April, 1918.....	16,445,531.99	83,012,299.95	93,113,711.68	16,111,894.79	635,705.85	209,319,144.26
May, 1918.....	19,925,706.94	342,104,796.75	135,081,929.01	97,254,972.78	378,705.51	594,746,110.99
June, 1918.....	17,598,789.28	1,786,647,885.43	104,052,171.39	22,817,686.62	655,481.06	1,931,772,013.78
Total for fiscal year 1918.....	179,998,383.49	2,314,006,291.84	872,028,020.27	292,513,814.82	6,036,354.28	3,664,582,864.70

Statement showing classified receipts of the United States Government, exclusive of the principal of the public debt, by months, from Apr. 6, 1917, to June 30, 1919, as published in daily Treasury statements—Continued.

	Customs.	Income and profits tax.	Miscellaneous internal revenue.	Miscellaneous revenue.	Panama Canal.	Total.
July, 1918.....	\$15,837,889.72	\$497,496,376.62	\$105,948,066.11	\$21,974,810.55	\$619,994.14	\$641,877,137.14
August, 1918.....	14,175,892.76	30,795,666.13	83,736,123.50	22,645,000.23	899,439.10	152,252,031.72
September, 1918.....	12,719,024.43	36,308,166.21	89,005,937.44	13,757,134.67	94,391.05	151,884,653.80
October, 1918.....	11,453,096.69	30,136,620.58	93,327,251.94	16,058,975.73	604,815.02	151,580,759.96
November, 1918.....	12,583,861.29	28,820,184.49	99,743,394.83	169,112,403.43	734,419.15	310,994,263.19
December, 1918.....	9,681,907.59	61,916,648.37	117,658,483.35	14,213,636.93	431,587.99	203,902,264.23
January, 1919.....	12,732,514.54	43,141,373.49	112,287,675.18	27,054,788.82	626,489.31	195,842,841.34
February, 1919.....	14,979,078.02	30,341,342.50	94,310,163.04	22,361,050.46	767,529.81	162,759,163.83
March, 1919.....	17,876,270.46	1,129,821,269.04	118,240,897.00	31,555,382.12	355,127.60	1,297,848,946.22
April, 1919.....	20,141,486.97	107,696,034.35	135,039,064.46	159,228,529.45	427,185.33	422,552,300.56
May, 1919.....	20,896,644.65	50,614,139.20	115,265,091.71	92,026,548.47	459,786.65	279,262,210.68
June, 1919.....	21,380,290.27	971,695,866.31	131,919,143.11	56,151,439.19	353,824.88	1,181,500,563.76
Total for fiscal year 1919.....	184,457,867.39	3,018,783,687.29	1,296,501,291.67	646,139,700.05	6,374,590.03	5,152,257,136.43
RECAPITULATION.						
April 6 to June 30, 1917.....	65,210,500.96	146,533,426.49	322,754,537.75	31,286,970.82	1,643,271.07	567,438,707.09
Fiscal year 1918.....	179,998,383.49	2,314,003,291.84	872,028,020.27	292,513,814.82	6,036,354.28	3,664,582,844.70
Fiscal year 1919.....	184,457,867.39	3,018,783,687.29	1,296,501,291.67	646,139,700.05	6,374,590.03	5,152,257,136.43
Grand totals.....	429,666,751.84	5,479,323,405.62	2,491,293,849.69	969,940,485.69	14,054,215.38	9,384,278,708.22

D.

Statement showing classified disbursements of the United States Government, exclusive of the principal of the public debt, by months, from Apr. 6, 1917, to June 30, 1919, as published in daily Treasury statements.

	Ordinary.	Foreign loans.	Other special.	Total.
Apr. 6 to 30, 1917.....	\$71,328,006.70	\$200,000,000.00	\$7,885,770.50	\$279,213,777.20
May, 1917.....	114,102,809.68	407,500,000.00	4,962,746.28	526,565,555.96
June, 1917 (revised).....	131,687,849.61	277,500,000.00	919,445.78	410,107,255.39
Total Apr. 6, 1917, to June 30, 1917.....	317,118,665.99	885,000,000.00	13,767,962.56	1,215,886,628.55
July, 1917.....	208,299,031.05	452,500,000.00	1,511,814.92	662,310,845.97
August, 1917.....	277,438,000.64	2,019,363.50	757,457,364.14	757,457,364.14
September, 1917.....	349,013,305.34	396,000,000.00	1,364,980.35	746,378,285.69
October, 1917.....	462,045,359.94	480,700,000.00	1,623,392.58	944,368,752.52
November, 1917.....	512,952,035.17	471,929,750.00	1,200,022.36	986,081,807.53
December, 1917.....	611,297,425.62	492,000,000.00	1,914,433.70	1,105,211,859.32
January, 1918.....	715,302,039.83	370,200,000.00	4,854,005.86	1,090,356,045.69
February, 1918.....	675,209,068.43	325,000,000.00	12,477,917.31	1,012,686,985.74
March, 1918.....	819,955,367.26	317,500,000.00	18,338,441.98	1,155,793,809.24
April, 1918.....	910,756,758.95	287,500,000.00	17,031,020.28	1,215,287,779.23
May, 1918.....	1,068,203,026.82	424,000,000.00	15,992,206.83	1,508,195,233.65
June, 1918.....	1,263,914,905.86	242,700,000.00	5,958,796.56	1,512,573,702.42
Total for fiscal year 1918.....	7,874,386,324.91	4,738,029,750.00	84,286,396.23	12,696,702,471.14
July, 1918.....	1,259,782,599.23	343,485,000.00	5,015,055.21	1,608,282,654.44
August, 1918.....	1,524,901,777.74	279,250,000.00	1,361,445.28	1,805,513,223.02
September, 1918.....	1,274,505,845.05	282,150,000.00	608,440.22	1,557,264,285.27
October, 1918.....	1,174,622,406.40	489,100,000.00	1,133,854.59	1,664,862,260.99
November, 1918.....	1,655,051,004.19	278,949,697.70	1,248,607.04	1,935,249,308.93
December, 1918.....	1,670,890,396.88	389,052,000.00	1,033,458.60	2,060,975,855.48
January, 1919.....	1,659,580,520.24	290,250,800.00	12,519,629.59	1,962,350,949.83
February, 1919.....	1,035,130,805.19	145,397,302.30	9,385,796.13	1,189,913,903.62
March, 1919.....	1,042,182,523.55	322,350,000.00	15,279,261.96	1,379,811,785.51
April, 1919.....	1,003,862,122.73	409,608,608.27	15,457,575.38	1,428,928,306.38
May, 1919.....	907,492,923.94	194,911,857.29	9,932,690.50	1,112,337,471.73
June, 1919.....	727,845,814.48	54,750,000.00	26,794,135.35	809,389,949.83
Total for fiscal year 1919.....	14,935,848,739.62	3,479,255,265.56	99,775,949.85	18,514,879,955.03
RECAPITULATION.				
Apr. 6, 1917, to June 30, 1917.....	317,118,665.99	885,000,000.00	13,767,962.56	1,215,886,628.55
Fiscal year 1918.....	7,874,386,324.91	4,738,029,750.00	84,286,396.23	12,696,702,471.14
Fiscal year 1919.....	14,935,848,739.62	3,479,255,265.56	99,775,949.85	18,514,879,955.03
Grand totals.....	23,127,353,730.52	9,102,285,015.56	197,830,308.64	32,427,469,054.72

EX OFFICIO MEMBERS

ARTER GLASS

SECRETARY OF THE TREASURY

CHAIRMAN

JOHN SKELTON WILLIAMS

COMPTROLLER OF THE CURRENCY

FEDERAL RESERVE BOARD

WASHINGTON

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W. T. CHAPMAN, ASSISTANT SECRETARY
W. M. IMLAY, FISCAL AGENTADDRESS REPLY TO
FEDERAL RESERVE BOARD

C O P Y

For release to Monday Morning Papers,
August 11, 1919.

August 8, 1919.

X-1648

Dear Sir:

The Federal Reserve Board acknowledges receipt of your letter of the 5th instant asking for an expression of its views as to the advisability of legislation providing for the gradual reduction of the currency in circulation as proposed by Senate Resolution 142,

The Board would suggest that in determining whether or not legislation is necessary or desirable to regulate the volume of currency in circulation, consideration be given to the various forms of money which make up the sum total of our volume of currency. A distinction should also be drawn between the stock of money in the country and the amount actually in circulation.

With respect to gold coin, gold certificates, standard silver dollars, silver certificates, subsidiary silver and Treasury notes of 1890, the Board assumes that it is recognized that no legislation is necessary.

The United States notes, or legal tenders, which have remained at the fixed amount of \$346,681,016.00 since March 31, 1878, have not been a disturbing factor since the passage of the act of March 14, 1900. An adequate gold reserve of more than 45% is now held against these notes, most of which are in the form of small bills

of \$1, \$2, and \$5 denominations. Notes of these denominations are needed in the daily transactions of the public, and were the United States notes to be retired, the issue of an equal volume of small bills in some other form of currency would be necessary. To effect the retirement of the United States notes, funds would have to be withdrawn from the Treasury to be supplied either by taxation or by the sale of interest-bearing obligations. The Board does not believe that any legislation with respect to United States notes is necessary or desirable at this time.

The national bank notes outstanding on August 1, 1919, amounted to \$658,118,555.00, a reduction of nearly \$60,000,000 since July 1, 1914. The greater part of these notes is secured by United States 2% bonds, and provision has already been made in Section 18 of the Federal Reserve Act for their gradual retirement.

Federal reserve bank notes, which are secured by United States obligations and are taxed just as national bank notes are, have been issued only to replace in part national bank notes retired, and standard silver dollars melted or broken up and sold as bullion under authority of the act of April 23, 1918, known as the Pittman Act. The issue of these notes has, therefore, brought about no increase in the circulating medium.

The amount of Federal reserve notes outstanding has increased from \$357,239,000 on April 1, 1917, to \$2,504,753,000 on August 1, 1919. It appears therefore that those who see in the larger volume of circulation in the United States the prime cause of increased costs of

living and who seek a remedy by a forced contraction of the currency must have in mind the Federal reserve note and Section 16 of the Federal Reserve Act as amended June 21, 1917, which provides for its issue and redemption.

In analyzing our present monetary situation, and in considering the causes which have led to the expansion of credits and note issues during the war, we should not lose sight of some of the developments of the pre-war period and of their effect upon credits and prices. Very heavy purchases of supplies of all kinds were made in this country by European belligerents during the years 1915 and 1916, payment for which involved the shipment to us of large amounts of gold. The stock of gold in the United States on July 1, 1914, was \$1,890,678,304. This amount increased steadily until April, 1917, the date of our own entry into the war, when it reached \$3,088,904,808, an increase of about \$1,200,000,000. Bank deposits likewise show a large increase, the net deposits of national banks having risen from \$7,495,149,000 on June 30, 1914, to \$10,489,217,000 on March 5, 1917, while the net deposits of all banks in the United States increased from \$17,966,150,000 in June, 1914, to \$24,891,218,000 in June, 1917. Net deposits of national banks had further increased up to May 12, 1919, to \$11,718,095,000, and those of all banks in June, 1918, (the latest date for which figures are available) to \$26,769,546,000. Shortly after April 6, 1917, when the Congress declared war, the Treasury began to sell bonds, notes and certificates in large amounts resulting in a net increase in the public debt to August 1, 1919, of \$24,518,064,840.

On July 1, 1914, the total stock of money in the United States, exclusive of that held by the United States Treasury, was
\$3,419,168,368

On April 1, 1917, the stock of money, estimated on the same basis, was \$4,702,130,941, an increase of \$1,282,962,573 of which increase \$883,481,028 was in gold.

On July 1, 1914, there were no Federal reserve notes in existence, while on April 1, 1917, there were outstanding \$357,239,000.

The amendment to the Federal Reserve Act approved June 21, 1917, changed substantially the original reserve requirements for member banks and provided that their entire lawful reserve should be carried with the Federal reserve banks. The same amendment authorized the Federal reserve banks to exchange Federal reserve notes for gold. The result of these two changes in the law was to transfer immediately large sums of gold from the vaults of the member and nonmember banks and from general circulation to the Federal reserve banks, and this caused a change in the methods of accounting for gold by the Federal reserve banks and Federal reserve agents.

In order to avoid confusion in determining the volume of money in actual circulation, it is necessary to distinguish between tables showing the total stock of money in the country, and tables showing the circulation outside of the Treasury and Federal reserve agents' vaults, and to limit our view to amounts held by member and nonmember banks and the public, which are exclusive of amounts on hand at Federal reserve banks, held by Federal reserve agents, and held in the Treasury.

The reserve money held by or for the Federal reserve banks serves, of course, as a basis for credit, but it forms no part of the currency in circulation. Upon this basis, the amount of money in circulation on July 1, 1914, (There being no Federal reserve banks in operation at that time) was \$3,419,168,368, made up as follows: Gold coin and certificates \$1,649,775,803; silver dollars and silver certificates, including Treasury notes of 1890, \$552,203,610; all other currency \$1,217,188,955, being circulation per capita \$34.53.

The corresponding amounts of money in circulation on April 1, 1917, December 1, 1918, and August 1, 1919, are shown in the following table.:

AMOUNT OF MONEY OUTSIDE THE TREASURY AND FEDERAL RESERVE BANKS

	: April 1, : 1917	: December 1, : 1918	: August 1, : 1919
Gold coin and certificates	\$1,989,152,000	\$ 861,245,000	\$ 728,046,000
Silver dollars and silver certificates, (including Treasury notes of 1890)	532,700,000	372,489,000	241,505,000
Federal Reserve notes	357,239,000	2,607,445,000	2,504,753,000
Federal Reserve bank notes	3,170,000	87,737,000	166,289,000
All other currency	1,218,715,000	1,201,069,000	1,156,297,000
Total	4,100,976,000	5,129,985,000	4,798,890,000
Amount per capita outside the Treasury and the Federal Reserve banks	\$37.88	\$48.13	\$45.16

Assuming that the date December 1, 1918, marks the beginning of the post-war period, the table shows changes during this period up to August 1, 1919, as follows: Gold coin and certificates in circulation decreased \$133,199,000; silver dollars and silver certificates, including Treasury notes of 1890, decreased \$130,984,000; Federal reserve notes decreased \$102,692,000; Federal reserve bank notes increased \$78,552,000; all other currency decreased \$44,772,000, being a net decrease in circulation for the post-war period of \$333,095,000, or \$2.97 per capita.

In considering the question of currency in circulation, there should be taken into account the various factors which have entered into the demand for currency, among which are: The gradual enlargement of payrolls, both as to the number of workers and amount paid to each; the effect of higher wages upon deposits in banks and upon the amounts of money carried by shopkeepers in their tills and by individuals in their pockets; the amounts of money locked up or carried on their persons by workmen who have been receiving high wages and who, especially in the case of ignorant foreigners, are unwilling to deposit their savings in banks or to invest in Government bonds; the amount of money carried away by workmen returning to their homes in foreign countries; and the fact that the circulating media of the Philippine Islands, Hawaii, Cuba, Porto Rico, Santo Domingo, Haiti, Honduras, Panama, and in part, Mexico, ^{includes} of United States paper currency and subsidiary silver. The amounts ~~required~~ in these countries, most of which are very prosperous, have greatly increased in the last few years.

The total foreign circulation of United States currency cannot be stated accurately, but is estimated to be at least one hundred and fifty million dollars.

The difficulty, indeed the impossibility, of keeping in circulation an excessive volume of Federal Reserve notes should be understood. The issue of these notes has been carefully safeguarded by the Federal Reserve Act, and ample provision has been made for their redemption. Federal reserve notes are redeemable in gold; they cannot be forced into circulation in payment of the expenses of the Government, or for any other purpose, as they can be issued only in exchange for gold or against a deposit of negotiable paper growing out of a legitimate commercial transaction, plus the required gold reserve of not less than 40 per centum. Upon payment of commercial paper which has been deposited to secure Federal Reserve notes, there results either an immediate return of an equal amount of notes to the bank, or an automatic increase in the percentage of gold reserve available for their redemption. Federal Reserve notes are not legal tender, nor do they count as reserve money for member banks. They are issued only as a need for them develops, and as they become redundant in any locality they are returned to the Treasury at Washington, or to a Federal Reserve bank for redemption. Thus there cannot at any time be more Federal Reserve notes in circulation than the needs of the country at the present level of prices require, and as the need abates the volume of notes outstanding will be correspondingly reduced through redemption. The increased volume of Federal Reserve notes in circulation during the past three years, in so far as it is not the result of direct exchanges for gold and gold certificates which have been withdrawn from circulation, is the effect of advancing wages and prices, and not their cause.



THE SECRETARY OF THE TREASURY
WASHINGTON

September 8, 1919.

Dear Sir:

The third semimonthly issue of Treasury certificates of indebtedness, Series C 1920, in pursuance of the program outlined in my letter of July 25, 1919, was, in accordance with the announcement made on August 25, 1919, offered without asking the banking institutions of the country to subscribe for any specified quota. The Treasury felt confident that these certificates could be sold in amounts more than sufficient to meet the reduced needs of the Government without assigning the usual quota to individual banking institutions. This confidence was amply justified by the event. The certificates of Series C 1920 were dated September 2 and subscriptions closed on September 3, the following day. The aggregate amount of certificates of this series subscribed for and allotted was \$573,841,500, a sum greater by about \$40,000,000 than the amount subscribed for either of the two preceding issues, each of which had definite quota assignments and remained open a week after the date of issue. This aggregate was in excess of the immediate requirements of the Treasury but allotment was nevertheless made in full upon all subscriptions made on the date of issue and the day following, in order not to disappoint those subscribers who had presented their subscriptions with reasonable promptness; and the opportunity was taken to redeem on September 15 the certificates of Series V K maturing October 7, 1919 (the last of the certificates issued in anticipation of the Victory Loan). The redemption of these certificates should have a beneficial effect in connection with the large payments of income and profits taxes due on September 15.

The aggregate amount of Treasury certificates of indebtedness still outstanding on August 30 of the several series maturing or called for redemption on September 9 and 15, 1919, was \$1,799,041,500. This entire sum (which has since been reduced by exchanges and cash redemptions) is provided for from cash in bank and income and profits taxes due September 15, leaving an ample balance in the general fund.

There remain no maturities of certificates to provide for prior to 1920, as the certificates maturing December 15 are more than covered by the income and profits tax installment due on that date.

In the month of August just past ordinary and special disbursements exceeded ordinary receipts by less than \$500,000,000. In September, because of the income and profits tax installment payment, ordinary receipts should exceed ordinary and special disbursements by approximately \$500,000,000.

The success of recent issues of Treasury certificates, the fortunate cash position of the Treasury at the moment and the reinvestment demand which will result from the payment of so large an amount of certificates

on or before September 15 create a situation which should be availed of to make an important step forward in financing the debt growing out of the war. In my letter of July 25, above referred to, I indicated that the Treasury certificate program might be varied at opportune times by the substitution of issues of tax certificates. This obviously is an opportune time, and accordingly the Treasury is offering two series of so-called tax certificates, both dated September 15, 1919, Series T 9 maturing March 15, 1920, and bearing interest at the rate of 4 1/4 per cent, and Series T 10 maturing September 15, 1920, and bearing interest at the rate of 4 1/2 per cent, payable semiannually. It is not possible to say definitely when semi-monthly issues of loan certificates will be resumed nor upon what terms they will be issued; but such issues will certainly not be resumed before October 15, and the minimum amount offered should not exceed \$250,000,000. In view of the important fact that now for the first time in over a year certificates (of Series T 9, maturing March 15) are offered at a lower rate than 4 1/2 per cent, I deem it proper to say that, if hereafter certificates maturing on or before March 15, 1920, should be issued bearing interest at a higher rate than 4 1/4 per cent, certificates of Series T 9 will be accepted at par with an adjustment of accrued interest in payment for certificates of such series which may be subscribed for and allotted.

I hope that each and every banking institution in the United States will not only subscribe liberally for one or both issues of the certificates now offered but also will use its best endeavors to procure the widest possible redistribution of such certificates among investors. The certificates, although acceptable in payment of income and profits taxes payable at maturity, are, as you know, payable in cash when they mature, and should make a wide appeal to investors generally because of their valuable exemptions from taxation and attractive maturities. The success of these issues will be an important advance in the process of financing the war debt in such a way as to avoid the necessity for great refunding operations, by spreading maturities and meeting them, so far as may be, out of tax receipts. Incorporated banks and trust companies which are not qualified depositories are urged to become such in order that they, like others, may participate in the temporary deposits growing out of these issues.

The patriotic, loyal, and enlightened support which the banking institutions of the country gave to the Treasury during the darkest days of the war and continued through the perhaps more difficult period after the cessation of hostilities, when war expenditures were at their peak, justifies the Treasury in addressing to them this confident appeal now that the turn of the tide has come.

Cordially yours,

Walter Rease.

To
The President
of the Bank or
Trust Company addressed.

For Immediate Release

27

STATEMENT BY SECRETARY GLASS ON THE BUDGET
DELIVERED BEFORE THE SELECT COMMITTEE ON THE BUDGET OF THE
HOUSE OF REPRESENTATIVES, OCTOBER 4, 1919.

I am heartily in favor of a budget system. Without effective control over Governmental expenditures and limitation of them to the Government's income we shall bring down upon our heads the splendid structure which our fathers have built, and which we have preserved. The very success (which you will pardon me if I call brilliant) with which the Treasury has financed the stupendous requirements imposed upon America by the great war may become a menace. All sense of values seems to have departed from among us. The departments, bureaus and boards, all inspired by a laudable enthusiasm for their work, but some by a less laudable instinct to magnify its importance and incidentally their own, bombard the Committees of Congress with projects, some more or less meritorious, some of no merit whatever, but all conceived in sublime indifference to the fact that the great business of Government is being run at a loss and that each one of these projects increases the deficit of the Government and consequently the burden to be thrown upon the great body of people, whether the deficit be met by increasing taxes or by floating additional loans. For no fallacy is more grotesque than the assumption that by issuing bonds or notes or certificates of indebtedness now we may pass on to future generations the burden of our own extravagance. The burden of these issues will have to be met today, not only in the interest and sinking fund charges added to an already heavy load but in the expansion of credit which is inevitable as a result of the issue of such securities, constituting as they do a prime basis for

additional credit in the hands of the holders, whoever they may be. I shall not elaborate upon that point but I want to say to you in all solemnity that one hundred million American people will pay for the extravagance of the Government, whether that extravagance finds its incidence in Governmental waste or in the desire to accomplish real or fancied benefits for a portion of the community.

Let us now get back to bed rock. Let us remember that there can be no spending by the Government without paying by the Government and that the Government cannot pay except out of the pockets of the people. Let us remember too that in the last analysis taxes and the cost of Government loans are borne by one hundred million people. The burden of taxation, the burden of credit expansion is inevitably shifted to the whole people of the United States. Some methods of finance are better than others. Some taxes are less readily adapted to being shifted from the backs of the original taxpayers, presumably better able to bear them, to the backs of the people as a whole, but in the long run the burden of Governmental waste and extravagance falls more heavily upon the poor than upon the well-to-do and more heavily upon the well-to-do than upon the rich. By graduated income taxes we tend to mitigate this consequence but we cannot wholly avoid it. Let us not fail to remember that the Government of the United States is simply a name for the people of the United States and that all of the people of the United States will pay in inverse order to their ability for extravagances of the Government perpetrated in the interest of a portion of the people or a section of the country.

You gentlemen, I am sure, have learned as well as I by long service in Congress that the instincts and enthusiasms of departments, bureaus and boards find support in the Committees of Congress appointed to have charge of their particular affairs. As a result we find that Governmental expenditure initiated in a department of the Government charged with the specific business of creating an army, or of creating a navy, or of creating a merchant marine, or of stimulating commerce, or of protecting labor, or of aiding the development of agriculture, is submitted to the Congress without consultation with or approval by the finance officer of the Government, the Secretary of the Treasury, who serves merely as a messenger, and whose office is charged with the heavy burden of finding financial means in loans and taxes to meet expenditures; and when it reaches Congress is referred to the corresponding Committees of the Congress whose specific function is also to see to the development of the army, the navy, the merchant marine, etc. And the Congress passes upon all of these projects - good, bad and indifferent - without a report from the Committee on Ways and Means or the Committee on Finance, the Committees of Congress which share with the Secretary of the Treasury the ^{heavy} burden of finance.

It undoubtedly is true that, oftener than otherwise, the sum of department estimates is greater than allowed by the Committees of Congress. I have heard it said that this is invariably so. I suspect that estimates are frequently contrived with a confident expectation of such a fate. Nevertheless, it must be admitted that each jurisdictional

committee deals with estimates in a singularly sympathetic spirit, that would not be manifested by a budgetary official charged with the responsibility of advising the Congress as to the levying of taxes as well as with the responsibility of collecting the money of which appropriations are made. Moreover, it will not be denied that these various jurisdictional committees, acting separately and without complete information concerning the activities of one another, accentuate the importance of the departments, bureaus and boards which they respectively have under their care. This would not be so if appropriations were made by a single committee, any more than would the initial estimates be allowed so far to exceed the probable revenues if the Finance Minister of the Government were given power to assemble, review and alter them before transmitting them to the Congress. Extravagance of executive departments and bureaus would thereby be appreciably restrained. I think it amazing that under such a system the Congress has done so well for so long a time; but I feel constrained to warn you gentlemen, in view of the greatly expanded activities of the government and the extraordinary financial burdens which the country must endure, that it would be hazardous to continue on the old way of transacting the public business.

The Government of the United States is like a great company whose operating managers, publicity managers, sales managers, purchasing department, are given carte blanche to make expenditures, conceived by them to be in the interest of the development of the business, without

consultation with or control by those officers of the company who are charged with the business of ascertaining its revenues and borrowing the money to make good their deficiencies.

Or again the Government of the United States is like a private family in which the wife, having charge of the spending part of the family's business, were given carte blanche to buy houses, yachts, automobiles, clothes, and food, and to employ servants, as she might find wise with a view to increasing the comfort, improving the education, cultivating the taste and enhancing the prestige and social standing of the family; and the husband's sole business were to see that there was money in the bank to meet her checks as they were presented.

That is a most pronounced hyperbole but it is literally true that the Secretary of the Treasury under existing law and practice is unable to obtain from any department of the Government an accurate or approximately accurate estimate of its expenditures for a few weeks in advance, not to say months or years. He must be guided not by information furnished by them but by his own shrewd guess as a result of putting together an infinite number of little facts and figures. That the Treasury has been able, notwithstanding these intolerable conditions, to finance the Government through the great war and up to this date without impairing the credit but, on the contrary, with enhancement of the credit of the Government of the United States, is due, first, to the loyalty and devotion of the whole American people throughout the period of the war, to the magnificent efforts of the patriotic Liberty Loan organizations, to the unqualified support given the Treasury by the Congress without regard to party, and, if I may say so, to the rather exceptional skill and ingenuity with which the

Treasury has been conducted during this difficult period. But I say to you it is an intolerable thing that such conditions should exist and that the welfare and economic life of the American people should be at the hazard of such things as these.

As a former colleague, and in a spirit of frank comradeship which such association inspires, I am prompted here to enter a complaint which may not be ascribed to a desire to be critical, but to a hope that it may be given serious attention in behalf of administrative efficiency. The Congress votes with a lavish hand stupendous sums conceived in a magnificent spirit of generosity with a view to the enhancement of the prestige of the Nation, or for the benefit of this or that element in the community. This it does upon the advice of the Committee of Congress charged with the business of caring for such special interests. Then, speaking through the great Committee on Appropriations, it pursues a policy of restriction with relation to the expenditures of some of the departments of the Government which makes it impossible for those departments to conduct the vast affairs imposed upon them with efficiency and economy. The Government of the United States today is spending hundreds of millions of dollars, even billions of dollars, for armies, for navies, for merchant fleets and other magnificent activities and at the same time refusing the payment of a living wage to the faithful clerks and employees in departments of the Government charged with the stupendous responsibility of transacting these vast affairs honestly, expeditiously and economically.

While your Committee is considering a budget and an audit in the interest of the Government, the Government of the United States

is in danger of losing millions of dollars because some of the Departments charged with the conduct of its business are undermanned, limited to the employment of less efficient help than they should have and provided with insufficient space to house those employees. While you are considering the reform of the audit, the work in the office of the Auditors is months behind because of the failure to provide an adequate force or adequate space to transact their business.

While you discuss the budget plans and audit plans the Congress withholds the necessary funds to erect an adequate vault for the protection of the vast gold store of the United States. It withholds the necessary appropriation to enable the Treasury of the United States to count Federal Reserve Bank notes and National Bank notes turned in for redemption, with the result that the Treasury is unable to take credit for those notes and is obliged to borrow corresponding sums of moneys at interest running at $4\frac{1}{4}\%$ and $4\frac{1}{2}\%$ and this notwithstanding that any appropriation made for this purpose will be charged back to the banks and cost not one penny to the Government of the United States. Bonds, notes, and gold with the custody of which the Treasury is charged, are inadequately protected. There is an insufficient force to care for them. The force we have is underpaid. The work in the Treasurer's office is behind, the work in the Division of Loans and Currency is behind, the work in the Division of Public Moneys is behind, the work in the Register's office is behind, the work in the offices of all the Auditors is behind, and the securities and moneys of the United States are inadequately protected because the Congress withholds the necessary appropriations.

I have spoken of the need of an executive budget covering all

appropriations asked for by the executive departments. But let us be honest with ourselves and honest with the American people. A budget which does not cover the initiation or increase of appropriations by Congress will be a semblance of the real thing. I note that not a little has been said about the Constitutional prerogatives of Congress, but I know of no clause in our Constitution that will prevent the Congress exercising self-control. The houses of Congress can, by amendment of their own rules, surround with proper safeguards the initiation and the increase of appropriations by Congress.

Today the credit of the United States is imperiled by projects initiated and supported on the floor of Congress with a view to capturing the so-called soldier vote. I do not believe for a minute there is any such thing as the soldier vote. I do not believe that that magnificent body of strong, brave lusty young men who went out to France, or were ready to go, want to see the people of the United States exploited in order that each of them may receive a donation. I do not believe these fine young men, if they realized what it is that is proposed in their behalf, would accept a gift made at the expense of their fathers and mothers and sisters and the children that are to come after them in order to give them a holiday. While of course you cannot commit to terms of money the value of the service rendered by the Army of America, I call your attention to the fact that the actual pay of our soldiers was doubled at the outset of the war, that our soldiers have been paid with liberality never dreamed of in the history of this or any other country and that the projects now advocated so lavishly and with so little regard for the welfare of the American people are not limited to those heroic men who suffered

injury or death at the hands of the enemy, not even to those who actually saw the front, not even to those who were sent to France. These projects extend to everyone of some four and one-half million men, mostly young men, who were included in the military and naval forces of the United States, even to those of their number who sought and obtained employment of a character which would relieve them from being exposed to personal risk.

It has been the disheartening task of the Treasury to examine scores and scores of bills drawn and presented with a view to benefiting a section of the country or a portion of its citizenship at the expense of the whole. Many of these bills were apparently devised to avoid the appearance of an appropriation by requiring the Secretary of the Treasury to issue bonds, notes or certificates of indebtedness to meet the expenditure involved, and all of these bills were such as would not be readied by a purely executive budget.

I have said the finances of the United States are in excellent condition. I have said in substance that I do not anticipate a deficit in the current fiscal year in excess of \$1,000,000,000 and that that deficit is covered by deferred installments of the Victory Loan, payable within the fiscal year. I have said that there need be no more Liberty Loans. But I say to you in all solemnity that if a prompt and immediate halt is not called to this great peril, there must be another Liberty Loan and you gentlemen will have to go out to the people of the United States and call upon them to subscribe for bonds, the proceeds of which are to be given away to the well and strong young men who you and I and the American people know went out

in a spirit of unselfishness, not one of self-seeking, to fight for their country. You may ask the old men and the widows, the school children, the rich and the poor, who responded to the call of their country to the number of twenty millions during the period of the war to respond again to this call for a donation. I hope I shall never shrink from the performance of any public duty, yet I do not covet the task of making such an appeal and I shall not willingly be a party to offering this affront to the generous, heroic, unselfish Army and Navy of America that saved the freedom of the world.

The Congress may propose to pay this gift in bonds themselves; but that should not fool anyone. If bonds are given away to the soldiers the issuance in that manner of those bonds will depress the prices of existing bonds so gravely as to imperil the credit of the United States and force additional sacrifices from the twenty million people who participated in financing the war, in providing the pay, food, and munitions which made it possible for our splendid army to contribute decisively to the great victory.

I have spoken of the initiation of appropriations in Congress. Let me speak also of the increase of appropriations. As you all know, and as I know after seventeen years in Congress and not more than half as many months in the Treasury, the processes employed in framing and passing public buildings, and rivers and harbors bills lead to a great waste of the money of the people. The continuance of the United States Government's activities where they are not needed, whether those activities be army posts or subtreasuries or hospitals, would have scant consideration in a real business budget submitted

by a Finance Minister, duly empowered by law, and managed through Congress by a single committee under rules of limitation imposed by the Congress on itself. In my belief, you cannot make a real budget unless you face these facts and deal with them. The Congress of the United States, in attempting this great reform in the interest of economy and efficiency, will fail and fail utterly if, while imposing the necessary firm control over the expenditures of the executive departments, it fails to exercise the sublime quality of self-control.

Coming to matters of detail, let me summarize briefly my views as follows: First, a budget, to be effective, must cover all appropriations and all increases of appropriations, whether initiated in the executive departments or in the Congress. The Bureau of the Budget should be in the office of the Secretary of the Treasury, the Officer of the Government charged with the heavy burden of finding the means to finance its requirements. The division of responsibility is the bane of our Government. It is intolerable that the Secretary of the Treasury should have no voice in the determination of the expenditures of the Government. It is intolerable to think that his function should be merely to go out and borrow the money when someone else has spent it without consultation with him or consideration of the means to raise it. The preparation of the budget should be the principal duty of the Finance Minister. We all know that the President cannot do this thing. We all know that a bureau chief in the office of the President would be helpless to assert his opinion in opposition to the members of the President's cabinet. Projects of the Government involving expenditures should be determined in conference between the members of the Cabinet concerned, and the President's decision

should be final. So far as concerns the question how much money can be raised in loans and taxes and to what amount, therefore, the total expenditures of the Government should be limited and for all budgetary work, the President should obtain his advice from the Secretary of the Treasury and not from a bureau chief appointed for the purpose, and paralleling the work of the Secretary of the Treasury. The budget plans presented to this Committee generally do not contemplate increasing the voice of the Secretary of the Treasury in determining the Government's expenditures but, on the contrary, contemplate depriving him of such voice as he already has. I ask you what there is in the record of the Treasury of the United States from the time of Alexander Hamilton to this present day which justifies this distrust? Which of the departments of the Government has deserved better of the American people or of this Congress? What reason have you to believe that the Secretary of the Treasury, with the support of the great institution over which he presides, the oldest of Government departments, cannot, if due authority be conferred upon him, undertake this task so vital to the welfare of the people and so vital to the success of the administration of his office? We multiply boards and bureaus, we multiply clerks and statisticians, and perpetually we attempt to hobble those great officers of the Government upon whom rest the responsibility for producing the necessary results. Why not go back to first principles and trust these men until they fail you and then get rid of them? What good can come of a policy of imposing tremendous responsibility upon the great officers of the Government and then tying their hands so that they can accomplish nothing?

Whether the budget service should be in the form of a bureau in the Treasury is a matter of detail which can be worked out. Whatever form such a staff of the Secretary of the Treasury should take, I am inclined to believe that it should be composed of experts whose tenure of office, with the possible exception of the head, would be in the nature of permanence.

If this additional duty should be imposed upon the Secretary of the Treasury, I think it would be wise to relieve him of activities which have no relation to the financial operations of the Government. The Department should retain all the fiscal bureaus and divisions, and the Coast Guard which has to do with the collection and protection of the revenue, but in a readjustment of this character I think that it could well dispense with the Bureau of War Risk Insurance, the Bureau of Public Health, and perhaps the Supervising Architect's Office.

Second, when the budget has been received by the Congress it will be accepted as the President's program of finance. If I may venture an opinion as to whether the budget should be considered in one committee or distributed among the present committees that consider appropriations, I should say that it would be preferable to consider it as a whole and by one committee. The forum of consideration, however, is not quite so important as the question of the disposition of the budget at the hands of Congress. That, in my judgment, is of the essence of an effective budget. While Congress should retain the right to reduce the estimates, I believe that it should, as far as the budget itself is concerned, put some distinct limitation on the right to increase any item either in committee or on the floor unless

Recommended by the Secretary of the Treasury, or, in the absence of such recommendation, unless approved by two-thirds of the membership of Congress. The only increase on the floor which should be permitted would be the restoration of an item reduced by the committee to the original figure recommended by the Secretary.

Under such a scheme the budget would come out of Congress practically as the President's budget and for which he must stand definitely responsible before the country. If the Congress desired to propose new expenditures, it should be done in a separate bill, and if the expenditure which such legislation would entail would make ~~the~~ total expenditures exceed the estimated revenues, the Congress should provide in the bill of appropriation specifically for the required revenue to make up the deficit. In this way Congress would not forfeit any right to initiate appropriations but such right would be only separated from the budget.

The program would stand before the country with a clear line of demarcation as to the appropriations for which the President was responsible and those for which the Congress assumed the principal responsibility.

Third, there should be an audit and an effective audit. The audit now provided by law is effective when made to ensure that expenditures have been made in accordance with law. The first step before Congress is to appropriate funds sufficient to enable the Auditors to make the audit which is provided for under existing law. The second step is to enlarge the scope of the audit, strengthen the powers and enlarge the force so that there may be covered also the question whether expenditures have been made efficiently, economically and without duplication. For this purpose it is vitally necessary that there should be only one auditor instead of half a dozen. It is desirable that the offices of the comptroller and auditors should be rolled into one. As a step in that direction Secretary McAdoo on October 25, 1918, issued an order directing the Comptroller of the Treasury to exercise administrative supervision and direction of all the auditing offices. This was the first time that the auditors were placed under the administrative control of the Comptroller, and the order was as far as it was possible to go without amendment of the law.

In connection with the suggestion that the Comptroller of the Treasury and the Auditors be divorced from the Treasury Department and erected as an independent establishment, it is not clearly defined in any of the proposals just what change is contemplated in the accounting system. It must be remembered that the Comptroller and the Auditors are not merely auditors of expenditures with respect to their regularity and legality, but they are the accounting officers of the Treasury.

They pass upon and check the accounts in connection with every financial transaction, whether it relates to the receipt of money, to direct payments out of the Treasury, to repayments to the credit of appropriations, to credits to disbursing officers, or to payments by disbursing officers.

In the management of the nation's finances the Secretary of the Treasury must have an effective system of accounting and bookkeeping. If the Comptroller and Auditors were transferred from the Treasury I am inclined to think that it would be necessary to duplicate much of this accounting and bookkeeping in their offices. If the Comptroller, as an independent officer, is to be in a position to give information to the Congress, as the suggestions seem to contemplate, unquestionably it would be necessary for him to duplicate the bookkeeping operations of the Division of Public Moneys and the Division of Bookkeeping and Warrants of the Treasury Department, and also some of the bookkeeping operations of the office of the Treasurer of the United States. At the present time, however, I express no definite opinion on this suggested change because it has not been put forward in such detail as to permit the expression of judgment from the standpoint of the accounting and bookkeeping requirements of the Treasury. If the auditing department should be without the walls of the Treasury, it is vital that the auditor or comptroller, whatever he may be called, should be as free from interference by the members of the legislature and by

members of the other departments of the Government as he is now in the Treasury. It has been the duty and the pleasure of the Treasury Department to uphold the Comptroller in his independence as a quasi-judicial officer even in cases where his determinations did not commend themselves to the Treasury. It is, of course, only human for the Comptroller to favor his own personal elevation from a subordinate to an independent position. There is nothing blame worthy in that. The present Comptroller has my support and confidence. He is a brave, upright and on the whole wise public servant. Whether any Comptroller would be able to exercise his functions as effectively and freely, deprived of the support and prestige of the great Treasury Department and left to stand upon his own feet as the head of an independent office, I am doubtful. On the whole, I am inclined to the view that the best interests of efficiency and economy require that the audit be conducted under the supervision of the Finance Minister of the Government, the man upon whose shoulders will fall the consequences of extravagance and waste.

The Act of March 4, 1909, provides:

"Immediately upon the receipt of the regular annual estimates of appropriations needed for the various branches of the Government it shall be the duty of the Secretary of the Treasury to estimate as nearly as may be the revenues of the Government for the ensuing fiscal year, and if the estimates for appropriations, including the estimated amount necessary to meet all continuing and permanent appropriations, shall exceed the estimated revenues the Secretary of the Treasury shall transmit the estimates to Congress as heretofore required by law and at once transmit a detailed statement of all of said estimates to the President, to the end that he may, in giving Congress information of the state of the Union and in recommending to their consideration such measures as he may judge necessary, advise the Congress how in his judgment the estimated appropriations could with least injury to the public service be reduced so as to bring the appropriations within the estimated revenues, or, if such reduction be not in his judgment practicable without undue injury to the public service, that he may recommend to Congress such loans or new taxes as may be necessary to cover the deficiency."

It has been stated that this section of law already gives the President power to prepare an adequate book of estimates. Such, in my judgment, is not the case. In the first place the act states that in case the estimates for appropriations exceed the estimated revenues, a detailed statement shall be made to the President by the Secretary of the Treasury in order that he may advise the Congress how in his judgment the estimated appropriations could with least injury to the public service be reduced, or, if they can not be reduced, in order that he may recommend such loans or new taxes as may be necessary to cover the deficiency. I call your particular attention to the fact that the act states that in the contingency mentioned the President may recommend how the appropriations may be reduced. That is an implicit sanction by law of the present situation, or at least a recognition in the statute that the estimates as now submitted are not economically compiled. When the estimates go to Congress under any proper system, they should represent in the first instance the minimum requirements of the Government as related to its prospective receipts.

In the second place I invite attention to the fact that this law applies only to the regular annual estimates of appropriations, that is to say, the appropriations which are submitted for the ensuing fiscal year. It does not apply to estimates for deficiencies and supplemental appropriations. When the Secretary of the Treasury sends the book of estimates to the Congress, less than one-half of the current fiscal year has expired, but there is no requirement in law for any action whatever on the part of the executive in case of an estimated deficit in the Treasury at the end of that current fiscal year as a result of deficiency and supplemental estimates.

In the third place I should point out that this law compares estimated receipts and estimates of appropriations, whereas it should compare estimated receipts and estimated expenditures. At the time it was drawn, however, it was not customary for the Secretary of the Treasury to estimate the expenditure for the ensuing fiscal year.

It has been stated that no attention has been paid to the statute. The facts are these:

The estimates for the fiscal year 1911 were transmitted to Congress December 6, 1909, and, therefore, were the first regular annual estimates of appropriations to be transmitted after the passage of the law.

The 1911 estimates showed an estimated excess of ordinary receipts over ordinary appropriations of \$35,931,327.49, but with the Panama Canal appropriations added instead of a surplus there would be shown a deficit of \$12,132,197.21. As authority existed for the issue of Panama Canal bonds, undoubtedly it was held that the Act of

March 4, 1909, did not apply, there being more than sufficient revenue to meet the estimated ordinary appropriations for 1911. This assumption is confirmed by the fact that the annual report of Secretary McVeagh for 1909 refers to the sale of bonds or certificates of indebtedness to meet anticipated deficit shown in estimates.

For the year 1912 the same condition was presented, it being estimated that the ordinary receipts would exceed the ordinary appropriations by approximately \$49,500,000, but taking the Panama Canal appropriation into account there would be a deficit of more than \$7,000,000. A similar condition existed for 1913.

The estimates for 1914, sent to Congress on December 3, 1912, were \$732,556,023.03 and estimated receipts \$710,000,000, showing an estimated deficit of \$22,556,023.03, exclusive of Panama Canal appropriations. President Taft reported this deficiency in his message to the Congress December 6, 1912, and in his annual report submitted to the Congress in December, 1916, Secretary McVeagh made the following observation:

"These estimates of appropriations, of course, are based upon conditions that now exist and upon the laws which now prevail; and between now and the end of the fiscal year 1914 much may occur through legislative action to change the basis upon which they are made. There are also included in these estimates items for projected public works the payments for which will not be concluded during the fiscal year in question."

Estimates for 1915, transmitted to Congress December 1, 1913, showed estimated ordinary receipts of \$728,000,000 and estimated ordinary appropriations of \$714,684,675.02, the estimated surplus of ordinary receipts being \$13,315,000, exclusive of Panama Canal appropriations. When the Government's revenue was largely decreased by

reason of the European war, President Wilson delivered a special message to Congress on September 4, 1914, urging that additional revenue of \$100,000,000 be raised through internal taxation.

For 1916, the estimated excess of ordinary receipts over ordinary appropriations was \$21,234,895.20.

The annual report of the Secretary of the Treasury of December 6, 1915, pages 48 to 52, deals with receipts and disbursements for 1916 and 1917, and recommended the means of obtaining the additional revenue required for the fiscal year 1917. In conformity with the statute, President Wilson similarly dealt with the situation in his message to Congress December 7.

The annual report of the Secretary of the Treasury, sent to Congress in December, 1916, referred to the estimates for the fiscal year ending June 30, 1918. The estimates indicated that there would be a deficit on account of the program of preparedness. The Secretary pointed out that on account of the untried new revenue laws relating to taxation of inheritances and war munitions, and the uncertainties as to the actual expenditure that might be made on account of the large program for preparedness, it was very difficult to estimate with accuracy the receipts and expenditures for the fiscal year 1917 and particularly for the fiscal year 1918. He urged upon the attention of Congress the necessity of passing such measures as would provide additional revenue to meet the preparedness program. This was only a few months before the declaration of war. After war was declared, the Secretary of the Treasury was in constant touch with the Committee on Ways and Means of the House and the Finance Committee of the Senate, advising them periodically of the needs of the Government. As a result of these advices the Congress levied taxes and authorized issues of securities as the needs of the Government developed.

SUGGESTED DISTRICT WAR SAVINGS ORGANIZATIONS.

10-18-19

28

The paid staff of the Savings Organization of each District shall after January 1, 1920, consist of the headquarters force. The various paid state and other divisional workers will be eliminated. In Districts covering large territories, it may be permissible to maintain one or two branch offices.

Broadly the staff may be arranged as follows:

DIRECTOR

SALES DIRECTOR

This Director and his Assistants shall be responsible for the sale of War Savings securities. They are to see that the securities are on sale in all parts of the District and to secure more active and widespread cooperation by the banks and trust companies of the country in making sales. A direct field selling force is inadvisable since to accomplish large results would require a prohibitive expense and the method tends to diminish the prestige of Government securities.

DIRECTOR OF COOPERATING ORGANIZATIONS.

The Director of Cooperating Organizations and his Assistants shall make contacts with the school authorities, women's organizations, labor bodies, fraternal societies, commercial associations, agricultural organizations, and foreign speaking groups. They shall seek to establish the movement in these bodies in such a way that its continuance will become automatic and the Savings Organization can therefore relinquish direct control. It must never be lost sight of that only those

things which have to do directly with the Treasury Savings Movement should be promoted.

PUBLICITY

The publicity should be directly supervised by the District Savings Director. The publicity writers must interpret the policy of the Organization to the public and not attempt to create flash news of a cheap nature.

The suggestions on Information in the memorandum the "Treasury Savings Movement" fairly cover the line of publicity to be issued. Results obtained from elaborate outdoor advertising, posters, and "stunt publicity" do not justify the expenditure.

LOCAL ORGANIZATIONS.

A member of the staff should have as his work the securing of local volunteer Savings Chairmen and committees wherever possible. These local organizations can be made of great and lasting value.

October 18, 1919.



THE SECRETARY OF THE TREASURY
WASHINGTON

30

November 24, 1919.

Dear Sir:

In my letter of September 8th I stated that, while it could not be said definitely when semimonthly issues of loan certificates would be resumed, such issues would certainly not be resumed before October 15th. Though most factors in the general situation since that letter was written have been adverse, the position of the Treasury has developed more favorably than then there seemed any reason to hope. The great success of the issue of tax certificates then announced, the reduction in current expenditures and the increase of receipts, notably from sales of war materials and supplies, have made it possible to avoid until now the resumption of the issue of certificates.

On the basis of Treasury daily statements, in the month of October the net current deficit (excess of disbursements over receipts, exclusive of transactions in the principal of the public debt) was \$319,239,450.35, the lowest figure for any month since April, 1917, excluding the months in which income and profits taxes were payable, and for the first half of the month of November the net current deficit was \$118,630,787.30, indicating the likelihood of a further important reduction for that month.

On the basis of Treasury daily statements, the total gross debt, which on June 30, 1919, amounted to \$25,484,506,160.05 and on August 31, 1919, had reached the peak at \$26,596,701,648.01, had been reduced by September 30th by more than \$400,000,000, and, notwithstanding the increase resulting from the Victory Loan installment payments in October and November, when the final payment was made, stood on November 15th at \$26,210,905,795, a net reduction of about \$385,000,000 from the high mark at the end of August, and a net increase since June 30th of only \$726,399,634.95, although in that period only one quarterly income and profits tax installment had been received. The total amount of loan certificates outstanding and unmatured, which on June 30th was \$2,478,317,500 and on August 31st \$2,012,387,500, was reduced in September to \$1,634,671,500, at which figure it stands; while the total amount of tax certificates outstanding and unmatured, which on June 30th was \$789,561,000 and on August 31st was \$1,925,837,500, was reduced in September to \$1,827,586,500, at which figure it stands. Of the latter, certificates to the amount of \$746,869,500 mature December 15, 1919, and are amply provided for by the income and profits tax installment payable on that date.

Very gratifying progress has been made in the absorption by investors of Government securities. During the period of five months from June 6th (when holdings of Victory Notes were first reported separately) to November 7th (the last date for which reports are available) all reporting member banks (about 783 member banks in leading cities, which are believed to

control about forty per cent of the commercial bank deposits of the country) have, according to Federal Reserve Board reports, reduced their holdings—

of Liberty Bonds from.....	\$646,273,000	
to.....	633,950,000	
or.....		\$12,323,000
of Victory Notes from.....	\$438,589,000	
to.....	292,410,000	
or.....		146,179,000
of United States certificates of indebtedness		
from.....	\$1,514,462,000	
to.....	847,558,000	
or.....		666,904,000
making a total reduction in all reporting member banks' hold- ings of United States war securities of.....		\$825,406,000

Loans by all reporting member banks secured by United States war securities, after deducting those rediscounted with Federal Reserve Banks, are reported as reduced in the same period by \$221,450,000 (from \$1,420,581,000 to \$1,199,131,000), this reduction being partly offset, however, by increased rediscounts of such paper with Federal Reserve Banks.

The long intermission in the issue of certificates of all kinds makes it possible, upon resuming, to issue loan certificates, bearing $4\frac{1}{4}\%$ interest, and having only two and one-half months to run, instead of five months as heretofore, while fixing the maturity one-half month later than that of the last issue of loan certificates. Along with the issue of these loan certificates it has been thought wise, in order to make it possible and convenient for taxpayers to prepare further for the large tax payments which fall due on March 15, 1920, to offer an issue of $4\frac{1}{4}\%$ tax certificates of that maturity.

The Treasury again confidently appeals to the banking institutions of the United States for their continued support and asks them not only to subscribe liberally to the certificates of one or both issues now offered but also to use their best efforts to secure the widest possible distribution among investors of the certificates so subscribed for.

Cordially yours,

Carter Glass.

To
The President
of the Bank or
Trust Company addressed.

FEDERAL RESERVE BOARD

STATEMENT FOR THE PRESS.,

X-1747

For immediate release.

Announcement was made today that under arrangements made between the Treasury and the Federal Reserve Board, standard silver dollars that are free in the Treasury will until further notice be delivered against other forms of money to the Division of Foreign Exchange of the Federal Reserve Board, which will, through the Federal Reserve Bank of New York, cooperating with the branches of American banks in the Orient, employ such dollars in regulating our exchanges with silver standard countries.

This arrangement does not, of course, affect the redemption of outstanding silver certificates in standard silver dollars.

December 6, 1919.

December 18, 1919.

My dear Congressman:

On October the 9th last, I sent you a copy of a public statement made by me on the 26th of September, relative to the obligations of foreign governments held by the United States Government; and also a copy of a letter written by me on October 9th, to Senator Penrose in reply to a letter from him, requesting information concerning the extension of the interest on such loans. In that statement and in my letter to Senator Penrose, I explained the policy which the Treasury proposed to adopt in respect to the funding of the demand obligations of foreign governments now held by the United States into long-time obligations, and the funding, during the reconstruction period of two or three years, of the interest on such obligations. Notwithstanding my public announcement of September 26 and the controlling reasons which prompted the Treasury to adopt this policy, it appears from statements which have been made lately in Congress and elsewhere that there still exists a misunderstanding in respect to this question. Some of the statements to the effect that it is the duty of our Government, notwithstanding the present grave derangement of foreign exchanges, to insist upon immediate payment of interest amounting to about \$475,000,000 a year, indicate a tendency to overlook certain aspects of the question and a failure to grasp the meaning of the present position of the finances of the world. While the Treasury favors such an arrangement, it does not favor the cancellation and indeed has no power to cancel any portion of the interest or principal. The collection in dollars of this interest, under present circumstances, would be no less disastrous to American interests than to the interest of our debtors.

The loans to foreign governments were made, as provided by Congress in April, 1917, for the purpose of assisting them in the prosecution of the war. Our entry into the war made it necessary for this Government to call upon the American people for vast sums of money for its own war purposes. In order to obtain such funds it was necessary substantially to close our

financial markets to all other borrowings, but at the same time it became most important that our associates in the war should be able to obtain in greater amounts than theretofore the supplies which they required and which we alone could furnish.

Except for the purpose of meeting commitments for war purposes previously made with the knowledge of the Treasury, the Treasury has since last April substantially discontinued the establishment of credits in favor of foreign governments. The program authorized by Congress for foreign loans was therefore substantially ended eight months ago.

At almost the same time the foreign governments of their own accord, but with the hearty approval of the Treasury, ceased the "pegging" of their exchanges.

These necessary steps by the United States Treasury and the Treasuries of our associates, in the endeavor to reduce governmental financial activity and to return trade and finance to normal channels, have been reflected in the great drop which has taken place in the foreign exchanges.

With the ending of the war and of the program of our loans to foreign governments, it was considered appropriate, in accordance with the authority conferred by the Liberty Bond Acts, to take up with those governments the funding of the demand obligations now held by the United States into long-time obligations; and in view of the fact that, as indicated by the state of the foreign exchanges, the reconstruction of Europe has not proceeded to a point where Europe can even yet pay by exports for its necessary food, it was considered by the Treasury most expedient that, as a part of a general funding arrangement, provision should be made for deferring and spreading over a later period the payment of interest which would accrue during the next two or three years.

At the time of writing, exchanges of the principal Allies are quoted as follows:

Sterling	3.86	or at a discount of 20.7%
Francs	10.23	or at a discount of 49.4%
Lire	12.75	or at a discount of 59.4%
Belgian francs .	9.97	or at a discount of 48%.

Under those circumstances, an impenetrable barrier exists which makes it impracticable for these governments to pay in dollars the amount of interest due from them to the United States. This involves no question as to the solvency or financial responsibility of these governments, nor a failure to raise funds by loans and taxes from their people and a corresponding burdening of our people, but results from the condition of the foreign exchange market. If the governments of the Allies were to raise immediately by taxes and loans the whole of their debt to us, those taxes and loans would produce only sterling, francs and lire, and those foreign currencies would not furnish one additional dollar of dollar exchange because conditions are not such as to permit those currencies now to be converted into dollars. The United States Treasury has no use at the present time for any considerable amounts of these currencies and could not afford to accumulate large idle foreign balances.

If the Treasury does not defer the collection of interest and thus adds to the present difficulties in the financial and economic rehabilitation of the world by demanding an immediate cash payment of interest before the industry and trade of Europe has an opportunity to revive, we should not only make it impossible for Europe to continue needed purchases here and decrease their ultimate capacity to pay their debt to us, but should hinder rather than help the reconstruction which the world should hasten. A nation can liquidate its foreign debts only by the accumulation of foreign credits which may be accomplished through an excess trade balance, invisible exchange items, the creation of credits by loans, or by the export of gold. Until our associates in the war, whose manufacture and trade suffered so much more than ours, have had an opportunity to resume normal industrial and commercial activities, they have not the exports with which to pay the interest due on our obligations and ~~could make such payment only by the shipment of gold, or by obtaining dollar~~ loans in the United States. The loans which the Allied Governments have so far been able to place in our markets have not been sufficient to correct the situation. I cannot believe that any one would consider it equitable or wise, in the present circumstances, for us to require payment in gold, of which we

already have enough, when the payment of one year's interest alone would exhaust about 50% of the gold reserves of our debtors. While I fully realize the desirability of collecting this interest and of decreasing at once by a corresponding amount the taxes which we must collect, I should be most reluctant, without specific instructions from Congress to the contrary, to demand the immediate payment of interest which would not only seriously retard the economic restoration of those countries without which they will be unable to pay the interest and principal of their debt to us, but which would also destroy their power to make needed purchases in our market.

My advisers are firmly of the opinion that, in connection with and as a part of a general funding of the demand obligations into time obligations, I am duly authorized under the Liberty Loan Acts to spread over subsequent years the interest which would accrue during the reconstruction period of, say, two or three years, and to include such amounts in the time obligations. If, however, the Ways and Means Committee of the House which shared with the Secretary of the Treasury the initial responsibility for the Liberty Loan Acts, should question my power so to act, I shall be pleased to have you so inform me at once in order that I may lay before your Committee a proposal for further enabling legislation.

Cordially yours,

(Signed) CARTER GLASS.

Honorable Joseph Fordney,

House of Representatives.

FROM THE ANNUAL REPORT OF THE SECRETARY OF THE
TREASURY 1919

Taxation

Though any appreciable reduction in the amount of the revenues from taxation is not to be thought of during a fiscal year when the Government's current disbursements will exceed its current receipts, when its unfunded debt amounts to upward of \$3,736,000,000 (October 31, 1919, on the basis of daily Treasury statements), and when the Congress is considering various measures carrying vast additional appropriations, it is, I believe, the duty of the Congress to give its closest attention to the study of the incidence of taxation with a view to the revision of the revenue act on lines which will produce the necessary revenue with the minimum of inconvenience and injustice. The Treasury's objections to the excess-profits tax even as a war expedient (in contradistinction to a war-profits tax) have been repeatedly voiced before the committees of the Congress. Still more objectionable is the operation of the excess-profits tax in peace times. It encourages wasteful expenditure, puts a premium on overcapitalization and a penalty on brains, energy and enterprise, discourages new ventures, and confirms old ventures in their monopolies. In many instances it acts as a consumption tax, is added to the cost of production upon which profits are figured in determining prices and has been, and will, so long as it is maintained upon the statute books, continue to be, a material factor in the increased cost of living.

The revenue sacrificed by elimination or reduction of this tax must be sought in an increase of the normal income tax (from which the income on Liberty bonds is exempt) and of the lower brackets of the surtax. The upmost brackets of the surtax have already passed the point of productivity and the only consequence of any further increase would be to drive possessors of these great incomes more and more to place their wealth in the billions of dollars of wholly exempt securities heretofore issued and still being issued by States and municipalities, as well as those heretofore issued by the United States. This process not only destroys a source of revenue to the Federal Government, but tends to withdraw the capital of very rich men from the development of

new enterprises and place it at the disposal of State and municipal governments upon terms so easy to them (the cost of exemptions from taxation falling more heavily upon the Federal Government) as to stimulate wasteful and non-productive expenditure by State and municipal governments.

In that connection I call attention to the urgent necessity of revision of the revenue law so as to require that, for the purpose of ascertaining the amount of surtax payable by a taxpayer, his income from State and municipal bonds shall be reported and included in his total income, and the portion of his income which is subject to taxation taxed at the rates specified in the act in respect to a total income of such amount. The Treasury's recommendations in this respect have been transmitted to the appropriate committees of Congress in connection with the Revenue Act of 1918, and again in the present calendar year. Under the present law a person having an income of, say, \$1,000,000 from taxable securities would, upon the sale of half his property and the investment of the proceeds of that half in State or municipal bonds, not only obtain exemption for the income derived from such investment in State and municipal bonds, but greatly reduce the surtaxes payable in respect to his other income. It is intolerable that taxpayers should be allowed, by purchase of exempt securities, not only to obtain exemption with respect to the income derived therefrom, but to reduce the supertaxes upon their other income, and to have the supertaxes upon their other income determined upon the assumption, contrary to fact, that they are not in possession of income derived from State and municipal bonds.

It is impossible to determine the actual gain in revenue to the Government which would result from such an amendment of the law. That it would be very material I have no doubt. A still more important result of the amendment of the law in this respect, however, would be the reflex benefit to Liberty bonds which carry exemption from normal income tax, but as to the great bulk not from surtaxes. The very great advantage the States and municipalities now have in conferring upon holders of their bonds larger exemptions from Federal taxation than the Federal Government itself confers upon holders of Liberty

bonds should be reduced, so far as it may be reduced, by the adoption of appropriate administrative provisions in the Federal revenue law.

A question has been raised concerning the right of the Federal Government under the Constitution to tax the income from State and municipal bonds, but there can be no doubt of the constitutionality of such an administrative provision. The proposal is not to tax the income derived from State and municipal securities, but to prevent evasion of the tax in respect to other income. The principles involved are abundantly established in the decisions of the Supreme Court sustaining taxes upon corporations, bank stock, etc., computed after taking into account income derived from Government, State and municipal bonds.

I am calling attention to these matters because it is of the utmost importance that the Congress should follow the wise precedent adopted by the last Congress in determining in advance of the year's business the basis upon which taxes are to be imposed. Uncertainty in respect to taxation during any given business period results in each taxpayer's setting aside for taxes an ample margin to cover variations in the tax law which may affect him onerously and calculating his costs and prices on that basis. Even a bad law is better than a retroactive law. It is, therefore, of the utmost importance, in my judgment, that the Congress should give consideration in the calendar year 1920 to the question of revision of the tax law with a view to making such revision effective well in advance in respect to the incomes and profits of the calendar year 1921.

The administration of the Revenue Act of 1918 is discussed later under the heading "Bureau of Internal Revenue."

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FROM THE ANNUAL REPORT OF THE SECRETARY OF THE
TREASURY 1919

Economy

Accepting a warning from the innumerable requests that are constantly being pressed upon the Congress for grants from the general fund, it becomes the clear duty of this department to point out that there appears to be grave danger that the extraordinary success of the Treasury in financing the stupendous war expenditures may lead to a riot of public expenditure after the war, the consequences of which could only be disastrous. It can not be too often repeated or too strongly urged that the optimistic outlook of the future of the Government's finances, as presented in the beginning of this report, is based upon the practice of the most rigid economy and the continuance of ample revenues from taxation. Any other policy means a calamitous upsetting of the entire program.

Government expenditure is, I need scarcely say, the most vital, fundamental factor in increasing the cost of living. Its evil effect in that respect is mitigated, but can not be wholly eliminated, by the wisdom and practical success of the financial measures adopted by the Government to meet its expenditures. Roughly speaking, the worst of these methods (which has been adopted in greater or less degree in the countries of Europe and not at all in the United States) is currency inflation. Far less harmful as a means of financing Government expenditures is the issue of bonds, notes, and other obligations of the Government, which, to the extent that they find lodgment in the hands of investors who pay for them from savings, are a means of meeting expenditures without expansion. The least harmful of all means of meeting Government expenditures is taxation, because this enforces a considerable measure of saving on the part of the taxpayer, who is not, as in the case of loans, furnished with a new basis of credit in exchange for the buying power he transfers to the Government. Of taxes the least harmful is the personal-income tax, graduated in accordance with the means of the taxpayer, since this is a direct tax and is only with great difficulty and to a limited extent shifted to the consumer. Indirect taxes, such as protective tariffs, consumption taxes and the excess-profits tax, though less harmful than currency inflation or loans, and having a less direct effect in increasing

the cost of living, nevertheless, have an appreciable influence in that direction.

Inevitably, then, Government expenditure increases the cost of living. The function of the Treasury, once the expenditure has been determined upon, is to devise means of meeting it with the least injurious results. What increases the general cost of living imposes an indirect tax on the whole people of the United States which, in the nature of things, bears more heavily upon the poor than upon the rich, and upon the needy than upon the poor, because expenditures for the necessities of life absorb practically the whole income of the poor and needy and a negligible portion of the income of the rich.

Measures for governmental expenditures for the benefit of a portion of the community at the expense of the whole by adding to the cost of living and to the burden it imposes upon the community as a whole, will only aggravate evils which the sentimental supporters of those measures think to mitigate, and the burdens thus imposed invariably fall most heavily upon those least able to bear them.

I have ventured thus to recall to mind the general principles of economics and finance which underlie the present situation and which so frequently are ignored by the advocates of specific policies and measures that are subversive of sound principles. I discussed the matter somewhat in detail before the House Select Committee on the Budget on October 4, and my statement to that committee is quoted elsewhere in this report under the heading "A Budget System."

It is earnestly urged that the Congress deny every proposal for expenditures in new fields or the continuance or expansion of old unless they represent imperative and unquestioned need. This policy is particularly important in this period when the solution of the problem of the cost of living is to be found in such large measure in the most rigid economy in public expenditure and in the firm determination to meet that expenditure from current taxes.

FROM THE ANNUAL REPORT OF THE SECRETARY OF THE
TREASURY 1919

The international financial situation

The international financial situation is one of great importance and in which we are seriously interested. The present position relative to foreign financing and the general policy of the Treasury concerning this vital problem should be fully stated.

Since the armistice the United States has advanced to the Governments of the Allies, as of the close of business October 31, 1919, the sum of \$2,329,257,138.55, and there remained on that date an unexpended balance of \$593,628,111.45, from the total loans of \$10,000,000,000 authorized under the Liberty loan acts.

The Treasury asked and obtained power for the War Finance Corporation to make advances up to the amount of \$1,000,000,000 for nonwar purposes and the War Finance Corporation is prepared to make such advances.

By the act approved September 17, 1919, the Federal Reserve Board is authorized to permit, until January 1, 1921, national banks to invest to a limited extent in the stock of American corporations principally engaged in such phases of international or foreign financial operations as may be necessary to facilitate exports.

The Secretary of War is authorized to sell surplus Army stores on credit.

The United States wheat director is authorized to sell wheat to Europe on credit.

The power which at present exists in the Government or governmental agencies to assist in meeting Europe's financial needs is, therefore, considerable. This power must, of course, be exercised with extreme caution and with the most careful regard for the urgent needs of our own people for an ample supply of foodstuffs and other necessities of life at reasonable prices.

The Treasury is considering with representatives of the Governments of the Allies the funding of the demand obligations which the United States holds into long-time obligations, and at the same time the funding during the reconstruction period, or say for a period of two or three years, of the interest on the obligations of foreign Governments acquired by the United States under the Liberty loan acts.

The Treasury believes that the need of Europe for financial assistance, very great and very real though it is, has been much exaggerated both here and abroad. Our hearts have been so touched by the suffering which the war left in its train, and our experience is so recent of the financial conditions which existed during the war (when men were devoting themselves to the business of destruction) that we are prone to overlook the vast recuperative power inherent in any country which, though devastated, has not been depopulated, and the people of which are not starved afterwards. We must all feel deep sympathy for the suffering in Europe to-day, but we must not allow our sympathy to warp our judgment and, by exaggerating Europe's financial needs, make it more difficult to fill them.

Men must go back to work in Europe, must contribute to increase production. The industries of Europe, of course, can not be set to work without raw materials, machinery, etc., and, to the extent that these are to be secured from the United States, the problem of financing the restoration of Europe belongs primarily to our exporters. Governmental financial assistance in the past and talk of plans for future Government or banking aid to finance exports have apparently led our industrial concerns to the erroneous expectation that their war profits, based so largely on exports, will continue indefinitely without effort or risk on their part. To them will fall the profits of the exports and upon them will fall the consequences of failure to make the exports. So soon as domestic stocks, which were very low at the time of the armistice, have been replenished, those industries which have been developed to meet a demand for great exports,

paid for out of Government war loans, will be forced to close plants and forego dividends unless they maintain and develop an outlet abroad. The industries of the country must be brought to a realization of the gravity of this problem, must go out and seek markets abroad, must reduce prices at home and abroad to a reasonable level, and create or cooperate in creating the means of financial export business. There is no reason for high commodity prices in the specter of European demand nor for high interest rates in the specter of European credits. Our fear must be that the cessation of war exports will result in closed plants, passed dividends, and general depression. The way to avoid those evils is to stimulate production and encourage industrial and commercial activity and not to burden them with high interest rates which are a deterrent to these things, but unfortunately are not a deterrent, except temporarily, in such times as these to speculation.

Since armistice day, the consistent policy of the Treasury has been, as far as possible, to restore private initiative and remove governmental controls and interferences. It has been the view of the Treasury that only thus can the prompt restoration of healthy economic life be gained. The embargoes on gold and silver and control of foreign exchange have been removed, as well as the voluntary and informal control of call money and the stock exchange loan account. The control exercised by the Capital Issues Committee over capital issues has been discontinued. Thus the financial markets of the United States have been opened to the whole world and all restrictions removed that might have hindered America's capital and credit resources, as well as its great gold reserve, from being available in aid of the world's commerce and Europe's need.

There are those who believe that the dollar should be kept at par -- no more, no less -- in the market of foreign exchange. If effective action were taken to carry out such a policy, it could only be done by drawing gold out of the United States when the dollar would otherwise be at a discount and by inflating credit when the dollar would otherwise be at a premium.

The dollar is now at a premium almost everywhere in the world. Its artificial reduction and maintenance at the gold par of exchange in all currencies is quite unthinkable unless we propose to level all differences in the relative credit of nations and for our gold reserve substitute a reserve consisting of the promises to pay of any nation that chooses to become our debtor. Inequalities of exchange reflect not only the trade and financial balance between two countries, but, particularly after a great war such as that we have been through, the inequalities of domestic finance. The United States has met a greater proportion of the cost of the war from taxes and bond issues than any other country. Largely as a consequence of this policy, the buying power of the dollar at home has been better sustained than has the buying power at home of the currency of any European belligerent. For the United States to determine by governmental action to depress the dollar as measured in terms of foreign exchange and to improve the position of other currencies as measured in terms of dollars would be to shift to the American people the tax and loan burdens of foreign countries. This shifted burden would be measured by the taxes to be imposed and the further loans to be absorbed by our people as a consequence, and by increased domestic prices.

United States Government action at this time to prevent in respect to foreign exchange the ordinary operation of the law of supply and demand, which automatically sets in action corrective causes, and to prevent the dollar from going to a premium when its natural tendency is to do so, would artificially stimulate our exports, and, through the competition of export demand with domestic demand, maintain or increase domestic prices.

The view of the Governments of the Allies, I take it, is that had they (after the war control of their imports had been relaxed) attempted to continue to "peg" their exchanges here at an artificial level by Government borrowing, the effect would have been to stimulate their imports and discourage their exports, thus aggravating their already unfavorable international balances.

It is not, of course, to be expected that the breach left by the withdrawal of governmental support of exchange can be filled by private initiative until the ratification of the treaty of peace has given reasonable assurance against the political risk which, rather than any commercial or credit risk, now deters private lenders. Some progress has already been made in placing here through private channels the loans of allied and neutral European countries and municipalities. The Treasury favors the making, in our markets, of such loans, which contribute to relieve the exchanges. I am sure that when peace is consummated, and the political risk measurably removed, American exporters and European importers will lay the basis of credit in sound business transactions, and I know that American bankers will not fail then to devise means of financing the needs of the situation nor American investors to respond to Europe's demand for capital on a sound investment basis.

Meanwhile it is well to remember the invisible factors, which are always at work toward a solution of the problem. Immigrants' remittances to Europe are, and will continue to be, a very large item in rectifying the exchanges. As soon as peace is concluded foreign travel will be a further item. Another very important factor is the purchase of European securities and properties and repurchase of foreign-held American securities by American investors. But the principal factor in Europe's favor is the inevitable curtailment of her imports and expansion of her exports. These processes, of course, are stimulated by the very position of the exchanges which they tend to correct.

January 7, 1920.

My dear Congressman:

With reference to my letter of December 18 to you, calling your attention to the desperate situation in certain portions of Europe where urgent relief is required, and requesting an opportunity to lay before your Committee further information and proposals for legislation which will enable this Government to assist in alleviating that situation, I have the honor to submit herewith a summary of the many reports and despatches from various reliable sources as to the situation in those parts of Europe where relief is so urgently necessary; namely, Poland, Austria and Armenia. I also have the honor to submit a proposed legislative authorization which, in my opinion, would enable this country to give the assistance which is imperatively required.

POLAND: According to the best information obtainable, the minimum grain requirement necessary to carry Poland until the next harvest, and which cannot be filled anywhere but in the United States, is 300,000 tons. This deficiency is due to a partial failure of the wheat crop and to a lack of fuel for threshing. Poland is at present living under a hand-to-mouth regime, which can be remedied only by a steady flow of imports from the only available surplus stocks of food; namely, those in the United States. The potato crop, which is the staple food of the poorer classes, has been destroyed by frosts to the extent of 50% in many districts, as it is impossible properly to care for potatoes in transit due to delays in transportation. Poland has been unable to procure clothing since the beginning of the war, and the result is that during the past five years practically

all clothing has been worn out and has not yet been replaced. The food situation in Poland is so serious that the European Children's Relief Fund has felt obliged to loan Poland small quantities of flour from the stocks intended for child feeding. The assistance to the children of Poland rendered through this fund, which feeds 1,300,000 children daily, is claimed by its administrators there to have been a powerful means of averting revolutions up to this time, and the failure of the Polish Government properly to ration its adult population has already caused demonstrations by the Reds in Warsaw. The cost of supplying the 300,000 ton grain minimum would be approximately \$50,000,000. It is possible that a portion of this requirement may be met through private charity, and that the British Government may be able to supply some tonnage for the transportation of this grain from the United States. In so far as this outside aid is received, the assistance to be furnished by the United States would be diminished.

AUSTRIA: In Austria the acute misery and suffering are probably greater than in Poland. Two-tenths only of the present Austrian state are self-supporting in food, and the remaining eight-tenths, even before the war, produced food to supply themselves for six months of the year at most, and were dependent for the remaining six months upon importations. Consequently, the situation today, especially in Vienna, has become exceedingly grave, due to a shortage of coal and food. There is every indication that unless some relief is afforded immediately, the population cannot withstand the strain of conditions that are already well-nigh intolerable. Coal and food rations for domestic consumption have been reduced

below a safety minimum, and it is only a question of days before existing stocks will be exhausted, when even the present reduced rations will become impossible unless new supplies are obtained. Already the forests in the neighborhood of Vienna are being cut down for fuel, as are also many of the wooden dwellings. Famine riots have broken out in some Austrian towns during the past months, and although the population of Vienna has shown admirable patience, this city and large parts of Austria are faced with the danger of a complete breakdown, which according to the Chancellor, Dr. Remer, must unavoidably occur by the end of January unless outside assistance is obtained.

What the effect of a general social breakdown in Austria would be, can of course only be conjectured. That it would be confined to Austria, however, seems highly improbable, and if it spread to Germany, Poland and possibly all of Europe, the result would be no less than a general disintegration of political cohesion in Western Europe. Such an event would be fraught with the most serious consequences for the United States, and would certainly leave in its wake severe suffering and thousands of deaths among the poorer classes of the people.

The British Government has definitely proposed to join, to the extent of its ability, with the United States Government in furnishing relief to Austria. The British Government has explained, however, that with the present depreciation in its exchange, it could not supply dollars for the purchase of food in the United States, but it can no doubt supply the requisite tonnage and some relief supplies obtainable in the United Kingdom. The total estimated requirements

for Austrian relief are \$100,000,000, but the British participation should reduce the amount of relief to be supplied from the United States to Austria to about \$70,000,000.

ARMENIA: Although the population of Armenia is small, the situation there is desperate, and the winter season will see many deaths unless adequate food, medical supplies and clothing are received from outside sources. It has been estimated that a bare minimum program of 7,500 tons of flour, together with other necessities amounting in all to \$500,000 monthly, will be required to meet the situation, and if deliveries are not maintained after the severe winter weather sets in, orphanages will close and great numbers of deaths will result. At present there are 700,000 destitute people being kept alive by this program and partial aid is being furnished to many others.

As there are private charitable funds available for Armenia, it is probable that the amount of relief which the United States Government would be called upon to furnish to Armenia would not exceed \$1,000,000.

In addition to the three above-mentioned countries or territories where the requirements are most urgent, it may be necessary to furnish some supplies to other sections of Europe (outside the boundaries of Germany) where the situation is not now so desperate, but where food supplies will be required to carry them through until the next harvest. It is estimated that \$25,000,000 would suffice for this purpose.

In this summary of conditions no attempt has been made to cover all the ground or even touch on all the aspects of the situation

in the countries mentioned. Data in the form of consular despatches and telegrams from various official and unofficial American representatives abroad exist in abundance to substantiate the foregoing summary of the dire need of the people of these countries for immediate relief.

In conclusion I may say that while it is impossible now to estimate definitely just what will be required, I am of the opinion, from the information so far obtainable, that a minimum of \$125,000,000 and a maximum of \$200,000,000 would suffice to supply the portion of relief to be assumed by this Government, provided Congress should grant the necessary authorization to participate in alleviating this serious and desperate situation.

As any relief undertaking, so far as concerns the United States, would be primarily a question of supplying food, and as it is advisable that the purchases of food for Europe should be handled and coordinated in such a manner as not to increase the prices of food in the United States, I am recommending in the proposed legislation that the United States Grain Corporation be empowered to purchase, sell, and deliver food and relief supplies for Europe up to the amount of \$150,000,000, and that for the supplies so furnished credit may be extended by the Grain Corporation. If this amount proves insufficient to meet the minimum requirements, the Treasury will again submit the matter to Congress for such action as it may deem expedient.

If you desire further information than that contained herein, Assistant Secretary Davis and Mr. Hoover, who are most conversant with this situation, will be glad to appear before your Committee on the 10th instant, at 10:30 a.m.

Cordially yours,

(Sgd.) Carter Glass.

Honorable Joseph W. Fordney,
Chairman of Ways and Means Committee,
House of Representatives.

A BILL

Providing for the relief of populations in Europe and in countries contiguous thereto

Be it enacted by the Senate and House of Representatives of the United States of America in Congress Assembled. That for the participation of the Government of the United States in the furnishing of foodstuffs and other relief supplies and for the transportation thereof to populations in Europe and countries contiguous thereto, the United States Grain Corporation is authorized, with the approval of the Secretary of the Treasury and to an amount not exceeding \$150,000,000; to buy or contract for the purchase of wheat of the crops of 1918 - 1919 and flour produced therefrom and other food and food products and relief supplies necessary for the purposes of this Act, and to sell, consign or contract for the sale, and to deliver or contract for the delivery, of the same, for cash or on credit at such prices and on such terms or conditions as may be necessary to carry out the purposes of this Act and to relieve populations in the countries of Europe or countries contiguous thereto: Provided, That an audited itemized report of the receipts and expenditures of the United States Grain Corporation for the purposes authorized by this Act shall be submitted to Congress not later than December 31, 1920.

1) The undersigned individuals beg leave to lay before their Government,
2) the Reparations Commission, and the Chamber of Commerce of the United
3) States, the following observations, and to recommend that the Chamber of Com-
4) merce of the United States designate representatives of commerce and finance
5) to meet forthwith (the matter being of the greatest urgency) with those of
6) other countries chiefly concerned, which should include the United Kingdom
7) and the British Dominions, France, Belgium, Italy, Japan, Germany, Austria,
8) the neutral countries of Europe, the United States, and the chief exporting
9) countries of South America, for the purpose of examining the situation briefly
10) set forth below and to recommend upon the basis of authentic information what
11) action in the various countries is advisable among the peoples interested in
12) reviving and maintaining international commerce.

13) They venture to add to the above recommendation the following
14) observations:

15) The war has left to conqueror and conquered alike the problem of
16) finding means effectively to arrest and counteract the continuous growth in
17) the volume of outstanding money and of Government obligations, and, its
18) concomitant, the constant increase of prices. A decrease of excessive
19) consumption and an increase of production and taxation are recognized as
20) the most hopeful, - if not the only, - remedies. Unless they are promptly
21) applied, the depreciation of money, it is to be feared, will continue, wiping
22) out the savings of the past and leading to a gradual but persistent spreading
23) of bankruptcy and anarchy in Europe.

24) There can be no social or economic future for any country, which adopts
25) a permanent policy of meeting its current expenditure by a continuous infla-
26) tion of its circulation and by increasing its interest-bearing debts without
27) a corresponding increase of its tangible assets. In practice every country
28) will have to be treated after careful study and with due regard to its in-
29) dividual conditions and requirements. No country, however, is deserving
30) of credit, nor can it be considered a solvent debtor, whose obligations we
31) may treat as items of actual value in formulating our plans for the future,
32) that will not or cannot bring its current expenditure within the compass of
33) its receipts from taxation and other regular income. This principle must be

34) clearly brought home to the peoples of all countries; for it will be impos-
35) sible otherwise to arouse them from a dream of false hopes and illusions to
36) the recognition of hard facts.

37) It is evident that Germany and Austria will have to bear a heavier load
38) than their conquerors, and that, in conformity with the Treaty of Peace,
39) they must bear the largest possible burden they may safely assume. But care
40) will have to be taken that this burden does not exceed the measure of the
41) highest practicable taxation and that it does not destroy the power of pro-
42) duction, which forms the very source of effective taxation. For the sake of
43) their creditors and for the sake of the world, whose future social and econ-
44) omic development is involved, Germany and Austria must not be rendered bank-
45) rupt. If, for instance, upon close examination, the Commission des Repara-
46) tions finds that, even with the most drastic plan of taxation of property,
47) income, trade and consumption, the sums that these countries will be able to
48) contribute immediately towards the current expenses of their creditors will
49) not reach the obligations now stipulated, then the Commission might be ex-
50) pected to take the view that the scope of the annual contribution must be
51) brought within the limits within which solvency can be preserved, even
52) though it might be necessary for that purpose to extend the period of in-
53) stalments. The load of the burden and the period during which it is to be
54) borne, must not, however, exceed certain bounds; it must not bring about so
55) drastic a lowering of the standard of living that a willingness to pay a
56) just debt is converted into a spirit of despair and revolt.

57) It is also true that amongst the victorious countries there are some whose
58) economic condition is exceedingly grave, and which will have to reach the
59) limits of their taxing-powers. It appears therefore to the undersigned,
60) that the position of these countries, too, should be examined from the same
61) point of view of keeping taxation within the power of endurance, and within
62) a scope that will not be conducive to financial chaos and social unrest.

63) When once the expenditure of the various European countries has been
64) brought within their taxable capacity, (which should be a first condition
65) of granting them further assistance), and when the burdens of indebtedness,

66) as between the different nations, have been brought within the limits of
67) endurance, the problem arises as to how these countries are to be furnished
68) with the working capital necessary for them to purchase the imports required
69) for re-starting the circle of exchange, to restore their productivity, and
70) to reorganize their currencies.

71) The signatories submit that, while much can be done through normal
72) banking channels, the working capital needed is too large in amount and is
73) required too quickly for such channels to be adequate. They are of opinion
74) therefore that a more comprehensive scheme is necessary. It is not a
75) question of affording aid only to a single country, or even a single group
76) of countries which were allied in the war. The interests of the whole of
77) Europe and indeed of the whole world are at stake.

78) It is not our intention to suggest in detail the method by which such
79) international co-operation in the grant of credit may be secured. But we
80) allow ourselves the following observations:

- 81) 1. The greater part of the funds must necessarily be supplied by those
82) countries, where the trade balance and the exchanges are
83) favourable.
- 84) 2. Long term foreign credit, such as is here contemplated, is only de-
85) sirable in so far as it is absolutely necessary to restore produc-
86) tive processes. It is not a substitute for those efforts and sac-
87) rifices on the part of each country, by which alone they can solve
88) their internal problem. It is only by the real economic conditions
89) pressing severely, as they must, on the individual that equilibrium
90) can be restored.
- 91) 3. For this reason, and also because of the great demands on capital
92) for their own internal purposes in the lending countries themselves,
93) the credit supplied should be reduced to the minimum absolutely
94) necessary.
- 95) 4. Assistance should as far as possible be given in a form which
96) leaves national and international trade free from the restrictive
97) control of Governments.

- 98) 5. Any scheme should encourage to the greatest extent possible the
99) supply of credit and the development of trade through normal
100) channels.
- 101) 6. In so far as it proves possible to issue loans to the public in
102) the lending countries, these loans must be on such terms as will at-
103) tract the real savings of the individual; otherwise inflation would
104) be increased.
- 105) 7. The borrowing countries would have to provide the best obtainable
106) security. For this purpose it should be agreed that:
- 107) a. Such loans should rank in front of all other indebtedness
108) whatsoever whether internal debt, reparation payments or
109) interallied governmental debt.
- 110) b. Special security should be set aside by the borrowing countries
111) as a guarantee for the payment of interest and amortization,
112) the character of such security varying perhaps from country to
113) country, but including in the case of Germany and the new
114) States the assignment of import and export duties payable on a
115) gold basis, and in the case of States entitled to receipts from
116) Germany, a first charge on such receipts.

117) The outlook at present is dark. No greater task is before us now,
118) than to devise means by which some measure of hopefulness will reenter.
119) the minds of the masses. The reestablishment of a willingness to work and
120) to save, of incentives to the highest individual effort and of opportunities
121) for every one to enjoy a reasonable share of the fruit of his exertions
122) must be the aim towards which the best minds in all countries should co-
123) operate. Only if we recognize that the time has now come when all
124) countries must help one another, can we hope to bring about an atmosphere,
125) in which we can look forward to the restoration of normal conditions and to
126) the end of our present evils.

127) In conclusion the signatories desire to reiterate their conviction as
128) to the very grave urgency of these questions in point of time. Every month
129) which passes will aggravate the problem and render its eventual solution

- 130) increasingly difficult. All the information at their disposal convinces
131) them that very critical days for Europe are now imminent and that no time
132) must be lost if catastrophes are to be averted.

AMERICAN SIGNATORIES:

EDWIN A. ALDERMAN,
University of Virginia.
FRANK B. ANDERSEN,
San Francisco.
JULIUS H. BARNES,
Duluth.
ROBERT L. BROOKINGS,
St. Louis.
EMORY W. CLARK,
Detroit.
CLEVELAND H. DODGE,
New York.
CHARLES W. ELIOT,
Cambridge.
HERBERT FLEISCHACKER,
San Francisco.
JAMES B. FORGAN,
Chicago.
ARTHUR T. HADLEY,
Yale College.
R. S. HAWES,
St. Louis.
A. BARTON HEPBURN,
New York.
MYRON T. HERRICK,
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LOUIS W. HILL,
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HERBERT HOOVER,
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H. B. JUDSON,
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DARWIN P. KINGSLEY,
New York.
GEORGE H. McFADDEN,
Philadelphia.
WM. H. TAFT,
New Haven.
F. W. TAUSSIG,
Harvard University.
FRANK A. VANDERLIP,
New York.
FESTUS J. WADE,
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ALFRED E. MARLING,
New York.
A. W. MELLON,
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A. L. MILLS,
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J. P. MORGAN,
New York.
WM. FELLOWES MORGAN,
New York.
F. H. RAWSON,
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SAMUEL REA,
Philadelphia.
GEO. M. REYNOLDS,
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R. G. RHETT,
Charlestown, S. C.
ELIHU ROOT,
New York.
LEVI L. RUE,
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CHARLES H. SABIN,
New York.
JACOB H. SCHIFF,
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EDWIN R. A. SELIGMAN,
Columbia College.
JOHN G. SHEDD,
Chicago.
JOHN SHERWIN,
Cleveland.
JAMES A. STILLMAN,
New York.
HENRY SUZALLO,
University of Washington,
Seattle.
PAUL M. WARBURG,
New York.
F. O. WATTS,
St. Louis.
HARRY A. WHEELER,
Chicago.
DANIEL WILLARD,
Baltimore.

January 15, 1920.

45

March, 1920.

Hon. Joseph W. Fordney,
Chairman, Committee on Ways and Means,
House of Representatives.

My dear Mr. Fordney:

I am very glad to respond to your threefold request, communicated through Dr. Adams, for estimates of the loss in revenue which may be expected to result from the recent decision of the Supreme Court in the stock-dividend case, for recommendations concerning a new method of dealing with personal service corporations, and for definite suggestions looking to the fundamental simplification of the income and profits taxes, brief enough to receive but thorough-going enough to deserve careful consideration at a session of the Congress crowded with other questions of grave importance. To facilitate their presentation I may discuss these subjects in the inverse order in which they have been mentioned above.

SIMPLIFICATION OF THE INCOME AND PROFITS TAXES.

In dealing with this subject I may go at once to what is, in many respects, its most vital aspect -- the question of early action. Public opinion has not yet awakened to the gravity of the consequences which are likely to follow a failure to simplify the tax law at this legislative session. Unless the necessary amendments be passed now they will be delayed in all probability, I understand, until the autumn or winter of the year 1921, with the result, unless they are to disrupt the administrative procedure and confuse the necessary calculations of the taxpayer by being made retroactive, that income and profits taxes must continue to be collected on the basis of the present law until the close of the calendar year 1922, and in the case of some taxpayers on the so-called fiscal year basis, until the early months of the calendar year 1923. I can not contemplate such delay without the gravest apprehension. An imperfect and uncertain tax affects the future even more adversely than the present, and for similar reasons it is costly and unwise to make a beneficent modification of the tax law retroactive or even to delay its adoption and announcement until the time at which it is to take effect. It would be manifestly unsafe, in my opinion, to reduce now the income and profits taxes to be collected in the calendar years 1920 and 1921, but I can see nothing in the financial prospects for the calendar year 1922 and thereafter which would make impossible or unwise the very modest reduction involved in the plan of simplification hereinafter presented; and it should never be forgotten that the tax system itself is one of the most powerful causal factors affecting public expenditures. A tax system yielding, or likely to yield in the future a surplus of revenue over expenditures is an open invitation to public extravagance, whereas an announced resolution to reduce taxes as the occasion which called them forth recedes into the past is one of the most potent means of insuring economy in public expenditures. The people therefore, consumers as well as producers, indirect as well as direct taxpayers, may fairly ask to be told now the earliest future date at which the most obsolete features of the tax law are to be repealed.

Complexity in tax laws violates the most fundamental canon of taxation -- that the liability shall be certain and definite. It is not merely a source of irritation, labor, and expense to the taxpayer, but when conjoined, as it is in the present law, with the heavy rates of taxation which war exigency has forced upon us it becomes a major menace, threatening enterprise with heavy but indefinable future obligations, generating a cloud of old claims and potential back taxes which fill the taxpayer with dread, creating, to be sure, an attractive source of additional revenue, but clogging the administrative machinery and threatening, indeed, its possible breakdown.

1. Final determination and settlement of tax claims and assessments; I recommend, therefore, as the most urgent and important of the measures of simplification which could advantageously be put into effect at once, an amendment authorizing the Commissioner of Internal Revenue, with the consent of the taxpayer and the approval of the Secretary of the Treasury (or under such other public safeguards as the Congress may prefer), to make a final determination and settlement of any tax claim or assessment, which shall not thereafter be reopened by the Government or modified or set aside by any officer, employee, or court of the United States, except upon a showing of fraud, malfeasance, or misrepresentation of fact materially affecting the determination thus made.

This recommendation is of major importance. At present the taxpayer never knows when he is through. Every time an old ruling is changed by court decision, opinion of the Attorney General, or reconsideration by the department, the department feels bound to apply the new ruling to past transactions. The necessity of constantly correcting old returns and settlements is as distressing to the department as it is obnoxious to the taxpayer. But an even more serious situation arises in connection with the assessment of back taxes. The tax return of a large corporation is likely to be crowded with debatable points which the corporation, in the first instance, usually decides in its own favor. The auditing of these returns has been necessarily delayed by the inability of the Bureau of Internal Revenue to engage and hold a sufficient force of experts to audit promptly the more complex and difficult returns; but when the audit comes to be made it ordinarily brings to light a large amount of back taxes. A prompt determination and collection of such back taxes due would probably bring in additional revenue exceeding \$1,000,000,000. On the other hand, this situation must fill the taxpayers concerned with the gravest apprehension. If present taxes be continued and a period of industrial depression ensues during which the department finds the time and the men with which to clear up both current and back taxes within the same year, the result may be highly disastrous to business.

The commissioner should be empowered and directed to dispose of these cases promptly and finally. This procedure would bring in much additional revenue, relieve business from grave uncertainty, keep out of the courts many debatable cases, and help to avert an administrative deadlock.

2. Interpretative regulations or Treasury decisions not to be retroactive: As a desirable concomitant of the preceding suggestion and for reasons stated in explaining that suggestion, I recommend the adoption of an amendment providing in substance that in case a regulation or Treasury decision made by the commissioner or the Secretary, or by the commissioner with the approval of the Secretary, is reversed by the subsequent issue of a similar regulation or decision, and such reversal is not immediately caused by or based upon an opinion of the Attorney General or a decision of a court of competent jurisdiction, such new regulation or decision may be made effective from the date of approval.

3. Five-year limitation on time for bringing suit for collection of taxes: Section 250 of the revenue act of 1918 now provides, in sub-division (d), that no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made, except in the case of false or fraudulent returns with intent to evade the tax. This subdivision has been held to apply only to taxes due under the revenue act of 1918. I recommend that this time limit be extended to all income and profits taxes due either under present or prior acts of Congress.

4. Simplification of Liberty-bond exemption: The exemptions from income surtaxes authorized by the several Liberty-bond acts are highly complex and responsible for perhaps the most intricate schedule of the return which the individual taxpayer is required to fill out. My predecessor in office has recommended a consolidation of these exemptions which while not breaking faith with the holders of Liberty bonds would simplify their tax returns, and operate

to strengthen the market standing of such bonds without in any appreciable amount reducing the public revenue. I heartily indorse this recommendation, the detailed provisions of which may be found on pages 99 and 100 of the Annual Report of the Secretary of the Treasury for 1919.

5. Compensation for personal service and gains from sales or dealings in property: The heavy surtaxes cause real hardships when income earned over a period of years is realized or received in one year and taxed as a lump sum in that year. I recommend, therefore, that such extraordinary income, when it constitutes a material part of the gross income for that year, be deemed to have accrued or been received ratably during the years in which the service was rendered or the property held, and the amount of the extraordinary income so assigned to any year be subjected to the surtax rates prescribed by law for that year.

7. Excess-profits tax: Provision for the simplification and fundamental modification or repeal of the excess-profits tax at the earliest possible future date should, in my opinion, be made now. In explaining this conclusion it is unnecessary to enter into a discussion of controversial details. Two facts impress me as indisputable and conclusive: First, the application or calculation of the excess-profits tax is so complex that it has proved impossible to keep up to date the administrative work of audit and assessment. New returns are being made faster than old returns can be audited, resulting in an accumulation of claims and potential back taxes, the dangers of which have already been described. Second, the profits tax is confined to a small fraction (in number) of the business concerns of the country. Personal-service corporations, partnerships, sole proprietors, and most forms of trust organizations are exempt from the tax. If the principle be sound, it should be extended to all forms of business organization, a proposal which administrative considerations alone stamp as impracticable either in the present or any future period near enough to be worth consideration.

The general course or principle which simplification of this part of the tax law should follow is, I believe, reasonably clear. The outstanding feature of the present system of income taxation in its most important application to business income is the fact that we employ for this purpose two systems of taxation which are incommensurate and irreconcilable. Corporations pay the profits tax and normal income tax while their stockholders pay surtaxes on dividends or distributed profits, but nothing in respect of the undistributed corporate profits. On the other hand, sole proprietors and the members of partnerships pay full income tax, normal tax, and surtaxes upon the entire profits of their business whether distributed or not, but are exempt from the profits tax. The profits tax on corporations is evidently meant to be a rough equivalent for the surtaxes levied upon the reinvested or undistributed profits of other forms of business. But no true equivalence is reached. In 1918 the members of a well-known partnership paid nearly \$1,125,000 more taxes than they would have paid had their business been organized as a corporation. And the contrary is quite as frequently true.

There should be one system and not two systems of income taxation applicable to persons engaged in business. Substantial uniformity of treatment or at least a nearer approach to uniformity of treatment, could be achieved in a variety of ways, the details of which it is not necessary to discuss here. I outline below one such plan which has many attractive features, the detailed provisions of which I shall be glad to supply upon request. The technical details while important are elastic and susceptible of modification. The essential thing is to simplify the excess-profits tax and grasp a uniquely opportune moment to remedy a deeply rooted defect in our system of income taxation by providing for the just taxation of the undistributed profits of corporations at a time when such taxation represents simplification and relief, not further complexity and heavier burdens. Equalization of the tax upon corporate and unincorporated business can be accomplished now with benefit to the corporations, the Government, and the general public. We should grasp an opportunity which may never return. The principal features of the plan referred to above are as follows:

(a) This plan is designed, first, to eliminate from the war-profits and excess-profits tax law (except as it is applied to profits derived from the so-called "war contracts"), all reference to or use of "invested capital"; and, second, to place the taxation of incorporated and unincorporated business concerns, so far as may be, on substantially the same basis.

(b) The first object is accomplished by substituting for the present graduated rates of 20 and 40 per cent, a flat tax on profits in excess of the distributed earnings. A rate of 20 per cent has been used as the basis of certain estimates quoted below, but the adoption of the proper rate is, of course, a matter which the committee will desire to settle for itself. It would be possible to adopt a declining rate, say, of 25 per cent, for the first year in which the suggested amendment is in operation, 20 per cent for the second year, and 15 per cent thereafter. It is only necessary that the rate should be fixed at one figure for a particular year.

(c) The second object could be accomplished (although the plan would be well worth while without this feature) by making it explicit in the law that corporations have the right to pay dividends in bonds or promises to pay bearing a fair rate of interest which are taxable to the stockholders as ordinary dividends, or by authorizing corporations to receive back from their stockholders as "paid-in surplus," cash, or other dividends recently distributed. Under these or analogous procedures a corporation could retain its profits for use in the business and yet convert the profits tax into a genuine income tax. The excess-profits tax would thus become a flat tax on undistributed earnings; "invested capital" would practically disappear; and the corporation if it desired could place itself on substantially the same basis as the partnership, the personal-service corporation, and the sole proprietor. The principal object of this suggested amendment is to simplify the tax by removing the greatest source of inequality and complexity now found in the tax laws, i.e., the use of "invested capital."

(d) Revenue needs make it impracticable, in my opinion, to apply the preceding amendment to profits for the calendar year 1920, the taxes upon which will be payable in the calendar year 1921. But it should be put into effect as soon thereafter as the diminishing expenditures of the Government will permit. It is estimated that with a 20 per cent rate and on the basis of present corporate net income the suggested amendment would reduce the tax revenue by approximately \$430,000,000 a year. If, for instance, the amendment were adopted and made to apply to income received on and after January 1, 1921, the first reduction in the tax collections would occur in the last half of the fiscal year 1922, and would amount to \$215,000,000 for that fiscal year.

(e) However, present corporate conditions can hardly be maintained, and if corporate income declines and invested capital increases as rapidly as they have done in the past 12 months the proposed amendment would probably cause no reduction in the future revenue. New schemes are constantly being devised for the purpose of increasing invested capital. It is time to provide for a modification of the excess-profits tax, not only to relieve the taxpayer but because of an approaching decline in its productivity.

§. Reduction of surtaxes on income saved and reinvested: In connection with the suggested tax on the undistributed profits of corporations attention may appropriately be directed to a possible extension of its application which would go far to rectify one of the most dangerous defects of the present income tax. Because of possible doubt about the effects of such a change upon the revenue and because the details of the proposal as they now present themselves to my mind could not accurately be said to simplify the mere computation of the tax I do not urge its adoption at this session of the Congress, but I have no hesitation in expressing my personal opinion that this or some similar amendment embodying the same idea could advantageously be adopted, to take effect at the earliest future date at which, in the opinion of the Congress, revenue needs and prospects permit.

While it is vitally important that saving and reinvestment effected through the medium of the corporation should not be dealt with more leniently than similar savings made by the partnership or individual, it is equally important that the methods of taxation employed should in all cases penalize saving and investment as little as possible. Our present surtaxes offend greatly in this respect. We attempt to levy surtaxes, rising to 65 per cent upon ordinary income, while there are thousands of millions of tax-free securities in the market the income from which is practically exempt from all taxation. The result is to make investment by wealthier taxpayers in the expansion of industry or foreign trade unattractive and unprofitable. It is obvious that this situation should be remedied.

The remedy which most commends itself to my judgment at the present time is to reduce (e. g., by one-fourth) surtaxes attributable to that part of the net income which is saved and reinvested in business or property yielding taxable income and at the same time to limit the total amount of such reduced surtaxes to the same per centage (e. g., 20 per cent) of the reinvested income as the rate imposed upon the undistributed profits of corporations. The maximum tax upon such saved income would thus be approximately the same, whether reinvested by the individual, the partnership, or the corporation, and whether reinvested personally by the stockholders of a corporation or by such corporation for its stockholders. If at any later date the profits of a corporation which had paid the undistributed profits tax came to be distributed, a credit equal to the tax already paid by the corporation, could, if it were thought wise, be easily granted to the stockholders.

The revenue lost by such an amendment could, if necessary, be made up by increasing the normal tax or that portion of the surtaxes attributable to income spent for purposes of consumption. But the time is fast approaching when the adoption of such an amendment would cause little real reduction of the revenue. We can not long continue to collect surtaxes rising to 65 per cent upon income from ordinary business and investment while exempt interest at a remunerative rate can easily be secured from tax-free bonds. We must take something less than 65 per cent or in the end take nothing. On the other hand, no reduction is urged in respect of income spent for unnecessary or ostentatious consumption. Income saved and reinvested in property or business yielding a taxable income should be taxed at a lower rate; income spent for consumption or invested in tax-exempt securities should pay at established rates both the normal tax and surtaxes. To the extent that it falls on savings the income tax should be reduced; to the extent that it is a tax on waste it should be maintained or even increased.

PERSONAL-SERVICE CORPORATIONS.

Under the revenue act of 1918 personal-service corporations are treated substantially as partnerships, i. e., the corporation as such is exempt from income, profits, and capital stock taxes, but stockholders are subject to both normal income tax and surtaxes upon their full distributive shares in the net income of the corporation whether such income is actually distributed or not. The validity of this procedure is involved in the gravest doubt by the doctrine enunciated in the stock-dividend case, which apparently leads to the conclusion that a stockholder of a corporation, particularly a minority stockholder, can not be taxed (without apportionment according to population) upon a share of the corporation's income which he has not actually received. It is possible, notwithstanding the above reasoning, that the present statutory method of dealing with personal-service corporations might be sustained on the ground that it represents in general, in its effects upon personal-service corporations and their stockholders as a class, a relief provision imposed in lieu of the excess-profits tax which is unsuited to personal-service corporations, and if applied to them generally would in many cases work intolerable hardships. But this interesting question need not be discussed here. There is a grave possibility, if not probability, that the stock-dividend decision practically exempts from all

income and profits taxation a group of approximately 2,500 corporations and their stockholders, who would pay under existing law - and should in fairness pay at least - from five to six million dollars. This possibility with its consequent uncertainties, should plainly be removed by the passage of amendatory legislation.

Fortunately it is possible to place personal-service corporations and their stockholders in nearly the same position that they now occupy - in a manner wholly consistent with the spirit and letter of the ruling of the Supreme Court - by applying to such corporations on and after January 1, 1918, the tax on undistributed profits recommended above for all corporations on and after January 1, 1921. This tax would, of course, be in lieu of the war-profits and excess-profits tax, which, because of its dependence upon "invested capital," can not intelligently be applied to personal-service corporations in which, by definition, "capital (whether invested or borrowed) is not a material income producing factor." It is plain also that the law should be so amended as to tax dividends received by the stockholders of personal-service corporations in the same manner as other dividends are taxed.

It would be desirable, moreover, in my opinion, to permit personal-service corporations at their option to distribute during the year 1920 cash or other taxable dividends to the full extent of their profits earned during 1918 and 1919, but not yet distributed; and such retroactive distributions should be made taxable by the stockholders at the surtax rates applicable to the years in which the profits were accumulated by the corporation. By so doing personal-service corporations could, if they desired, place themselves and their stockholders in nearly the same position that they now occupy, i.e., they would pay no profits tax at all, while the entire corporate income (having been distributed) would be taxable in the hands of the stockholders. Indeed, so closely would the proposed plan resemble in effect the method of taxing personal-service corporations prescribed in the revenue act of 1918 that it would be eminently proper - and probably a source of great convenience to the taxpayers concerned - to authorize personal-service corporations with the written consent of their stockholders to select voluntarily to pay taxes for the years 1918 and 1919 on the basis prescribed in the revenue act of 1918.

ESTIMATES OF PROBABLE LOSS IN REVENUE RESULTING FROM THE DECISION
IN EISNER AGAINST MACOMBER.

The loss resulting from this decision falls into two principal classes, that chargeable to the possible exemption of public-service corporations and their stockholders, and that chargeable to the complete exemption of the stock dividends.

There are about 2,500 personal-service corporations having net income of approximately \$30,000,000 involved, the taxes upon which, under existing law, do not exceed \$6,000,000 for the year 1918, and a slightly smaller amount for the year 1919. The aggregate loss for the two years 1918 and 1919, would probably be between \$10,000,000 and \$12,000,000. The need for legislation in this connection arises not so much from the possible loss of revenue as from the obvious undesirability of permitting 2,500 corporations and their stockholders to escape both the taxes upon corporations and those imposed upon individuals.

The loss resulting from the exemption of stock dividends is very difficult to estimate, owing to the fact that such dividends have not in the past been separately shown on the returns, while the losses from the exemption of stock dividends as such will be partially or wholly offset by the heavier taxes resulting from the decision upon any gains realized from subsequent sale of stock and by other offsetting factors which need not be mentioned in detail. After consideration of these factors the actuary of the Treasury Department estimates that the net loss or refund of taxes already paid - i.e., taxes for the period ending

with the year 1918 - will be in the neighborhood of \$35,000,000, and that taxes for the year 1919 (payable in the calendar year of 1920) will be reduced by approximately \$70,000,000 on this account. These figures may be regarded as maxima, and most of the experts of the department are of the opinion that the entire net loss resulting from the exemption of stock dividends will amount to less than \$25,000,000.

The suggestions made above do not comprehend all the changes in the present law, which, in my opinion, could be advantageously adopted at the present session of Congress. I have confined my suggestions to an irreducible minimum of measures looking largely to the simplification of the income and profits taxes, for the consideration of which there still remains time and action upon which at this session of Congress may reasonably be asked by the tax-paying public. I shall be glad, upon request, to submit drafts of amendments embodying the suggestions here presented and to place at your disposal for the work of tax revision all of the personnel and facilities of the Treasury Department.

Respectfully,

DAVID F. HOUSTON, Secretary.



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THE SECRETARY OF THE TREASURY
WASHINGTON

March 13, 1920.

Dear Sir:

The prosperity, progress and welfare of the American people are so vitally dependent on thrift, economy and saving that I deem it highly important and appropriate to address an emphatic appeal to you, endorsing and supporting a recent statement by my predecessor urging the cooperation of the banks and trust companies of the country in the Treasury's program for saving and investment in Government securities. An effective and patriotic service can be rendered by the banking institutions, with many compensating advantages to themselves, by becoming agents and wholeheartedly promoting the distribution of Thrift and Savings Stamps and Treasury Savings Certificates.

The Treasury Savings Movement is on a firm and permanent basis. The sale of Savings securities during the last half of the year 1919 showed encouraging progress, and redemptions were on a lower level. In view of the exigencies of the present economic situation it is obvious that the movement is fundamental, and in order that the fullest measure of success may be obtained the movement must be assisted directly and actively by the banks and trust companies through the agency service.

The war has left us with many financial and economic problems, and the Treasury Savings program can help materially in their solution. Aside from the fact that the proceeds from the sales of the securities will assist in serving the cash requirements of the Treasury, the movement is of the very essence of fundamental economics, affording a tangible means of combating high prices and extravagance and the ills that follow in their train. Economy must be the watchword of the Government and the people in public and private finance, and we can not expect the return of a normal healthy condition unless the people produce more, save more, and spend less. That is the doctrine of the Savings Movement. It can be vitalized and reduced to reality only if all agencies of the country which are capable of reaching the millions of investors, or those who should be investors, however small, will lend their cooperation.

The unique position which the banking institutions occupy between the Treasury on the one hand and the people on the other gives them a strategic advantage of great importance. Even considerations of self interest should impel the banking institutions to assume their acknowledged and rightful leadership with sufficient vigor and force to arouse the American people and turn them from the perils of heedless extravagance to the habits of saving and thrift made imperative by this reconstruction period.

With this statement of the situation, it is confidently expected that every banking institution in the country will qualify AT ONCE to handle Government Savings securities. In responding nobly and loyally now as they did during the war, they will serve their country, their community, and themselves. Agency provisions and application blanks may be obtained from the Government Savings Organization of the Federal Reserve Bank in each district.

Cordially yours,

J. A. Houston

Secretary of the Treasury.

To

The President
of the Bank or
Trust Company addressed.

TREASURY DEPARTMENT

Office of the Secretary

GOVERNMENT ACTUARY.

WASHINGTON

March 18, 1920.

Sir:

I am in receipt of a request from Assistant Secretary Davis that I compute the rate of interest which the United States will receive on the obligations held by it of foreign Governments upon the following assumptions:

(1) That the total principal amount is \$9,500,000,000.

(2) That \$2,114,000,000 mature in the spring of 1947, and the remainder in the autumn of 1938.

(3) That interest has been paid up to the spring of 1919.

(4) No interest to be collected until October, or some other proper date or dates in the autumn of 1922. On such date or dates, there would be payable, at the rate of five per cent per annum, interest for the previous six months on the obligations held by the United States, and such interest would be then collected and interest accruing thereafter would be collected as it matured. By that time the interest accrued and unpaid for the period from April and May, 1919, to the spring of 1922 would amount to fifteen per cent of the principal, namely, three years at five per cent. For the purpose of liquidating these arrears, there would also be paid beginning on this date, in addition to the payment of current interest above mentioned, one-half of one per cent of the total principal amount per annum to and including the spring of 1924. Beginning with the autumn of 1924, the payments on account of deferred interest would be increased from one-half of one per cent to one per cent of the principal per annum to and including the spring of 1926, and thereafter to payments of one and one-half per cent of the principal per annum to and including the spring of 1934. By the payment in the spring of 1934, the last of the accumulated fifteen per cent of the principal would thus have been discharged.

I have the honor to report my computation and conclusions as follows:

The present worth April 15, 1919, of the six semi-annual payments of \$237,500,000, interest deferred on \$9,500,000,000, beginning October 15, 1919, and ending April 15, 1922, money at 5 per cent per annum, reinvested semi-annually, is \$1,308,180,000.

The present worth April 15, 1919, of the twenty four semi-annual payments of deferred interest, beginning October 15, 1922, and ending October 15, 1934, as suggested, upon the same basis is \$874,899,000.

The loss to the Government as of April 15, 1919, is, therefore, \$433,281,000.

The total interest from April 15, 1919, to maturity is:

Interest on \$9,500,000,000, 4/15/22 to 10/15/38 @ 5%-----	\$7,837,500,000
Interest on \$2,114,000,000, 10/15/38 to 4/15/47 @ 5%-----	898,450,000
Interest on \$9,500,000,000, 4/15/19 to 4/15/22 deferred-----	1,425,000,000
Total interest-----	\$10,160,950,000
Loss as above-----	433,281,000
	<u>\$ 9,727,669,000</u>

There are 33 semi-annual payments of interest on \$9,500,000,000 and 17 semi-annual payments upon \$2,114,000,000, which must amount to this \$9,727,669,000. In order to amount to this sum the semi-annual rate must be 2.393 plus per cent or 4.786 plus per cent per annum.

Respectfully,

(Sgd) JOS. S. MCCOY

The Honorable

The Secretary of the Treasury.

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X-1875

FEDERAL RESERVE BOARD .

March 27, 1920.

Subject: Reply to Senate Resolution No. 328.

Sir:-

On March 8, 1920, the Senate adopted the following resolution:

"RESOLVED that the Federal Reserve Board be and is hereby directed to advise the Senate what is the cause and justification for the usurious rates of interest on collateral call loans in the financial centers, under what law authorized, and what steps, if any, are required to abate this condition."

In reply the Board desires first to invite attention to the following tables showing discount and interest rates prevailing in various centers in all Federal reserve districts during the two thirty-day periods ended January 15, 1920, and February 15, 1920. It will be seen from these tables that the maximum and minimum rates on demand loans secured by collateral are approximately the same as those for commercial paper in all cities except Boston and New York. While the legal rate of interest in Massachusetts is 6%, higher contract rates are authorized, and consequently the 6% limitation is occasionally exceeded.

(Tables referred to appear on pages 286 and 287 of Federal Reserve Bulletin for March 1920.)

The only financial center in this country in which there is maintained a call money market of national importance is New York City, and while the rates charged there on call loans are frequently in excess of the legal rates allowed for commercial paper, they are not "usurious" under the laws of the State of New York, which specifically exempt collateral call loans from the 6% limitation which lenders must observe on other loans on pain of incurring the penalty prescribed for usury. Section 115 of the Banking Law (L.1914, Ch. 369; Consol. L. Ch. 2) provides that upon advances of money repayable on demand to an amount not less than \$5,000 made upon warehouse receipts, bills of lading, certificates of stock, etc., or other negotiable instruments as collateral, any bank may receive and collect as compensation any sum which may be agreed upon by the parties to such transaction. The section reads:

"Sec. 115. Interest on collateral demand loans of not less than five thousand dollars.

"Upon advances of money repayable on demand to an amount not less than five thousand dollars made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments, pledged as collateral security for such repayment, any bank may receive or contract to receive and collect as compensation for making such advances any sum which may be agreed upon by the parties to such transaction."

Section 201 of the Banking Law, identical in language with Section 115 above quoted, makes the same provision in the case of collateral loans by trust companies. In the General Business Law (L.1909, Ch. 25; Consol. L.Ch. 20) there is the following general provision of a like character:

"Sec. 379. Interest ^{permitted} on advances on collateral security.

In any case hereafter in which advances of money, repayable on demand, to any amount not less than five thousand dollars, are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, it shall be lawful to receive or to contract to receive and collect, as compensation for making such advances, any sum to be agreed upon in writing, by the parties to such transaction."

National Bank Act.

The National Bank Act provides that national banks may receive and charge on any loan or discount interest at the rate allowed by the law of the State, territory or district where the bank is located. The applicable provision reads:

"Limitation upon rate of interest which may be taken.

422. Sec. 3197.- Any association may take, receive, reserve and charge on any loan or discount made, or upon any note, bill of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory or District where the bank is located, and no more, except that where by the laws of any State a different rate is limited for banks of issue organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this Title. When no rate is fixed by the laws of the State or Territory or District, the bank may take, receive, reserve, or charge a rate not exceeding seven per centum, and such interest may be taken in advance, reckoning the days for which the note, bill or other evidence of debt has to run. And the purchase discount, or sale of a bona fide bill of

exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest."

It will be observed that the effect of the foregoing provisions is to authorize in the State of New York on collateral call loans of not less than \$5,000 rates of interest which may be in excess of those permitted for loans of other character, and that such higher rates are not prohibited as usurious.

As to the "cause and justification" of the high rates of interest which it thus appears may legally be charged on collateral call loans in New York, and as to the "steps *** required to abate this condition", there is, as is well known, a wide difference of opinion among persons who have given thought and study to the question. Indeed, broad and fundamental questions of general economic and social policy are involved - in the last analysis, the whole question of the utility of speculative dealings in securities and commodities on organized exchanges is involved; and more immediately, the question of the methods and practices of the leading speculative markets of the country, margining, stock manipulation, and kindred matters also susceptible of abuse. As to those the Board has never had occasion officially to form an opinion; the Federal Reserve Act specifically precludes the purchase or discount by Federal reserve banks of "notes, drafts or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States". The Board could not undertake to form a judgment upon the matters above referred to without study and investigation of such a comprehensive nature as would seriously interfere with the conduct of its regular work and which, had the Board the requisite authority, would require the services of experts and assistants for the employment of which the Board does not feel authorized to expend funds accruing from statutory assessments on the Federal reserve banks for the purpose of defraying the ordinary expenses contemplated by the Federal Reserve Act.

There is submitted as an appendix hereto a memorandum prepared for the information of the Board by the Federal Reserve Agent in New York, explaining in general the nature and operation of the New York call money market and causes of high and fluctuating rates for call money in that center.

Respectfully,

W.P.G.Harding

Governor.

The President of the Senate.

THE NEW YORK CALL MONEY MARKET

Definition of Call Loans.

Collateral call loans, in the general acceptance of the term, are made chiefly in New York City, which is practically the only important call money market in the United States. They are loans which are payable on demand of the lender without previous notice, secured by the pledge of investment securities, i.e. stocks and bonds, generally those which are dealt in on the New York Stock Exchange. The interest rates on these loans, as on other classes of loans, are on the basis of a rate per annum.

The Borrowers.

The loans are made for the most part to houses which are members of the Stock Exchange and the money so borrowed constitutes a portion of the funds employed ordinarily in purchasing and carrying securities for their customers and sometimes for themselves.

The Lenders.

The principal supplies of money for collateral call loans are loanable funds of banks and bankers located both in and out-

side of New York City, including foreign banks and agencies of foreign banks: and similarly the loanable funds of firms, individuals and corporations seeking temporary investment. The proportion of the whole fund loaned by these **several** interests varies seasonally and in accordance with the attractiveness of other opportunities for investment, either locally or in other markets. The bulk of call money is lent on the floor of the New York Stock Exchange at "the money post" where through various brokers loanable funds are offered and bids for funds are received. Most of the business is done between the hours of 12 noon and 2:45 p.m. The important relation to the money market of the present system of daily settlement of balances resulting from the purchases and sales of securities on the Stock Exchange will be discussed more fully hereafter.

Commercial Requirements have the Prior Claim.

In the matter of the supply or attraction of funds to the call money market, there is generally a definite and well understood obligation on the part of banks to accommodate first their own commercial clients, so that it is only the excess of loanable funds which they may have from time to time that is available for the collateral call money market or for the purchase of commercial paper in the open market. This excess of loanable funds available for employment in the securities market varies, therefore, according to the commercial requirements of the country. It has long been

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recognized that for assurance of a sufficient amount of money to finance the volume of business in securities, reliance cannot be placed on a rate of interest limited to the rates which obtain or are permitted in commercial transactions whose prior claim on banking accommodations is universally conceded.

CAUSES AFFECTING PRESENT CALL MONEY RATES.

The reference in the resolution to the present high rates for call money in the financial centers and the inquiry as to their causes require, it is felt, a survey of the operations of the money markets and the reflection therein of the underlying economic conditions which govern, in varying degrees, all money rates, including those for call money.

Present Changed Conditions of Supply.

In former times, and specifically prior to the institution of the Federal Reserve System, bankers, especially in reserve centers, were accustomed to look upon call loans as their principal secondary reserve on the theory that inasmuch as those loans were payable upon demand, funds so invested could always be promptly obtained on short notice to meet withdrawals of deposits or for other use. In these circumstances there was ordinarily available for collateral call loans a supply of funds sufficient

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for ordinary market requirements and at low rates, although at times the rates rose to high levels as the supply of funds diminished, or the demands increased.

This attitude of the banks toward call loans as their chief secondary reserve has been greatly modified by two causes. The first was the closing of the Stock Exchange at the outbreak of the European War in the summer of 1914, when it became practically impossible to realize on call loans secured by investment securities, which became, therefore, "frozen loans". This resulted in a more or less permanent prejudice against dependence upon call loans as secondary reserves. The second and more important factor was the creation of the Federal Reserve System. Under the terms of the Federal Reserve Act provision is made for the rediscount of commercial paper, but the rediscount of loans for the purpose of carrying investment securities, other than United States Government obligations, is excluded. Consequently, in order to maintain maximum liquidity, with suitable provision for secondary reserves that can be immediately availed of, banks, including foreign agency banks, now invest a greater proportion of their resources in assets that can be realized upon at the Federal Reserve Bank. Another changed factor in the present situation grows out of the fact that the war and post-war conditions have rendered unavailable supplies of money which formerly came from foreign banks. Since the summer of 1914, while total banking resources have largely in-

creased, the volume of bank money available to the securities market at low or normal rates has not increased proportionately, but on the contrary has probably decreased. All of these circumstances explain in some measure, the increased rates which have often been required during the past year for money loaned in the securities market.

Present Changed Conditions of Demand.

Changed conditions are also present in the factors governing the demand for money. Prior to the armistice agencies of Government were employed to restrict the issue of new securities for purposes other than those which were deemed essential for carrying on the war. At the same time, as the Treasury undertook to sell large amounts of certificates of indebtedness and Liberty Bonds bearing low rates of interest, the question arose as to whether the competition of the general investment markets might not prejudice the success of the Government issues. In these circumstances, with full understanding on the part of the Treasury Department, the officers and members of the New York Stock Exchange undertook to limit transactions which would involve the increased use of money for other purposes in consideration of which the principal banks of New York City endeavored to provide a stable amount of money for the requirements of the security market.

After the armistice these restrictions were removed and ordinary market forces reasserted themselves. The issuance of new securities was resumed in unprecedented volume and consumed a vast amount of

capital and credit, when bank credit was already expanded by the necessity of carrying large amounts of Government securities which the investment market was not prepared to absorb. Thus arose a further cause for the increased cost at times of accommodation on collateral call loans.

Since the armistice these causes have been augmented by the increased volume and velocity of transactions in securities generally. Before examining the figures, it should be explained that the amount of call money employed by the securities market fluctuates according to the amount of other funds available for this purpose, i.e. customers' money invested and time money borrowed, and also as the volume of business varies.

Volume.

The volume of money outstanding on call is more or less constant, fluctuating only over relatively long periods, and the amount which is loaned from day to day is but a small proportion of this constant volume. The constant volume of outstanding call loans bears a rate of interest which is determined daily and is known as the renewal rate. The daily borrowings, either in replacement of loans called for payment or representing new money borrowed, are made at rates which may or may not be the same as the renewal rate and which frequently vary during the same day.

Turning to the figures, it appears that over a period of years during the pre-war period the volume of all money, both time and call, employed in the securities market was estimated at about

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\$1,000,000,000., of which the average on call was about 60% and the average on time about 40%, or a normal volume of call money, say of \$600,000,000. The daily turnover in call money, i.e. old loans called for payment, loans made in replacement thereof, and new money borrowed, ranged from \$15,000,000 to \$30,000,000., and averaged about \$20,000,000. The daily turnover during the year 1919, however, ordinarily ranged from \$25,000,000 to \$40,000,000, and averaged about \$30,000,000. Moreover it is important to notice there has been a disproportionate increase in the amount of call loans, as distinguished from time money, with the consequence that the former, it is now estimated, constitute about 75% of the total money employed in the securities market. At a time of such heavy credit requirements as the present the greater volume of borrowings, not only in the aggregate but in the day to day demands, naturally often results in high rates for the money loaned. Indeed, so reluctant have the bankers been during the past few months to supply the large demand for credit based on securities that the occasional loaning of relatively small amounts of money at very high rates often represents a desire not to secure the high rate quoted but to prevent the rate from going very much higher with the consequent demoralization which might result.

. Intermittent Factors.

There are certain other factors, the influence of which is principally manifested in intermittent wide fluctuations in the daily rates or in the rates which apply for brief periods. The increased

volume of demand loans called daily for payment noted above, coupled with the decreased amount of time money loaned on securities, produces more or less apprehension on the part of borrowers as to their ability to re-borrow money called for payment. This apprehension, quickened by the number of insistent borrowers bidding at times when momentarily loanable funds are exhausted or are offered in small quantity, frequently results in competitive bidding for funds which advances the rates for a day or part of a day beyond the actual necessities of the situation.

Another active and important influence which has recently affected the supply of funds available for collateral loans and precipitated at times a rise in the rates, has been the periodic transfers of Government deposits from depositary banks to the Federal Reserve Banks in connection with the fiscal operations of the Treasury. Such withdrawals result in the depositary banks calling money from the securities market, which causes sharp advances in the rate bid for call money in replacement of the loans called for payment.

RATES ARE DETERMINED BY THE OPERATION
OF THE LAW OF SUPPLY AND DEMAND.

The underlying cause of fluctuations and, especially of increases in call money rates is the operation of the law of supply and demand. In other words, as the supply of loanable

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funds diminishes in proportion to the volume of the demand, the rate for collateral demand loans advances. However, in the case of the daily borrowings of call money -- to which the abnormal high and low rates apply and which represent but a comparatively small proportion of the total outstanding loans -- other factors, incidental to the temporary circumstances and conditions of the market, tend in times of stress to greater fluctuations in rates than result from the more normal operation of the law which is reflected in the renewal rate for the greater volume of the outstanding call loans. The renewal rate is regarded as the real barometer of market conditions and its fluctuations throughout the longer periods more nearly reflect the relation between the amount of the loanable funds and the amount of the demand. In other words, high renewal rates are mainly due to other demands for credit, resulting in part from the increased requirements of the commercial community and in part from other temporary factors, such as depletion of bank reserves resulting either or both from credit expansion or loss of reserves through gold export, speculation in commodities and real estate, and congestion of commercial transactions incidental to slow or interrupted transportation.

Commercial Rates are Similarly and Independently Determined.

The operation of the law of supply and demand is equally effective in determining the rate for commercial loans and all other borrowings. In fact, rates for commercial loans and rates for collateral call loans have a common root in the law of supply and demand, and the conditions which affect one, in the main affect the other, although not in like degree, as is demonstrated by the far wider fluctuation of call rates and the higher points to which they go. The rates for call money do not determine and have not exerted an important influence on the rates for commercial borrowings. It is the universal custom of the banks, to satisfy first the commercial needs of their customers. They feel an obligation to customers but none to those who borrow in the open market on securities. Besides as the resources of the banks mainly come from the commercial customers, their own self-interest compels a preference in favor of their commercial borrowers, since failure to grant them reasonable accommodation would induce them to withdraw their deposits and so reduce the ability of the banks to do business. Although the money of the banks and trust companies comprises by far the greater proportion of the money loaned on the securities market, an examination of the prevailing rates on commercial paper at times when the call money market is particularly strained indicates that there is little causal relation between the rates for call money and those on commercial loans. Exhibits Nos. 1 and 2, showing respectively the rates for call money on the New York Stock Exchange during the years 1906-1919 and the rates for commercial paper in New York for the period from 1915 to 1920, are attached.

POSSIBILITIES OF CHANGE IN THE CONDITIONS AND METHODS
OF THE CALL MONEY MARKET

So long as collateral call loans are made under prevailing conditions it is difficult to see how the present situation can be altered, because of the impracticability of controlling the underlying cause of high rates, which in the last analysis, is the excess demand over supply.

An attempt to control the rates for call loans by the establishment of an arbitrary limit at a low level, without the ability to modify the causes above enumerated which operate to increase rates, would be distinctly hazardous, for the reason that up to the point where the arbitrary rate would limit the supply of new money, speculation and expansion might proceed unchecked and the natural elements of correction or regulation would not obtain. In other words, high rates act as a deterrent to over-speculation and undue expansion of credit. On the other hand, should the supply of money available at a fixed maximum rate become exhausted, liquidation might suddenly be forced because the demands for additional accommodation for the consummation of commitments already made could not be met. The effect of such liquidation would be to embarrass not only investors and dealers in securities, but frequently might affect dealers and merchants in commodities as well. As an example of the latter, the case might be cited

of a commitment to purchase a round amount of cotton on a certain day. Many of the houses on the Cotton Exchange are also members of the Stock Exchange and frequently borrow very largely on the Stock Exchange against investment securities to provide funds for settling their transactions in cotton. If, therefore, when an important cotton settlement is imminent, borrowings on securities could not be availed of, the cotton transaction could not be consummated and a drastic liquidation through sale either of securities or of the cotton might be required to avoid default. Similar consequences might obtain in the cases of transactions by members of other commodity exchanges who are also members of the Stock Exchange and have recourse to the call money market.

THE IMPORTANCE OF A "CALL MONEY" MARKET

Call money in some form is indispensable to every important financial center. There must be not only an outlet for the employment of funds temporarily idle, but a large volume of call and short time money is essential to the successful and economical conduct of business. It is particularly essential to the international and domestic commercial business but the diversion of the use of the major portion of such money to the securities markets is not in accordance with sound banking principles. It is to be noted that

in no great world market, other than New York, is the call money market so dependent upon investment securities and so susceptible to speculative influences. In other markets the reverse is true, as their call money is based principally on commercial paper upon which realization can be had at the central bank, at a price, in case of need. We have seen that in this country call loans on securities lack this essential quality of liquidity required for quick and certain realization, and that this fact has now been more generally taken into consideration by our lenders. But the safe and successful divorce in this country of the use of call money from its dependence upon investment securities as a basis requires careful study in order that safe and adequate methods may be substituted for the present methods of the securities market.

Term Settlements.

The achievement of this end probably depends upon the successful development of a plan for term settlements of the balances resulting from operations on the Stock Exchange, in lieu of the present method of daily settlements. The principal effect of such a change of the method of settlements would be to relieve the call money market from the necessities of the securities market and release funds now used in collateral call loans based on investment securities for employment in call loans based on the collateral of more liquid securities, of a commercial

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nature, generally recognized abroad as the preferred bases for demand loans. From this change a broader discount market would naturally develop. Under term settlements the borrowing required by the securities market would be on the basis of short time accommodation, i. e. for the term between settlements, whether they were weekly, fortnightly or at other intervals.

Agitation for the improvement of the present method of settlement of stock exchange contracts has extended over some years and as the result of extensive studies and deliberations of officers and members of the New York Stock Exchange, as well as bankers, an important step has been taken to provide enlarged clearing facilities through the organization of a new corporation known as the Stock Clearing Corporation, which is expected to begin operations in April, 1920. A general description of the purposes and contemplated operations of the corporation is contained in the pamphlet attached hereto as Exhibit No. 3. The functions of this corporation include providing facilities for clearing contracts between members, for the receipt and delivery of securities between members and banks, trust companies and others, and for the clearing of collateral call loans. It is not asserted or expected that the institution of these operations will materially affect either the amount of money loaned from one day to another on the call money market or the rates of such loans, but it is expected that it will operate materially to decrease the amount of bank certifications on day loans, which the present practice requires

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in the interval between paying one call loan and replacing it with another on the same day. It should be noted that the mechanism afforded by the corporation is an indispensable prerequisite to the establishment of a system of term settlements.

The more recent and definite development toward the substitution of term settlements for the present system of daily settlements may be said to have had its inception in the action of the American Acceptance Council at its annual meeting on December 4, 1919. At that time the following resolution was adopted:

"Whereas, The present method of daily stock exchange settlements, with its dominating and often unsettling effect on the call money market, influences adversely the development of a wide and healthy discount market in the United States:

"Resolved, That the Chairman of the Executive Committee be authorized to appoint a committee consisting of members of the Executive Committee and other individuals to study the advisability, ways and means of modifying the present system of settlements on the New York Stock Exchange and substituting therefor some system of periodical settlement, with power to take such steps as may seem advisable in the case."

A copy of the annual report of the American Acceptance Council is appended hereto as Exhibit No. 4, in which the resolution appears on page 5, and the report of the Chairman of the Executive Committee appears on pages 16 to 27, inclusive.

The Committee thus provided for was appointed and held two extended conferences in which the problem was fully discussed, both from the point of view of the banks and of the Stock Exchange.

For illustration of the subject matter of the discussion there is attached hereto as Exhibit No. 5, a detailed report compiled by one of the members of the Committee, Mr. Samuel F. Streit, Chairman of the Committee on Clearing House of the Stock Exchange describing the term settlement operations in London and on the European continent, which presently will be published by the American Acceptance Council. Through its courtesy an advance copy of the report has been received. There are also attached, as Exhibits Nos. 6 and 7, respectively, two other publications of the American Acceptance Council, "Acceptance Corporation", by F. Abbott Goodhue, Vice President of the First National Bank of Boston, Mass., and "The Acceptance as the Basis of the American Discount Market", by John E. Rovensky, Vice President of the National Bank of Commerce, New York, in which on pages 14 and 22 respectively, the necessity for term settlements as a means of relieving the call money market from the necessities of the securities market and as a precedent to a broad and stable discount market is discussed.

The members of the committee have unanimously expressed the opinion that the adoption of a term settlement by the Stock Exchange would offer advantages in that it would eliminate duplication of the handling of securities and in payments. The committee holds,

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however, that, inasmuch as the adoption of a term settlement by the Exchange would involve changes of great importance, both to banks and to members of the Exchange, it will require the most careful study of the subject by the committee, and in any case the term settlement can not be put into operation until the new system of daily Stock Exchange settlements through the Stock Clearing Corporation, above referred to, has been perfected and has been in practical operation for a reasonable time.

April 10, 1920.

My dear Senator:

I received your letter of April 6, 1920, in which you request a statement of the Treasury's views as to S. 4119, introduced by you "to authorize an issue of bonds in exchange for bonds of the first, second, third, and fourth Liberty loan issues." I have carefully examined the bill and note that what you propose is, in substance, the refunding of the Liberty Loans into one consolidated loan, maturing in 50 years, bearing interest at $3\frac{1}{2}$ per cent and carrying substantially complete exemption from taxation.

It is my considered judgment that the Bill which you propose offers no satisfactory solution of the problem of the present depreciation in the market prices of Liberty bonds, and that it should not be enacted into law.

I should like to call your attention in the first place to the fact that while the Bill would authorize an issue of bonds to the amount of \$30,000,000,000, the total face amount of the bonds of the First, Second, Third and Fourth Liberty Loans outstanding on March 31, 1920 (on the basis of daily Treasury statements), was only \$15,616,872,038. Inasmuch as the Bill provides that the bonds which it authorizes shall be issued solely for the purpose of retiring bonds of the First, Second, Third and Fourth Liberty Loans, it is obvious that the authority which

it proposes to confer is almost twice as large as would be appropriate for the purpose.

As to the merits of the Bill, I feel that from the point of view of the Treasury it is neither necessary nor desirable to attempt to consolidate the outstanding bonds of the Liberty Loans into one loan. In this connection I am enclosing for your information a copy of Form L & C 400, recently issued by the Department, which summarizes in convenient form the terms of the several issues of Liberty bonds, including their exemption from taxation. As you will see upon examining this summary, the maturities, redemption dates, and interest payment dates for the several issues were determined by the Treasury with great care, in order to spread maturities over a considerable period of years and provide sufficient redemption privileges in the intervals between maturities to permit the convenient handling of the retirement or refunding of the several issues. The interest payment dates, moreover, were carefully fixed with a view to spreading the heavy interest payments over the several months of the year. In my opinion, therefore, no consolidation of the Liberty issues is necessary from the point of view of fiscal convenience; in fact I believe it would be a serious mistake to attempt to consolidate the maturities of either principal or interest into one loan.

The Treasury is also definitely opposed to the issue of further obligations of the United States bearing full exemptions from taxation, for what it regards as fundamental reasons of social and economic policy.

Its position in this respect was fully set forth in Secretary McAdoo's testimony before the Committee on Ways and Means of the House of Representatives on August 28-29, 1917, in connection with the Second Liberty Bond Act. I am enclosing, for your information, a copy of an extract from this testimony. The chief objection to the total exemption from taxation is that its value depends largely upon the wealth of the individual investor and is greatest in the case of the wealthiest investor. Such an exemption from taxation, moreover, would materially cut down the revenues of the Government of the United States at a time when it cannot afford to dispense with any of the receipts which would otherwise accrue on account of taxes.

I think that as a practical matter, moreover, the enactment of the Bill proposed by you would be without important effect upon the market prices of $4\frac{1}{2}$ per cent Liberty bonds. Fully exempt $3\frac{1}{2}$ per cent bonds of the First Liberty Loan are selling in the neighborhood of 97. Fully exempt $3\frac{3}{4}$ per cent Victory notes are selling in the neighborhood of the same price, and every $4\frac{3}{4}$ per cent Victory note carries with it the continuing right to convert it into a fully exempt $3\frac{3}{4}$ per cent Victory note; yet on December 31, 1919, of a total issue of about \$4,500,000,000 only \$940,000,000 consisted of $3\frac{3}{4}$ per cent Victory notes. I should not expect to see any very large proportion of the $4\frac{1}{2}$ per cent bonds converted into $3\frac{1}{2}$ per cent exempt bonds. I should expect that the passage of your Bill and the carrying out of the plan would reduce the market value of the present $3\frac{1}{2}$ per cent bonds to about the level now

established for the $4\frac{1}{4}$ per cent bonds rather than bring up the market price of the $4\frac{1}{4}$ per cent bonds to the level of that of the $3\frac{1}{2}$ per cent bonds. There are only about a billion and a half dollars of tax exempt First $3\frac{1}{2}$'s and there are some fourteen billion dollars of taxable $4\frac{1}{4}$'s. If all the holders of $4\frac{1}{4}$ per cent bonds had an option to convert them into $3\frac{1}{2}$ per cent bonds fully exempt, that option would probably have the effect of depreciating the price of $3\frac{1}{2}$'s rather than appreciating the price of $4\frac{1}{4}$'s. The number of persons with wealth sufficient to make the value of the total exemption from surtaxes compensate them for the surrender of an amount equal to $\frac{3}{4}$ of one per cent per annum is limited. The present market price of the $3\frac{1}{2}$ per cent bonds is in no small measure due to their relative scarcity. This scarcity value would, of course, disappear the moment an option to convert was given to the holders of ten times their amount of $4\frac{1}{4}$ per cent bonds.

The proviso in Section 1 of the Bill, which would subject the proposed bonds to the normal income tax in the event that the normal tax should be reduced to the rate in force on January 1, 1914, would effect a complete reversal of the Government's established policy. All the Liberty bonds and Victory notes are now exempt from the normal Federal income tax, and the Treasury believes that this exemption from normal tax should not be withdrawn, since it is fair to all holders, with no undue advantages to large holders, and is an important factor in maintaining the

market prices of all the issues.

I do not believe, therefore, that your Bill offers any real solution of the problem of the market prices of Liberty bonds. As the Treasury views it, the present depreciation of Liberty bonds on the market is due chiefly to the fact that of the 20,000,000 Americans who patriotically subscribed during the period of the war, large numbers have not been willing or able to exercise such control over their personal expenditure as would enable them to retain their bonds after the cessation of hostilities. Liberty bonds, like other bonds, are subject to market influences, including the law of supply and demand, and their market quotations have declined in consequence of the failure of the great investing public to save in proportion to the enormous expenditure of capital during and since the war. Many patriotic people bought Liberty bonds under the impulse of patriotism who have been unwilling, since the war was over, to continue to lend their money to the Government, and have forced their holdings on the market more rapidly than others could save funds to invest, with consequent depreciation in market prices. The remedy for this condition is for the people to work and save, to keep their holdings of Liberty bonds as investments, and to purchase additional Government securities with their savings.

The present market prices of Liberty bonds are causing no loss to real investors who are holding their bonds as permanent investments; they are not suffering because others see fit to sell their bonds now for less than they are worth, and neither these investors nor those who wish to sell their bonds have any ground for expecting a donation from the United States in the form of additional tax exemptions or other

privileges. The United States is under no obligation to guarantee the holders of Liberty bonds against variations in money market conditions or to guarantee a market at par for the bonds. To make valuable gifts to the people who subscribed for their bonds on definite terms for a definite period of time would, in my opinion, be subversive of all decent principles of Government. The Treasury is as much opposed to a bonus to bondholders as to a bonus to other special classes in the community.

As you doubtless know, the Government is already doing everything in its power to protect the market for Liberty bonds and the interests of Liberty bond holders by means of purchases for the five per cent Bond Purchase Fund provided by existing law. These purchases, which have greatly tended to sustain and strengthen the market for the bonds, have been made under the authority of Section 15 of the Second Liberty Bond Act, as amended by Section 6 of the Third Liberty Bond Act, which authorized the Secretary of the Treasury to purchase annually, until the expiration of one year after the termination of the war, up to five per cent of the bonds of each series outstanding, at not exceeding par and accrued interest. To November 30th last, as shown by Secretary Glass's report to Congress, a copy of which is enclosed, \$1,043,080,500 principal amount of Liberty bonds had been purchased, the principal amount paid therefor being \$993,363,526.15. The authority thus conferred by Congress has been exercised by the Treasury for the sole purpose of stabilizing the market, and in my judgment very important results have

been achieved redounding to the benefit of all holders of Liberty bonds. The Treasury has not profited by the action of those Liberty bond holders who have forced their bonds on the market, nor by its purchases of those bonds. It has been obliged to borrow at higher rates of interest the money to make the purchases which have been forced on it for the protection of the holders of Liberty bonds and of the Government's credit.

In this connection, and with particular reference to the provisions of Section 2 of S. 4119, I feel that I should call your attention to the provisions of Section 6 of the Victory Liberty Loan Act, approved March 3, 1919, creating a $2\frac{1}{2}$ per cent cumulative sinking fund which goes into operation on July 1, 1920, and is calculated to retire the Liberty bonds and Victory notes outstanding on that date within approximately twenty-five years (except for an amount equivalent to the obligations of foreign governments held by the United States on said date). This cumulative sinking fund was established pursuant to the recommendation of Secretary Glass in his letter of February 10, 1919, to the Committee on Ways and Means, and received the careful consideration of the Congress in connection with the Victory Liberty Loan Act. In view of the provision for the sinking fund which has already been made, therefore, no necessity exists for the sinking fund proposed in S. 4119 except, of course, in so far as it might be designed to retire the new bonds proposed to be issued under the Bill. As to the Liberty bonds and Victory notes outstanding, the ground has already been covered.

Very truly yours,

Hon. Joseph S. Frelinghuysen,
United States Senate,
Washington, D. C.

(Sgd). D. F. HOUSTON
Secretary

3 enclosures.

April 22, 1920.

Dear Sir:

I received your letter of April 17, 1920, as to the market prices of Liberty bonds. The Treasury is not contemplating the issue at this time of any new United States bonds, and you were misinformed if you heard that the United States was about to issue new bonds bearing interest at a higher rate than the Liberty bonds. There is at the present time no outstanding privilege of converting First Liberty Loan $3\frac{1}{2}$ per cent bonds into bonds bearing a higher rate of interest, although First 4's and Second 4's are still convertible into $4\frac{1}{2}$ per cent bonds pursuant to the extended conversion privilege described in Treasury Department Circular No. 137, dated March 7, 1919, as amended and supplemented June 10 and November 1, 1919, copies of which are enclosed.

Your suggestion that Liberty bonds be made legal tender is, in the opinion of the Treasury, entirely untenable. The currency needs of the country are being amply provided for by the operation of the Federal Reserve System, and to give Liberty bonds the legal tender quality would make them so much spending money, produce unprecedented inflation of the currency, and fundamentally upset prices.

The Treasury is also definitely opposed to the proposal that the Liberty bonds be exchanges for bonds bearing a higher rate of interest, and believes that it offers no solution of the problem of the depreciation in the market prices of Liberty bonds.

As the Treasury views it, the Liberty bond problem is chiefly one of quantity. Unfortunately, many holders of Liberty bonds who patriotically subscribed for them and held them during the war, have since regarded them as so much spending money and thrown them on the market more rapidly than others could save funds to invest, with consequent depreciation in market prices. People generally have been spending money freely and saving relatively little, so that there has not been sufficient capital saved to overcome the pressure upon the market from those who bought bonds as patriots but not as investors. In these circumstances, to add a fraction to the rate of interest borne by the bonds would have no important or lasting effect upon their market prices, while it would have an injurious effect upon the Government's credit and burden the Government and the taxpayers with higher interest charges over a long period of years. The Government could not, of course, manufacture savings or create buyers for its securities simply by increasing the interest rate on the outstanding bonds. The only effect of such a course would be to depreciate all other securities automatically and establish a high interest level for many years which would be burdensome to the development of the country.

The present market prices of Liberty bonds are causing no loss to real investors who are holding their bonds as permanent investments; they are not suffering because others see fit to sell their bonds now for less than they are worth, and neither these investors nor those who wish to sell their bonds have any ground for expecting a donation from

the United States in the form of additional interest on the bonds. The United States is under no obligation to guarantee the holders of Liberty bonds against variations in money market conditions or to guarantee a market at par for the bonds. To make a gift of a higher rate of interest to the people who subscribed for their bonds on definite terms for a definite period of time would, in my opinion, be subversive of all decent principles of Government. To limit such a gift to original subscribers would be impracticable; to extend it to market purchasers would be utterly indefensible. The Treasury would vigorously oppose any donation of this character.

Very truly yours,

(Signed) D. F. HOUSTON

Secretary.

3 enclosures.

May 7, 1920.

Dear Potter:

I received your letter of May 6th. As you know, the Treasury has to all practical intents and purposes discontinued market purchases for the Bond Purchase Fund. I send you herewith a copy of Secretary Houston's statement upon this subject. As to the past practice of the Treasury in this respect, I enclose herewith a copy of a letter which pretty well stated my views.

As you know, the Bond Purchase Fund was not a fund for the retirement of the public debt but a fund for the stabilization of its market price and its only real purpose was to take up the selling which resulted from the fact that some of the bonds had been badly distributed, that is to say, were in the hands of people who could not or would not keep them in any event.

The operations of the Sinking Fund begin July 1, 1920. The amount of this fund is, to start with, $2\frac{1}{2}\%$ of the bonds and notes outstanding on July 1, 1920, less the amount of foreign obligations held by the Treasury. If the bonds and notes outstanding on July 1 amount to \$20,000,000,000 and the foreign obligations held by the Government amount to, say, \$10,000,000,000, then the Sinking Fund will amount to \$250,000,000 or $1\frac{1}{4}\%$ of the total amount of bonds and notes outstanding.

In view of the heavy expenditures which Congress is making and the delay in salvaging war assets which Congress is enforcing, it seems to me that the Sinking Fund must be used to retire Victory Notes, which mature in three years. I believe this will benefit the market for all of the Government's securities most by applying the available funds to the retirement of the earliest maturities. This is the more obvious when Victory Notes are selling at much the highest interest basis. I believe nothing will do so much good to the market for all of the bonds as the retirement of the short-dated debt. As a practical matter, therefore, the Treasury's plan is to apply the Sinking Fund of \$250,000,000 to the purchase and retirement of Victory Notes. The discount on the Victory Notes is very small on the present basis and the application of the Sinking Fund to them ought to greatly reduce that discount. In view of this, it seems to me that the advantage of drawing the Notes for redemption at par would not be sufficiently great to counterbalance the enormous mechanical labor, expense and annoyance of the operation.

Furthermore, I question whether, if the Sinking Fund were to be applied to redemption at par, the Treasury would be justified in applying it exclusively to Victory Notes. I do not have any difficulty with the notion of applying it exclusively to any one issue when purchases are made at the market, and the effect of them will presumably be to benefit all alike, but if a special privilege of turning them in above the market were to be given I should feel that we would have to allow all securities alike to participate in it. This would dissipate the Sinking Fund and deprive it of its useful effect in re-

deeming the debt which matures so soon.

For these reasons I am clearly of the opinion that it would be a mistake to adopt the suggestion of redeeming bonds and notes at par at the present time.

You may be interested in the enclosed copy of my Academy speech in which I made some further suggestions for improving the market position. My notion is that the one way to put Liberty Bonds up is to retire the floating debt and reduce the amount of the Victory Loan materially before maturity, thus relieving the holders of long-time bonds of the apprehension of further financing to refund the short-dated debt upon terms which would impair the value of the bonds.

Very truly yours,

(Signed) R. C. Leffingwell.

Clarkson Potter, Esq.,
Chairman, Government Bond Committee,
Investment Bankers Association,
Greenbrier Hotel,
White Sulphur Springs, W. Va.

MAY 22, 1920. FOR IMMEDIATE RELEASE.

May 10, 1920.

My dear

I received your letter of May 7th.

I think it would be a mistake to accept Liberty Bonds in payment of any part of the Federal taxes for 1921 except estate taxes. The Government's necessities are so urgent that the whole amount of its revenues must be applied to meet its current disbursements including, if possible, the reduction of its floating debt. To accept payment of even ten per cent of the taxes in Liberty Bonds would add to the Government's financial burdens and the difference would have to be made up by additions to floating debt, an operation which could not in the end benefit the outstanding bonds. After all, the thing which will most benefit the market for Liberty Bonds is the retirement of the floating debt. The suggestion which has been made to you would reverse this process and in effect convert funded debt into floating debt.

I may add that Liberty Bonds are widely distributed among persons of small means, who are not themselves heavy taxpayers, and are not so largely held by corporations and persons of great wealth. A provision at this time permitting them to be accepted in payment of taxes would under these circumstances result in making it possible for corporations and wealthy persons to reduce the amount of their taxes by

buying Liberty Bonds in the market at a discount and turning them in to the Government at a profit. It would not correspondingly benefit the great majority of holders of Liberty Bonds.

The effort in the Liberty Loan campaigns and since has been to reach the savings of the people and place the Government's war debt in the hands of millions who would become to that extent capitalists and permanent investors. If we are to reach promptly a sound economic position, the peoples' taxes and other current outgo should be met out of their current income. To accept the Government's funded war debt in payment of current taxes would be a step towards further undoing the work of the Liberty Loan Organization in seeking out funds for permanent investment from savings. This objection does not lie against the acceptance of Liberty Bonds in payment of estate taxes which, economically speaking, are capital taxes; but to accept Liberty Bonds which are or should be a capital investment in payment of an income tax would be a mistake. The present depreciation of Liberty Bonds is largely due to the reaction which our people underwent after armistice day and the tendency to treat them as spending money for current purposes. This is a tendency which the Government should discourage, not encourage.

It is a matter of the utmost importance for our future welfare that the Government should exercise the most rigid economy and retire the war debt with the utmost rapidity. The proper course, however, to be pursued in that respect is to retire first

the debt of shortest maturity. This in the long run will benefit most the holders of the Liberty Bonds of longer maturity because they will be relieved of apprehension of further financing to meet the floating debt and earlier maturing funded debt. I hope very much that as a result of rigid economy in Government expenditure, the maintenance of adequate revenue from taxation and the prompt salvaging of disposable war assets it will be possible within the next two years to retire the bulk of the floating debt (Treasury Certificates) and to apply taxes due during the year before their maturity to the payment of the Victory Notes which mature in May, 1923. The adoption of such a course will do more to bring Liberty Bonds to par or better than anything else that can be done. In the long run their holders would only be injured by the reverse process of retiring the bonds of longer maturity before the floating debt and the short-dated Victory Notes have been gotten out of the way.

For these reasons I believe that the suggestion which has been made to you would be undesirable in every way.

Sincerely yours,

(Signed) R. C. LEFFINGWELL

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May 14, 1920.

PERSONAL.

Dear Governor Merss:

I received your letter of April 21st. I have been delayed in answering it partly by a brief illness and partly by the great pressure of business.

I want again to express to you, and through you to the banks of your district, my warm appreciation of the subscriptions made in the Boston district for certificates of the last issue.

In your letter you describe the difficulties encountered in selling the certificates, refer to the high rates of interest borne by other investment securities and ask whether in the future you ought to urge certificates upon your commercial banks.

I am very glad that you have written to me so fully and frankly concerning this subject because it seems to me one of vital importance.

The rates and terms of the issues of Treasury certificates dated April 15th were determined by the Secretary after conference with the Governors of the Federal Reserve Banks, at the time assembled in Washington, and were those suggested by the Governors by a vote of nine to three. But only four Federal Reserve Districts equaled or exceeded their quota and two of these four

(Boston and Atlanta) were districts whose Governors had voted with the minority for rates of interest higher by one-quarter of one per cent per annum.

You, of course, recall that the amount of the Victory Loan issue was limited to \$4,500,000,000 after conference with the Governors of the Federal Reserve Banks and with their hearty approval and full knowledge that this involved the necessity of revolving Treasury certificates to a possible amount much in excess of that now outstanding.

The amount of loan and tax certificates outstanding which on April 30, 1919, was nearly \$6,000,000,000 and on August, 31, 1919, was nearly \$4,000,000,000, had on April 30, 1920, been reduced to less than \$2,750,000,000. Of the certificates outstanding on April 30th only \$478,870,000, or considerably less than twenty per cent, were pledged with the Federal Reserve Banks, notwithstanding the preferential rate maintained by those banks for loans and discounts so secured.

The Federal Reserve Bank's combined loans and discounts secured by Government war obligations were reduced from \$1,863,000,000 on May 16, 1919, (when they were at their highest) to \$1,465,000,000 on April 30, 1920, or about \$400,000,000, but in the same period their other loans and investments increased from \$359,000,000 to \$1,477,000,000, or more than four hundred per cent.

From May 2, 1919, when all reporting member banks' investments in and loans upon United States war securities were at their highest, to April 23, 1920, these investments and loans decreased from \$4,083,193,000 to \$2,225,272,000. During the same period their other loans and investments increased from \$10,326,851,000 to \$14,286,225,000. Roughly speaking, for every dollar of credit released by the Government and borrowers on Government securities two dollars were extracted by other borrowers. Reporting member banks' loans on miscellaneous stocks and bonds included in their "other loans and investments" amount to over \$3,000,000,000, or nearly one and a half times their investments in and loans upon United States war securities.

From May 2, 1919, to April 23, 1920, the Boston Federal Reserve Bank's loans and discounts secured by Government war obligations decreased from \$158,981,000 to \$84,866,000, but its other loans and investments increased from \$17,756,000 to \$103,320,000. In the same period your reporting member banks' holdings of and loans upon United States war securities decreased from \$234,708,000 to \$93,613,000, but their other loans and investments increased from \$792,192,000 to \$948,857,000.

United States war securities have been forced out of the Federal Reserve Banks and member banks, not to get liquidation, but to make room for ever-increasing expansion of commercial loans.

Evidently about 85 per cent of member banks' borrowings from the Federal Reserve Banks today are for commercial and speculative purposes, one-half of their borrowings being collaterally secured by the pledge of Government securities simply because the reserve banks maintain differential rates in favor of loans so secured. I think that for their own protection, the Federal Reserve Banks have done wisely to differentiate between the various kinds of security offered to them. There is a great deal of nonsense talked about the liquidity of commercial paper. I don't know anything much less liquid than some commercial paper. I should rather have United States Government short-term certificates of indebtedness as security for a loan than silk piled up on Fourth Avenue, or bacon rotting on Thames wharves.

Because of the failure to control expansion in any other way, I became in January, and am still, a strong advocate of increased rates as a necessary evil growing out of the failure to control credit in other ways. But the credit situation is not one which will yield to high rates of interest and discount alone. Rates cannot function internationally because of the gold embargoes maintained in Europe and our already excessive export balance to Europe. They cannot function effectively on the domestic situation until the Reserve Banks' rates exceed the open market rates. They cannot be put above the open market rates except in one big jump - big enough to create a panic. Otherwise each increase in Reserve Bank

rates will serve to push the open market rates further up and above the new Reserve Bank rates.

Increases in rates of interest and discount under these circumstances may, if they are the sole reliance, far from improving the general situation, actually make it worse. Money is now so dear that there is a marked tendency to defer capital issues seeking investment money and to finance current necessities by bank loans. The cost of money is so high as to be almost prohibitive to railroads, public utilities and other businesses operating on a low margin of profit and at the same time the high cost offers little or no obstacle to borrowings by those engaged in speculative and non-essential enterprises and anticipating a very great profit.

The expansion of commercial credits has proceeded more rapidly since the Reserve Bank rates were increased in January than at any other period, and notwithstanding that, for the most part, this was a period when normally liquidation might have been expected.

It is at present impossible for the Government to borrow below the rate maintained by the Federal Reserve Banks for loans and discounts on the security of such certificates and will continue to be impossible to do so as long as the open market rate for commercial paper is above the Reserve Banks' rate on commercial paper. I believe that the Treasury should accept the consequences of any

necessary steps taken with a view to controlling commercial credits. Liquidation of war paper is, however, progressing satisfactorily, and the holders of it should not be punished, or nagged, separately.

The commercial banks, naturally enough, do not want to buy Treasury certificates for their own account on any terms when they are being pressed by the Reserve Banks, unsuccessfully, to reduce their borrowings and by their customers, successfully, to increase their loans. They do not even want to sell Treasury certificates to customers because that involves loss of deposits. The whole plan for the sale of Treasury certificates is predicated upon original purchase by the banks and resale by them to their customers, the banks acting in a way as underwriters and finding some compensation in the war loan deposit. A bank which does not buy Treasury certificates in the first instance will not try to sell them to its customers and may even discourage their purchase.

The notion which some of the banks seem to hold that their first duty is to their commercial customers is, in my opinion, a mistaken one. The above figures show that the banks, as a whole, have very much overdone their duty to their commercial customers. Furthermore commercial business cannot prosper if the Government's necessities are not met. I have been as vigorous in advocacy of economy in Government expenditure as anyone. If those who believe

in economy would direct their attention to Congress, they would do well. But the newspaper talk about rationing the Treasury is foolish - as though the Government of the United States could stop payment after the appropriations have been made and the expenditures incurred:

The Treasury proposes to be financed without direct borrowing from the Federal Reserve banks except as heretofore for a few days at a time on tax installment dates and to meet emergencies. But if exorbitant terms are extorted from it and terms which are injurious to its credit, to holders of the Government's outstanding securities, and to its future financing, the only course for the Treasury to adopt will be to demand an immediate increase in taxes with a view to eliminating the floating debt and making a big reduction in the amount of the Victory Loan. It may be that this is the proper course to pursue. Certainly it will become a necessary course if the Federal Reserve Banks cannot control commercial credits and regain the cooperation of the member banks in aid of the Government's necessary temporary borrowings.

In my opinion it is the imperative duty of the Federal Reserve Banks, as banks of reserve and issue, to put an end to the persistent inflation of commercial credits, and, as fiscal agents of the United States, to call upon the banks of their respective districts to take their proportionate part of each issue of Treasury certificates offered from time to time to meet the Government's

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necessities and to use their best efforts to redistribute them among their customers.

Very truly yours,

(Signed) R. C. LEFFINGWELL.

Chas. A. Morss, Esq.,
Governor, Federal Reserve Bank,
Boston, Mass.

EXHIBIT A

TREASURY DEPARTMENT

For release morning papers

Monday, May 17, 1920.

STATEMENT BY THE DIRECTOR OF THE MINT.

The provisions of the Pittman Act are mandatory and, in accordance with them, the Secretary of the Treasury has given standing orders to the Director of the Mint to buy silver at \$1 per ounce, 1000 fine, delivered at the option of the Director of the Mint at the Assay Office in New York or the mints in Philadelphia, Denver and San Francisco, up to the aggregate amount of 207,000,000 ounces. Under the terms of the Act the silver so purchased must be the product both of mines situated in the United States and of reduction works so located, and clear and unequivocal proof to that effect will be required. Forms for such proof may be obtained at said assay office and mints.

May 18, 1920.

Dear Mr. Fordney:

I received your letter of May 1st, with the enclosed copies of Bills H. R. 13798, introduced by Mr. Johnson, and H. R. 13799 introduced by Mr. Rainey, to provide for the payment of adjusted compensation to the veterans of the World War. Both bills impose an 80 per cent war profits tax.

The most serious aspect of this compensation matter, as I pointed out when I had the honor of appearing before the Committee, is the proposal greatly to add, especially at this time, to the present grievous burdens resting upon the people of the nation and upon the Treasury. The method of financing the proposal raises grave problems but is secondary. The very heavy burdens which will rest upon the Treasury by reason of laws already enacted, including particularly the recent railroad laws, which it is estimated will entail an expenditure of approximately \$1,000,000,000, and also by reason of the delay in making provision to realize upon the Government's investments in railroads and ships, taken in connection with the existing credit situation, suggest the need of grave consideration of the question whether, quite aside from and in addition to any taxation which it might be necessary to impose in order to pay a bonus to the soldiers, it may not be necessary to provide for meeting the necessities

of the Government in larger measure from taxation. The total indebtedness of the Government maturing within three years, represented by Treasury Certificates, War Savings Certificates and Victory Notes, is in the neighborhood of eight billions of dollars. It is no longer possible to finance the current needs of the Government in part by the issue of Treasury Certificates except on onerous terms which reflect upon the value of the Government's long-time bonds and depreciate them in the market. Furthermore, it would appear to be bad economy and bad finance for the Government to borrow money on short-term certificates of indebtedness (maturing within three to six months) to be invested for a term of years in railroads and ships.

It is a matter of serious concern to have the Government appearing in the market every few weeks for loans. Certainly nothing ought to be done to add to existing credit expansion that can possibly be avoided. The result would be to increase prices and to make a difficult situation less satisfactory. In the circumstances obviously the Government ought to appear in the market for loans as infrequently as possible and for the lowest sums. Additional taxes are also undesirable but they may be less undesirable than borrowing. They would at least have the effect in part of enforcing economies. The first thing to do, I am sure you will agree, is to keep Federal expenditures down to the minimum and it is obvious also that other governmental jurisdictions and private individuals should do likewise.

I beg to submit to your Committee for its serious consideration the question whether, all things considered, it would not now be advisable

to seek out additional sources of revenue to meet the current requirements of the Government, over and above any additional revenue which would be necessary if the soldier bonus plan is determined upon, in order to obviate the necessity of continuing in considerable measure to meet them by borrowing. Having these things in mind, I hesitate to express an opinion concerning the bills which you have submitted to me, taken by themselves. There are many grave objections, both to the proposed new war profits tax and to the alternative measure, a sales tax, which I understand your Committee is considering. If, in view of the urgent needs of the Government for money to meet its requirements, your Committee concludes that it will be wise to raise a larger amount by taxation and desires any suggestions from the Treasury, I shall be glad to have the experts place themselves at its disposal. In the meantime I refrain from making any further comment on either proposal.

For the reasons indicated, and for other reasons, I think it would be highly unfortunate for any new obligations to be placed upon the Treasury through the enactment of the bonus proposal in any form, however financed.

Very truly yours,

(Signed) D. F. Houston

Hon. Joseph W. Fordney,
Chairman, Committee on Ways and Means,
House of Representatives.

YOUR LIBERTY BOND

If you sell your Liberty Bond now, you are cheating yourself. You paid fifty dollars for your bond, and now you can only get in the neighborhood of from \$43 to \$48 for it. The Government promised to pay you one hundred cents for every dollar you put into your bond, but it did not promise to pay it to you this year. Read your bond, and you will see the year it comes due. Uncle Sam will pay you back in full on that date and in the meantime will pay you every cent of interest he promised. Nobody who has lent our government money has ever lost it, and you will not.

Liberty Bonds are selling at low rates now because many people are not keeping them until the time the Government asked them to but are getting rid of them. When many people want to sell a thing and few want to buy, the price goes down. Foolish men are selling, and wise ones are buying. Be one of the wise ones. Hold on to the bond you have and buy some more. If you buy a Fifty Dollar Liberty Bond for \$43 now, you will get the interest on fifty dollars and when the bond matures, the Government will pay you \$50 for it. Pretty good business, isn't it? Every Liberty Bond you buy will help raise the price of all Liberty Bonds, because when a great many people want to buy a thing and only a few want to sell, the price goes up.

Help yourself, your friends and your government. Hold on to your Liberty Bond and buy more. Be a wise one.

May 20, 1920.

STATEMENT BY SECRETARY HOUSTON.

Liberty Bonds and Victory Notes are selling below par partly because many of the people who bought them in a spirit of patriotism found themselves after the war was over unable or unwilling to continue to save and treated them as spending money. They are selling below par partly because the war and post-armistice conditions have resulted in a world-wide shortage of capital and credit which has greatly increased the price of money. The expansion of credits and increase in prices and the correlative decrease in the buying power of money necessarily carry with them a decrease in the market value of the promise to pay a fixed sum of money at a future date with interest at a fixed rate. This has nothing at all to do with the question whether the money will be paid at that future date or not. No one doubts that it will be. The obligation of the Government of the United States carries with it no risk whatever. It is certain of payment. The market price of that obligation is practically an indication of the pure interest rate at any given time, that is to say, of the present value of the promise to pay a given sum at a future date with interest in the meanwhile. It is simply an economic law that the decrease in the buying power of money or, to put it the other way around, the increase in the prices of commodities carries with it necessarily a depreciation in the present value of the promise to repay money at a future date.

During the past year or more Liberty Bonds and Victory Notes have been gradually shifting from the hands of those who borrowed to buy

them and were unable or unwilling to save and pay for them into the hands of permanent investors whose holdings are taken out of the banks and put away in safe deposit vaults. One evidence of this is the tremendous decrease in banks' holdings of and loans upon Government war securities during the past year. Another indication of the steady absorption which is proceeding is the fact that the principal of amount of Liberty Bonds and Victory Notes which are held in registered form instead of coupon form has increased 55% or 60% since original issue and is steadily increasing.

From all parts of the country I hear reports from banks that their customers' purchases of Liberty Bonds and Victory Notes have during the past few months for the first time exceeded their sales. This indicates that real investors all over the country are absorbing the securities which are being sold, in consequence of strigent credit conditions, by corporations and others who purchased out of patriotism or as a secondary reserve against future requirements.

The necessity of those business companies and business men who are being forced to sell their securities at bargain prices in the present credit stringency is the opportunity of investors.

Just as expansion is accompanied by a decrease in the buying power of money and consequently of the value of an obligation to repay money at a future date, so deflation will be accompanied by an increase in the buying power of money and consequently of the promise to pay money at a future date. Dear money results in part from the effort to prevent fur-

ther expansion. Naturally enough, its first effect is to force the best securities in the world on the market because they are the easiest to realize upon. As the inevitable deflation takes place and the price of money approaches normal again the market price of Liberty and Victory securities will, of course, appreciate in accordance with inexorable economic laws.

In the long run, therefor, the raising of discount rates in the effort to prevent further inflation will help Liberty Bond and Victory Note values, although the first effect of those steps has been to some extent to force them on the market out of weak hands. Deflation means increased buying power of money and of the present value of the promise to pay money at a future date.

There can be no doubt that Liberty Bonds and Victory Notes are, as they always were, the safest investment in the world and that the present abnormal credit position affords a unique opportunity to those who have or can save money for investment in these securities.

May 24, 1920.

My dear Senator:

Your letter of the 14th instant was duly received, but unusual pressure of routine business has prevented an earlier reply.

I notice that you renew the suggestion made in your letter of April 27th that the Federal Reserve Board lower the discount rates of Federal Reserve Banks as a means of helping to restore Liberty Bonds to par, and that you take the view that as the Federal Reserve Banks pay no interest on deposits and that as they made very large earnings last year on a four per cent rate; that "3 per cent is a rate high enough to enable them to make all the money they are entitled to make out of the public", and you say that "the Federal Reserve Banks should not be put in the attitude of profiteering or of setting the example of profiteering to member banks".

Your suggestion that the discount rates of the Federal Reserve Banks be fixed with reference to their dividend requirements is certainly a novel one, but before entering into a discussion of the propriety of fixing rates from this point of view I wish to say something regarding your intimation that the Federal Reserve Banks are putting themselves in the attitude of profiteering.

Section 7 of the Federal Reserve Act provides that "after all

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necessary expenses of a Federal reserve bank have been paid or provided for, the stockholders shall be entitled to receive an annual dividend of six per centum on the paid-in capital stock, which dividend shall be cumulative". As originally enacted this section provided further that after dividend claims had been fully met "all the net earnings shall be paid to the United States as a franchise tax, except that one-half of such net earnings shall be paid into a surplus fund until it shall amount to forty per centum of the paid-in capital stock of such bank". The Act of March 3, 1919, which passed the Senate only as a result of your watchful care throughout an all-night session near the end of the Sixty-fifth Congress, amended Section 7 by providing that "after the aforesaid dividend claims have been fully met, the net earnings shall be paid to the United States as a franchise tax except that the whole of such net earnings, including those for the year ending December thirty-first, nineteen hundred and eighteen, shall be paid into a surplus fund until it shall amount to one hundred per centum of the subscribed capital stock of such bank, and that thereafter ten per centum of such net earnings shall be paid into the surplus".

Section 7 also provides that in case a Federal Reserve Bank should be "dissolved or go into liquidation, any surplus remaining after the payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States". On May 21, 1920, the paid-in capital stock of all the twelve Federal Reserve Banks aggregated \$93,786,000. On this

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basis of capitalization for the year the member banks can receive dividends at the rate of 6%, amounting to \$5,627,160; the remainder of the net earnings, however great, will be paid in larger part directly to the Government as a franchise tax, the balance being carried to the surplus funds of the Federal Reserve Banks with ultimate reversion to the Government. On May 21, 1920, the consolidated statement of the twelve Federal Reserve Banks shows bills discounted secured by Government war obligations, \$1,446,723,000; all other rediscounts for member banks, \$1,053,663,000; bills bought in the open market, \$417,368,000; making a total of notes and bills rediscounted of \$2,917,754,000. At the same time the reserve deposits of member banks were \$1,833,665,000; total reserves held were \$2,079,538,000, and Federal Reserve notes in actual circulation amounted to \$3,085,202,000.

The ability of the Federal Reserve Banks to extend so large a volume of discount accommodations is due to the use of Federal Reserve notes, and this fact ought not to be overlooked. It follows therefore that the earnings of the Federal Reserve Banks are derived in larger part from the circulation of Federal Reserve notes, which are obligations of the Government. The Federal Reserve Board is authorized in Section 16 of the Federal Reserve Act to require the Federal Reserve Banks to pay such rate of interest as the Board may establish on the amount of Federal Reserve notes outstanding less the amount of gold or gold certificates held by the Federal Reserve Agents as collateral security. On May 21st, after setting aside the reserve of 35% against net deposit liabilities, the combined statement of the Federal Reserve Banks shows a reserve against Federal Reserve notes outstanding of

47.1%. Even though all excess gold were deposited with the Federal Reserve Agents there would be 52.9% of the outstanding note issue, or \$1,632,071,858, subject to an interest charge, the imposition of which would very materially reduce the apparent earnings of the Federal Reserve Banks. The Act gives the Board discretion in the matter, however, and no charge has been imposed for the reason that the excess earnings of the Federal Reserve Banks go to the Government in any event.

It seems to me, Senator, that you are disposed in all your discussions of the money and credit situation to ignore the fundamental law of supply and demand. Let me point out a few statements in your last letter which appear to be inconsistent. You state that you are "certainly opposed to inflation", but you are "strongly in favor of the extension of business, increasing production and improving distribution by extending credits on a stable low interest rate", and you say "The expansion of credit for such purposes is justified, but, of course, the expansion of credit beyond the available resources, even for the most important of purposes, is not justified". You say further that "credits ought to be extended at a low rate to the extent of the capacity of the Reserve Banks for productive purposes", and you intimate that as the Federal Reserve Banks pay no interest on deposits, a three per cent rate is high enough. While you do not say in direct terms that Federal Reserve Banks should stand ready to make loans on Liberty Bonds and Victory Notes at a three per cent rate your letter admits of this construction, although you do say that you do not advocate the Reserve Banks "lending beyond their resources at any rate, or on any securities". You say "Assuredly raising the rates of interest will deflate credits, even the

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credits of the United States, of which I complain, but I am anxious the Federal Reserve Board shall only deflate those credits that require deflation and not deflate credits of the Government and of legitimate productive business which ought not to be deflated". You say that "The only deflation of credit justified is the deflation of credits employed in speculative loans on investment securities, on real estate, and on commodities for hoarding by profiteers".

From all this I understand your view to be that the Federal Reserve Banks should lend at a low stable rate on Government securities and on other eligible paper, barring only "speculative loans on investment securities, on real estate, and on commodities for hoarding by profiteers" and that in your judgment this stable low rate ought to be three per cent.

You admit the correctness of the observation made in my letter of the 3rd instant that "there is a world-wide demand for capital, and the demand for bank credit in this country for agricultural, commercial and industrial purposes is heavier than has ^{ever} been known before; investment demands for new construction, for the maintenance and equipment of railroads, and for the financing of our foreign trade are very great". You ask "Are ^{these} just demands to be met by denying the credits, or are they to be repressed by raising the rates". I cannot escape the conclusion, Senator, that were the Federal Reserve Banks to establish the stable low rate proposed by you they would soon reach the limit of their available resources, beyond which point, you state, the expansion of credit, "even for the most important of purposes, is not justified". It seems to me that the adoption of the policy proposed by you would result in a wild scramble

for discount accommodations at the Federal Reserve Banks with an enforced denial of all credit after the first few days.

The Board is insisting that all banks use a discriminating judgment in making loans, giving preference to those which are necessary for the production and distribution of the basic necessities of life, such as clothing, food and fuel, but in the exercise of this discretion it is necessary to have the restraining influence of a rate. It is idle to preach against excessive borrowings and then to invite borrowings by an artificially low rate less than half the current open market rate.

You have had a good deal to say about the low rates which prevailed in bygone years, in England, France and Belgium, and I might call your attention also to the low rates which prevailed at the Federal Reserve Banks during the year 1915 when there was no demand for loans. But we are dealing with the pressing problems of the present; changing conditions must be recognized and dealt with as occasion demands. You no doubt know, although you have never called attention to the fact, that official discount rates are high everywhere, even in countries where inflation has been carried to extremes and which are no longer on a gold basis. The official rate in Italy is $5\frac{1}{2}\%$, that of the Bank of France is 6% , and that of the Bank of England is 7% , having recently been raised from 6% .

The Federal Reserve Board does not take the view that discount rates should be arbitrarily fixed by it; it recognizes the fact that there are certain basic conditions which affect the demand for and the supply of credit throughout this country and throughout the world, and that the formal

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establishment of a discount rate is merely an interpretation of these conditions. You call attention to the fact that the open market rate in London during the war was $3\frac{1}{2}\%$. It is now $6\frac{3}{4}$ to $6\frac{7}{8}$ per cent, against an official bank rate of 7% . You do not question the wisdom of the management of the bank of England, which you say is conducted by the wisest merchants in the world, although I have always had an idea that many of these merchants are credit merchants, or private bankers, as they would be called in this country. The advances in rates in London are evidently due to natural causes and there has been no attempt to maintain artificially the low rates to which you refer. Why then is it not just as reasonable to concede to the directors of the Federal Reserve Banks and to the Federal Reserve Board some degree of honesty of purpose and intelligence in making the advances in rates of which you complain so vigorously?

From your own figures, Senator, it is clearly impossible for the Federal Reserve Banks to carry at any rate which may be fixed the entire volume of the Government war obligations, and if a stable low rate of 3% were to be established no very great volume of additional loans could be made, and instead of there being a stabilization of the bond market there would be chaotic conditions.

The obligations of the Government of the United States offer the best opportunity for investment in the world today. They are being sold now on a most attractive investment basis, and as speculative tendencies are curbed, as the gains of the profiteers are reduced, as commodity prices decline, and as the business and industry of this country settle down to a more normal peace basis, the market value of these securities will rise very

rapidly. This conclusion is justified by the experience of the past. The six per cent 20-year bonds of the Government during the Civil War sold at a heavy discount (I think they were down at one time to about 80), but two years from the time of their greatest depression they reached par and were selling at a ^{premium} of about 25% in 1869, only twelve years before their maturity. I am satisfied that we will have a similar experience with Liberty Bonds, provided there are rigid economies in Governmental expenditures from this time forth and inflationary tendencies generally are held in check.

I do not know of anything further that I can say regarding the call money rates in New York. You continue to insist that the powers of the Government should be exercised through the offices of the Federal Reserve Board, the Federal Reserve Banks and the Comptroller of the Currency to remove the causes which lead to fluctuating rates there, and I have already pointed out to you that the interest rates in New York City are regulated by the laws of the State of New York and that there is nothing that can be done by the Federal Reserve Board, or by the Federal Reserve Bank of New York, except, perhaps, to decline to make loans on Government bonds to banks which in turn lend on Stock Exchange collateral. This would result in even higher rates.

It is interesting to note, however, that the high rates of which you complain reached their peak in November, 1919, before the discount rates of the Federal Reserve Banks had been advanced and that since the rates were advanced to their present level, on January 23rd last, call

money rates have ruled, with the exception of one or two temporary flurries, quite steadily around their present level of from six to seven per cent.

Very truly yours,

W.P.G. HARDING,

Governor.

Hon. Robert L. Owen,
United States Senate,
Washington, D.C.

May 25, 1920.

X-1936.

Sir:

On May 17th, 1920, the Senate adopted the following resolution.

"Resolved, That the Federal Reserve Board be directed to advise the Senate what steps it purposes to take or to recommend to the member banks of the Federal Reserve System to meet the existing inflation of currency and credits and consequent high prices, and what further steps it purposes to take or recommend to mobilize credits in order to move the 1920 crop".

In response the Board desires to say that it has recognized for many months past that the expansion of bank credits in this country was proceeding at a rate not warranted by the production and consumption of goods. It has repeatedly admonished the Federal Reserve Banks that influence should be exerted upon the member banks to induce them to avoid undue expansion of loans and to keep their volume of outstanding credits within moderate bounds.

Beginning six months ago the rates of discount on various classes of paper at the Federal Reserve Banks were advanced. During the latter part of January the present rates were put into effect. These advances, while undoubtedly checking credit transactions which otherwise would have been made, have not been entirely effective in bringing about the reduction in loans desired and which might normally have been expected during the early months of the year. Liquidation during these months

is entirely natural and healthy and is necessary in order that the banks may be prepared to meet the demands made upon them during the crop making and harvesting seasons, but there has been no such liquidation and on the contrary commercial loans have steadily increased. Thus it appears that the public has anticipated demands for banking credit which are usually made later on in the year. The average reserves of the Federal Reserve Banks are now a little over $42\frac{1}{2}$ per cent, as against 45 per cent at the beginning of the year and about 51 per cent twelve months ago.

The Federal Advisory Council, which is composed of one member from each Federal Reserve District, elected annually by the Board of Directors of the Federal Reserve Bank, is required by Section 12 of the Federal Reserve Act to meet in Washington at least four times each year. The Council is authorized "to confer directly with the Federal Reserve Board on general business conditions; to make oral or written representations concerning matters within the jurisdiction of said board; to call for information and to make recommendations in regard to discount rates, rediscount business, note issues, reserve conditions in the various Districts, the purchase and sale of gold or securities by reserve banks, open-market operations by said banks, and the general affairs of the reserve banking system."

Upon receipt of a notice that the Council would hold its regular meeting on May 17th, the Board extended an invitation to the three Class "A" Directors of each Federal Reserve Bank, who are the representatives of the stockholding banks, to come to Washington at the

same time for conference with the Federal Reserve Board and the Federal Advisory Council. This conference was held on the 18th instant and it was developed at the meeting that the present credit expansion is due in great part to the abnormally high prices of goods and commodities now prevailing throughout the country and to the congestion of food-stuffs and essential raw materials at, or near, points of production because of lack of transportation facilities.

The Board is convinced that if the unsold portions of last year's crops can be brought to market before the new crop matures, the liquidation of credits which are now tied up in carrying the old crops will be sufficient to offset to a considerable degree the credit demands which will be made upon the banks in moving the crop of 1920.

At the conference above referred to the Board's views were outlined by its Governor substantially, as follows: The member banks should lean less heavily upon the Federal Reserve Banks and rely more upon their own resources, unnecessary and habitual borrowings should be discouraged and the liquidation of long standing, non-essential loans should proceed. Banks were cautioned, however, that drastic steps should be avoided and that the methods adopted should be orderly, for gradual liquidation will result in permanent improvement while too rapid deflation would be injurious and should be avoided. The Board pointed out the necessity for extending such credits as may be necessary to promote essential production, especially of foodstuffs and that if for any reason it should prove impracticable to increase essential production, there should be a greater economy in consumption and more moderation in the use of credit. The problem of the banking

system of the country is to check further expansion and to bring about a normal and healthy liquidation without curtailing essential production and without shock to industry, and, as far as possible, without disturbance of legitimate commerce and business. In order to effect this it seems necessary to distinguish between essential and non-essential loans but the Federal Reserve Board feels it would be a most difficult task, which it should not undertake, to attempt by general rule of country-wide application to make this distinction. During the war there was a broad underlying principle that essentials must be "necessary or contributory to the conduct of the war", but notwithstanding the sharp outline of this principle much difficulty was experienced by the various war boards in defining essentials and non-essentials. All the more difficult would it be for the Federal Reserve Board to make such a general definition in the present circumstances.

Section 13 of the Federal Reserve Act defines the eligibility of paper for discount by the Federal Reserve Banks and lays down a general rule that any paper maturing within the time prescribed and "issued or drawn for agricultural, industrial or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes" is eligible. No expressed condition is made regarding the essential or non-essential character of the transactions giving rise to notes which may be offered for discount and the Federal Reserve Board is not required, and properly could not be expected, generally to adopt such a criterion of eligibility. It is too much a matter of local conditions

and local knowledge to justify at this time any general country-wide ruling by the Board even if such a ruling were deemed helpful.

On the other hand, there is nothing in the Federal Reserve Act which requires a Federal Reserve Bank to make any investment or to rediscount any particular paper or class of paper. The language of both Sections 13 and 14 is permissive only. Section 4 of the Federal Reserve Act, however, requires the directors of a Federal Reserve Bank to administer its affairs "fairly and impartially and without discrimination in favor of or against any member bank", and subject to the provisions of law and the orders of the Federal Reserve Board to extend "to each member bank such discounts, advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks". Thus the Directors of a Federal Reserve Bank have the power to limit the volume and character of loans which in their judgment may be safely and reasonably made to any member bank.

The recent amendment to paragraph (d) of Section 14 distinctly authorizes each Federal Reserve Bank on its own account, without reference to action taken by any other Federal Reserve Bank, to establish a normal discount or credit line for each member bank, and permits the imposition of graduated rates on discount lines in excess of the normal line. This amendment, however, does not repeal or modify Sections 4 and 13, and a Federal Reserve Bank is still free to decline to discount any paper which in its judgment does not constitute a desirable investment for it or which in its opinion would not constitute a safe and reasonable investment within the meaning of Section 4.

It is the view of the Board, however, that while Federal Reserve Banks may properly undertake in their transactions with member banks to discriminate between essential and non-essential loans, nevertheless that discrimination might much better be made at the source by the member banks themselves. The individual banker comes in direct contact with his customers; he is better qualified than anyone else to advise the customer, because of his familiarity, not only with the customer's business but with the general business conditions and needs in his immediate locality. In making loans he is bound by no general rule of law as to the character of the purpose for which a loan is being asked. He is entirely free to exercise discretion, and can make one loan and decline another as his judgment may dictate. He can estimate with a fair degree of accuracy the legitimate demands for credit which are liable to be made upon him, as well as the fluctuations in the volume of his deposits. He knows what industries sustain his community, and is thus qualified to pass upon the essential or non-essential character of loans offered him. He knows, or should know, what rediscount line he may reasonably expect of his Federal Reserve Bank, and he ought not to regard this line as a permanent addition to his capital. With knowledge of the limitations or penalties put upon his borrowings from the Federal Reserve Banks the banker may be depended upon to use a more discriminating judgment in granting credit accommodations to his customers, and that judgment he must exercise if the present situation is to be remedied fundamentally.

It is true that under existing conditions the volume of credit required in any transaction is much greater than was the case in pre-war times; but it is also true that the resources of the member and non-member banks would

be ample to take care of the essential business of the country and to a large extent of non-essentials as well if there were a freer flow of goods and credit. If "frozen loans" were liquified, and if commodities which are held back either for speculative purposes or because of lack of transportation facilities should go to the markets, and if large stocks of merchandise should be reduced, the resultant release of credit would have a most beneficial effect upon the general situation. In the meantime everything must be done to expedite the release of these credits and to restrict non-essential credits in future.

While the problem of credit regulation and control is national and even international in its scope, yet in the last analysis it is merely an aggregation of individual problems, and the proper working out of the situation must depend upon the public and upon the banks which deal with the public. The public must be made to realize the necessity of economy in expenditures and in consequent demands for banking credit. The banks themselves are best able to impress the importance of this policy upon the public.

For the further information of the Senate the Board quotes from the report of the Federal Advisory Council made to it on May 18th, signed by James B. Forgan, President.

"The Council has given consideration to the matters included in your communication of April 17th and begs to reply thereto in the following manner, following the order set out by you.

(a) "Causes of continued expansion of credits and of Federal note issues."

There are many contributing causes of which the following may be regarded as paramount.

1. To recognize, of course, that the first cause is the Great War.
2. Great extravagance, national, municipal and individual.
3. Inefficiency and indifference of labor resulting in lessening production.
4. A shortage of transportation facilities, thus preventing the normal movement of commodities.
5. The vicious circle of increasing wages and prices.

(b) 'How can the reserve position of the Federal Reserve Banks be materially strengthened before the seasonal demand sets in next fall without undue disturbance of the processes of production and distribution?'

By urging upon member banks through the Federal Reserve Banks the wisdom of showing borrowers the necessity of the curtailment of general credits, and especially for non-essential uses, as well as continuing to discourage loans for capital and speculative purposes: by checking excessive borrowings through the application of higher rates.

(c) 'If steps cannot be taken at this time leading to a more normal proportion between the volume of credits and the volume of goods, when can they be taken?'

In our opinion steps should be taken now, as outlined in answer to the last question.

(d) 'What is the effect upon the general situation of the increased Treasury borrowings and what should be the policy of the Federal Reserve Banks in establishing rates of discount on paper secured by certificates of indebtedness?'

It is obvious that the borrowings of the Treasury have the same effect upon the general credit situation as those of other borrowers. The Council would suggest the wisdom of Congressional relief from the burden of government financing by a policy of rigid economy; the provision of the tax laws for the sake of a more equitable distribution of the burden without reducing the revenue; the enactment of the budget system, the budget to include provision for the gradual payment of the short time obligations of the Treasury. These would of necessity preclude unwise appropriations, such as the proposed soldiers' bonus.

In view of the large volume of Treasury certificates of indebtedness carried by member banks at the instance of the Treasury Department, we believe that rates established by the Federal Reserve Banks on paper secured by them should not be materially greater than the rates borne by the certificates."

The Board feels assured that the banks of the country now realize the necessity of more conservatism in extending credits and of a reasonable reduction in the volume of credits now outstanding. The Board will not hesitate, so far as it may be necessary, to bring to bear all its statutory powers in regulating the volume of credit, but wishes to point out that the more vital problems relating to the movement of the 1920 crop are physical rather than financial.

This was the unanimous view of those present at the conference on the 18th instant, at which the following resolution was adopted:

"The whole country is suffering from inflation of prices with the consequent inflation of credit. From reports made by the members of this conference, representing every section of the country, it is obvious that great sums are tied up in products which if marketed would relieve necessity, tend to reduce the price level and relieve the strain on our credit system.

"This congestion of freight is found in practically all of the large railroad centers and shipping ports. It arises chiefly from inadequate transportation facilities available at this time and is seriously crippling business. We are informed that the per ton mile of freight increased in three years - 1916, 1917, and 1918 - 47%, while the freight cars in service during the same period increased 1.9%.

"A striking necessity exists which can only be relieved through the upbuilding of the credit of the railroads. This must come through adequate and prompt increase in freight rates. Any delay means the paying of greater cost directly and indirectly and places a burden on the credit system which in the approaching time for seasonal expansion may cause abnormal strain. Even under the load of war inflation, high price level, and extravagances the bank reserves would probably be sufficient if quick transportation could be assured during the time of the greatest strain.

"Therefore Be It Resolved: That this conference urge as the most important remedies that the Interstate Commerce Commission and the United States Shipping Board give increased

rates and adequate facilities such immediate effect as may be warranted under their authority and that a committee of five, representing the various sections of the country, be appointed by the Chairman to present this resolution to the Interstate Commerce Commission and the United States Shipping Board with such verbal presentation as may seem appropriate to the committee."

Much will depend upon the restoration of the normal efficiency of railroad and steamship lines. If adequate transportation facilities can be provided the Board sees no occasion for apprehension in connection with the movement of crops now being grown.

Respectfully,

Governor.

The President of the Senate.

May 26, 1920.
Before Bond Club, New York.

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MR. HOUSTON.

Mr. Chairman and Gentleman:

I am grateful grateful to you for your very cordial welcome. I regret that I am not better prepared to speak to you. As a matter of fact I am violating one of my most fundamental principles of action--not to attempt to speak to a body of men without preparation. I have had no opportunity to prepare anything for you. My plight is even worse than that. I am compelled to dismiss from my mind the things I had been turning over in it since my departure from Washington. Since I came into this room I have discovered that the object of the gathering is different from what I had been led to believe. I must therefore not only attempt to speak without preparation but in the midst of the process of readjusting the direction of my thoughts. I am aware that this is very dangerous--dangerous for you as well as for me. A very distinguished friend of mine many years ago issued a warning against the dangers of unpremeditated speech, a warning which I have always taken to heart. Still, I am going to proceed and shall probably victimize you as well as myself by thinking aloud for a short time.

By the calendar it is approximately six years sine I met in this city a group of gentlemen whose interests were substantially similar to yours. I see near me some gentlemen who were at the hearings of the Federal Reserve Organization Committee of which I ^{has} happened to be a member. Judging by what happened it seems more like six generations. Much water has gone over the dam since then. The greatest war in the history of mankind has been fought; and, although

we were then on the verge of it, none of us had the faintest notion that such an explosion was about to occur. Who of you imagined that very soon the whole world would be in an uproar, that forth millions of men would be engaged in the deadly work of destruction and especially that this nation would become involved? Who of you would have conceived that in a relatively short time this nation would resort to the draft, would register more than ten millions of men, and would have more than two millions of them in France? But all this happened and a great victory for civilization was won, although apparently eighty-three committees of Congress have not yet succeeded in discovering the fact.

At the time of our appearance here there were only a few small clouds on the horizon. Domestically we were engaged in working out a great program of useful and constructive legislation. The nation's finances were in normal condition and its expenses, then regarded as huge, were by present standards inconsiderable. It is true, as you will recall, that there was a certain amount of business depression, a certain sort of industrial chill, which in spite of the fact that it was world-wide, was attributed by many here to the tinkering of the tariff; but the real explanation I now think, is to be found in the activities of the Central Empires of Europe to finance the war for which they were then planning and particularly in their successful efforts greatly to increase their gold holdings, drawing it from many quarters of the world and hoarding it by hundreds of millions. These operations attracted little attention at the time and it was not until the storm burst that their sinister significance was seen. This part of the world at least had a

certain feeling of security. Men everywhere seemed confident that there would and could be no great war. It was a common assertion that business men and bankers would not permit it, that the cost could not be borne, even at a time when nobody dreamed what the actual scale of warfare and the actual cost would be. How greatly were the prophets confounded and proven once more to be false!

When the forces of Germany moved and first Belgium, then France and Great Britain were drawn in, men everywhere were dazed and held their breath. The effects on this nation were immediate and striking. The nation's normal life was altered and disrupted in a moment. The South was threatened with a financial collapse because of the shutting off of the market for her principal crop, the greater part of which is normally exported. The Government's receipts from customs duties greatly declined; and the question immediately arose how the half billion of indebtedness of business men and bankers to Great Britain, maturing in January, 1915, could be discharged. Economically and politically we were in the war from the moment of the first movement of the German troops. We were in it years before we entered it formally in military fashion and we shall be in it economically and politically for many years after our last soldier is withdrawn from Europe.

How idle it is for men to insist that this nation shall live in isolation! It can not live apart from the world. It is hopelessly entangled with it. Nothing of great importance either of an economic, financial or military nature, can happen again anywhere in the world

without producing serious disturbances here. Improvements in transportation and communication have drawn the parts of the world together and made it relatively small. Reflect that it takes less time to go from Mount New York to Liverpool than it took Washington to go from Mount Verner to his national capital and less time to speak to Paris than it took Washington to speak to his rector at Alexandria. The problem confronting us is not how to avoid entanglements,--that is impossible; but how to control entanglements so that peace may prevail and war with its horrors be obviated,--so that militarism and what is of equal importance, the militarist, may be abated.

Quickly, relatively speaking, this nation became involved in the war in military fashion. Almost immediately thereafter, almost before any of us realized what was happening, some very momentous things were done. In particular, the draft law was enacted, more than nine millions of men were registered, and then in one short session of Congress there were authorized expenditures of more than twenty-one billions of dollars. These things men from abroad could grasp no more easily than many of us here. I remember that in the spring of 1917, when Mr. Balfour was in Washington, I happened to be sitting near him at dinner. Suddenly, he turned to me and said: "Am I dreaming, or is it true that you have passed a draft act, registered over nine millions of men and authorized these gignatic expenditures?" I replied: "Unless I too am dreaming it is true." He then said: "I must of course accept what you say, but I don't believe it."

The war proceeded and it was fought to a victorious conclusion.

We emerged from it having expended more than thirty-eight billions of dollars, about a third of this amount having been raised by taxation and the remainder by loans. Today we have an outstanding indebtedness of approximately twenty-five billions of dollars, including the foreign loans, and a scheme of taxation whose annual receipts have been six times as great as those of the pre-war period. These financial operations were on a scale undreamed of before the European war broke out, and the burden was one which no one before the war would have imagined this nation could stand without financial disorder and probably without suspension of specie payments; and yet we have gone forward in orderly fashion and are now in a position where we can continue to proceed without grave difficulties if the people possess the requisite self-control and wisdom. Of course, we have grave financial and fiscal problems confronting us. It is almost literally true that nearly every nation in the world has its eyes fixed on the banks and the Treasury of the United States. It is also true, unfortunately, that very many groups of people in the United States, taught in no small measure to do so during the war, are looking to Washington for financial salvation which ought to come in the main through individual, group, and community effort, and through the devotion of thought and energy on the part of every individual to hard work and to thrift. There is no situation which may confront the people of this nation which they can not meet if they will show the requisite steadiness, common sense and recognition of the part which each individual and each community must play.

No one will doubt that it is of the first importance, notwithstanding the immense industrial strength of this nation, that we carefully husband our resources if we are to meet not only pressing domestic needs but be prepared also to do what we should through practicable business measures to aid Europe to get on her feet once more and to make her due economic contribution to the world.

A great deal is being thought and said about the increasing difficulty of securing money or credit. I assume you agree that there has been very considerable credit expansion and that there is inflation in this country as well as Europe, although in smaller measure here. I shall not consume your time discussing in detail the causes for credit expansion or inflation. It is a fact. The moving cause was the war itself,--the sudden call for commodities on an enormous scale, the bidding for raw materials and for labor at any price, the abstraction of great numbers of men from industry, the necessity for resort to borrowing to finance the industrial operations and the consequent increase in prices.

Unfortunately, the credit expansion did not cease with the war. It has persisted not only in many nations in Europe but also here. Accordingly to the best estimate I have seen, loans by all the banks of the nation have increased since July, 1919, about nine billions of dollars, and since the beginning of this year by three and one-half or four billions of dollars. More recently there have been signs not only of a check on this movement but of a return to a lower level, that is, of a deflation. I assume that every intelligent man wishes to see a return as quickly as possible not to the pre-war condition, which I imagine

we shall never see, but towards that condition, at any rate towards a stable one. It is utterly out of the question that further credit expansions and inflation should be permitted, and can be permitted, without grave danger, and it seems beyond dispute that every helpful agency should work steadily for prudent deflation.

The accomplishments of this task, like everything of the kind, will have as its incidents pains and penalties. I think the nation might as well square itself to this fact and proceed accordingly. The accomplishments of the purpose need not alarm anybody. It does call for calm, intelligent and thoughtful effort, especially for discriminating effort, and particularly for the cooperation not only of every banker but also of every business man with the Federal Reserve Bank, the Federal Reserve Board and the Treasury.

I say that intelligent effort and discriminating effort must be put forth and that cooperation must obtain. We must see to it that the essential activities of the nation go forward and that those promoting them have the requisite credit. This implies discrimination. It is a difficult task. It must obtain not only in respect to domestic enterprises but also in respect to those for the relief of Europe.

This nation, through its business men, will desire to do what can prudently be done to assist Europe to get on its feet, but those who wish to assist Europe have a right to expect that she take all possible steps to put her house in order and that her people practice the same things which we demand that our people practice, and that the nations there practice, so far as possible, what this nation is practicing.

Some nations in Europe are not pursuing wise financial and fiscal courses, Some did not do so during the war. Some of them relied entirely too much on borrowing, on currency issues with consequent inflation, and too little taxation. Some of them are still doing this, while in a few conspicuous instances action along right lines is being taken. Some nations in Europe are still fighting. Some are not taking the requisite steps to decrease expenditure and to balance their budgets. Clearly, it would be imprudent for the business men of this nation to throw good money after bad or into a bottomless pit. I think they will have a right to require of the people of Europe who ask assistance that they present as far as possible a sound business scheme for their consideration. It will then be incumbent upon those here from whom credit is sought that they examine the proposals carefully and take pains to see that the uses to which the credit is put are wise from the point of view of European reconstruction. The resources of this nation are great but they are not unlimited and of necessity the business men of the nation must consider in what directions lie the wisest use of the means at their disposal, whether it be a foreign or a domestic direction.

From every section of the nation itself come demands for money and credit. Many are based upon pleas of paramount necessity. Many are coupled with representations that nonessential enterprises are securing credit while essential ones suffer. There are sufficient means in this nation to take care of the urgent needs if the practice of discrimination is exercised and if the people of the nation who can save will save and make their savings available either for the necessary business enter-

Cigar and Cigarette holders	\$ 1,000,000
Tobacco and snuff	800,000,000
Toilet soaps, etc.	400,000,000
Jewelry, watches, etc.	500,000,000
Perfumery and cosmetics	750,000,000
Admissions to places of amusement and dues	800,000,000
Pianos, organs, victrolas, etc.	250,000,000
Fur articles	300,000,000
Carpets, rugs, luxurious wearing apparel, etc.	1,500,000,000
Hunting garments, liveries, firearms & shells	60,000,000
Art works	25,000,000
Yachts	1,000,000
Portable electric fans	8,000,000
Sporting goods	25,000,000
Luxurious services	3,000,000,000
Luxuries in hotels and restaurants	75,000,000
Luxurious articles of food, etc.	5,000,000,000
Other luxuries, including joy riding, pleasure resorts, races, etc.	3,000,000,000
Automobiles and parts	2,000,000,000

Think of it, an expenditure of \$50,000,000 for chewing gum! A nation that can chew \$50,000,000 of chewing gum ought to be able to do almost anything. Think of it, \$1,000,000,000 for candy, \$800,000,000 for cigarets, \$800,000,000 for tobacco and snuff, \$800,000,000 for admissions to places of amusement, \$750,000,000 for perfumery and cosmetics,--any one of these amounts falling not far short of our pre-war Federal budget excluding the postal expenditure and receipts!

Opinion will differ as to whether many of these articles should be classed as luxuries or nonessentials and expenditure on them as unwise or extravagant. Expenditure in reasonable measure for many of the articles would not be regarded as luxurious or wasteful but expenditure in such volume of any of them and the aggregate expenditure for such things and services would, I imagine, be regarded as unreasonable and extravagant, especially in view of present domestic and world conditions. Of course we may not expect people to give up all expenditure on what is classed as luxuries, or even the greater part of it, but of they were to save ah

appreciable fraction, even 10 per cent, and see that it was directed along more essential lines, or invested for instance in Government securities, Liberty bonds and Victory notes, or in part in prudent charities, what a tremendous relief it would be.

The saving and investing of a part of such amount in Government bonds would immediately solve a somewhat difficult and serious problem. Incidentally it would greatly benefit those who did the saving and investing. Perhaps not again in this generation will the average man have presented to him so good an investment with the best security in the world. Those who know all the facts I imagine are not doing a great deal of worrying over the present prices of Government securities. They understand the situation. They understand that Government securities, like many other, follow the market.

It is nothing new in the history of nations to have the price of government securities change from time to time. English consols dropped, between 1903 and 1913, from $90\frac{3}{4}$ per cent to 73 and a fraction, and still we heard no apprehension expressed that Great Britain was going to the dogs. I shall not enter upon a lengthy discussion as to whether the Government made a mistake in offering its bonds at the rates of interest they bear, first $3\frac{1}{2}$ per cent, then at increased rates until finally the rate of $4\frac{3}{4}$ per cent was reached on Victory notes. I not infrequently read things that sound rather strange to me, such as that the bonds were issued at an artificial rate. What do gentlemen mean when they speak of an artificial rate? Is there such a thing as an artificial rate, as contrasted with a natural rate? What did the Treasury have to guide it?

What was the rate before the war? Have men forgotten that on the average Government bonds had not borne a rate above 4 per cent since 1890, a rate above 3 per cent since 1901, or a rate averaging above $2\frac{1}{3}$ per cent since 1908? When the first issue of bonds was under consideration, of course, the best advice was sought wherever it could be found. There were many things to consider and some of them the gentlemen who are now asserting that the rate was artificial were among the very ones who advised against different rates. Some of them at the outset protested against higher rates, particularly because of the effect they would have on outstanding securities. Or do the gentlemen contend that the rate was artificial because the people of the country were patriotic and the bonds were absorbed therefore at a rate at which that would not have been taken if you had not been patriotic? Would they claim that you ought not to have been patriotic, or that the Government ought not to have assumed that you were patriotic? Ought the Government to have assumed that you were patriotic and would demand an exceptionally high price for your contribution? Has not the Government a right to assume that its people are patriotic and consider this as one of the factors which should influence it in fixing the rate of interest on its securities? Is not this what some of these gentlemen have in mind when they represent that the Government ought to refund the bonds and by some kind of manipulation keep the bonds daily at par so that those who wish to sell them may temporarily suffer no loss? Of course they know, as everyone should know, that the Government will keep its contract, that it will pay its obligations according to contract at par with interest in the meantime. I doubt whether the people of the United States will wish to be represented as being too patriotic in war time or as being

without patriotism and intelligence in peace times. Do those who demand the refunding of bonds at a higher rate not know that this would involve the people of the nation in a vast and annually increased expenditure for interest charges, leading to the assessment of new taxes or, what is worse, to the floating of new bond issues? Are they willing to contend that they made a mistake during the war in being patriotic and offering the use of their capital for the winning of the war? Do they now wish to capitalize their patriotism, to recall it so to speak, and to demand a bonus for the capital that fought? I certainly, who have been objecting not only for financial reasons but also in principle to a bonus for men who offered their lives, will not be one of those who are in the uneasy position of advocating a bonus for capital and capitalists.

Suggestions like these get us nowhere in dealing with this important problem. They do not involve sound ways of dealing with the matter. I am unwilling to entertain the notion that those who lent their money at a good rate of interest and who will receive it back from the Government according to contract wish a bonus for the use of their capital any more than I am willing to concede that the great mass of the fine men who offered their lives for their country do want a bonus or will want a bonus when they realize what it means to the people. If I thought the great masses of our people had such ideals and standards I should be very pessimistic about the future of the Republic. There is only one fundamentally sound way of dealing with

this problem, and that is for the people to hold on to their bonds and for others to save and to invest in them as they can secure them. I may add that while history is full of instances of governments refunding bonds at a lower rate of interest I recall no case in which it has refunded its bonds at a higher rate of interest after the trouble had passed.

There is this trouble about proposals of this bonus sort and all other attempts to secure money out of the Federal Treasury. A small minority will be very noisy about it. They will omit nothing to influence Congress and to convince Congress that the nation wants what they desire. The great mass of people will say very little and naturally the Congressmen will imagine that it is unanimous. Washington is full of groups of people who presume to represent all the people of the nation but who as a matter of fact represent very little that is worth while. I frequently hear it said that the Executive Departments are responsible for increased Government expenditures and that they are constantly in the game of seeking more money for this or that purpose. Of course there are enthusiasts in every sort of establishment. There are enthusiasts in Government Departments. They see opportunities to render service to the nation and they desire funds with which to conduct the services. Sometimes they get them and sometimes they do not, and sometimes it is uneconomical for Congress not to grant their requests; but I think I may safely say from more than seven years experience in Washington that the average head of a Department spends many times as much time in resisting demands for appropriations from

groups of people as he spends in trying to get money to run the Department. I wish I could get this thought firmly lodged in the minds of the American people, that they are responsible in the main for increased expenditures. It is because they, or particular groups of them, demand things that the money is provided. Sometimes the people as a whole do not desire the appropriation but every noisy fraction of them is busy trying to get it. Like those seeking this bonus, they clamor for appropriations while the mass sit quietly and say nothing. The mass of the people of the nation in the last analysis are responsible for increased appropriations, as they are for the expansion of the activities of the Departments in Washington. When they want things, instead of looking around to see if they can not provide them for themselves or to see if their community or their city or their State cannot provide them, they run to Washington, because they have learned that it is easier to get things from people who are not near and do not realize the whole situation and can not estimate the character and strength of those who are urging them.

In the main, our course of action is clear. We have large obligations left over from the war that we must pay. The Government must run. Its current bills must be paid. It is of the first importance that Congress be economical, that it appropriate the minimum amount needed to meet existing obligations and to run the Government on a thoroughly economic basis. It is highly important that at the earliest moment the nation have a thorough-going genuine budget system--one which will not only control the Executive, but, what is of equal importance,

the Congress itself. Not only should the Executive be required to prepare a carefully considered budget and there be an independent audit and check, but the Congress should reform its system of dealing with appropriations. It should have the budget submitted considered by a single budget committee, or at any rate one for each House, and change its rules so that after the committee or committees report and present a budget for action no change shall be made in it except by an unusual majority, say a majority of two-thirds or three-fourths. It is equally important that a thorough-going business-like budgetary arrangement be adopted in every State of the Union and by municipalities and counties, and that every Government jurisdiction, as well as every individual, shall practice economy.

When these things are done, when this old injunction that everybody work and save finds a fuller lodgment and fuller practice, when the freight jam under which the nation is now staggering is broken, when the railroads are permitted to make and do make proper provision for increasing their facilities, I shall have no apprehension as to the financial condition of this nation.

We must, as I have said, make up our minds to endure some present pains. We can endure them and go forward in orderly fashion if we have the requisite self-control and intelligence. I believe that the signs that we shall are encouraging. If Congress practices the requisite economies we can continue to meet the left-over war obligations and carry on the Government for the immediate future, perhaps without resort to additional taxation. I am aware of the fact that our expenditures will remain on a high level for a number of years. Usually it has been three

or four years after great upheavals before national budgets have settled down to something like their former status. It would be singular if ours settled down in a shorter time after such a war as that through which we have passed. We not only have heavy pressing bills to meet but we have a floating indebtedness of nearly \$3,000,000,000 to pay off, and now the Victory Loan maturing in a little more than two years, is coming to the point where we shall be justified in regarding it as in the nature of a floating indebtedness.

There are several things we might do in regard to this floating debt and to the Victory Loan, but there is in my judgment only one sound course to pursue. The floating debt now represented by short-time certificates, in considerable volume tax certificates, we should pay off. We should not fund them, and we should place ourselves in a position where we can also extinguish a very considerable part of the Victory notes. These things we can do if we practice economy, if we save, and if we keep the aggregate receipts from taxation at least up to the present point and if necessary increase them. To follow this course will in the long^{run} be the least expensive way. We do not want to perpetuate our very large debt. We must prevent this by paying off the floating indebtedness and by the orderly application of the sinking fund to the bonded indebtedness. Let us avoid the mistake so frequently made in the past, of beginning to tamper with the sinking fund. History proves that when a nation once begins tampering with its sinking fund it is likely to recognize its mistake and to retrace its steps as a very late date.

Of course you will all agree with me that taxes should not be kept at a high point unless it is necessary, and most of you will agree that our present tax system should be modified and that some of the taxes should be abolished. I know very ^{few} students of taxation who are enthusiastic admirers of the excess profits tax. In my judgment, while it has some advantages, it has many disadvantages. It conduces in no small degree to extravagance. It works unjustly and inequitably as among businesses. It depends in too great measure on the accident of organization; but it can no be abolished and have nothing substituted unless businesses to which it now attached are placed in a position of advantage over partnerships, sole proprietors, and some forms of trusts. There are administrative changes also which it is urgently imperative should be made. These administrative changes I have been urging for some time, but up to the present moment without success. I have expecially urged that the Treasury of the United States should be given power to make a final settlement with taxpayers. It is one of the fundamental requisites of a good tax system that the taxpayer know his liability, that there be certainty. Some of you know that your liabilities are uncertain; some of you have thought that you paid your 1918 or 1917 taxes in full and had little reminders from time to time that you were mistaken. I have been told that one corporation was informed that it owed \$10,000,000, that with great difficulty it arranged to make payment, that after straining itself nearly to the limit it was then informed that it owed a half million more. I think you will agree with me that it would be better for the Treasury occasionally to lose money than to have this outstanding uncertainty and menace to industry and possible ruin to many businesses.

Difficult as are our present problems, as much trouble as you here are those throughout the nation are having, by working in the directions I have indicated, we can come through this trying period of the next nine or twelve months, and this nation not only will move forward in orderly fashion but Europe as well, will move upward. I am confident that Europe is slowly moving and moving upward. For more than a year I have felt and said that after another crop year with reasonably favorable harvests there would be no little improvement for that reason alone in Europe and throughout the world. The indications now are that many of the European nations are going to have reasonably good crops and be very much better circumstanced in respect to food than they have been since the beginning of the European war. I think with all the grounds for discouragement, also, the people of Europe slowly and painfully will work upward industrially and within a reasonable time will begin to get on their feet.

Of course none of you are pessimistic, not only as to the recovery of this nation but also as to the ultimate and not distant rapid progress of this nation. It takes a very alert man to keep up with this nation, as you know. How many of you realize that in twenty years, that is, since 1900, we gained 30,000,000 people; that our banking resources even between 1900 and 1915, when conditions were still normal, rose from $10\frac{1}{4}$ to 27 billions of dollars; and that the wealth of the nation rose from 89 billion to perhaps 200 billions of dollars? What the figures are today I do not undertake to say, because we are on an abnormal value basis, but the bank resources are reported to be 48 billions of dollars, and I am told that we have gained in excess of 8,000,000 people since the European war broke out.

Industry is readjusting itself, is struggling to recover itself, and, in a reasonably short time, in two or three years perhaps, will move forward as before the war.

I am confident that that great basic industry with which I have had to deal so recently, and about which so many pessimistic statements are made from time to time, namely, agriculture, will continue to move forward as it has moved forward for the last two or three generations. There is more nonsense talked about agriculture and rural life by urban people and by some real people than about almost any other phase of our national economy, and I realize that I am making a pretty strong statement when I make this comparison. I had been troubled so much with false statements in this field that I took some trouble a short time ago to get the facts. I found these things to be true. I found that in the period since 1870 the yields of leading cereals increased 16 per cent; that the production per capita, in spite of the enormous growth in population, had increased; and that production per farm worker was steadily upward. Fifty years ago the production of the six leading cereals per capita was 38 bushels, while in 1914-1915 it was fifty two bushels; that of cotton increased from $36\frac{1}{2}$ pounds to 60 pounds; and milk from 84 gallons in 1889 to 96 in 1919. There was another very significant advance, and that is in the variety of our production and in the rise of minor crops to large proportions. This is evidenced by the gain in the canning industry from 20,000,000 cases in 1889 to 52,000,000 in 1914, and of dried fruits from 85,000,000 pounds to 521,000,000 pounds. Not only did the production per farm worker increase from 266 bushels in the decade of 70's to 418 in the five years 1915-1919, but the number of farm workers increased from 5.9 million in 1870 to 13.7 million in 1910.

So that, taking the three principal tests, it is clear that the agriculture of the nation is progressing; and, in my judgment, it will continue to progress in fuller measure because more things are being done by this nation to aid the farmers than by any other three or four nations in the world combined. When you bear these things in mind and realize that we still have only ^{about} 40 per cent of our arable land under cultivation, and that only about 15 per cent of that is yielding what it should, you can realize the possibilities, you can see the distance the nation has to go in developing its foundations, to bring 60 per cent of it under cultivation and 85 per cent of its land up to the level of the best yields.

I have said more than enough to convey my thought to you. Each of us has his part to play to carry the nation through this difficult period. What we need now particularly is a little more devotion of thought by each individual as to what he can do and not as to what he can avoid doing or how he can call upon somebody else to assist him and do his task for him. We must prevent further credit expansion. We must bring about a prudent deflation. We must bear the necessary payments and penalties involved in the progress. We must work and save, We must practice discrimination in projecting our enterprises and in extending credit either for domestic or foreign purposes. Economy must be practiced by every Government jurisdiction and every individual. A spirit of thrift and saving must prevail and persist. Those who save must be taught wisely to invest. These things done, I have no doubt about the future of the nation. I have no doubt about the present

material greatness of the nation, and in spite of some evidences to the contrary, as to the present spiritual greatness of the nation. It does look at times as if there had been a demobilization of patriotism, as Mr. George said there had been in England, but I trust that it is only in appearance. I believe the people are still patriotic and that they will manifest it. You will agree with me that if the liberties of the nation were worth fighting for, the opportunity that victory has given us to pursue the paths of peace and to lead the kind of national life we desire to lead should call forth our best impulses and efforts to maintain and practice the same standards of conduct and thinking that made us victorious in the war. I wish it were possible for every individual in the nation to be less partisan, for the people to demand that their leaders be less partisan, that their leaders, whether of the press or in public station, reveal a greater regard for the facts and ability and desire to get the facts, to interpret them impartially and then show the courage to follow their conclusions and to apply them no matter where they lead. I believe in parties. I believe if such a policy were pursued there would still be ample room for differences of opinion and for parties. I know that the application of such a standard would eliminate many leaders from the field, but I think the nation would suffer no great detriment from their retirement. Democracy in this country, with its growing complexity, its increase in population, and its intricate relations, will have sufficiently hard sledding if such a standard is applied. Democracy without it, democracy by misrepresentation, may result in failure.

The Chairman: I think Secretary Houston has told us some things that we perhaps appreciated to a certain extent before, told us a great many things that we perhaps did not know about; and the way to appreciate and to show our appreciation for his visit is to practice some of the things that he has convinced me we should practice.



THE SECRETARY OF THE TREASURY
WASHINGTON

June 10, 1920.

Dear Sir:

Treasury certificates to the amount of nearly \$1,000,000,000 mature on or before July 15. The greater part of these are provided for by the income and profits tax installment payable in June. To refund the balance and provide for current requirements up to July 15th, according to the best estimates now available, it seems desirable at this time to issue Treasury certificates to the amount of \$400,000,000 or thereabouts; and accordingly the Treasury is offering certificates in two series, both dated June 15th, Series A 1921, bearing interest at 5 3-4% and maturing January 3, 1921, and Series T J-1921, bearing interest at 6% and maturing June 15, 1921, particulars concerning which will be furnished by the Federal Reserve Banks.

On the basis of Treasury daily statements and excluding transactions in the principal of the public debt, though the first quarter, ended September 30, 1919, of the present fiscal year ending June 30, 1920, was marked by a deficit of about \$770,000,000, in the second quarter, ended December 31, 1919, there was a surplus of over \$150,000,000, in the third quarter, ended March 31, 1920, there was a surplus of nearly \$400,000,000, and the fourth quarter, ending June 30th next, should also show a surplus. The completed fiscal year's operations should show little, if any, deficit--the Government having about balanced its budget, current receipts against current disbursements, for the first full fiscal year after fighting stopped.

The total gross debt of the United States, which, on June 30, 1919, on the basis of Treasury daily statements, amounted to nearly \$25,500,000,000 and on August 31, 1919, to nearly \$26,600,000,000, had been reduced on May 31, 1920, to less than \$25,000,000,000. The floating debt outstanding (loan and tax certificates), which on June 30, 1919, amounted to over \$3,250,000,000, and on August 31, 1919, to nearly \$4,000,000,000, had been reduced on May 31, 1920, to less than \$2,850,000,000. The reduced ordinary

and public debt disbursements have made possible a very important reduction in the amount of the net balance in the general fund, which has been applied to the reduction of debt. Both gross debt and floating debt will be further greatly reduced by the operations outlined in the first paragraph of this letter.

During the coming fiscal year, beginning July 1, 1920, the Treasury expects, though it is impossible to speak positively, that there will be a further reduction of both gross debt and floating debt in the first two quarters, and, unless additional burdens should be imposed by future legislation, that there will be a very important reduction in the last two quarters.

The period of upwards of twelve months since the flotation of the Victory Liberty Loan has witnessed great expansion of commercial credits, but steady liquidation of United States Government war securities. The Federal Reserve Banks' combined loans and discounts secured by United States Government war securities have been reduced by more than \$400,000,000, though they have increased their other loans and investments by about \$1,200,000,000. All reporting member banks (about 800 member banks in leading cities which are believed to control about 40% of the commercial bank deposits of the country) have reduced their holdings of and loans upon United States Government war securities by about \$2,000,000,000, but have increased their other loans and investments by about \$4,000,000,000.

The Treasury confidently asks the banking institutions of the country for their continued support and, in particular, to subscribe liberally for the certificates now offered and use their best efforts to obtain the widest possible distribution of them among investors.

Cordially yours,

J. A. Houston

To

The President

of the Bank or

Trust Company addressed.

June 11, 1920.

Gentlemen:

I have your note of June 7th, referring to a reported statement from me to the effect that a canvass of the tax returns for 1919 show that there has been expended in this country at least \$22,000,000,000 for luxuries. You ask that I advise you as to the accuracy of the report and the basis for the figures.

My statement on which the report seems to have been based was that I had asked the Treasury experts to canvass the tax returns and any other sources of information and give me an approximate estimate of what the people would expend in twelve months on what, for the purpose of taxation, Congress seemed to regard as luxuries, or what they would class as luxuries. They handed me the following estimate of expenditure on the items indicated. The estimates under 1 and 2 are based on the tax rates and the tax receipts. Those under 3 are based on such information as the experts could gather.

1.

ESTIMATED EXPENDITURES FOR CERTAIN ARTICLES UPON WHICH FEDERAL TAXES
ARE NOW LEVIED.

Chewing gum.....	\$ 50,000,000
Candy.....	1,000,000,000
Cigarettes.....	800,000,000
Soft drinks, including ice cream & soda.....	350,000,000
Perfumery and cosmetics.....	750,000,000
Admissions and dues.....	800,000,000
Jewelry.....	500,000,000
Cereal beverages.....	230,000,000
Cigars.....	510,000,000
Tobacco and snuff.....	800,000,000
Sporting goods.....	25,000,000
Firearms and shells.....	50,000,000

Cigar and cigarette holders.....	\$ 1,000,000
Hunting and shooting garments.....	7,000,000
Fur articles.....	300,000,000
Yachts.....	1,000,000
Carpets, rugs and wearing apparel (on ex- cesses over stated prices).....	<u>1,500,000,000</u>

Total of above.....7,674,000,000

2.

Liveries.....	3,000,000
Pianos, organs, victrolas, etc.....	250,000,000
Electric fans, portable.....	8,000,000
Art works.....	15,000,000
Toilet soaps, etc.....	400,000,000
Automobiles and parts.....	<u>2,000,000,000</u>

Total.....2,676,000,000

3.

ADDITIONAL ARTICLES.

Ice cream.....	250,000,000
Cakes, confections, etc.....	350,000,000
Luxurious services.....	3,000,000,000
Luxuries in hotels and restaurants.....	750,000,000
Luxurious food, etc.....	5,000,000,000
Other luxuries--joy riding, pleasure re- sorts, races, etc.....	<u>3,000,000,000</u>
Total.....	12,350,000,000

Total estimated expenditures.....\$22,700,000,000

Opinion will differ as to whether many of these articles should be classed as luxuries or nonessentials and expenditure on them as unwise or extravagant. Expenditure in reasonable measure for many of the articles would not be regarded as luxurious or wasteful, but expenditure in such volume on any of them and the aggregate expenditure for such things and services would, I imagine, be regarded as unreasonable and extravagant, especially in view of

present domestic and world conditions. I am aware of the fact that no one would ask the public to eliminate all such expenditure or expect the public to make more than a reasonable reduction of it.

As bearing on the clamor about the shortage of sugar, I would call your attention to the expenditure, outside of the household, that is, on things prepared or sold outside of the household, in which sugar is a large ingredient, of \$1,000,000,000 for candy, \$350,000,000 for soft drinks, \$230,000,000 for cereal beverages, \$250,000,000 for ice cream, and \$350,000,000 for cakes, confections, etc., a total of over \$2,000,000,000.

Very truly yours,

(Signed) D. F. Houston

EXHIBIT B

TREASURY DEPARTMENT

FOR RELEASE, MORNING PAPERS,

Friday, June 18, 1920.

STATEMENT BY THE DIRECTOR OF THE MINT.

Under the express terms of the Pittman Act, silver purchased by the Director of the Mint under the Act at the fixed price of \$1 per ounce one thousand fine must be the product both of mines situated in the United States and of reduction works so located. As previously announced, the Director of the Mint has received standing orders from the Secretary of the Treasury to purchase silver under the Act up to an aggregate amount of 207,000,000 ounces, delivered at the option of the Director of the Mint at the Assay Office in New York, or at the Mints in Philadelphia, Denver, or San Francisco, and is making such purchases when satisfied by clear and unequivocal proof that the silver is the product of mines situated in the United States and of reduction works so located. Forms for such proof, appropriate for use in case of silver wholly produced and reduced in the United States, without admixture of foreign silver, were furnished to said Assay Office and Mints under date of May 15, 1920.

In order to cover the practical situation presented by the fact that a large proportion of the domestic production of silver is smelted and refined in conjunction with foreign silver and comes from the refineries as part of a mixed product of domestic and foreign silver, the Director of the Mint is further prepared to purchase under the Act silver which forms part of a mixture of foreign silver and domestic silver up to the proportionate part of such mixed product which represents the product of mines located within the United States and of reduction works so located, upon clear and unequivocal proof as to the proportionate

part of the mixed product which represents domestic production. Forms for such proof, appropriate for use in case of mixed silver, will be available at said Assay Office and Mints, and in addition to a general affidavit from the vendor in each case will include supporting affidavits from the miner, smelter, and refiner, together with such sworn statements and exhibits from their books of account as may be required by the Director of the Mint. The form of general affidavit from the vendor, and of supporting affidavit from the miner are appended hereto for the information of all concerned; full information as to the additional supporting affidavits and proof will be available at said Assay Office and Mints.

Deliveries of mixed silver under the Act will be accepted upon the filing of a satisfactory general affidavit by the vendor, subject to the later filing of the necessary supporting proof. It will be noted that as to mixed silver already produced and refined, it will be necessary to show that the silver mined in the United States which enters into the mixed product, was delivered to reduction works located in the United States since January 17, 1920. It will be noted further that in order to have assurance that the benefits of the Pittman Act go to American producers, for whom they were intended, the Director of the Mint will require in connection with the purchases supporting affidavits from the miners to the effect that settlement has been made with them on the basis of the fixed price of \$1 per ounce, adjusted to the equivalent price for silver 999 fine and to the cost of delivery refinery to Mint.

Affidavits by Vendor, Miner, Smelter and Refiner in
Connection with Sale of Unmixed Silver under Pittman Act.

STATE OF)
) ss.
COUNTY OF)

In order to make a sale of silver to the Director of the Mint, in accordance with the provisions of the Pittman Act, approved April 23, 1918, the undersigned hereby represents and certifies, under oath, that he is the _____ of _____, owner of said silver, that said silver to the amount of _____ fine ounces, delivered to the United States Mint at _____ this _____ day of _____, 192____, for sale to the Director of the Mint under said Act, was produced in the United States at the _____, situated in _____, between
(Name of Mine) (County) (State)
_____ and _____, and was the product of reduction works situated in _____, _____; that no
(Insert dates) (County) (State)
part of said silver was mined outside of the United States of America or at any time treated by reduction works or refineries located outside of the United States; and that payment has been made to the aforesaid miner for said silver at the rate of not less than \$1.00 per ounce, adjusted to the equivalent price for silver 999 fine and to the cost of delivery refinery to mint.

(Signature of Vendor or of duly authorized officer)

Subscribed to and sworn to before me this _____ day _____, 192____.

Notary Public.

STATE OF)
) ss.
COUNTY OF)

The undersigned, being duly sworn, deposes and says that he has read the foregoing affidavit of _____, dated _____, 192__, and is the _____ of _____, owner of the mine described in said affidavit; that the silver described in said affidavit, in the amount of _____ fine ounces, was produced in the United States at the said _____, situated in _____ (Name of Mine) _____ (County) _____, between _____ and _____ (State) _____ (Insert dates) and that said silver was paid for at the rate of not less than \$1.00 per ounce, adjusted to the equivalent price for silver 999 fine and to the cost of delivery refinery to mint.

(Signature of owner of Mine or duly authorized officer).

Subscribed to and sworn to before me this _____ day of _____, 192__.

Notary Public.

STATE OF)
) ss.
COUNTY OF)

The undersigned, being duly sworn, deposes and says that he has read the foregoing affidavit of _____ dated _____, 192__, and is the _____ of _____, owner of the reduction works described in said affidavit; and that the silver described in said affidavit, in the amount of _____ fine ounces, was the product of the said reduction works situated in _____, _____, in the United States, and not the product of any reduction works located outside of the United States.

(Signature of Owner of reduction works or duly authorized officer.)

Subscribed to and sworn to before me this _____ day of _____,
192 ____.

Notary Public.

Note: Affidavits must be presented in the above form from the vendor, the mine-owner, the smelter and the refiner. The Act approved April 23, 1918, requires that the silver to be purchased thereunder shall be "the product of mines situated in the United States and of reduction works so located".

EXTRACT FROM "ANNUAL REPORT OF THE SECRETARY OF THE TREASURY ON THE
STATE OF THE FINANCES FOR THE FISCAL YEAR ENDED JUNE 30, 1920."

RETIREMENTS OF LIBERTY BONDS AND VICTORY NOTES.

Five per cent bond purchase fund.

Purchases of Liberty bonds and Victory notes for the bond-purchase fund were continued during the fiscal year 1920, but ceased on June 30, 1920. Section 15 of the second Liberty bond act, as amended by section 6 of the third Liberty bond act and the Victory Liberty loan act, authorized the Secretary of the Treasury, until the expiration of one year after the termination of the war, to buy annually bonds and notes issued under authority of the second Liberty bond act, as amended, including bonds issued upon conversion of bonds issued under the first Liberty bond act or the second Liberty bond act, as amended, at such prices and upon such terms and conditions as he might prescribe, up to 5 per cent of the par amount of bonds or notes of any series outstanding at the beginning of the bond-purchase fund year. The Treasury's purchases under this authorization have been made from time to time, at average cost, through the Federal reserve bank of New York, and from the War Finance Corporation. These agencies in turn made purchases in the open market, when it was deemed necessary to stabilize market prices and to protect the Government's credit. These operations undoubtedly sustained and strengthened the market for Liberty bonds and Victory notes and so redounded to the benefit of all holders of these issues. The securities bought have been canceled and retired. On April 18, 1920, the following statement was issued by the Secretary with reference to purchases for the bond-purchase fund to June 30, 1920, and thereafter for the cumulative sinking fund:

The authorization conferred upon the Secretary of the Treasury by Congress to make purchases of Liberty bonds and Victory notes for the 5 per cent bond-purchase fund expires one year after the termination of the war. The continuance of a technical state of war beyond the period contemplated at the time the authority was conferred has presented to the Secretary of the Treasury the practical problem of determining what his future course should be with respect to the bond-purchase fund. Secretary Glass, in his annual report, said, "Purchases of bonds under authority of section 6 of the act of April 4, 1918 (bond-purchase fund), are not included as an item of estimated expenditure (for the fiscal year beginning July 1, 1920); this authority expires one year after the termination of the war, and the Secretary reserves decision with respect to such purchases after July 1, 1920." Congress created in the Victory Liberty Loan act a $2\frac{1}{2}$ per cent sinking fund to commence July 1, 1920. In view of the fact that on July 1 more than a year will have elapsed since the flotation of the last Liberty loan and of the further fact that unless Government expenditures should be greatly decreased or taxes increased, continued purchases for the bond-purchase fund could only be financed by the issue of additional certificates of indebtedness, thus increasing the floating debt while decreasing the funded debt, my present intention is not to treat the two funds as cumulative, but to discontinue purchases for the bond-purchase fund on and after July 1, 1920, and to make purchases thereafter only for the sinking fund created under the Victory Liberty loan act. The approximate amount of the bond-purchase fund quota for the period ending June 30, 1920, will be taken over from the War Finance Corporation or, to a limited extent, purchased in the market, and in either case canceled and retired.

Hereafter such purchases as the Treasury may have to make for the bond-purchase fund or the sinking fund under the general program above announced will be occasional and not habitual.

I am confirmed in the determinations above set forth by the fact that the natural market in Liberty bonds and Victory notes has now reached such dimensions that the purchases for the bond-purchase fund have ceased to be a dominating factor. The recent liquidation which has brought the bonds and notes to new low levels seems to find its chief source in selling by industrial and other corporations which were large purchasers during the Liberty loan campaigns and which are now under pressure to find funds for their current business, in a period when necessary measures of credit control make further expansion of bank loans both difficult and expensive. This offers a unique opportunity to investors, large and small, the quotations for the bonds and notes being extremely attractive to investing institutions and private investors. I believe that the time has come when the disappearance of the Government from the market, except as an occasional purchaser within the limitations above outlined, will have a beneficial effect upon the market for the bonds and notes, both by reducing the Treasury's current borrowings on Treasury certificates, and stimulating the interest of investment bankers and the public in the market for Liberty and Victory securities.

Pursuant to this announcement, no purchases for the 5 per cent bond-purchase fund have been made since June 30, 1920, and those made prior to that date, after April 18, 1920, represented chiefly accumulations taken over from the War Finance Corporation.

The aggregate par value of Liberty bonds and Victory notes retired by the bond-purchase fund between April 15, 1918, and June 30, 1920, when purchase ceased, was \$1,764,896,150, and the aggregate paid therefor was \$1,677,566,210.26, or, on an average, slightly more than 95 per cent of the par value. The following is a summary of the purchases:

Summary statement of bond purchases to June 30, 1920.

Loan	Par amount purchased.	Amount paid	Accrued interest paid,
First Liberty loan converted 4 per cent and $4\frac{1}{4}$ per cent bonds 1932-1947.....	\$36,912,000	\$34,722,342.29	\$532,112.62
Second Liberty loan 4 per cent and $4\frac{1}{4}$ per cent bonds, 1927-1942.....	478,688,000	452,358,913.01	6,896,021.63
Third Liberty loan $4\frac{1}{4}$ per cent bonds, 1928.....	433,308,100	414,067,698.57	3,679,624.35
Fourth Liberty loan $4\frac{1}{4}$ per cent bonds, 1933-1938.....	566,987,050	530,548,515.45	6,523,811.37
Victory loan, $4\frac{3}{4}$ per cent and $3\frac{3}{4}$ per cent notes, 1922-1923.....	249,001,000	245,868,740.94	3,500,393.93
Total.....	1,764,896,150	1,677,566,210.26	21,131,963.90

In accordance with the requirements of section 6 of the third Liberty bond act, a detailed statement of the complete operations will be submitted to the Congress in a separate report. Now that operations have been completed, attention may be called to the reasons which actuated the Treasury in making its purchases. The bond-purchase fund was discussed at length by the Secretary of the Treasury in connection with the third Liberty loan and subsequent Liberty loans and was an important factor in the success of those loans. Of late, however, there seems to have been some misapprehension on the subject. The considerations which moved the Treasury in recommending that the bond-purchase fund authority be granted, and which guided it in the exercise of the authority, are set forth in the testimony of the Secretary of the Treasury before the Committee on Ways and Means of the House of Representatives in connection with the third Liberty bond bill, on March 27, 1918, as follows:

Very careful and earnest attention to the situation which has developed since the last Liberty loan has convinced me that the United States must do what each of the warring countries in one form or another does, and prepare itself to support the market for its bonds. No measure of this sort, however, can be of any value unless the fund provided for the purpose is a large one. Every effort must be made to reach the people who have money to invest or those who will have and who can be induced to save and pay for the bonds for which they subscribe. In connection with every issue, however, it will be found that the patriotism of some has outrun their ability to pay for the bonds, so that either those who buy them and get tired of holding them do not want to hold them, or those who from necessity or for other reasons are obliged to sell them, will offer their bonds in the market; and it puts the Government at a very great disadvantage if there is no means of sustaining the market to a reasonable extent so as to steady it * * *. Inevitably during the period of the war, after each Liberty loan has been closed, we have been forced to face the facts that there will be more sellers than buyers of the bonds. The present bill would authorize the Treasury to retire the excess. That is, it would authorize through the sinking fund a repurchase of such an amount of the bonds as the sinking fund would permit and would take up the surplus offerings, and the amount provided, I think, would be sufficient for the purpose. With such a sinking fund and the secondary distribution which the War Finance Corporation can bring about, there will not be such a desire to sell the bonds, because the very fact that they can sell them will make people feel more confident about holding them. There is a curious feeling in the breast of the average man that if he buys a Government bond, even though he contracts to lend his money to the Government, nevertheless if he gets tired of his investment and wants to get his money back, that he ought to be able to sell the bond at par regardless of the fact that the Government is not under any obligation to redeem that bond before maturity. It is extraordinary the extent to which that feeling exists. People would not have that feeling about a corporation which sold its bonds, or about any individual who gave his note. They would not expect them to be redeemed at par before maturity. It is a perfectly unreasonable feeling, but one of the things we have got to reckon with. I believe that the provision for this sinking fund will relieve the situation somewhat. This sinking fund, by the way, ought not to be a mandatory sinking fund but discretionary; that is, the Secretary ought to be permitted within the limits of 5 per cent of the bonds issued to buy back bonds.

It is a most difficult thing, but a thing which we must face, to try to keep Government bonds measurably around par. We have got to continue Government borrowings at a reasonable rate of interest. I think that some such thing as this sinking fund will be much cheaper for the Government than to increase the interest rate; at least we ought to try it. The reason I say it is cheaper is this: Suppose we need three billions, and the sinking fund on the entire outstanding bonds for the year -- assuming we had ten billions outstanding -- at 5 per cent would be \$500,000,000. It only means that we should have to sell a few more bonds and then buy them back and keep the rate of interest up, and it does not hurt us any. We are just taking back some of the bonds. * * * This 5 per cent each year is intended to apply during the war only. * * *.

It is also interesting to note, in view of the widespread contention that purchases should have been made at par rather than at the market, that this very proposal was rejected by the Committee on Ways and Means, when the matter of granting the authority was under consideration. The Secretary of the Treasury in his testimony before the Committee said in this connection:

I do not think it would be a wise thing for us to attempt that -- that is to say, to purchase the bonds at par -- because I think if we were to state that we had \$100,000,000 that the Government would invest in these bonds at par, for instance, that would simply be an invitation to the people to sell their bonds to the Government at par and you would exhaust the fund in short order.

Bonds purchased from repayments of foreign loans.

In accordance with the provisions of section 3, of the first Liberty bond act, and section 3 of the second Liberty bond act, repayments by foreign Governments on account of the principal of their obligations bought under authority of these acts have been applied to the purchase and retirement of Liberty bonds. The face value of these secured to November 15, 1920, was \$119,109,050. They were bought for \$114,538,818.16, or slightly less than 95 per cent of the par value. These operations are fully set forth in the separate detailed statement of all expenditures under the Liberty bond acts. The purchases may be summarized as follows:

Bonds purchased as the result of payment of foreign loans to Nov. 15, 1920.

Loan	Principal amount purchased	Amount paid	Amount of accrued interest paid
Third Liberty Loan $4\frac{1}{4}$ per cent coupon bonds.....	\$80,758,750	\$76,472,985.84	\$927,529.20
Third Liberty loan $4\frac{1}{4}$ per cent registered bonds.....	8,407,550	8,407,550.00	6,909.52
Fourth Liberty loan $4\frac{1}{4}$ per cent coupon bonds.....	29,942,750	29,658,282.32	553,567.76
Total.....	119,109,050	114,538,818.16	1,488,006.48

Bonds purchased with franchise tax paid by Federal reserve banks.

Section 7 of the Federal reserve act provides that the net earnings derived by the United States from the Federal reserve banks, as franchise tax, shall in the discretion of the Secretary be used to supplement the gold reserve held against outstanding United States notes, or applied to the reduction of the outstanding bonded indebtedness. These earnings for the calendar year 1919 have been applied to the purchase, at the market of \$2,922,450 par amount of second Liberty Loan $4\frac{1}{4}$ per cent bonds, at a cost of \$2,703,850.74, with accrued interest of \$20,814.43, the latter amount being chargeable as interest on the public debt. These bonds have been canceled and retired.

Bonds retired on account of gifts.

From time to time various persons, for patriotic or other reasons, present Liberty bonds and Victory notes to the Government. These are redeemed at par and retired, and the proceeds are covered into the Treasury as miscellaneous receipts. The aggregate amount presented and retired to November 15, 1920, is \$12,850, as follows:

Bonds retired account of gifts, November 15, 1920.

Loan	Par Amount	Accrued interest matured	Accrued interest unmatured
First Liberty loan $4\frac{1}{4}$ per cent coupon bonds.....	\$350.00	.....	\$6.22
Second Liberty loan 4 per cent coupon bonds.....	700.00	\$51.00	2.35
Second Liberty loan 4 per cent registered bond.....	7,000.00	.....	44.59
Second Liberty loan $4\frac{1}{4}$ per cent coupon bonds.....	2,150.00	42.49	2.93
Third Liberty loan $4\frac{1}{4}$ per cent coupon bonds.....	800.00	40.10	5.71
Third Liberty Loan $4\frac{1}{4}$ per cent registered bonds.....	500.00	.....	9.81
Fourth Liberty loan $4\frac{1}{4}$ per cent coupon bonds.....	1,350.00	35.24	7.02
Total coupons.....	5,350.00	168.83	24.23
Total registered.....	7,500.00	.....	54.40
Grand total.....	12,850.00	168.83	78.63

Bonds retired on account of forfeitures to the United States.

Whenever Liberty bonds or Victory notes are forfeited to the United States for any reason and deposited in the Treasury, they are canceled and retired. Up to November 15, 1920, there have been retired on this account \$3,550 of bonds and notes, as follows:

Bonds retired account of forfeitures to the United States to Nov. 15, 1920.

Loan	Par Amount
First Liberty loan 3 $\frac{3}{8}$ per cent coupon bond.....	\$50
First Liberty loan 4 $\frac{1}{4}$ per cent converted coupon bond.....	50
Third Liberty loan 4 $\frac{1}{4}$ per cent coupon bonds.....	700
Fourth Liberty loan 4 $\frac{1}{4}$ per cent coupon bonds.....	2,650
Victory Liberty loan 4 $\frac{3}{4}$ per cent coupon notes.....	100
Total.....	3,550

Bonds retired on account of estate and inheritance taxes.

Under Section 14 of the second Liberty bond act, as amended by the third Liberty bond act and the Victory Liberty loan act, 4 $\frac{1}{4}$ per cent Liberty bonds and 4 $\frac{3}{4}$ per cent Victory notes are receivable by the United States at par and accrued interest in payment of any estate or inheritance taxes. Such securities are canceled and retired, and the face amount, with any accrued interest, is covered into the Treasury as receipts on account of Federal estate (or inheritance) taxes. The value of those received to November 15, 1920, is \$9,781,750, as follows:

Acceptance of Liberty bonds and Victory notes in payment of estate or inheritance taxes to Nov. 15, 1920.

Loan	Par amount of bonds	Interest paid
First Liberty loan converted 4 $\frac{1}{4}$ per cent coupon bonds...	\$159,400.00	\$1,839.57
First Liberty loan converted 4 $\frac{1}{4}$ per cent registered bonds:	3,800.00	31.85
Second Liberty loan converted 4 $\frac{1}{4}$ per cent coupon bonds...	2,120,950.00	23,144.63
Second Liberty loan converted 4 $\frac{1}{4}$ per cent registered bonds.....	456,700.00	4,180.25
Third Liberty loan 4 $\frac{1}{4}$ per cent coupon bonds.....	3,477,600.00	38,512.74
Third Liberty loan 4 $\frac{1}{4}$ per cent registered bonds.....	613,650.00	5,676.59
Fourth Liberty loan 4 $\frac{1}{4}$ per cent coupon bonds.....	2,799,950.00	25,633.92
Fourth Liberty loan 4 $\frac{1}{4}$ per cent registered bonds.....	131,600.00	865.27
Victory Liberty loan 4 $\frac{3}{4}$ per cent coupon notes.....	18,100.00	197.29
Total coupon.....	8,576,000.00	89,328.15
Total registered.....	1,205,750.00	10,753.96
Grand total.....	*9,781,750.00	*100,082.11

*Subject to adjustment because of items in transit.

Summary of retirements to Nov. 15, 1920 -- par amount of bonds or notes (including cumulative sinking fund).

5 per cent bond purchase fund (to June 30, 1920).....	\$1,764,896,150
Purchases on account of sinking fund.....	15,040,250
Purchases with payments on foreign loans.....	119,109,050
Purchases with earnings of Federal reserve banks.....	2,922,450
Gifts.....	12,850
Forfeited.....	3,550
Estate or inheritances taxes.....	9,781,750
Total.....	\$1,911,766,050

EXTRACT FROM "ANNUAL REPORT OF THE SECRETARY OF THE TREASURY ON THE STATE OF THE FINANCES FOR THE FISCAL YEAR ENDED JUNE 30, 1920."

CUMULATIVE SINKING FUND.

The cumulative sinking fund established by section 6 of the Victory Liberty loan act approved March 3, 1919, became effective July 1, 1920. The law permanently appropriates, for the current fiscal year and for each fiscal year thereafter until the debt is discharged, an amount equal to the sum of "(1) $2\frac{1}{2}$ per centum of the aggregate amount of such bonds and notes outstanding on July 1, 1920, less an amount equal to the par amount of any obligations of foreign Governments held by the United States on July 1, 1920, and (2) the interest which would have been payable during the fiscal year for which the appropriation is made on the bonds and notes purchased, redeemed, or paid out of the sinking fund during such year or in previous years."

On this basis the constant appropriation annually for sinking-fund purposes is \$253,404,864.87, derived as follows:

Aggregate amount Liberty bonds and Victory notes out-	
standing July 1, 1920-----	\$19,581,201,450.00
Less par amount obligations of foreign Governments pur-	
chased under the several Liberty loan acts and held by	
the United States on July 1, 1920-----	9,445,006,855.18
Difference-----	
$2\frac{1}{2}$ per cent thereof-----	10,136,194,594.82
	253,404,864.87

To this sum there will be added each year the interest which would have been payable on any bonds or notes paid, redeemed, or purchased for sinking-fund account during the year or in previous fiscal years.

The cumulative sinking fund, it is calculated, will retire the funded war debt of the United States, less the amount representing the foreign obligations held by the United States on July 1, 1920, in about 25 years. Under other provisions of the Liberty loan acts any repayments of the principal of the foreign obligations must be applied to the retirement of Liberty bonds. The floating debt is not covered by the sinking fund, but is to be retired out of current revenues. The prewar debt also is not covered, but the only important items there are of indeterminate maturities after specified dates, which may be retired after such dates from time to time as the condition of the Treasury may warrant.

The cumulative sinking fund was created for the retirement of the funded war debt in the order of its maturity, a course which should in the long run benefit most the holders of all the Liberty bonds, because of its tendency to provide for the earliest maturing obligations without undue refunding operations and the fact that the earlier maturing obligations are most likely to sell on the highest interest basis. During the current fiscal year the operation of the sinking-fund provisions has been seriously limited by the extraordinary payments required to be made on account of the railroads,

which, as set forth elsewhere in this report, have likewise limited the Treasury's progress in the retirement of the floating debt. Substantial sinking-fund purchases during the first part of the fiscal year would therefore have increased the floating debt or prevented its reduction, and would thus have tended to substitute floating debt for funded debt. The market for Liberty bonds and Victory notes, moreover, has been in a state of approximate equilibrium since the sinking-fund provisions became operative, and it has not been necessary to give support by Government purchases.

Up to November 15, 1920, sinking-fund purchases have accordingly been moderate in amount, as appears from the following table:

July-----	\$5,261,250
August-----	-----
September-----	-----
October-----	3,425,000
November 1-15-----	6,354,000
Total-----	<u>15,040,250</u>

It is hoped, however, that with some relief from the heaviest railroad expenditures and from other extraordinary payments, the Treasury will, during the balance of the fiscal year, and at least after the beginning of the calendar year 1921, be able to proceed to apply the remainder of the cumulative sinking fund for the current fiscal year to the retirement of the debt. Purchases for the sinking fund are made in the open market at the prevailing market prices, chiefly through the Federal reserve bank of New York, as fiscal agent, and are therefore reflected in the controlling market prices and redound to the benefit of all holders of Liberty bonds and Victory notes.

[Extract from "Annual Report of the Secretary of the Treasury on the State of the Finances for the Fiscal Year Ended June 30, 1920."]

TAXATION.

Fiscal and business conditions indicate the imperative need of a thorough revision of the tax law, in order that the more important changes may, without important retroactive application, be made effective with respect to income and profits for the calendar year 1921. The business interests of the country have a right to know in advance the rate of taxation they will be called upon to pay. The purchaser and consumer have an equally vital interest in the early determination of the tax burden, and unless the making of returns and the prompt payment of the tax are to be obstructed the Bureau of Internal Revenue must be given a considerable period of time before the first installment payment in which to interpret the new law, to study, prepare, and issue regulations, print the requisite forms, and create any new administrative machinery which may be necessary. For more than 18 months—since the opening of the special session of the Congress which began May 19, 1919—the President and his chief financial advisers have repeatedly urged revision of the internal-tax laws. There is pressing need for expedition in this matter by the Congress. Unless the principal amendments to the income and excess-profits tax law be adopted in the early months of 1921 they can not, without widespread confusion, be made to apply to income for the calendar year 1921.

Revision without reduction of revenues.

While it is highly desirable that the tax law should be revised at the earliest possible date, it is imperative, in my opinion, that the revenue from taxation be maintained after this fiscal year on a level of not less than four billions a year, to the end at least of the fiscal year 1923. The internal-revenue receipts may not greatly exceed \$4,000,000,000 even in the fiscal year 1921, on the basis of existing law. We now have a floating debt (tax and loan certificates maturing within 12 months) of approximately \$2,350,000,000. This short-

time debt should not be funded, but should be retired, if possible, by the end of the fiscal year 1922. On January 1, 1923, war-savings certificates now amounting to about \$800,000,000 fall due, and on May 20, 1923, Victory notes now amounting to about \$4,250,000,000 mature. The retirement of the tax and loan certificates, the reduction of the volume of obligations maturing in 1923, to some extent by the operations of the sinking fund, and the successful refunding of the balance of those obligations constitute a colossal task to the accomplishment of which the whole financial policy of the Government must be shaped. With obligations of approximately \$7,500,000,000 maturing in the next two and a half years, it would be unwise, unless compelled by the severest form of industrial depression, to plan for aggregate tax receipts after this fiscal year and till at least the end of the fiscal year 1923, of less than four billions a year. But this, of course, does not mean that the public will have to pay as large a tax amount in the aggregate in that period as in the current or the preceding fiscal year.

Future relations between expenditures and receipts are beset with great uncertainty. The estimated receipts and expenditures for the fiscal years 1921 and 1922 are recited on pages 273 to 278 of this report. These estimates of expenditures were prepared by the several departments and independent establishments and not by the Treasury, except for the Treasury Department. If rigid economy is practiced and the estimates reduced wherever possible, there is some hope that by the close of the fiscal year 1922 the floating debt may be extinguished, provided, of course, that adequate revenues from taxation are maintained. There is no certain means, however, of predicting the course of business or of incomes and profits, and it is a certainty that tax receipts even under existing law will not keep up to the 1920 level. There are also frequent efforts by extraordinary measures, like the soldiers' bonus, to bring about a radical increase in expenditures. In these circumstances—as was suggested in my letter of May 18, 1920, to the chairman of the Committee on Ways and Means of the House of Representatives—the only question which should be considered is whether a due regard for the protection of the Treasury does not impose upon the Congress a real duty to seek out additional sources of tax revenue for the next two years. The country at times is being encouraged to expect a "reduction of taxes." Revision of taxes should be effected. There can and should be a better distribution of the tax burden. Unwise taxes should be eliminated. But any scheme which would after this fiscal year yield for several years to come less than four billions of dollars would be incompatible with safety and sound finance. And the country should face the fact

that present taxes even may not in the future be relied upon to yield the needed revenue. The letter of May 18, 1920, referred to, reads as follows:

WASHINGTON, May 18, 1920.

DEAR MR. FORDNEY: I received your letter of May 1, with the inclosed copies of bills H. R. 13798, introduced by Mr. Johnson, and H. R. 13799, introduced by Mr. Rainey, to provide for the payment of adjusted compensation to the veterans of the World War. Both bills impose an 80 per cent war-profits tax.

The most serious aspect of this compensation matter, as I pointed out when I had the honor of appearing before the committee, is the proposal greatly to add, especially at this time, to the present grievous burdens resting upon the people of the Nation and upon the Treasury. The method of financing the proposal raises grave problems, but is secondary. The very heavy burdens which will rest upon the Treasury by reason of laws already enacted, including particularly the recent railroad law, which it is estimated will entail an expenditure of approximately \$1,000,000,000, and also by reason of the delay in making provision to realize upon the Government's investments in railroads and ships, taken in connection with the existing credit situation, suggest the need of grave consideration of the question whether, quite aside from and in addition to any taxation which it might be necessary to impose in order to pay a bonus to the soldiers, it may not be necessary to provide for meeting the necessities of the Government in larger measure from taxation. The total indebtedness of the Government maturing within three years, represented by Treasury certificates, war-savings certificates and Victory notes, is in the neighborhood of \$8,000,000,000. It is no longer possible to finance the current needs of the Government in part by the issue of Treasury certificates except on onerous terms which reflect upon the value of the Government's long-time bonds and depreciate them in the market. Furthermore, it would appear to be bad economy and bad finance for the Government to borrow money on short-term certificates of indebtedness (maturing within three to six months) to be invested for a term of years in railroads and ships.

It is a matter of serious concern to have the Government appearing in the market every few weeks for loans. Certainly nothing ought to be done to add to existing credit expansion that can possibly be avoided. The result would be to increase prices and to make a difficult situation less satisfactory. In the circumstances obviously the Government ought to appear in the market for loans as infrequently as possible and for the lowest sums. Additional taxes are also undesirable, but they may be less undesirable than borrowing. They would at least have the effect in part of enforcing economies. The first thing to do, I am sure you will agree, is to keep Federal expenditures down to the minimum and it is obvious also that other governmental jurisdictions and private individuals should do likewise.

I beg to submit to your committee for its serious consideration the question whether, all things considered, it would not now be advisable to seek out additional sources of revenue to meet the current requirements of the Government, over and above any additional revenue which would be necessary if the soldier bonus plan is determined upon, in order to obviate the necessity of continuing in considerable measure to meet them by borrowing. Having these things in mind, I hesitate to express an opinion concerning the bills which you have submitted to me, taken by themselves. There are many grave objections, both to the proposed new war-profits tax and to the alternative measure, a sales tax,

which I understand your committee is considering. If, in view of the urgent needs of the Government for money to meet its requirements, your committee concludes that it will be wise to raise a larger amount by taxation and desires any suggestions from the Treasury, I shall be glad to have the experts place themselves at its disposal. In the meantime I refrain from making any further comment on either proposal.

For the reasons indicated, and for other reasons, I think it would be highly unfortunate for any new obligations to be placed upon the Treasury through the enactment of the bonus proposal in any form, however financed.

Very truly yours,

D. F. HOUSTON.

Hon. JOSEPH W. FORDNEY,

Chairman Committee on Ways and Means,

House of Representatives.

"This letter voices my deliberate conviction that "it would be highly unfortunate for any new obligations to be placed upon the Treasury through the enactment of the bonus proposal in any form, however financed." I repeat the statement with a renewed feeling of its soundness. In the form in which it passed the House of Representatives, the bill providing for the soldiers' bonus would involve new cash expenditures of not less than \$1,250,000,000, to be made during the period in which the Treasury will be most severely tried by the burden of meeting heavy maturing obligations. It would increase the present tax burden, delay the lightening of that burden, and dismay taxpayers with its promise or threat of future drafts of like character upon the public purse. It would, in short, dominate the entire program of tax legislation during the next two years or more. It seems plain that the bonus question must be definitely settled before the larger outlines of the tax program for the next year can be intelligently determined and that the bonus bill must be disposed of before the general revision of the tax law can proceed. The Treasury's views with respect to the bonus proposal are set forth more in detail elsewhere in this report on pages 102 and 103 under the heading "Soldiers' bonus."

From this letter it will be noted that, in the Treasury's opinion, there are many grave objections to a sales tax. Further consideration of the subject has convinced me that a general sales or turnover tax is altogether inexpedient. It would apply not only to the absolute necessities of life—the food and clothing of the very poor—but it would similarly raise the prices of the materials and equipment used in agriculture and manufactures. It would confer, in effect, a substantial bounty upon large corporate combinations and place at corresponding disadvantage the smaller or disassociated industries which carry on separately the business operations that in many combinations and trusts are united under one ownership. The group of

independent producers would pay several taxes, the combination only one tax. Finally, it would add a heavy administrative load to the Bureau of Internal Revenue which—burdened as it is with the responsibility of enforcing the child-labor tax law, the national prohibition act, the narcotic-drug law, the adulterated butter and mixed flour tax laws—is already near the limit of its capacity. Simplification of the tax law and restriction rather than extension of its scope are as important from the standpoint of successful administration as from that of the taxpayers' interests. Consumption taxes, if used at all, should be laid upon other than absolute necessities and restricted to a few articles of widespread use, so that the administration of the tax may be concentrated and made relatively simple.

As early as March of this year I pointed out in a letter to the chairman of the Committee on Ways and Means the necessity of a simplification of the tax system and the repeal of the excess-profits tax, a modification of the income supertaxes, and certain fundamental administrative changes such as the giving to the Treasury the power to make final settlement of tax claims and to issue regulations which should be effective from the date of their approval. The letter in question is as follows:

WASHINGTON, March 17, 1920.

HON. JOSEPH W. FORDNEY,

*Chairman Committee on Ways and Means,
House of Representatives.*

MY DEAR MR. FORDNEY: I am very glad to respond to your threefold request, communicated through Dr. Adams, for estimates of the loss in revenue which may be expected to result from the recent decision of the Supreme Court in the stock-dividend case, for recommendations concerning a new method of dealing with personal service corporations; and for definite suggestions looking to the fundamental simplification of the income and profits taxes, brief enough to receive, but thoroughgoing enough to deserve, careful consideration at a session of the Congress crowded with other questions of grave importance. To facilitate their presentation, I may discuss these subjects in the inverse order in which they have been mentioned above.

SIMPLIFICATION OF THE INCOME AND PROFITS TAXES.

In dealing with this subject I may go at once to what is, in many respects, its most vital aspect—the question of early action. Public opinion has not yet awakened to the gravity of the consequences which are likely to follow a failure to simplify the tax law at this legislative session. Unless the necessary amendments be passed now, they will be delayed in all probability, I understand, until the autumn or winter of the year 1921, with the result, unless they are to disrupt the administrative procedure and confuse the necessary calculations of the taxpayer by being made retroactive, that income and profits taxes must continue to be collected on the basis of the present law until the close of the calendar year 1922, and, in the case of some taxpayers on the so-called fiscal year basis, until the early months of the calendar year 1923. I can not contemplate such delay without the gravest apprehension. An imperfect and uncertain

tax affects the future even more adversely than the present, and for similar reasons it is costly and unwise to make a beneficent modification of the tax law retroactive or even to delay its adoption and announcement until the time at which it is to take effect.

It would be manifestly unsafe, in my opinion, to reduce now the income and profits taxes to be collected in the calendar years 1920 and 1921, but I can see nothing in the financial prospects for the calendar year 1922 and thereafter which would make impossible or unwise the very modest reduction involved in the plan of simplification hereinafter presented; and it should never be forgotten that the tax system itself is one of the most powerful causal factors affecting public expenditures. A tax system yielding, or likely to yield in the future, a surplus of revenue over expenditures is an open invitation to public extravagance, whereas an announced resolution to reduce taxes as the occasion which called them forth recedes into the past is one of the most potent means of insuring economy in public expenditures. The people, therefore, consumers as well as producers, indirect as well as direct taxpayers, may fairly ask to be told now the earliest future date at which the most obsolete features of the tax law are to be repealed.

Complexity in tax laws violates the most fundamental canon of taxation—that the liability shall be certain and definite. It is not merely a source of irritation, labor, and expense to the taxpayer; but when conjoined, as it is in the present law, with the heavy rates of taxation which war exigency has forced upon us, it becomes a major menace, threatening enterprise with heavy but indefinable future obligations, generating a cloud of old claims and potential back taxes which fill the taxpayer with dread, creating, to be sure, an attractive source of additional revenue, but clogging the administrative machinery and threatening, indeed, its possible breakdown.

FINAL DETERMINATION AND SETTLEMENT OF TAX CLAIMS AND ASSESSMENTS.

1. I recommend, therefore, as the most urgent and important of the measures of simplification which could advantageously be put into effect at once, an amendment authorizing the Commissioner of Internal Revenue, with the consent of the taxpayer and the approval of the Secretary of the Treasury (or under such other public safeguards as the Congress may prefer), to make a final determination and settlement of any tax claim or assessment, which shall not thereafter be reopened by the Government or modified or set aside by any officer, employee, or court of the United States, except upon a showing of fraud, malfeasance, or misrepresentation of fact materially affecting the determination thus made.

This recommendation is of major importance. At present the taxpayer never knows when he is through. Every time an old ruling is changed by court decision, opinion of the Attorney General, or reconsideration by the department, the department feels bound to apply the new ruling to past transactions. The necessity of constantly correcting old returns and settlements is as distressing to the department as it is obnoxious to the taxpayer. But an even more serious situation arises in connection with the assessment of back taxes. The tax return of a large corporation is likely to be crowded with debatable points which the corporation, in the first instance, usually decides in its own favor. The auditing of these returns has been necessarily delayed by the inability of the Bureau of Internal Revenue to engage and hold a sufficient force of experts to audit promptly the more complex and difficult returns; but when the audit comes to be made it ordinarily brings to light a large amount of back taxes.

A prompt determination and collection of such back taxes due would probably bring in additional revenue exceeding \$1,000,000,000. On the other hand, this situation must fill the taxpayers concerned with the gravest apprehension. If present taxes be continued and a period of industrial depression ensues during which the department finds the time and the men with which to clear up both current and back taxes within the same year the result may be highly disastrous to business.

The commissioner should be empowered and directed to dispose of these cases promptly and finally. This procedure would bring in much additional revenue, relieve business from grave uncertainty, keep out of the courts many lebatable cases, and help to avert an administrative deadlock.

INTERPRETATIVE REGULATIONS OR TREASURY DECISIONS NOT TO BE RETROACTIVE.

2. As a desirable concomitant of the preceding suggestion and for reasons stated in explaining that suggestion, I recommend the adoption of an amendment providing in substance that in case a regulation or Treasury decision made by the commissioner or the Secretary, or by the commissioner with the approval of the Secretary, is reversed by the subsequent issue of a similar regulation or decision, and such reversal is not immediately caused by or based upon an opinion of the Attorney General or a decision of a court of competent jurisdiction, such new regulation or decision may be made effective from the date of approval.

FIVE-YEAR LIMITATION ON TIME FOR BRINGING SUIT FOR COLLECTION OF TAXES.

3. Section 250 of the revenue act of 1918 now provides, in subdivision (d), that no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made, except in the case of false or fraudulent returns with intent to evade the tax. This subdivision has been held to apply only to taxes due under the revenue act of 1918. I recommend that this time limit be extended to all income and profits taxes due either under present or prior acts of Congress.

SIMPLIFICATION OF LIBERTY BOND EXEMPTION.

4. The exemptions from income surtaxes authorized by the several Liberty bond acts are highly complex and responsible for perhaps the most intricate schedule of the return which the individual taxpayer is required to fill out. My predecessor in office has recommended a consolidation of these exemptions which, while not breaking faith with the holders of Liberty bonds, would simplify their tax returns and operate to strengthen the market standing of such bonds without in any appreciable amount reducing the public revenue. I heartily indorse this recommendation, the detailed provisions of which may be found on pages 99 and 100 of the Annual Report of the Secretary of the Treasury for 1919.

COMPENSATION FOR PERSONAL SERVICE AND GAINS FROM SALES OR DEALINGS IN PROPERTY.

5. The heavy surtaxes cause real hardships when income earned over a period of years is realized or received in one year and taxed as a lump sum in that year. I recommend, therefore, that such extraordinary income, when it constitutes a material part of the gross income for that year, be deemed to have ac-

crued or been received ratably during the years in which the service was rendered or the property held, and the amount of the extraordinary income so assigned to any year be subjected to the surtax rates prescribed by law for that year.

EXCESS-PROFITS TAX.

6. Provision for the simplification and fundamental modification or repeal of the excess-profits tax at the earliest possible future date should, in my opinion, be made now. In explaining this conclusion it is unnecessary to enter into a discussion of controversial details. Two facts impress me as indisputable and conclusive: First, the application or calculation of the excess-profits tax is so complex that it has proved impossible to keep up to date the administrative work of audit and assessment. New returns are being made faster than old returns can be audited, resulting in an accumulation of claims and potential back taxes, the dangers of which have already been described. Second, the profits tax is confined to a small fraction (in number) of the business concerns of the country. Personal-service corporations, partnerships, sole proprietors, and most forms of trust organizations are exempt from the tax. If the principle be sound, it should be extended to all forms of business organization, a proposal which administrative considerations alone stamp as impracticable either in the present or any future period near enough to be worth consideration.

The general course or principle which simplification of this part of the tax law should follow is, I believe, reasonably clear. The outstanding feature of the present system of income taxation in its most important application to business income is the fact that we employ for this purpose two systems of taxation which are incommensurate and irreconcilable. Corporations pay the profits tax and normal income tax while their stockholders pay surtaxes on dividends or distributed profits, but nothing in respect of the undistributed corporate profits. On the other hand, sole proprietors and the members of partnerships pay full income tax, normal tax, and surtaxes upon the entire profits of their business whether distributed or not, but are exempt from the profits tax. The profits tax on corporations is evidently meant to be a rough equivalent for the surtaxes levied upon the reinvested or undistributed profits of other forms of business. But no true equivalence is reached. In 1918 the members of a well-known partnership paid nearly \$1,125,000 more taxes than they would have paid had their business been organized as a corporation. And the contrary is quite as frequently true.

There should be one system and not two systems of income taxation applicable to persons engaged in business. Substantial uniformity of treatment, or at least a nearer approach to uniformity of treatment, could be achieved in a variety of ways, the details of which it is not necessary to discuss here. I outline below one such plan which has many attractive features, the detailed provisions of which I shall be glad to supply upon request. The technical details, while important, are elastic and susceptible of modification. The essential thing is to simplify the excess-profits tax and grasp a uniquely opportune moment to remedy a deeply rooted defect in our system of income taxation by providing for the just taxation of the undistributed profits of corporations at a time when such taxation represents simplification and relief, not further complexity and heavier burdens. Equalization of the tax upon corporate and unincorporated business can be accomplished now with benefit to the corporations, the Government, and the general public. We should grasp an opportunity which may never return. The principal features of the plan referred to above are as follows:

(a) This plan is designed, first, to eliminate from the war-profits and excess-profits tax law (except as it is applied to profits derived from the so-called "war contracts") all reference to or use of "invested capital," and, second, to place the taxation of incorporated and unincorporated business concerns, so far as may be, on substantially the same basis.

(b) The first object is accomplished by substituting for the present graduated rates of 20 and 40 per cent, a flat tax on profits in excess of the distributed earnings. A rate of 20 per cent has been used as the basis of certain estimates quoted below, but the adoption of the proper rate is, of course, a matter which the committee will desire to settle for itself. It would be possible to adopt a declining rate, say, of 25 per cent for the fiscal year in which the suggested amendment is in operation, 20 per cent for the second year, and 15 per cent thereafter. It is only necessary that the rate should be fixed at one figure for a particular year.

(c) The second object could be accomplished (although the plan would be well worth while without this feature) by making it explicit in the law that corporations have the right to pay dividends in bonds or promises to pay bearing a fair rate of interest which are taxable to the stockholders as ordinary dividends, or by authorizing corporations to receive back from their stockholders as "paid-in surplus" cash or other dividends recently distributed. Under these or analogous procedures a corporation could retain its profits for use in the business and yet convert the profits tax into a genuine income tax. The excess-profits tax would thus become a flat tax on undistributed earnings; "invested capital" would practically disappear; and the corporation, if it desired, could place itself on substantially the same basis as the partnership, the personal-service corporation, and the sole proprietor. The principal object of this suggested amendment is to simplify the tax by removing the greatest source of inequality and complexity now found in the tax laws, i. e., the use of "invested capital."

(d) Revenue needs make it impracticable, in my opinion, to apply the preceding amendment to profits for the calendar year 1920, the taxes upon which will be payable in the calendar year 1921. But it should be put into effect as soon thereafter as the diminishing expenditures of the Government will permit. It is estimated that with a 20 per cent rate *and on the basis of present corporate net income* the suggested amendment would reduce the tax revenue by approximately \$430,000,000 a year. If, for instance, the amendment were adopted and made to apply to income received on and after January 1, 1921, the first reduction in the tax collections would occur in the last half of the fiscal year 1922, and would amount to \$215,000,000 for that fiscal year.

(e) However, present corporate conditions can hardly be maintained, and if corporate income declines and invested capital increases as rapidly as they have done in the past 12 months the proposed amendment would probably cause no reduction in the future revenue. New schemes are constantly being devised for the purpose of increasing invested capital. It is time to provide for a modification of the excess-profits tax, not only to relieve the taxpayer, but because of an approaching decline in its productivity.

REDUCTION OF SURTAXES ON INCOME SAVED AND REINVESTED.

7. In connection with the suggested tax on the undistributed profits of corporations, attention may appropriately be directed to a possible extension of its application which would go far to rectify one of the most dangerous defects of the present income tax. Because of possible doubt about the effects of such a change upon the revenue, and because the details of the proposal as they now

present themselves to my mind could not accurately be said to simplify the mere computation of the tax, I do not urge its adoption at this session of the Congress; but I have no hesitation in expressing my personal opinion that this or some similar amendment embodying the same idea could advantageously be adopted, to take effect at the earliest future date at which, in the opinion of the Congress, revenue needs and prospects permit.

While it is vitally important that saving and reinvestment effected through the medium of the corporation should not be dealt with more leniently than similar savings made by the partnership or individual, it is equally important that the methods of taxation employed should in all cases penalize saving and investment as little as possible. Our present surtaxes offend greatly in this respect. We attempt to levy surtaxes, rising to 65 per cent upon ordinary income, while there are thousands of millions of tax-free securities in the market, the income from which is practically exempt from all taxation. The result is to make investment by wealthier taxpayers in the expansion of industry or foreign trade unattractive and unprofitable. It is obvious that this situation should be remedied.

The remedy which most commends itself to my judgment at the present time is to reduce (e. g., by one-fourth) surtaxes attributable to that part of the net income which is saved and reinvested in business or property yielding taxable income and at the same time to limit the total amount of such reduced surtaxes to the same percentage (e. g., 20 per cent) of the reinvested income as the rate imposed upon the undistributed profits of corporations. The maximum tax upon such saved income would thus be approximately the same, whether reinvested by the individual, the partnership, or the corporation, and whether reinvested personally by the stockholders of a corporation or by such corporation for its stockholders. If at any later date the profits of a corporation which had paid the undistributed profits tax came to be distributed, a credit equal to the tax already paid by the corporation could, if it were thought wise, be easily granted to the stockholders.

The revenue lost by such an amendment could, if necessary, be made up by increasing the normal tax or that portion of the surtaxes attributable to income spent for purposes of consumption. But the time is fast approaching when the adoption of such an amendment would cause little real reduction of the revenue. We can not long continue to collect surtaxes rising to 65 per cent upon income from ordinary business and investment while exempt interest at a remunerative rate can easily be secured from tax-free bonds. We must take something less than 65 per cent or in the end take nothing. On the other hand, no reduction is urged in respect of income spent for unnecessary or ostentatious consumption. Income saved and reinvested in property or business yielding a taxable income should be taxed at a lower rate; income spent for consumption or invested in tax-exempt securities should pay at established rates both the normal tax and surtaxes. To the extent that it falls on savings the income tax should be reduced; to the extent that it is a tax on waste it should be maintained or even increased.

PERSONAL-SERVICE CORPORATIONS.

Under the revenue act of 1918 personal-service corporations are treated substantially as partnerships; i. e., the corporation as such is exempt from income, profits, and capital-stock taxes, but stockholders are subject to both normal income tax and surtaxes upon their full distributive shares in the net income of the corporation whether such income is actually distributed or not. The validity of this procedure is involved in the gravest doubt by the doctrine enunciated in the stock-dividend case, which apparently leads to the conclusion that

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a stockholder of a corporation, particularly a minority stockholder, can not be taxed (without apportionment according to population) upon a share of the corporation's income which he has not actually received. It is possible, notwithstanding the above reasoning, that the present statutory method of dealing with personal-service corporations might be sustained on the ground that it represents in general, in its effects upon personal-service corporations and their stockholders as a class, a relief provision imposed in lieu of the excess-profits tax which is unsuited to personal-service corporations and if applied to them generally would in many cases work intolerable hardships. But this interesting question need not be discussed here. There is a grave possibility, if not probability, that the stock-dividend decision practically exempts from all income and profits taxation a group of approximately 2,500 corporations and their stockholders, who would pay under existing law—and should in fairness pay at least—from five to six million dollars. This possibility with its consequent uncertainties should plainly be removed by the passage of amendatory legislation.

Fortunately it is possible to place personal-service corporations and their stockholders in nearly the same position that they now occupy—in a manner wholly consistent with the spirit and letter of the ruling of the Supreme Court—by applying to such corporation and after January 1, 1918, the tax on undistributed profits recommended above for all corporations on and after January 1, 1921. This tax would, of course, be in lieu of the war-profits and excess-profits tax which, because of its dependence upon "invested capital," can not intelligently be applied to personal-service corporations in which, by definition, "capital (whether invested or borrowed) is not a material income-producing factor." It is plain also that the law should be so amended as to tax dividends received by the stockholders of personal-service corporations in the same manner as other dividends are taxed.

It would be desirable, moreover, in my opinion, to permit personal-service corporations at their option to distribute during the year 1920 cash or other taxable dividends to the full extent of their profits earned during 1918 and 1919, but not yet distributed; and such retroactive distributions should be made taxable by the stockholders at the surtax rates applicable to the years in which the profits were accumulated by the corporation. By so doing personal-service corporations could, if they desired, place themselves and their stockholders in nearly the same position that they now occupy, i. e., they would pay no profits tax at all, while the entire corporate income (having been distributed) would be taxable in the hands of the stockholders. Indeed, so closely would the proposed plan resemble in effect the method of taxing personal-service corporations prescribed in the revenue act of 1918 that it would be eminently proper—and probably a source of great convenience to the taxpayers concerned—to authorize personal-service corporations with the written consent of their stockholders to elect voluntarily to pay taxes for the years 1918 and 1919 on the basis prescribed in the revenue act of 1918.

ESTIMATES OF PROBABLE LOSS IN REVENUE RESULTING FROM THE DECISION IN EISNER V. MACOMBER.

The loss resulting from this decision falls into two principal classes, that chargeable to the possible exemption of public-service corporations and their stockholders, and that chargeable to the complete exemption of stock dividends.

There are about 2,500 personal-service corporations having net income of approximately \$30,000,000 involved, the taxes upon which, under existing law, do not exceed \$6,000,000 for the year 1918, and a slightly smaller amount for the year 1919. The aggregate loss for the two years, 1918 and 1919, would

probably be between \$10,000,000 and \$12,000,000. The need for legislation in this connection arises not so much from the possible loss of revenue as from the obvious undesirability of permitting 2,500 corporations and their stockholders to escape both the taxes upon corporations and those imposed upon individuals.

The loss resulting from the exemption of stock dividends is very difficult to estimate, owing to the fact that such dividends have not in the past been separately shown on the returns, while the losses from the exemption of stock dividends as such will be partially or wholly offset by the heavier taxes resulting from the decision upon any gains realized from subsequent sale of the stock, and by other offsetting factors which need not be mentioned in detail. After consideration of these factors the Actuary of the Treasury Department estimates that the net loss or refund of taxes already paid—i. e., taxes for the period ending with the year 1918 will be in the neighborhood of \$35,000,000—and that taxes for the year 1919 (payable in the calendar year of 1920) will be reduced by approximately \$70,000,000 on this account. These figures may be regarded as maxima, and most of the experts of the department are of the opinion that the entire net loss resulting from the exemption of stock dividends will amount to less than \$25,000,000.

The suggestions made above do not comprehend all the changes in the present law which, in my opinion, could be advantageously adopted at the present session of Congress. I have confined my suggestions to an irreducible minimum of measures, looking largely to the simplification of the income and profits taxes, for the consideration of which there still remains time and action upon which at this session of Congress may reasonably be asked by the taxpaying public. I shall be glad, upon request, to submit drafts of amendments embodying the suggestions here presented, and to place at your disposal for the work of tax revision all of the personnel and facilities of the Treasury Department.

Respectfully,

D. F. HOUSTON, *Secretary.*

Income surtaxes.

Since the adoption of the heavy war surtaxes in the revenue act of 1917, the Treasury has repeatedly called attention to the fact that these surtaxes are excessive; that they have passed the point of maximum productivity and are rapidly driving the wealthier taxpayers to transfer their investments into the thousands of millions of tax-free securities which compete so disastrously with the industrial and railroad securities upon the ready purchase of which the development of industry and the expansion of foreign trade intimately depend.

It seems idle to speculate in the abstract as to whether or not a progressive income-tax schedule rising to rates in excess of 70 per cent is justifiable. We are confronted with a condition, not a theory. The fact is that such rates can not be successfully collected. Tax returns and statistics are demonstrating what it should require no statistical evidence to prove. For the year 1916 net income amounting to \$992,972,985 was included in the returns of taxpayers having net income over \$300,000 a year. This aggregate fell to \$731,372,153

for the year 1917 and to \$392,247,329 for the year 1918. There is little reason to believe that the actual income of the richer taxpayers of the country had fallen in that interval. It is the taxable income which has been reduced and almost certainly through investment by the richer taxpayers in tax-exempt properties. Whatever one may believe, therefore, about the abstract propriety of projecting income-tax rates to a point above 70 per cent, when the taxpayers affected are subject also to State and local taxation, the fact remains that to retain such rates in the tax law is to cling to a shadow while relinquishing the substance. The effective way to tax the rich is to adopt rates that do not force investment in tax-exempt securities.

The simplest remedy for this situation would be a general reduction of the higher surtaxes, accompanied by increases in the lower surtax rates. It is suggested that the Congress consider such a general revision, with a reduction to a maximum rate lower than that contained in the present law, provided acceptable new taxes of equal yield can be found. But if for the immediate future it is found impracticable to reduce the higher surtaxes to a level which would induce or make it profitable for wealthier taxpayers to select taxable rather than tax-exempt investments, an effective remedy might be found in limiting the surtax rates possibly to about 20 per cent on that part of the taxpayer's income which is saved and reinvested in property or business yielding taxable income (hereinafter referred to as "saved" income), leaving higher rates—perhaps the present rates—upon income which is spent or wasted or invested in tax-free securities.

By adopting this partial abatement, the yield of the surtaxes would not be as greatly reduced as if the general level of the surtaxes were lowered, a premium would be placed upon saving and a penalty upon spending, and a legitimate check would be imposed upon investment in nontaxables. This policy could be applied in a number of different ways, which the proper committees of the Congress may desire to consider in detail. Thus, a reduction on all saved income could be given by including it in the taxable income at 80 per cent of the full amount; or the proportionate amount of surtax attributable to that part of the income which is saved could, for example, be reduced one-fifth, with a provision that such surtax should never exceed 20 per cent of the saved income. But the simplest plan would be to treat saved income as "at the top" of the taxable income, or, in other words, as subject to the highest surtax rates, and then limit the tax on saved income to 20 per cent or whatever other rate was selected as the proper limit. The last plan would work as follows in the case of a head of a family with no dependents having an income of \$300,000, of which \$100,000 is "saved" and \$200,000 spent. Under the present law he would pay \$23,680 normal tax and \$137,510 surtax,

or \$161,190 in all. With the limited tax on saved income in the third form suggested above, the surtax on \$200,000 of spent income would be \$77,510; the 20 per cent surtax on \$100,000 of saved income would be \$20,000; and the total tax would be \$121,190, a reduction of \$40,000 from the present tax. It is important to note not only that the limited rate of 20 per cent would make a "taxable" investment at $7\frac{1}{2}$ per cent approximately as attractive, so far as Federal taxation is concerned, as a tax-free investment at 6 per cent, but the taxpayer would have the tax abatement of \$40,000 to use or invest as additional capital, a consideration which would throw the balance in favor of investment in industrial or other taxable fields. The maximum loss of revenue which would result from the limitation of surtaxes on saved income to 20 per cent is estimated at \$230,000,000. This could be made up by increasing the lower surtaxes, or, if it is thought wise, the normal tax, or by adopting some of the new taxes later indicated.

In any revision of the surtaxes, attention should be given to the serious direct loss involved in our present treatment of income derived from tax-free securities. The Annual Report of the Secretary of the Treasury for the year 1919 called attention to the apparent injustice and unwisdom of the bounty or privilege now accorded to this class of income. I heartily indorse the remedial recommendations alluded to in the following excerpt from that report:

In that connection I call attention to the urgent necessity of revision of the revenue law so as to require that, for the purpose of ascertaining the amount of surtax payable by a taxpayer, his income from State and municipal bonds shall be reported and included in his total income, and the portion of his income which is subject to taxation taxed at the rates specified in the act in respect to a total income of such amount. The Treasury's recommendations in this respect have been transmitted to the appropriate committees of Congress in connection with the revenue act of 1918, and again in the present calendar year. Under the present law a person having an income of, say, \$1,000,000 from taxable securities would, upon the sale of half his property and the investment of the proceeds of that half in State or municipal bonds, not only obtain exemption for the income derived from such investment in State and municipal bonds, but greatly reduce the surtaxes payable in respect to his other income. It is intolerable that taxpayers should be allowed, by purchase of exempt securities, not only to obtain exemption with respect to the income derived therefrom, but to reduce the supertaxes upon their other income, and to have the supertaxes upon their other income determined upon the assumption, contrary to fact, that they are not in possession of income derived from State and municipal bonds.

Excess-profits tax.

The reasons for the repeal of the excess-profits tax should be convincing even to those who on grounds of theory or general political philosophy are in favor of taxes of this nature. The tax does not attain in practice the theoretical end at which it aims. It discriminates against conservatively financed corporations and in

favor of those whose capitalization is exaggerated; indeed, many overcapitalized corporations escape with unduly small contributions. It is exceedingly complex in its application and difficult of administration, despite the fact that it is limited to one class of business concerns—corporations. Moreover, it is rapidly losing its productivity. The invested capital of the average corporation, earning profits high enough to subject it to the excess-profit tax, is now estimated to be increasing at the approximate rate of 12 per cent a year, while the income of the average corporation is almost certainly declining at as great a rate. Both movements cut into the productivity of the tax. If the present changes in capital and income continue for some time in the future, as now seems probable, large reduction may be expected in the yield of the excess-profits tax. For the present fiscal year, the profits tax, with collections of back taxes, is estimated to yield about \$1,250,000,000, and for the fiscal year 1922 about \$800,000,000, as against an estimated yield for the fiscal year 1920 of slightly over \$2,000,000,000.

The excess-profits tax, however, must be replaced, not merely repealed, and I believe that it should be replaced in large part by some form of corporation profits tax. This conclusion is based not only upon the Government's need for revenue but upon grounds of equality and justice. So long as taxpayers other than corporations are subject to a progressive income tax rising now to over 70 per cent, corporation profits should not be allowed to escape with a single tax of only 10 per cent. Individuals (and partnerships in effect) pay normal taxes and surtaxes upon all net income, whether spent, saved, or retained in the business of the taxpayer. Corporations pay only normal tax on such income, although their stockholders pay in addition surtaxes on the profits of the corporation which are distributed as dividends. But no surtaxes are paid on or with respect to the profits not distributed. It seems plain, therefore, that when the excess-profits tax is repealed some equivalent or compensatory tax should be placed upon the corporation in lieu of the surtax upon re-invested income paid by other taxpayers. Unless this be done, a heavy premium would be given to the corporate form of business. If, for example, three equal partners in a business invest capital of \$2,000,000 and make net profits of \$600,000, draw out \$75,000 as salary and \$75,000 as profits, leaving \$450,000 in the business, these partners would together pay income taxes of approximately \$279,570. But if they should incorporate the business, the total income and capital-stock taxes on the corporation and its three stockholders would, in case the excess-profits tax were repealed, be only \$75,865.

One partial substitute for the excess-profits tax would be a tax on the undistributed profits of corporations as nearly as possible equal to the surtax imposed upon the saved income of the individual. If

individuals doing business in partnership pay 20 per cent on undistributed profits, individuals doing business through the medium of the corporation should pay 20 per cent. This plan could be applied in many different ways: (1) The distributed profits of the corporation could be substituted for the so-called excess-profits credit of the excess-profits tax and the remaining or taxable profits be taxed at 20 per cent; or (2) a 20 per cent tax on undistributed profits could be applied as a corporation surtax under Title II of the revenue act; or (3) corporations could in form be subjected to the same progressive surtaxes as individuals—a proposal which would prove very advantageous to all corporations with small incomes—with a proviso that the total surtax should never exceed an amount equal to 20 per cent of the undistributed profits. None of these plans presents any grave administrative difficulty or involves any particular complexity of operation.

If an undistributed profits tax be adopted, it should contain provisions expressly recognizing the various devices by which many corporations find it possible to distribute statutory "dividends," while actually retaining the profits in the business. The object should be to subject stockholders of corporations to the same tax burdens imposed upon the members of a partnership, and any procedure which facilitates the attainment of this object should be welcomed. The stockholders of any corporation should be permitted, for example, by a unanimous vote to elect to be taxed as the members of a partnership or as the stockholders of a personal-service corporation are now taxed under existing law. It would be advisable seriously to consider the propriety of requiring every corporation, 95 per cent or more of the stock of which is held by one individual, to be treated as a partnership or personal-service corporation. This would go far toward solving the problem whose solution is now vainly sought in section 220 of the revenue act of 1918.

The object of these suggestions is to establish so far as possible an exact equivalence between the taxation of corporation stockholders and other taxpayers. The undistributed-profits tax appears to be one practical means of obtaining approximate equality of treatment. This is not only to satisfy a theoretical sense of justice. It is, I believe, the course of practical wisdom. At some points the revenue law as now formulated discriminates unjustifiably against the individual in favor of the corporation. At others it discriminates unduly against corporations in favor of the individual.

These discriminations operate to force many business enterprises into forms of organization not intrinsically the best suited to their needs. Furthermore, the most troublesome problem of income taxation is the same in case of both corporations and unincorporated taxpayers, i. e., the repressive effects of heavy rates when applied

to income which is saved and reinvested. That and many other problems of personal and corporation income taxation will best be decided when linked together. We are now taxing reinvested income of individuals at rates which may exceed 70 per cent. The error of this treatment appears plainly when we attempt to apply such rates in the case of corporations. It would be unthinkable to tax the saved income of corporations at 70 per cent. On the other hand the stockholders of corporations are forced to pay through the corporation a higher normal tax than individuals. They receive no credit against this normal tax for the personal exemptions, and—under existing law—profits which have paid both the corporation income tax and the heavy excess-profits tax are again subjected, when distributed as dividends to stockholders, to surtaxes rising in some cases to 65 per cent. In the latter instances the discrimination is against the corporation and its stockholders. Like treatment should prove in the long run the surest means of obtaining just and wholesome treatment. Separate treatment will in the long run conduce to corporation baiting. If corporations insist upon different treatment, they are in the long run likely to receive worse treatment. The next revision of the tax law should place the income tax upon an enduring foundation of sound principle. Lasting solutions and not temporary makeshifts should be sought.

The tax on undistributed profits has certain obvious disadvantages, as, in fact, have all tax proposals. It is widely opposed because it would, in form, fall on reinvested profits, although the personal-income tax falls also on reinvested profits. It is believed also by many honest and able men that, notwithstanding the fact that it would reduce the tax burden upon corporations, it would tend to cause an undue dissemination of corporation profits and subject directors of corporations to a strong temptation to pay out as dividends profits actually needed in extending or maintaining the business itself.

If, in the opinion of the Congress, these or other difficulties make the undistributed-profits tax unavailable, the excess-profits tax might be replaced, in part at least, by a compensatory corporation tax, or "corporation surtax," at a flat rate. Such a tax, at any practicable rate, can not be made the equivalent of the individual or personal surtaxes on reinvested income. It would leave the corporation tax less burdensome than the personal tax on some business concerns and more burdensome than the personal tax on others. The undistributed-profits plan would tax income saved by corporations at the maximum rate paid by individuals on saved income, while leaving the corporation an option to distribute the profits—either constructively or actually—and thus subject such profits to taxation in the hands of the stockholders. But the "corporation surtax" has the great merit of

simplicity, and such a tax has recently been adopted in the United Kingdom for precisely the purposes here set forth; that is, to secure from corporations some contribution in lieu of the surtax collected from individuals on reinvested income. The discussion of this tax by the chancellor of the exchequer in his financial statement of April 19, 1920, is enlightening, and it is quoted in part below. The italics are mine:

CORPORATION-PROFITS TAX.

I propose therefore to introduce this year a new tax which, for the time being, will be levied concurrently with the excess-profits duty, but which, either in the form in which I propose it or in an amended form, may in the future prove a substitute for it. The character of the new tax, *a permanent tax*, has been the subject of most anxious consideration by the Government and myself and, as I have previously mentioned, I think, in the House last year, I sent out a mission to Canada and the United States to investigate and to study the schemes of profits taxation in force in those countries, and to see whether we could derive any lessons of use to us from their practice and experience. The results of the inquiry and of independent investigation in this country have not served to remove the difficulties which presented themselves to our first consideration of the proposal for a taxation of profits in excess of a certain return upon invested capital, and have not enabled us to see our way to adjust such a tax to existing business conditions and customs in this country. We, therefore, abandoned the idea of creating a tax on profits in excess of a fixed standard and we propose to have recourse to a different measure. I may describe our proposal as a corporation tax levied at the rate of 1 shilling in the pound on the profits and income of concerns with limited liability, engaged in trade or similar transactions. This tax will run concurrently with excess-profits duty until that duty is repealed. Where a concern is liable to both taxes, any excess-profits duty payable will be treated as a working expense in arriving at the profits for the purpose of the new tax. Both excess-profits duty and corporation tax will be deducted before the assessment of profits for income tax, and to prevent the new tax constituting too severe a burden on the ordinary shareholder of existing concerns in which there are large issues of debenture and preference shares, where a considerable proportion of the profit has to be allocated to the payment of interest and fixed dividends thereon, we propose that in no case shall the duty exceed 2 shillings to the pound on the profits which remain after the payment of such interest and dividends on existing issues of debentures and preference shares. *I would remind the committee that under the provisions of the excess-profits duty prosperous concerns with a large prewar profit standard may escape liability for the tax because their present profits, though high, are not in excess of their standard, and, at any rate, they pay a tax on what all of us think an unduly low scale. Incidentally, the new tax will do something to correct this anomaly. But I justify it on much broader grounds. Companies incorporated with a limited liability enjoy privileges and conveniences by virtue of the law for which they may well be asked to pay some acknowledgment. But, more than that, partners in a private partnership pay supertax not merely on the profits which they divide, but also on the undivided profits which they place to reserve. No such charge falls upon the undivided profits of limited liability companies. The corporation tax is justified by this distinction of the existing law in favor of such corporations, and it may be regarded as a composition in lieu of the liability to supertax.*

A flat corporation surtax of adequate rate could probably be substituted for the excess-profits tax without serious loss in revenue. Whether any loss would result by the substitution of an undistributed-profits tax is problematical. The shrinkage in the tax collected from corporations as the result of distributed profits would be partially counterbalanced by an increase in the taxation of the stockholders of the corporations involved. Furthermore, the yield of the excess-profits tax is declining and may decline rapidly in the near future. Two hundred million dollars is probably a maximum allowance for the loss of revenue that would result in 1922 if the excess-profits tax were replaced (as of January 1, 1921) by an undistributed-profits tax of 20 per cent. New taxes capable of yielding approximately this amount should be selected from the additional taxes suggested below or from other sources in case the undistributed-profits tax is adopted.

Excise and luxury taxes.

In the case of individuals who pay income tax, particularly surtax, the income tax operates as a general and perhaps the best form of luxury taxation. But there is luxurious or wasteful consumption among those persons who do not ordinarily pay income tax, and to reach this class of surplus income of taxable capacity excise or sales taxes—here briefly referred to as “consumption taxes”—must be employed.

It is not necessary, however, to tax every luxury. Consumption is elastic. If the tax is laid upon tobacco and the particular consumer prefers tobacco to candy he will reduce his consumption of candy in order to secure his accustomed supply of tobacco. It is desirable to avoid absolute necessities of life, however, because some individuals have little or no waste income to be tapped either directly or indirectly. But if the absolute necessities are avoided, the selection of other articles of taxation should be controlled by practical considerations of simplicity and convenience. In appearance consumption taxes do not conform to the theory of “ability to pay.” But when used as supplementary to a highly progressive income tax they do not necessarily—if moderate in amount and properly selected—violate this principle. The system of taxation may conform to this principle, though each tax may not. The continued use of consumption taxes in the budgets of the most advanced countries seems to prove that they have a legitimate though restricted place.

Consumption taxes must be largely justified, if at all, by the practical virtues of certainty, convenience, productivity, and efficient collection. Some of the excise or consumption taxes at present imposed by the revenue act of 1918 do not meet these tests. On this account I recommend the repeal of the taxes upon fountain drinks, ice cream, and other “similar articles of food and drink” imposed by section

630; the excess price or so-called "luxury" taxes imposed by section 904; and the taxes imposed upon medicinal articles by section 907 of the revenue act of 1918. These taxes are not highly productive (yielding in the aggregate less than \$50,000,000 in the fiscal year 1920); they are ill defined and uncertain; they are vexatious and expensive to the dealers who pay them; and I am informed by those in charge of their administration that they are widely evaded and that such evasion can not be stopped without the employment of a larger number of agents and measures more drastic than the potential importance of these taxes would justify. To this last statement there is one possible exception: The taxes imposed by section 907 apply not only to patent or proprietary medicinal preparations but to perfumes, toilet waters, cosmetics, and a long list of allied luxuries. The most striking defects of the present tax affecting these articles would be remedied by collecting the tax not on the individual sale but from the manufacturer, producer, or importer; and if the tax seems important enough to retain, it should be changed from the present basis to that suggested. It may be added that Canada has just changed the method of collecting stamp duties on patent and proprietary medicines and perfumery by having the stamps affixed by the manufacturer or importer and not by the retailer.

Additional sources of revenue.

The loss of revenue which would result from the adoption of the preceding recommendations, together with the loss to result even under existing law from the shrinkage of business, would have to be made up from new sources. For the convenience of the committees of the Congress which will be directly responsible for tax revision, I set out below a number of new or additional taxes capable of yielding in the aggregate as much as \$2,000,000,000 a year. These estimates are based upon conditions in the midsummer of 1920, and changes in the future may affect the revenue yield of the taxes mentioned.

Source.	Tax rate.	Estimated additional yield for a 12-month period.
Normal income tax.....	Increase the 4 and 8 per cent rates to 6 and 12 per cent.	¹ \$150,940,000
Readjusted surtax rates.....	(²).....	² 230,000,000
Corporation income tax.....	Additional 6 per cent.....	³ 465,000,000
Do.....	Abolish \$2,000 exemption.....	58,000,000

¹ It is estimated that an increase of the 4 and 8 per cent normal income-tax rates to 6 and 10 per cent, respectively, would yield during a 12-month period additional revenue amounting to \$75,470,000. It is also estimated that if only the 8 per cent normal income-tax rate is increased to 12 per cent, the additional revenue to be derived therefrom during a 12-month period would amount to \$103,090,000.

² The surtax rates, shown on page 45, it is estimated, would yield the same amount, \$990,000,000, as the present surtax rates. Inasmuch as the loss of revenue resulting from the abatement of surtaxes on saved or reinvested income has been estimated at \$230,000,000, only this amount has been included in the table of suggestions.

³ It is estimated that an increase in the corporation income tax from 10 to 12 per cent would yield during a 12-month period an additional revenue of \$118,800,000.

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Source.	Tax rate.	Estimated additional yield for a 12-month period.
Corporation undistributed profits tax: Increase in corporation income tax, estimated at \$190,000,000. Additional revenue from the application of the surtax rates to dividends distributed by corporations to avoid the 20 per cent undistributed profits tax, estimated at \$500,000,000.	20 per cent.....	\$890,000,000
Stamp taxes, Title XI, act of 1918.....	Individual surtax rate.....	
	Double rates in subdivision 10 and quadruple rates in subdivisions 1-9 11, and 12.....	\$134,000,000
Federal license tax on use of automobiles.....	50 cents per horsepower.....	100,000,000
Cigars.....	25 cents per 1,000 additional.....	5,000,000
Cigarettes, weighing not more than 3 pounds per 1,000.....	\$2 per 1,000 additional.....	70,000,000
Tobacco and snuff.....	6 cents per pound additional.....	8,000,000
Gasoline.....	2 cents per gallon.....	90,000,000
Admissions to theaters.....	10 per cent additional.....	70,000,000
Increase rates on following articles specified in section 900 of the revenue act of 1918: Automobiles (other than automobile trucks and wagons) and motor cycles, including automobiles and motor-cycle tires, inner tubes, parts, and accessories (subdivisions 2 and 3).....	5 per cent additional.....	100,000,000
Musical instruments (subdivision 4).....	.....do.....	13,000,000
Chewing gum (subdivision 6).....	7 per cent additional.....	2,000,000
Candy (subdivision 9).....	5 per cent additional.....	20,000,000
Toilet soap and toilet-soap powders (subdivision 21).....	7 per cent additional.....	4,000,000
Jewelry and articles of precious metal (sec. 905, revenue act of 1918).....	5 per cent additional.....	25,000,000
Motion-picture films (sec. 906, revenue act of 1918).....	.....do.....	4,000,000
Perfumes, cosmetics, and medicinal articles, a tax upon the sale by the manufacturer, producer, or importer in lieu of the tax imposed under section 907, revenue act of 1918, of.....	10 per cent.....	16,000,000

¹ If the stamp taxes imposed by Title XI of the revenue act of 1918 were doubled the additional yield for a 12-month period would, it is estimated, be \$90,000,000.

The following surtax rates, limited to 20 per cent on saved or reinvested income, would yield, it is estimated, as much as the present surtax rates:

Incomes	Surtax rates.		Incomes.	Surtax rates.	
	Saved income.	Remainder of income.		Saved income.	Remainder of income.
	Per cent.	Per cent.		Per cent.	Per cent.
\$5,000-\$6,000.....	2	2	\$30,000-\$40,000.....	20	25
\$6,000-\$8,000.....	5	5	\$40,000-\$50,000.....	20	30
\$8,000-\$10,000.....	10	10	\$50,000-\$75,000.....	20	35
\$10,000-\$15,000.....	12	12	\$75,000-\$100,000.....	20	40
\$15,000-\$20,000.....	15	15	Over \$100,000.....	20	50
\$20,000-\$30,000.....	20	20			

These possible sources of revenue are mentioned for the information of the Congress. While I shall not attempt to discuss them in detail, attention should be called to the new or additional consumption taxes included. Reasons have been given above for the belief that no valid objection exists against the employment of a moderate number of consumption taxes properly selected; but it would, in my opinion, be neither wise nor expedient to increase radically the

volume of consumption taxation. During the last fiscal year the taxes on transportation and insurance, beverages, tobacco products, admissions, and dues, together with the excise or sales taxes imposed by Title IX of the revenue act—taxes which may be roughly grouped as consumption taxes—yielded \$1,150,386,743, or 21 per cent of the total internal taxes. If necessary this amount could be moderately increased to perhaps 25 or 30 per cent of the total. But I can see no justification for a general-sales tax designed to substitute indirect taxes falling on the consumer for the income tax which now furnishes the backbone of the Federal fiscal system, nor even for an increase in specific sales or consumption taxes which would yield perhaps two billions in place of the one billion, approximately, now collected from the consumer.

The particular articles included in the suggested list of additional consumption taxes have not been selected because their use is particularly harmful or in any sense less legitimate than the use of articles not so included. Consumption taxes must be judged by practical standards. What should be sought are a few consumption taxes which will tap the surplus income which is being wasted, not a conglomerate multiplication of petty taxes upon every article of luxurious or unnecessary consumption, which can neither be clearly defined, cheaply collected, nor administered without widespread evasion.

Administrative amendments.

A number of important technical and administrative amendments were recommended in my letter of March 17, 1920, to the chairman of the Committee on Ways and Means, previously quoted. These recommendations have been substantially embodied in H. R. 14197 and H. R. 14198, both of which have already passed the House of Representatives. I earnestly hope that these bills may be promptly enacted into law.

Tax exemptions of Liberty bonds and Victory notes.

The attention of the Congress is again invited to the recommendation made in the Annual Report of the Secretary of the Treasury for 1919, on pages 96-100, that legislation be enacted to simplify and consolidate the limited exemptions of 4 and 4½ per cent Liberty bonds from surtaxes and profits taxes. The existing situation with respect to these exemptions, which were conferred upon Liberty bond holders by legislation enacted from time to time during the war, is fully set forth in the annual report for 1919. A provision embodying the Treasury's suggestions as to the simplification of these exemptions was incorporated in H. R. 13355, introduced in the House of Repre-

sentatives on March 30, 1920, and referred to the Committee on Ways and Means, and again in section 6 of H. R. 14198, which passed the House of Representatives on May 27, 1920, and has been referred to the Committee on Finance of the Senate. I believe that these simplified exemptions should be enacted into law and that any slight loss of revenue which may result will be more than counterbalanced by the gain to the Treasury which will result from the increased attractiveness of the taxable issues of Liberty bonds and the consequent benefit to the Government's credit, as well as from the simplification of administration in the Bureau of Internal Revenue.

August 30, 1920

REGULATIONS GOVERNING SALES OF SILVER TO THE DIRECTOR OF THE MINT
UNDER THE PITTMAN ACT. .

Under authority of the Pittman Act, approved April 23, 1918, and pursuant to the public statements of the Director of the Mint of May 17, 1920, and June 18, 1920, copies of which, marked Exhibit A and Exhibit B, respectively, are hereto attached, the following regulations are prescribed with reference to the proof required to be submitted to the Director of the Mint in connection with purchases of silver under said act:

UNMIXED SILVER.

(1) In the case of silver delivered for sale to the Director of the Mint, which is wholly the product of mines situated within the United States and of reduction works so located, without admixture of foreign silver, the vendor will be required to file at the time of such delivery a vendor's affidavit and affidavits by the miner, smelter and refiner substantially in the forms prescribed by the Director of the Mint under date of May 17, 1920, revised copies of which are attached.

MIXED SILVER.

(2) In the case of silver delivered for sale to the Director of the Mint which forms part of a mixture of foreign silver and domestic silver, the vendor will be required to file at the time of such delivery a vendor's affidavit substantially in the form prescribed by the Director of the Mint under date of June 18, 1920, a revised copy of which is attached.

(3) In addition to the affidavit prescribed by paragraph 2 above, and in accordance with the stipulations of the vendor's affidavit therein referred to, every vendor delivering for sale to the Director of the

Mint silver which forms a part of a mixture of foreign silver and domestic silver will also be required to file with the Director of the Mint an affidavit by the miner from whom the domestic silver was purchased substantially in the form prescribed by the Director of the Mint under date of June 18, 1920, a revised copy of which is attached. Such vendor will also be required to file with the Director of the Mint sworn copies of the liquidation sheets of the smelters to which the domestic silver covered by the miners' affidavits was delivered by said miners. Such liquidation sheets must cover all deliveries of silver to said smelters from January 17, 1920, for the entire period within which such silver is delivered for sale to the Director of the Mint. Said copies of liquidation sheets must be filed with the Director of the Mint monthly and must be accompanied by sworn abstracts showing total deliveries of foreign silver and domestic silver to said smelters during the month, as shown by said liquidation sheets.

(4) In addition to the sworn copies of the liquidation sheets, referred to in paragraph 3 above, the vendor will also be required to file with the Director of the Mint not less frequently than quarterly sworn abstracts from the books of account of the respective smelters and refineries by which said silver was treated showing:

(a) The amount of silver on hand at such smelter or refinery at the beginning of the period covered by said abstract;

(b) The amounts of silver received at said smelter or refinery for smelting or refining during said period, and sources from which received;

(c) The amount of silver smelted or refined at said smelter or refinery during said period;

(d) The amounts and consignees of all silver delivered from said smelter or refinery during said period; and

(e) The amount of silver remaining on hand at said smelter or refinery at the end of said period.

Such abstracts must form a continuous record of receipts, production and deliveries of silver at each said smelter or refinery from January 17, 1920, for the entire period within which silver is delivered for sale to the Director of the Mint under the Pittman Act.

(5) The Director of the Mint will purchase under the Pittman Act silver which forms a part of a mixture of domestic and foreign silver up to the proportion of such mixed product which represents silver wholly produced from mines situated in the United States and reduction works so located; provided, however, that the aggregate amount of silver purchased hereunder shall not exceed the amount of silver actually produced from mines situated in the United States and delivered to reduction works so located since January 17, 1920, as shown by the liquidation sheets of said reduction works, filed with the Director of the Mint as above required, and the supporting affidavits of the miners who delivered said silver to said reduction works; and provided further, that the aggregate amount of the total refined mixed product purchasable by the Director of the Mint under the Pittman Act shall not exceed the proportionate part thereof corresponding to the proportion in which silver actually produced from mines located within the United States entered into the aggregate amount of domestic and foreign silver

received by the smelters concerned since January 17, 1920, as shown by the liquidation sheets of such smelters, filed with the Director of the Mint as above required. All sales of mixed silver by the vendor prior to May 15, 1920, and all sales of mixed silver by the vendor after that date at a price exceeding \$1 per ounce, 1,000 fine, shall be deemed to be made out of domestic and foreign silver in the same proportion in which domestic and foreign silver are found to have entered into the mixed product pursuant to these regulations.

(6) All copies of liquidation sheets and abstracts from books of account filed as aforesaid with the Director of the Mint must be certified under oath by a duly authorized officer of the smelter or refinery rendering such statements to be true and correct copies or abstracts from the books of account of said smelter or refinery.

(7) Silver which has at any time been in the form of coined silver or sycee, will not be deemed to be domestic silver for the purpose of purchases by the Director of the Mint under the provisions of the Pittman Act and the regulations prescribed hereunder.

(8) The Director of the Mint may withdraw or amend at any time or from time to time any or all of the regulations herein prescribed.

R. T. BAKER
Director of the Mint.

August 30, 1920.

APPROVED:

S. P. GILBERT, JR.,
Assistant Secretary of the Treasury.

TREASURY DEPARTMENT

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For immediate release,
September 28, 1920.

Secretary Houston today gave to the press the following copies of his two letters of September 28, 1920, to James W. McCarter, Ex-Assistant Register of the Treasury.

September 28, 1920.

Sir:

Senator Carter Glass has referred to the Treasury Department for reply your letter of September 3, 1920, inquiring concerning figures given in the Annual Report of the Secretary of the Treasury for 1919, as to the outstanding interest-bearing public debt on July 1, 1919. The Treasury does not, of course, recognize any right on the part of the so-called "McCarter Corporation", or on your part as its President, to attack the correctness of the published figures as to the public debt, particularly in view of the fact that the inquiries which you make relate directly to the work under your charge as Assistant Register of the Treasury from before the beginning of the war until July 31, 1920 (when your resignation was accepted), and if any irregularities such as you suggest did exist you would presumably have taken steps to correct them and report them to the Secretary of the Treasury during your term of office. The facts are, however, entirely clear and in accordance with the figures published in the Annual Report, and I am glad to have this opportunity to correct the misapprehensions upon which your comments are obviously based.

You inquire particularly as to an item appearing on page 610 of the report for the fiscal year 1919, which states the total

interest-bearing debt of the United States on July 1, 1919, as \$25,234,496,273.54, and you imply that because of certain bonds issued with duplicate numbers, the public debt was in reality in excess of the amount stated. The figure given is correct, and your fears as to a possible overissue of the debt because of duplicate serial numbers have no basis whatever. If you had taken the pains during your term as Assistant Register to acquaint yourself with the facts as to the numbering of the bonds, you would know that such duplications in serial numbers as have occasionally appeared result simply from aberrations in the numbering machinery used by the Bureau of Engraving and Printing, and do not in any respect amount to a duplication or overissue of the public debt. Most of the duplications in serial numbers have been caught before issue, as the result of checks in the Bureau of Engraving and Printing, the Division of Loans and Currency, and the Office of the Register of the Treasury, but even the bonds which have been passed with duplicate numbers have been issued only after full payment therefor has been received by the Treasury, as required by law, in respect to both bonds issued with duplicate numbers. No Liberty bonds, Victory notes, or Treasury certificates of indebtedness have been issued by the United States except against full payment therefor to the Treasurer at par and accrued interest pursuant to law and the

regulations of the Treasury Department, and the amounts of cash shown to have been received by the Treasurer of the United States on account of the principal of the bonds, notes and certificates fully cover, therefore, the amounts issued and outstanding. In fact, by reason of partial payments and even full payments, against which securities have not been actually issued, the amount of such cash receipts more than covers the amount of securities actually issued and outstanding. In order that the situation as to the item you question may be plain to you, I call your attention particularly to the detailed figures set forth in the Financial Statement of the United States Government for June 30, 1919, appearing on pages 220 and following of the Annual Report for 1919; the footnotes to this statement explain that certain items, as therein stated, represent receipts of the Treasurer of the United States on account of principal. The figures so reported include all bonds, notes and certificates delivered against full paid subscriptions, and as indicated, necessarily include also certain partial payments against which securities are not deliverable and even the full paid subscriptions against which securities are deliverable but not yet physically delivered. According to the records of the Department, no duplicate issues of certificates have been made, though, as already indicated, it is a matter of common knowledge that some securities imperfect as to serial numbers have reached the public; these imperfections are of little or no consequence inasmuch as they do not indicate duplicate issues. You refer specifically in this connection to bond No. 7979985 of the Second Liberty Loan in the denomination of \$50. The bond bearing this number was a "make-up bond"

issued to replace a bond spoiled in printing; the spoiled bond was cancelled and destroyed and never became an obligation of the United States, and the erroneous number, therefore, does not represent any duplication whatever of the public debt.

You ask further whether the amount shown as outstanding on July 1, 1919, includes "blotted or defective bonds substituted by star or other perfect bonds at issue" or "uncancelled surrendered certificates, bonds or coupons if any were back in circulation." The statement, of course, does not include blotted or defective bonds substituted by star or other perfect bonds, for the reason that such imperfect or mutilated bonds are cancelled and destroyed and not issued. Your inquiry as to uncancelled securities is not quite clear, but apparently you refer to retired securities delivered to the Register, which in ordinary course are already cancelled, and if not cancelled when delivered to the Register are required to be cancelled immediately by him, pursuant to standing instructions from the office of the Secretary of the Treasury. Retired securities have ceased to be obligations of the United States and are not included in the public debt statements; after examination by the Register they are destroyed.

According to the records of the Department, not retired securities are now outstanding uncancelled, though, as you know, during your term of office as Assistant Register, \$30,000 face amount of uncancelled bonds were abstracted from the files by a thief and were later recovered by the Department over a year ago. If you have knowledge or information of any other abstractions of securities, cancelled or uncancelled, during your term of office or since its expiration, I have to request that you promptly advise the Treasury

in order that appropriate action may be taken. In this connection, I need scarcely remind you that while you were Assistant Register of the Treasury you were in immediate charge of the custody and cancellation of retired securities, and were responsible therefor as an officer of the United States.

Respectfully,

(Signed) D. F. HOUSTON

Secretary.

James W. McCarter, Esq.,

The McCarter Corporation

Ipswich, South Dakota.

September 28, 1920/

James W. McCarter, Esq.,
c/o The McCarter Corporation,
Ipswich, South Dakota.

Sir:

I received your letter of September 3, 1920, making inquire regarding the outstanding public debt of the United States, with particular reference to the cancellation and destruction of retired securities received by the Register of the Treasury during your incumbency of office as Assistant Register, I notice that you promptly took the liberty of publishing your letter in the Ipswich, South Dakota, Tribune, and that you have since circulated it widely throughout the country, notwithstanding the fact that the insinuations in your letter, if they have any basis in fact, are primarily areflection upon your own conduct as Assistant Register of the Treasury. In this connection I should like to remind you that serious charges were brought against you in 1919 and your removal approved by the President, and that you were retained in office only by special action of Secretary Glass, out of consideration for your family and after you had given promises of good behavior for the future. The Treasury does not, of course, recognize any right on the part of the so-called "McCarter Corporation", or on your part as its President, to institute any inquiry into the administration of the Treasury, particularly in view of the fact that the inquiries which you make relate directly to the work under your charge

as Assistant Register of the Treasury from before the beginning of the war until July 31, 1920 (when your resignation was accepted), and if any irregularities such as you suggest did exist you would presumably have taken steps to correct them and report them to the Secretary of the Treasury during your term of office. The facts as to the matters which trouble you are, however, entirely clear, and I am glad to have this opportunity to correct the misapprehensions upon which your comments are obviously based. With this in view, I have caused careful inquiry to be made touching the allegations which you make, and, in order that the record may be clear, answer them categorically and at length, as follows:

1. It is not true that "billions of dollars worth of payable to bearer surrendered certificates of indebtedness, bonds and coupons, known as unused, interchanges, exchanges and replacements, uncanceled and with no mark of 'paid or surrendered' on same but in the original state of issue ready for circulation, have passed through the hands of numerous un-bonded officials and clerks" to final file. The Treasury Department's standing instructions require that all paid or surrendered bearer securities shall be canceled by the paying agency, e. g., the Federal Reserve Bank, the Treasurer of the United States, or, in some cases, the Division of Loans and Currency, though it is unquestionably true that, during the war period and subsequently, owing to the enormous volume of retired securities handled, some retired

securities have reached the Register's office uncanceled. It is the duty of the Register's office, however, pursuant to long standing instructions from the Secretary of the Treasury, to make careful examination of all retired securities which it received, and, among other things, to detect uncanceled securities and cancel them before filing. After examination and filing, the canceled retired securities are required to be kept under proper surveillance in the Register's office, and are later destroyed under the supervision of the Destruction Committee of the Department. If, as you allege, any securities were delivered during your incumbency of office to the Vaults and Files Division of the Register's office for final file uncanceled, pending delivery to the Destruction Committee, the responsibility therefore rests primarily upon you, and you should have reported the facts to the Secretary of the Treasury for appropriate action.

2. Investigation discloses that the certificates of indebtedness numbering 474 pieces and aggregating \$1,376,000 cited by you as being uncanceled when filed, were canceled in the Register's office before filing. Cancellation had been purposely omitted by the Federal Reserve Bank which returned these unused certificates in order that they might be used to supply other Federal Reserve Banks, if necessary. The anticipated necessity did not arise, however, and the certificates were duly canceled before being placed in the Vaults and Files Division. It also appears that the three lots of Liberty Loan bonds which you named (Lots 2232, 1927 and 1942) were canceled before filing and re-

verified in each case after cancellation. The fact that cancellation had been omitted by the Federal Reserve Banks was properly discovered by the Register's office in these particular cases, which was one of the objects of the examination.

3. Your statement that paid coupons are occasionally found uncanceled when examined by the Coupon Audit Section in the Register's office is not news to the Department. The object of the examination by the Coupon Audit Section is to determine, among other things, if uncanceled coupons are present, and to see that all uncanceled coupons are canceled effectively before filing. Out of more than 100,000,000 coupons paid annually and sent in by Federal Reserve Banks and other paying agencies, it is natural that a few should be found uncanceled, notwithstanding the strict instructions requiring cancellation before shipment to the Department, and one of the reasons for maintaining the Register's office is to insure a final check upon the cancellation of paid coupons.

4. With reference to your statement as to the recovery of \$30,000 of bonds (not \$31,000 as stated by you) stolen from the Department in October, 1919, or thereabouts, the records show that the colored taxicab driver whom you mention had every opportunity to locate and identify the "white man" who, it was alleged, left the bonds in his vehicle, but failed to do so. The bonds in question were missing from a package of securities delivered to the Register's office on August 25, 1919, but not examined as to character and amount until about five weeks thereafter.

During this interval the package was stored in the control of a division in the Register's office which was under your immediate supervision as Assistant Register of the Treasury. If these bonds were abstracted prior to delivery to your custody, that fact should have been established by an immediate count thereof upon receipt, and, if not, the presence of the uncanceled bonds "in the center of this package" should have been discovered and cancellation effected by your office. Your statement is noted "that the bonds on both top and bottom of this package were cancelled and this \$31,000 in bonds were left in center of package uncanceled and were from there taken". This statement appears to be made on the basis of special information in your hands, and it is the first time that this circumstance has been brought to the attention of the Department, though if substantiated, it might have an important bearing on the investigation of the case. Your letter in this respect, therefore, means simply that you have withheld from the Department material facts within your knowledge, during your term of office. There is no record in the Department of a shortage of \$34,000 bonds which you state were stolen October 25, 1919, and if you have any specific information as to such a theft, I presume you will transmit it to the Treasury.

5. It is true that the Secret Service Division assisted the local police in locating the thief who stole \$3000 in Government bonds, which were the personal property of an employee in the Register's office. These bonds were in a desk in the office and the thief, another employee,

was apprehended. Following his confession, the thief was dismissed from the service, after which the case was turned wholly over to the police department. It is obvious that the participation of the Secret Service in this case was not primarily to assist the employee who was robbed but to detect the guilty person in the Department, who otherwise might have stolen securities in the custody of the Department belonging to the Government.

6 6. There is no evidence that "millions of dollars worth of duplicate numbered Liberty Loan bonds and coupons were issued and put in circulation" as alleged by you. Nor is there and basis whatever for the statement that "the Government lost the face value of each of the duplicate numbered bonds and coupons". If you had taken the pains during your term as Assistant Register to acquaint yourself with the facts as to the numbering of bonds, you would know that such duplications in serial numbers as have occasionally appeared result simply from aberrations in the numbering machinery used by the Bureau of Engraving and Printing, and do not in any respect represent duplications or overissues of the public debt. Most of the duplications in serial numbers have been caught before issue, as the result of checks in the Bureau of Engraving and Printing, the Division of Loans and Currency, and the office of the Register of the Treasury, but even the bonds which have been passed with duplicate numbers have been issued only after full payment therefor has been received by the Treasury, as required by law, in respect to both bonds issued with duplicate numbers.

The fact amount of bonds actually issued is correct and in agreement with the cash paid in by subscribers, notwithstanding the occasional errors in numbering. The total number of bonds with duplicate serial numbers which have been issued and returned to the Department up to this time is less than fifty pieces, with the aggregate face value of less than \$10,000. The number of duplicate numbered interest coupons is slightly larger. Notwithstanding your statement to the contrary, a record is and has been maintained of all duplicate numbered bonds or coupons received in the Register's office.

7. With reference to bond No. 7979985 of the Second Liberty Loan, denomination of \$50, which you state reached the Department through the Federal Reserve Bank of New York though the Treasury records showed the last number issued to be 7869000, it appears that this was an error in numbering and not an over-issue as you would imply. You state that the employee who reported this high number on February 2nd was asked to resign on February 5th, 1920. You are aware, probably, that this employee was under charges of misconduct prejudicial to the good of the service for five or six days before this bond was reported, and that resignation was permitted in lieu of the recommendation for dismissal which had been decided upon.

Ordinarily your letter would have received the brief attention and the short reply which by reason of its scurrilous character

it deserved. Coming, however, from a man whose official position of trust and responsibility during the past few years should have acquainted him fully with the facts and with the stupendous tasks performed by the Treasury Department, it has been deemed proper to answer at some length your artfully phrased questions in order that their absurdity may be clearly apparent. A critical examination of your letter and a careful consideration of its inquiries impels me to the conclusion that the Department's principal error, if any, in the administration of the Register's office was in heeding your earnest appeal and carrying you on the rolls after the charges of unfitness for office brought against you in 1919 had been substantiated and your removal from office officially approved.

Respectfully,

(Signed) D. F. HOUSTON

Secretary.

SUPPLEMENTAL REGULATIONS GOVERNING SALES OF SILVER TO THE
DIRECTOR OF THE MINT UNDER THE PITTMAN ACT

The regulations of the Director of the Mint, approved August 30, 1920, with reference to the proof required to be submitted in connection with purchases of silver under authority of the Pittman Act, approved April 23, 1918, are hereby amended as follows:

Paragraph (3) of said regulations now requires that sworn copies of liquidation sheets be filed with the Director of the Mint, as follows -

Such vendor will also be required to file with the Director of the Mint sworn copies of the liquidation sheets of the smelters to which the domestic silver covered by the miners' affidavits was delivered by said miners. Such liquidation sheets must cover all deliveries of silver to said smelters from January 17, 1920, for the entire period within which such silver is delivered for sale to the Director of the Mint. Said copies of liquidation sheets must be filed with the Director of the Mint monthly and must be accompanied by sworn abstracts showing total deliveries of foreign silver and domestic silver to said smelters during the month, as shown by said liquidation sheets.

In lieu of the filing of sworn copies of the liquidation sheets, pursuant to this requirement, the vendor may file with the Director of the Mint, not less frequently than quarterly, a sworn statement by the superintendent of each smelter receiving deliveries of domestic or foreign silver, covering each month during the period subsequent to January 17, 1920, and showing for each month the total deliveries of foreign silver and domestic silver to the smelter during the month and the names of the miners or other depositors from whom such deliveries of silver were received, with the amounts received from each such miner or other depositor. Such sworn state-

ments from the superintendent of the smelter must state expressly that the information contained therein is based upon examination of liquidation sheets filed with the smelter, that such liquidation sheets are in the custody of the smelter and constitute part of its records, and that the names and figures given cover all deliveries of silver, both foreign and domestic, to the smelter during the month.

R. T. BAKER

Director of the mint.

Approved, October 6, 1920.

S. P. GILBERT, JR.,

Assistant Secretary of the Treasury.

Released for morning papers. 91
WASHINGTON

Oct. 7, 1920
October 6, 1920.

The following are copies of letters which Secretary Houston recently wrote in response to inquiries:

September 29, 1920.

Dear Sir:

Referring to your visit to my office Monday and to our discussion of the problems of agricultural finance and marketing, I desire to repeat what I said to you. I am in full accord with the policies of the Federal Reserve Board as announced by it from time to time, with the views recently expressed by the Governor of the Federal Reserve Board in his addresses in Cleveland and those of Mr. Platt, a member of the Board, as expressed in his address in West Virginia. I take pleasure in sending you herewith copies of these three addresses.

The problems confronting the banks of the nation are complex and difficult. They will not be solved to the satisfaction of everybody but I think to those who know the facts and think fairly it will appear that the banks of the country as a whole are functioning very effectively in handling the problems confronting them and in extending accommodations to meet the needs of industry and agriculture. I am sure that you have in mind the extent to which credits have been extended. You know it became necessary to take steps to see that the banks were in position to meet the seasonal demands resulting especially from the marketing of our large crops. As a result of these steps I believe that the banks of the country will succeed in assisting in financing the crop movements and in taking care

of industrial needs, although of course not without difficulty. It is not true that there has been a contraction of credits. On the contrary there was an expansion of credits during the twelve months from the end of August, 1919, to the end of August, 1920, and there has been an upward tendency since the crop movement began. Between the end of August, 1919 and the end of August, 1920, the loans and investments of about 800 reporting member banks increased approximately one and three-quarter billions of dollars. As these reporting banks represent about 40 per cent of the resources of all the banks, it is estimated that the total increase in loans and investments for the twelve months indicated was over four and one-quarter billions of dollars. Even from January 23, 1920, when the increase in discount rates went into effect, to August 27, 1920, the loans of about 800 reporting member banks, exclusive of loans secured by Government obligations and other stocks and bonds, increased about one and a quarter billions of dollars. This would reflect a total increase of commercial loans in all banks, it is estimated, of perhaps three billions of dollars. Since the crop-moving demands came on the bills discounted and purchased by the Federal Reserve Banks have increased at the average rate of nearly twenty-two millions a week, and the Federal Reserve notes at the average rate of twenty millions a week. The increase in the volume of Federal Reserve notes from January 23, 1920, to August 27, 1920, was \$360,000,000.

I need scarcely say to you that I am in favor of every legitimate effort to promote the orderly marketing of all commodities. I have labored many years to stimulate legitimate cooperative enterprise on

the part of farmers not only for better production but also for better marketing of crops and for the more satisfactory financing of them. In such cooperation lies much of the future prosperity of agriculture. Farming must pay and rural life must be made comfortable and attractive. Only through the attainment of these objectives can we hope to have a sufficient number of efficient and contented farmers. I sincerely hope that cooperative movements of a legitimate and lawful kind will make even more rapid and satisfactory headway in the future. During the entire time I was Secretary of Agriculture one of my chief concerns was the matter of better marketing and better rural finance; and to this end I labored earnestly to promote the development of the Bureau of Markets and the Farm Loan System. These agencies have rendered vast service to the farmers and will render increasing service if their activities are not crippled.

Referring to the suggestion that the Treasury at this time deposit money in banks in certain sections of the country in order to ease the credit situation, I can only say that this is not feasible. The Treasury has no money to deposit for such a purpose and could in no event make deposits in the circumstances except to meet Government requirements. As a matter of fact the Treasury is itself borrowing money at a cost somewhat in excess of 6 per cent to meet current bills. The Treasury has no control over appropriations and must meet the bills that are presented under the law. It is true that the tax receipts for the twelve months will meet the ordinary expenditures of the Gov-

ernment, including the sinking-fund charges and interest on the public debt, and make possible a net reduction in considerable volume of floating indebtedness; but much of the taxes is received in quarterly installments and bills come in regularly and, therefore, the Treasury is under the necessity of borrowing temporarily to tide over the intervals. The Treasury should not be in the banking business. The banks of the country, under existing law, can and will, I believe, meet the situation, as far as it can be met, to the satisfaction of the mass of the people. It may be interesting to you to know that the rediscounts for Federal Reserve Banks in crop-moving sections with several of the Reserve Banks in other sections of the country at present are about six times the amount formerly deposited by the Secretary of the Treasury in banks in crop-moving seasons to assist in the marketing of crops.

The other suggestion that the activities of the War Finance Corporation, which were suspended last spring, be resumed and that it indicate its willingness to lend money to corporations or persons desiring to finance exports, is likewise unacceptable. The Finance Corporation was a war agency. So far as the financing of exports is concerned, the provision authorizing it was passed at a time when there was apprehension, caused by the chaotic condition after the armistice, that exports might not go forward. As a matter of fact, exports have gone forward in unprecedented volume. While in 1918, the last year of the war, the exports aggregated \$6,000,000,000, in 1919 they were valued at \$7,900,000,000 and in this year, 1920, on

the basis of the first seven months, they are going forward at the rate of \$8,400,000,000. Clearly, exports are being financed. They are being financed by private business agencies, as they should be. The aggregate value of exports for these three years will greatly exceed the value of imports, perhaps by more than \$10,000,000,000. I think it will be clearly recognized that the condition contemplated by Congress does not exist and that there is no need for the Government through the War Finance Corporation to intervene to stimulate exports. Furthermore, the War Finance Corporation could get the money only from the Treasury and the Treasury would have to borrow the money from the people at a cost exceeding 6 per cent. If the activities of the War Finance Corporation were resumed it could not discriminate as among classes of commodities, and, unquestionably, because of the possibility that applicants might think they could secure money from the Treasury at a lower rate than they could secure it from private sources, the amounts requested would be of tremendous volume. It would be unwise for the Treasury to undertake this burden in addition to its large current obligations.

The officers of the Federal Reserve Board have pointed out facts which many people overlook, namely, that the Federal Reserve Board has no discretion in the matter of loans which a member or non-member bank may wish to make or decline; that the Federal Reserve Board has

no lending power; and also that a Federal Reserve Bank has no discretion in the matter of a loan which a member or non-member bank may wish to make or decline. The Federal Reserve Board and the Federal Reserve Bank are concerned with the keeping of the assets of the Reserve Banks in sound condition and in having a large mass of liquid paper so that when urgent needs arise there may be reserves with which to meet them. The vast mass of the resources of the country are in the member and non-member banks. The Reserve Banks themselves have less than 10 per cent of the banking resources of the country and they do the business of rediscounting and should be in position to use this power in emergencies, as they are doing. Obviously the reserves should not be taxed to the limit steadily and constantly. If they were, the banks would not be able to meet exceptional conditions, such as now obtain.

Furthermore, as the Governor of the Board has pointed out, and with his view and that of the Board I am in entire accord, the Board itself cannot discriminate between essential and non-essential loans. This is a duty that must rest on the banks which make the loans. The Board can suggest to the bankers, however, a thing which good bankers everywhere recognize, that it is their prime duty to attempt to take care of the fundamental needs of their respective sections and that, where the demands for credit cannot be met in full and discrimination becomes necessary, they see to it that the more essential activities are supported even though some of a less essential nature have to suffer at least temporarily, for the time being. I thoroughly

endorse the view of the Board and good bankers generally that legitimate enterprise everywhere shall be first considered and encouraged and that speculative enterprises be discouraged; and the facts clearly demonstrate that there has been a very large decrease in the amount of speculative and non-essential loans.

I need not say to you that, after all, the supply of wealth at any one time is limited, and that necessarily credit extensions cannot be infinite or always be extended on terms satisfactory to every individual. We are still in the midst of abnormal conditions. The sad thing about war is not only that it is horrible while it lasts, but that it is not over when the fighting ceases. It leaves behind it conditions which in the nature of things cause hardships and sufferings for many years. It is gratifying that we have been able to proceed under the exceptionally difficult conditions as well as we have. Our people must face the fact that conditions will be difficult for some time to come. But with steadiness of purpose and intelligence we can meet the problems as they arise and in time bring the nation back to an orderly and sound basis. This nation does not live to itself. The whole world is in an abnormal state but it seems obvious that things are beginning to right themselves and I believe that there is light immediately ahead.

We have doubtless passed the crest of high prices. I am no prophet

but I imagine prices will recede and that the process will take several years. No one will wish to have the prices of what he produces lowered, but the consumer has evidently made up his mind not to continue to pay high prices, and much trouble which is attributed to the banks of the country and credit conditions unquestionably arise from fundamental conditions over which the banks have no control. Matters are further complicated for this nation by reason of the fact that it has not yet concluded peace with its enemies and has not yet joined the other great nations of the world in a cooperative effort to hasten the return of sound conditions and to allay the fears of the world as to the recurrence of other wars.

Very sincerely yours,

(Sgd.) D. F. HOUSTON.

October 4, 1920.

Dear Sir:

I was very glad to get your letter of September 29th. Apparently it is impossible to make any statement which everybody will interpret in the same way. The statement to which probably the report you have seen refers was made by me in reference to certain requests that the Treasury either deposit money in crop-moving sections or lend money to producers. In connection with some of the requests it was distinctly stated that the producers intended to hold their commodities until they could get substantially the prices prevailing during the war. I stated very specifically that the Treasury had no money to deposit or to lend, that the Treasury itself was borrowing money to meet current bills and that it could not be in the banking business. My statement had no reference to the operations of the Federal Reserve System or to the banks of the country, whether member or non-member banks.

I stated distinctly that so far as I was concerned, I was very definitely in favor of the orderly marketing of all commodities but that obviously the Government, that is, the Treasury, "could not be a party to an undertaking on the part of any sort of producers to hold their commodities artificially for speculative purposes to secure war prices or higher than war prices." This statement seems to me to contain such an obvious truth that there is no room for debate. I did not, of course, say that individuals who own commodities could not keep them as long as they

please and as long as they were able to keep them, if they desired to keep them. What I said was that the Treasury could not assist in any speculative movement of any sort and that it had no money in any event to deposit or to loan. For many years I have been working to promote the orderly and gradual marketing of agricultural crops especially. I labored for many years to build up the Bureau of Markets to assist the farmers with information and guidance. I labored many years to promote cooperation among farmers, not only for better production but for better marketing and for better financing of their activities. This movement has made considerable headway but not the headway it should have made and the imperfection of existing methods and machinery for such purposes, through the failure of the farmers to take the necessary action, is in part responsible for the difficulties in which they find themselves.

I think there are other difficulties. I am no prophet but I believe that prices have passed the high point. I believe that they have begun to recede. They may never go back to the pre-war prices but I think they will return towards a stable condition, and this process may cover several years. The consumer evidently has balked at the payment of war prices. He is becoming more economical. Conditions throughout the world are tending towards a better state of things, and all these things are resulting in a downward movement of prices. I do not know how it can be helped by artificial methods and I imagine that you would probably agree that the public would not look upon artificial efforts for speculative purposes to maintain war prices as either legal or justifiable.

I recognize existing difficulties and with the thought of promoting the orderly and gradual marketing of all commodities I have collaborated with

the other members of the Federal Reserve Board in every legitimate effort that the Board can reasonably make to assist producers. Of course, you understand that the Federal Reserve Board has no money to lend. You understand that the Federal Reserve Banks themselves cannot lend money to individuals. The money is loaned by the member or non-member banks. Neither the Federal Reserve Board or the Federal Reserve Bank has any discretion as to loans which member banks may make or decline to make. The Federal Reserve banks do rediscount eligible paper for member banks and as a matter of fact the member and non-member banks of the country are making larger loans to producers than ever before in the history of the nation. Between the end of August, 1919, and the end of August, 1920, the loans and investments of the banks of the country increased over four billions of dollars and between the 23rd of January, 1920, and the end of August they increased about three billions of dollars. In the first period the Federal Reserve notes increased \$320,000,000 and in the second period they increased \$360,000,000. Since the crop-moving season began the accommodations of the banks in the form of bills discounted and purchased have increased at the average rate of about twenty-two millions a week and the Federal Reserve notes at the average rate of about twenty millions a week. You will, of course, realize, therefore, that there has been no contraction. On the other hand, there has been an expansion of credit to meet the demands.

While the Federal Reserve Board has no power to make loans, and no discretion as to what loans the member banks may make or decline, it has used its influence in two directions especially: First, to urge the discouragement of loans for any sort of speculative purposes; and, Secondly,

where discrimination must be practiced because all demands cannot be met, that the banks see to it first that the fundamental needs of their communities are satisfied as fully as possible and before the non-essential or less essential things are met; and the banks have cooperated along both these lines. It is demonstrated that there has been a marked curtailment of funds for speculative purposes. You may be interested to know also that the banks in certain industrial sections of the nation are rediscounting in very large sums for banks in crop-moving sections in this emergency and that the sum total of such rediscounts for crop-moving sections is about six times the amount that the Secretary of the Treasury deposited in crop-moving sections to assist producers at the time when the Treasury had a surplus and before the Federal Reserve System was inaugurated.

Hoping that this statement covers the points you are troubled about, I am,

Very truly yours,

(Signed) D. F. HOUSTON.

October 6, 1920

SUPPLEMENTAL REGULATIONS GOVERNING SALES OF SILVER TO THE
DIRECTOR OF THE MINT UNDER THE PITTMAN ACT

The regulations of the Director of the Mint, approved August 30, 1920, with reference to the proof required to be submitted in connection with purchases of silver under authority of the Pittman Act, approved April 23, 1918, are hereby amended as follows:

Paragraph (3) of said regulations now requires that sworn copies of liquidation sheets be filed with the Director of the Mint, as follows -

Such vendor will also be required to file with the Director of the Mint sworn copies of the liquidation sheets of the smelters to which the domestic silver covered by the miners' affidavits was delivered by said miners. Such liquidation sheets must cover all deliveries of silver to said smelters from January 17, 1920, for the entire period within which such silver is delivered for sale to the Director of the Mint. Said copies of liquidation sheets must be filed with the Director of the Mint monthly and must be accompanied by sworn abstracts showing total deliveries of foreign silver and domestic silver to said smelters during the month, as shown by said liquidation sheets.

In lieu of the filing of sworn copies of the liquidation sheets, pursuant to this requirement, the vendor may file with the Director of the Mint, not less frequently than quarterly, a sworn statement by the superintendent of each smelter receiving deliveries of domestic or foreign silver, covering each month during the period subsequent to January 17, 1920, and showing for each month the total deliveries of foreign silver and domestic silver to the smelter during the month and the names of the miners or other depositors from whom such deliveries of silver were received, with the amounts received from each such miner or other depositor. Such sworn state-

ments from the superintendent of the smelter must state expressly that the information contained therein is based upon examination of liquidation sheets filed with the smelter, that such liquidation sheets are in the custody of the smelter and constitute part of its records, and that the names and figures given cover all deliveries of silver, both foreign and domestic, to the smelter during the month.

R. T. BAKER

Director of the mint.

Approved, October 6, 1920.

S. P. GILBERT, JR.,

Assistant Secretary of the Treasury.

WASHINGTON,

October 20, 1920.

In response to inquiries made concerning the amounts of money which have been advanced to carriers under Section 209, Transportation Act, 1920, and loaned under Section 210 of the same Act, the Treasury Department has issued the following statement, showing advances and loans to date pursuant to certificate of the Interstate Commerce Commission:

Total advances to carriers under Section 209,
Transportation Act, 1920.....\$233,719,974.

Total loans to carriers under Section 210,
Transportation Act, 1920..... 56,190,325.

The carriers to whom loans have been made, and the amount of each of the loans, are as follows:

Boston & Maine Railroad.....	\$5,000,000
Salt Lake & Utah Railroad Co.....	300,000
Carolina, Clinchfield & Ohio Railway.....	3,000,000
Bangor & Aroostook Railroad Co.....	20,000
Atlanta, Birmingham & Atlantic R. R. Co.....	200,000
Great Northern Railway Co.....	15,900,000
Western Maryland Railway Co.....	300,000
Chicago & Western Indiana R. R. Co.....	8,000,000
Erie Railroad Co.....	8,000,000
Terminal R. R. Association of St. Louis.....	896,925
Seaboard Air Line Railway Co.....	6,073,400
Chicago, Rock Island & Pacific R. R. Co.....	2,000,000
Baltimore & Ohio Railroad Co.....	3,000,000
Virginian Railway Co.....	1,000,000
Kansas City, Mexico and Orient Railroad Company, W. T. Kemper, Receiver.....	2,500,000

SAVINGS DIVISION
of the
TREASURY DEPARTMENT
FUNCTIONS AND ORGANIZATION.

October 23, 1920.

The work of the Savings Division of the Treasury Department with its District Organizations is directed to the following ends:

- (1) To develop and protect the secondary market for all war issues of Government Securities;
- (2) To sell Treasury Savings Securities;
- (3) To make permanent the habits of regular savings and investment in United States Government Securities.

In accomplishing this work, the Savings Organizations will continue in 1921 the policy pursued during the year 1920 in industrial plants and schools. As to the schools, however, it is hoped that before the end of the year the active direction of the school savings work can be turned over very largely to the school authorities.

Beginning January 1, 1921, the work with women's organizations will be centralized. Contact will be made by the Savings Division in Washington with the heads of national women's organizations. The office of District Director of Women's Activities will be discontinued.

In order that all publicity matter issued by the Savings Organization may be in accord with the policies of the Treasury Department, any material involving questions of the general policy of the organization should either originate with or be vised by the

Savings Division in Washington, with due allowance for changes in wording and subject-matter to meet local conditions in the several Districts. The greatest care should be taken to assure the accuracy and correctness of all publicity material. In this connection, the attention of the District Directors is called to the following statement in the memorandum of October 18, 1919: - "The publicity should be directly supervised by the District Savings Director. The publicity writers must interpret the policy of the organization to the public and not attempt to create flash news of a cheap nature".

District Directors should familiarize themselves with the provisions of the Postal Laws and Regulations governing the exercise of the franking privilege and the use of so-called penalty envelopes. These provisions are as follows:

Sec. 496 (1) It shall be lawful (for all officers of the United States Government.....) to transmit through the mail, free of postage, any letters, packages, or other matters relating exclusively to the business of the Government of the United States: PROVIDED, That every such letter or package to entitle it to pass free shall bear over the words "Official business" an endorsement showing also the name of the department, and, if from a bureau or office, or officer, as the case may be, whence transmitted, with a statement of the penalty for their misuse.

Sec. 496 (5) Any department or officer authorized to use the penalty envelope may enclose them with return address to any person or persons from or through whom official information is desired, the same to be used only to cover such official information and indorsements relating thereto.

Sec. 496 (7) Whoever shall make use of any official envelope, label, or indorsement authorized by law, to avoid the payment of postage or registry fee on his private letter, packet, or package or other matter in the mail shall be fined not more than three hundred dollars.

Sec. 497. No report, document, or publication of any kind distributed by or from an executive department or bureau of the Government shall contain any notice that the same is sent with "the compliments" of an officer of the Government, or with any special notice that it is so sent except that notice that it has been sent, with a request for an acknowledgment of its receipt, may be given.

Sec. 500. Persons not officers writing to the executive departments or to officers of the United States concerning the business of the writers with the Government may not use the penalty envelope to transmit their correspondence. Officers authorized to use such envelopes shall not furnish them for use to contractors with the Government or to enable private persons or concerns to send free reports, etc., which they are required by law to make.

Officers desiring official information from or through persons not officers may furnish penalty envelopes or labels to cover the same only with return address printed or written thereon. Where the information is to be forwarded periodically or on more than one occasion the envelopes or labels bearing printed return address may be furnished in quantities for the transmission of such information.

The right of an officer of the United States to use the penalty envelope ceases immediately upon his going out of office; and he may not use such envelopes in transmitting papers connected with the settlement of his accounts or other business pertaining to the office he has vacated except as he may receive them with requests for official information, with return address thereon, from a department or officer of the Government.

Sec. 495. It shall be unlawful for any person entitled under the law to the use of a frank to lend said frank or permit its use by any committee, organization, or association, or permit its use by any person for the benefit or use of any committee, organization, or association: PROVIDED, that this provision shall not apply to any committee composed of Members of Congress.

During the war, certain latitude in regard to the franking privilege was permitted by the Postal authorities, but it is now absolutely necessary to live up to the letter of the law. All matter sent under frank must relate exclusively to government business.

With the small personnel in the District Organizations, it is more than ever important that the District Director actively supervise the campaign for the sale of securities and the educational program in the field and that he spend a reasonable amount of time in making personal contact in various parts of the District and in stimulating the interest of postmasters, bankers, educators and others whose active cooperation is essential.



TREASURY DEPARTMENT

WASHINGTON

OFFICE OF
TREASURER OF THE UNITED STATES
IN REPLYING QUOTE INITIALS

October 25, 1920.

To Banks, Trust Companies and Others Concerned:

Since the beginning of the war it has been the policy of the Treasury to conserve gold and discourage its circulation, and this policy has not changed with the cessation of hostilities or the removal of the embargo on the exportation of gold. It is just as important as ever that gold, which is the foundation of our reserves and the backbone of all credit transactions, should be concentrated in the Federal Reserve Banks as reserve and for use in the settlement of balances growing out of international transactions, and it is the desire of the Treasury that the conservation of gold should continue and that there should be no revival of the use of gold coin or gold certificates for payrolls and everyday transactions generally, in which it serves no useful purpose. The circulation of gold coin and gold certificates tends to dissipate the reserves, and the circulation of gold coin involves a considerable loss due to abrasion which is avoided by having the gold carried in the vaults of the Federal Reserve Banks and the Treasury.

In accordance with this policy persons requesting gold are invited to accept other currency instead, but gold has not been and will not be, refused to persons who, after giving consideration to the Treasury's policy, demand it and are entitled to receive it by reason of the presentation and surrender of gold obligations. Wherever gold is demanded it is furthermore the Treasury's policy to pay out available, but not new, gold coin in the denomination of \$20 and gold certificates of large denominations, and to avoid so far as possible the use of gold coin in denominations of \$5 and \$10 and gold certificates in the denomination of \$10, though such denominations will not be refused if demanded. Payments of \$2.50 gold pieces, however, will not be made, inasmuch as no gold has been coined in this denomination for many years and there is no available supply in Treasury offices.

In view of the foregoing, and the fact that there has been relatively little coinage of gold for several years past, the Mints being taxed to their capacity to supply subsidiary silver and minor coins for ordinary business purposes, there will be no distribution of gold coins this year for holiday purposes.

JOHN BURKE

Treasurer.



THE SECRETARY OF THE TREASURY
WASHINGTON, D. C.

December 8, 1920.

Dear Sir:

About \$700,000,000 of Treasury certificates of indebtedness mature on December 15, 1920, about \$175,000,000 on January 3, 1921, and about \$125,000,000 additional on January 15, 1921. On December 15, 1920, there will also become payable the semi-annual interest on the First Liberty Loan and the Victory Liberty Loan, aggregating about \$140,000,000. The greater part of the \$700,000,000 of tax certificates maturing on December 15th will be covered by the installment of income and profits taxes payable on that date. In order to meet the remainder of these heavy maturities of principal and interest, and at the same time provide for the current requirements of the Government, the Treasury has decided, on the basis of the best estimates available at this time, to offer Treasury certificates of indebtedness in the amount of \$500,000,000, or thereabouts, in two series dated December 15, 1920, one series designated TJ 2-1921, bearing $5\frac{3}{4}$ per cent interest, maturing June 15, 1921, and the other series designated TD-1921, bearing 6 per cent interest and maturing December 15, 1921. Applications for Treasury certificates of these series will be received through the several Federal Reserve Banks, from which full particulars concerning the offering may be obtained. Treasury certificates of the series maturing December 15, 1920, January 3, 1921, and January 15, 1921, will be accepted at par with an adjustment of accrued interest in payment for any certificates of the two series now offered which may be subscribed for and allotted.

As indicated in the circular letter of September 7, 1920, to the banking institutions of the country, the operations of the Treasury for the first quarter of the present fiscal year, ended September 30, 1920, showed a surplus of ordinary receipts over ordinary expenditures amounting to \$289,224,706.29, notwithstanding actual cash payments to railroads during the quarter of some \$275,000,000 under the provisions of the Transportation Act, in connection with the return of the railroads to private control. The Treasury's current operations during the months of October and November show a net current deficit (excess of ordinary disbursements over ordinary receipts) amounting to \$357,134,068.15, of which about \$112,000,000 represents payments to the railroads under the Transportation Act. The Treasury confidently expects, however, that the current quarter, ending December 31, 1920, will still show a substantial surplus as the result of the quarterly payment of income and profits taxes in December.

In consequence of the operations incident to the retirement of the Treasury certificates which matured on September 15 and October 15, 1920, and the quarterly payment of income and profits taxes on September 15th, the gross debt of the Government on October 31, 1920, on the basis of daily Treasury statements, was reduced to \$24,062,509,672.96, of which about \$2,337,000,000 consisted of loan and tax certificates unmatured. On September 30, 1920, the gross debt had been \$24,087,356,128.65, of which about \$2,347,000,000 were loan and tax certificates unmatured. On November 30, 1920, after the issue of \$232,000,000 of Treasury certificates on November 15th and the retirement on the same

date of about \$100,000,000 of maturing certificates, the gross debt, on the basis of daily Treasury statements, amounted to \$24,175,156,244.14, of which about \$2,475,000,000 represented floating debt (loan and tax certificates unmatured). These temporary increases in both gross debt and floating debt will, it is expected, be more than overcome by December 31, 1920, in consequence of the December operations, and both gross debt and floating debt should, on December 31st, be reduced below the amounts outstanding on September 30th. The Government's further progress in retiring the gross debt and the floating debt will depend, of course, upon the relation between current receipts and current expenditures during the coming calendar year, but there is good reason to hope that unless new burdens are imposed by legislation, there should be important further reductions in the last two quarters of the current fiscal year, provided always that tax receipts are maintained at a sufficiently high level, salvage operations vigorously pressed, and the strictest economy practiced in Government expenditure.

The three months which have passed since the last quarterly tax payment period have been marked by a still further distribution of Treasury certificates among investors and a further reduction of holdings of Treasury certificates by the banks. The reporting member banks of the Federal Reserve System (about 823 member banks in leading cities, which are believed to control about 40 per cent of the commercial bank deposits of the country and to have subscribed in the first instance for perhaps 75 per cent of the Treasury certificates of indebtedness now outstanding) held on November 26, 1920, only about \$313,000,000 of Treasury certificates, as compared with reported holdings on August 27, 1920, of about \$430,000,000, and on November 28, 1919, of about \$816,000,000. On December 3, 1920, the Federal Reserve Banks reported that there were pledged with Federal Reserve Banks only about \$214,000,000 of Treasury certificates to secure loans and discounts, notwithstanding the preferential rates still maintained in many of the Federal Reserve Districts and the probability that borrowing banks would use Treasury certificates as convenient collateral to secure loans for commercial purposes.

The Treasury certificates of the two series now offered are exempt, like other Treasury certificates outstanding, from all State and local taxes (except estate and inheritance taxes), and from the normal Federal income tax and the corporation income tax, and are admissible assets for the purpose of calculating profits taxes. The certificates now offered are also acceptable in payment of Federal income and profits taxes payable at their respective maturities, and the United States reserves no option to call them for redemption before maturity. With these features, the attractive rates of interest, and absolute security of principal and interest, these certificates are extremely desirable investments and should prove particularly attractive to taxpayers having taxes to pay in the calendar year 1921, as well as to persons having idle funds awaiting investment. In these circumstances, the Treasury believes that banking institutions generally should feel free to enter subscriptions for the two issues now offered with the confident expectation of prompt resale for investment, and urges them, as in the past, to subscribe liberally for the certificates and devote their best efforts to obtain the widest possible distribution among investors.

Cordially yours,

D. A. Houston

Secretary.

To
The President
of the Bank or
Trust Company addressed.

Washington, Dec. 27, 1920.

SUMMARY OF RECOMMENDATIONS UPON TAXATION
MADE BY SECRETARY HOUSTON BEFORE THE
SENATE COMMITTEE ON FINANCE, DECEMBER 27, 1920.

1. I have recommended that the revenue from taxation be maintained after this fiscal year and until the close of the fiscal year 1923, on a level of at least \$4,000,000,000. This represents a substantial reduction of aggregate taxes collected from the people. During the fiscal year 1920 the internal tax receipts amounted to \$5,400,000,000; and it is estimated that for the fiscal year 1921 they will amount to \$4,700,000,000. The proposed \$4,000,000,000 levy, therefore, represents a reduction of \$1,400,000,000 from the level of 1919, and a reduction of \$700,000,000 from the level of 1921. What it means in brief is that a system of taxation based upon the income tax - adjusted to ability to pay, - bears less heavily upon the taxpayer and yields less revenue, as it must, when the income of the country declines.

2. I recommend the reduction of the extreme income surtaxes, not to exempt the rich but to tax the rich. At present, by investing in taxfree securities and by the use of other devices the very wealthy can and do avoid taxation. The taxable income of taxpayers having net incomes over \$300,000 a year fell from \$992,972,985 in 1916 to \$392,247,329 in 1918. This condition, I have suggested, may be met either by reducing the upper surtaxes to a lower general level, or by reducing the upper surtaxes with respect to that part of the income which is saved and reinvested in taxable property or business, leaving the present rates, if necessary, upon income which is wasted or used in ostentatious and unnecessary consumption.

3. The excess-profits tax should be replaced, primarily because it is losing its productivity, and promises in the near future to become a statute of exemptions rather than an effective tax. Moreover, the tax is so complicated that it imposes upon both taxpayers and administrative authorities burdens too difficult to be permanently carried. I recommend that it be replaced - not merely repealed - with a simpler and more certain tax upon corporation income or profits. I suggest in this connection for the consideration of the Congress either a flat additional tax on corporation profits, such as has recently been adopted in the United Kingdom, or a tax upon the undistributed profits of corporations under which, if adopted, corporations should be expressly authorized to pay taxes through their stockholders, as partnerships are now taxed through their members. By either of these proposals the income tax on corporations could be made a fair equivalent for the income tax as now applied in effect to individuals, partnerships and personal service corporations.

4. I recommend the retention of a simple system of specific sales or consumption taxes designed to collect a moderate proportion of the aggregate tax levy from a few highly productive taxes on non-essentials. Miscellaneous sales or excise taxes shifted in main to the consumer supplied in the last fiscal year about 20 per cent of the total taxes, or about 25 per cent if customs duties are counted as consumption taxes.

In view of the financial needs of the Government these proportions may properly be maintained or even increased to perhaps 30 or 35 per cent; but no radical increase such as doubling the consumption taxes would in my opinion be justified. There must be a fair balance in the tax system as a whole between taxes on the consumption of the masses and taxes on wealth, income and business. It would be especially unfortunate to substitute sales taxes, of any variety, for taxes upon corporation profits required both to balance the tax system and to equalize taxes on corporations with the progressive income tax as applied to unincorporated business concerns. To place such an unfair load on the masses would violate all the recognized principles of justice as to the division or distribution of the total tax burden. I do not oppose all sales taxes; but I have recommended the repeal of those sales taxes which are difficult to enforce, unduly vexatious and of inconsiderable yield. The entire tax system including the existing specific sales taxes should be simplified, not further complicated by the adoption of a turnover or general sales tax which would require a huge additional administrative force if administered properly and would result in widespread evasion if not thoroughly administered.

5. The excess-profits and other taxes which in my opinion should be replaced would yield in the future less than \$730,000,000 a year. In order to meet this reduction or deficit I have mentioned - merely for the convenience of the committees of Congress which will be directly responsible for tax revision - a large number of possible new or additional taxes including higher income taxes and additional specific sales taxes upon luxuries and non-essentials, capable of yielding over \$2,000,000,000 a year. Obviously all of these taxes are not recommended. They are mentioned as possible new sources from which to make a selection.

6. Except for newspaper misunderstanding it would be unnecessary to repeat what is so emphatically stated in my recent annual report, that sound policy demands the exercise of the most drastic economy. Unless every unnecessary expenditure such as the proposed appropriation for the payment of soldiers' bonus be avoided; unless every official or other estimate or request for appropriations be reduced to a minimum, no sound plan of tax revision can be carried out and the successful financial conduct of the Government during the next three years will be seriously imperilled.



OFFICE OF
TREASURER OF THE UNITED STATES
IN REPLYING QUOTE INITIALS

TREASURY DEPARTMENT

WASHINGTON

INSTRUCTIONS RELATIVE TO HANDLING UNITED STATES CERTIFICATES OF
INDEBTEDNESS RECEIVED BY FEDERAL RESERVE BANKS
(AND BRANCHES) FROM COLLECTORS OF
INTERNAL REVENUE

January 7, 1921.

1. Collectors of Internal Revenue have been authorized and directed to receive at par United States Treasury certificates of indebtedness of Series TM-1921, dated March 15, 1920, Series TM2-1921, dated July 15, 1920, Series TM3-1921, dated September 15, 1920, and Series TM4-1921, dated October 15, 1920, all maturing March 15, 1921, in payment of income and profits taxes payable on March 15, 1921. Collectors have also been authorized and directed to receive at par Treasury certificates of indebtedness of Series TJ-1921, dated June 15, 1920, maturing June 15, 1921, and Series TJ2-1921, dated December 15, 1920, in payment of income and profits taxes payable on June 15, 1921; Treasury certificates of indebtedness of Series TS-1921, dated September 15, 1920, maturing September 15, 1921, in payment of income and profits taxes payable on September 15, 1921; and Treasury certificates of indebtedness of Series TD-1921, dated December 15, 1920, maturing December 15, 1921, in payment of income and profits taxes payable on December 15, 1921. Collectors have been further authorized and directed to receive at par, in payment of income and profits taxes payable at the maturity of the certificates, respectively, Treasury certificates of indebtedness of any other series which may be issued maturing on March 15, June 15, September 15, or December 15, 1921, respectively, and expressed to be acceptable in payment of income and profits taxes. Collectors are not authorized to receive in payment of income or profits taxes any Treasury certificates of indebtedness not expressed to be acceptable in payment of income and profits taxes, nor any Treasury certificates maturing on a date other than the date on which the taxes are payable. Collectors have been authorized to receive Treasury certificates of indebtedness which are acceptable as herein provided in payment of income and profits taxes, in advance of the respective dates on which the certificates mature. Treasury certificates acceptable in payment of income and profits taxes have one or more interest coupons attached, including as to each series a coupon payable at the maturity of the certificates, but all interest coupons must in each case be detached by the taxpayer before presentation to the collector, and collected in ordinary course when due. The amount, at par, of the Treasury certificates of indebtedness presented by any taxpayer in payment of income and profits taxes must not exceed the amount of the taxes to be paid by him, and collectors are not authorized in any case to pay interest on the certificates or accept them for an amount other or greater than their face value.

2. Deposits of Treasury certificates of indebtedness received in payment of income and profits taxes must be made by collectors, unless otherwise specifically instructed by the Secretary of the Treasury, with the Federal Reserve Bank of the district in which the collector's head office is located, or in case such head office is located in the same city with a branch Federal Reserve Bank, with such branch Federal Reserve Bank. Specific instructions may be given for the deposit of the certificates with Federal Reserve Banks of other districts and branch Federal Reserve Banks. The term "Federal Reserve Bank," where it appears herein, unless otherwise indicated by the context, includes branch Federal Reserve Banks. Treasury certificates accepted by the collector prior to the dates when the certificates respectively mature, should be forwarded by the collector to the Federal Reserve Bank to be held for account of the collector until the date of maturity, and for deposit on such date.

3. Collectors have been instructed to stamp certificates of indebtedness accepted by them with an indelible stamp on the face thereof as follows, and when so stamped to deliver them to the Federal Reserve Bank in person if the Collector is located in the same city and in all other cases to transmit them to the Federal Reserve Bank by registered mail, uninsured:

"-----, 192

"This certificate has been accepted in payment of income and profits taxes and will not be redeemed by the United States except for credit of the undersigned.

"-----

"Collector of Internal Revenue
for the ----- District of -----"

4. For the purpose of saving taxpayers the expense of transmitting such certificates as are held in Federal Reserve cities or Federal Reserve branch bank cities to the office of the collector in whose district the taxes are payable, collectors have been instructed that taxpayers desiring to pay income and profits taxes by Treasury certificates of indebtedness acceptable in payment of such taxes should communicate with the collector of the district in which the taxes are payable and request from him authority to deposit such certificates with the Federal Reserve Bank or branch in the city in which the certificates are held. Collectors have been authorized to permit deposits of Treasury certificates of indebtedness in any Federal Reserve Bank or branch with the distinct understanding that the Federal Reserve Bank or branch is to issue a certificate of deposit in the collector's name, covering the amount of the certificates of indebtedness at par, and to state on the face of the certificate of deposit that the amount represented thereby is in payment of income and profits taxes. The Federal Reserve Bank or branch should forward the original certificate of deposit to the Treasurer of the United States with its daily transcript, and transmit to the collector the duplicate and triplicate, accompanied by a state-

ment giving the name of the taxpayer for whom the payment is made, in order that the collector may make the necessary record and forward the duplicate to the office of the Commissioner of Internal Revenue.

5. Collectors of Internal Revenue have been instructed that they are not authorized, unless otherwise notified by the Secretary of the Treasury, to receive in payment of income and profits taxes interim receipts issued by Federal Reserve Banks in lieu of definitive certificates of the series herein described.

6. Upon deposit of Treasury certificates of indebtedness received in payment of income and profits taxes by collectors as herein provided, the Federal Reserve Bank will charge the Treasurer's account with the par value thereof and will handle the certificates as an ordinary redemption, as provided in Sections 1 and 5 of the instructions of April 21, 1919, with the exceptions noted below:

(a) The total amount of the principal of the certificates of indebtedness must be credited in the Treasurer's account as Internal Revenue receipts, classified in accordance with the schedule of transmittal forwarded by the Collector, and the bank will issue the usual certificate of deposit therefor on "National Bank Form 15." The schedule of transmittal must show the serial number of each certificate, the date of issue and maturity, and face value. Certificates of indebtedness accepted by collectors prior to the date of maturity must be scheduled separately. Such income and profits tax deposits must in all cases be shown on the face of the certificate of deposit separate and distinct from the item of Miscellaneous Internal Revenue Collections (formerly called Ordinary). The certificate of deposit must also show the number and location of the collection district.

(b) The certificates of indebtedness when deposited should be listed on Form 912 under the caption "Certificates received from Collectors of Internal Revenue." Such certificates must not be reported on the same sheet as certificates that have been received from other sources for redemption. In the column "For Whom Redeemed," the Federal Reserve Bank must indicate the collector from whom each lot of certificates was received. Form 912 and the certificates described thereon must be forwarded promptly to the Treasurer of the United States, Division of Securities. The certificates must be canceled in accordance with Section 1 of the instructions of April 21, 1919.

(c) Care must be taken to see that no certificates except those receivable for income and profits taxes are accepted under these instructions.

G. F. ALLEN,
Acting Treasurer.

Approved:

S. P. GILBERT, Jr.,

Assistant Secretary of the Treasury.

January 13, 1921.

My dear Congressman:

I have received the invitation of the Committee on Interstate and Foreign Commerce of the House of Representatives to appear before it on the 14th instant to express my views concerning Bill H. R. 15551 to amend and reenact subdivision (g) of section 204 and subdivision (g) of section 209 of the Transportation Act, 1920. I have analyzed the Bill with care and, in order to spare the time of the Committee at the hearing on Friday, I take the liberty of setting forth my views below.

In section 209 of the Transportation Act the United States guarantees that the railway operating income of certain carriers for the six months following the return of the roads to private control shall be equal to or shall not be less than amounts computed as provided in the section. The amount necessary to make good the guaranty is to be paid to the railroads out of the public Treasury. This section also provides that if for the guaranty period as a whole the railway operating income of any one of certain carriers entitled to a guaranty is in excess of a certain amount, the carrier shall forthwith pay the excess into the Treasury of the United States. In response to a request of the Treasury for an estimate, the Interstate Commerce Commission has stated that, in its opinion, based upon the sworn monthly reports of Class 1 carriers, the total amount necessary to make good the guaranty provided by section 209 will aggregate approximately \$600,000,000. In order that the carriers might have the benefit of the guaranty at once upon

return of the roads to private ownership, paragraph (h) provided for the payment to the roads of advances on account of the guaranty upon giving of security as follows:

"Upon application of any carrier to the Commission, asking that during the guaranty period there may be advanced to it from time to time such sums, not in excess of the estimated amount necessary to make good the guaranty, as are necessary to enable it to meet its fixed charges and operating expenses, the Commission may certify to the Secretary of the Treasury the amount of, and times at which, such advances, if any, shall be made. The Secretary of the Treasury, on receipt of such certificate, is authorized and directed to make the advances in the amounts and at the times specified in the certificate, upon the execution by the carrier of a contract, secured in such manner as the Secretary may determine, that upon final determination of the amount of the guaranty provided for by this section such carrier will repay to the United States any amounts which it has received from such advances in excess of the guaranty, with interest at the rate of 6 per centum per annum from the time such excess was paid. There is hereby appropriated, out of any money in the Treasury not otherwise appropriated, a sum sufficient to enable the Secretary of the Treasury to make the advances referred to in this subdivision."

Under this paragraph advances have been made in the amount of \$260,431,874. A list of these by dates and amounts is enclosed. These payments were made in accordance with the Treasury's usual procedure which has been in effect for many years under statutes of long standing. That is to say, the certificate of the Interstate Commerce Commission, together with the other papers required by paragraph (h), were sent to the proper auditor who thereupon issued a settlement in favor of the carrier named in the certificate for the amount certified. Thereupon the Secretary of the Treasury issued a warrant and the Comptroller of the Treasury

countersigned it and registered it. Thereafter the warrant was signed by the Treasurer of the United States, entered and delivered. The Treasury has not received from the Commission any certificate certifying the total amount necessary to make good to a carrier the guaranty provided by section 209. The Commission did, however, certify a partial payment to a carrier which had not, during the guaranty period, applied for an advance under paragraph (h). The Comptroller of the Treasury decided that section 209 did not authorize the Interstate Commerce Commission except in accordance with the provisions of paragraph (h), to certify partial payment and that, therefore, the Secretary of the Treasury had not authority to issue a warrant for such a payment. Copies of the decisions, dated October 7, 1920, and November 27, 1920, are enclosed. A copy of the first may also be found on page 162 of the Annual Report of the Secretary of the Treasury for the fiscal year 1920. Pursuant to these decisions, the proper auditor made a settlement finding nothing due to the carrier. The Secretary of the Treasury, under statutes of long standing, was, therefore, powerless to issue a warrant. The carrier immediately sued in the Supreme Court of the District of Columbia for a writ of mandamus directing the Secretary of the Treasury to issue a warrant. The Court ruled that the Comptroller's construction of section 209 was correct and it denied the writ. A copy of the opinion of the Chief Justice is enclosed. The Comptroller of the Treasury has also decided that the Treasury is not authorized to issue

a warrant pursuant to a certificate of the Commission for an advance under paragraph (h) where the certificate was not made pursuant to an application filed before the end of the guaranty period. The Treasury understands that up to the present time few, if any, of the carriers have presented their final claims on account of the guaranty. In these circumstances, the bill proposes to amend paragraph (g) of section 209 so that it shall read as follows:

"(g) The Commission shall, as soon as practicable after the expiration of the guaranty period, ascertain and certify to the Secretary of the Treasury the several amounts necessary to make good the foregoing guaranty to each carrier. The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States for the amount shown in such certificate as necessary to make good such guaranty, it being the true intent and meaning hereof that whenever, and as often as, the commission shall certify to the Secretary of the Treasury an amount as certainly due and necessary to make good the foregoing guaranty to any such carrier, the Secretary of the Treasury is hereby authorized and directed, upon receipt of such certificate, to draw a warrant in favor of such carrier upon the Treasury of the United States for the amount shown in such certificate as an amount necessary to make good the foregoing guaranty, whether such amount is in final settlement or in partial payment, and the Comptroller of the Treasury is hereby directed to countersign the same forthwith. The Secretary of the Treasury shall thereupon deliver the said warrant to such carrier, and the Treasurer of the United States is hereby directed to pay the same, upon presentation, out of the appropriation made therefor in this subdivision. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated.

"In ascertaining the several amounts necessary to make good the foregoing guaranty to each carrier the commission is further authorized, in the case of debits and credits to railway operating income

which can not at the time be definitely determined, to make, whenever in its judgment practicable, a reasonable estimate of the net effect of any such items, and, when agreed to by the carrier interested, to use such estimate as a definitely ascertained amount in certifying the amounts due under the said guaranty, and such estimates so agreed to shall be binding in final settlement."

Upon the policy of authorizing to be made to a class of claimants who announce their claims as being vast but have not as yet committed themselves as to the amount, partial payments of public money to sustain them while they expend effort and money in the preparation and support of claims against the Government for losses sustained in their own management of their own property, I do not venture to express an opinion. This is a matter for Congress. If Congress shall decide that it is advisable to authorize relief of the carriers out of the public Treasury pending a further period of formulation by them of claims against the Treasury under section 209, I believe the Government should receive protection not contained in the present draft of the bill, and that the end apparently sought by the bill can be accomplished without making in sound Treasury procedure which rests upon old and well known statutes the changes which would result from the passage of the bill in its present form.

At the outset, I wish to make it clear that the Treasury is now and at all times has been prepared promptly to disburse, so far as authorized by law, the funds necessary to meet the Government's obligation under the Transportation Act, 1920. In order to accommodate the carriers other pressing matters in the Treasury have been deferred and

the administrative detail necessary to accomplishing payments to the roads hastened and given preference. Many payments have been made by telegraphic transfer. At great sacrifice of personal convenience the offices of the Solicitor of the Treasury, the Comptroller of the Treasury, the Treasurer of the United States, the Auditor for the State and other Departments, the Division of Bookkeeping and Warrants and my own office have frequently been kept open long past business hours and sometimes far into the night in order that a particular payment much desired by a railroad might be put through. It is, however, the belief of the Treasury that the amount of the Government's obligation to the carriers should be ascertained at the earliest possible moment in order that the Treasury may know its problem and dispose of it. The Treasury has understood it to be the intention of Congress as indicated by the Transportation Act, 1920, that a prompt disposal be made of all questions arising out of Federal control of the railroads and the guaranty, and the Treasury believes that it is obviously to the interest of the public and the carriers themselves, as well as of the Treasury, that these matters be brought to an early and a final close. I have many times reiterated my belief that every effort should be made to secure final determination of the amounts payable under the guaranty as promptly as may be necessary to meet the exigencies of the carriers. I should suppose it to be to the interest of the carriers, particularly those claiming to be in urgent need of funds, to present to the Interstate Commerce Commission their final claim for the remaining amounts necessary to make good the guaranty in order that the Commission may forthwith make a final determination as

to such amounts, and that the Treasury may pay them. If, however, Congress shall think it wise that payments out of the Treasury be made before the amounts of the final claims are determined, I should venture to suggest that this may be accomplished by one or the other of the two following methods:

(a) The operation of paragraph (h) of section 209 might be extended by striking out the words in the first sentence, "during the guaranty period", and substituting therefor the words, "prior to the first day of July, 1921," or such other day as Congress may deem wise. The employment of this method for the relief of the carriers, in case Congress believes such relief necessary, would have the advantage of extending, for such period as may be determined, a procedure which is already established. It would give the Government the benefit of security for repayment with interest of any part of the advances found on final determination of the amount of the guaranty to have been in excess of the amount necessary to make the guaranty good. The provisions of Section (h) limit the advances to such sums as are necessary to enable the carrier to meet its fixed charges and operating expenses. Prior to the ascertaining of the final amount necessary to make good the guaranty, there is no reason why there should be paid to the carriers out of the public Treasury funds for the purpose of enabling them to make dividends. Perhaps the greatest advantage of following this method would be that there would, as to each carrier, as is now the law, remain to be made under paragraph (g) only one certificate which would necessarily be final and which would, therefore, terminate the proceedings between the carrier and the government concerning the guaranty.

(b) Section (g) might be amended by inserting a provision authorizing certificates to be made from time to time for partial payments on account of the amount due upon the guaranty. If this method is followed there should also be inserted a provision similar to that in paragraph (h) for an agreement and security to be given by any carrier receiving a partial payment, that in case the amount of the partial payment together with all advances received by the carrier under paragraph (h) shall exceed the amount necessary to make good the guaranty as finally determined, the carrier will repay to the Secretary of the Treasury such excess with interest from the time of the over-payment.

Should either of the methods above suggested be adopted there should be inserted in paragraph (g) a provision that all claims by the carrier for any amount necessary to make good the guaranty must on or before such date as Congress may deem proper be filed with the Interstate Commerce Commission together with all supporting accounts upon which the carrier proposes to rely, or be forever completely barred. I venture to suggest that such date be September 1, 1921. This provides a period of 18 months from the return of the roads to private control and of one year from the end of the guaranty period, and affords ample time within which all reasonable claims should be made. The nature and purposes of the guaranty are not such as to require its final adjustment to be held open longer for the purpose

of meticulously adjusting it to all private claims which may conceivably later be made upon the carriers, even though such claims might theoretically affect the railway operating income of the carriers during the guaranty period. The Transportation Act in its present form is unusual in omitting such a provision of limitation. If either of the methods above suggested is adopted for permitting payments on account to be made to the carriers and a provision of limitation is not inserted the result is likely to be an indefinite delay in making the final certificate provided in paragraph (g), in case the method of amending paragraph (h) is adopted, or the continuing into an indefinite future of the presenting by the carriers of claims under the guaranty if the method is adopted of amending paragraph (g). This last would render it impossible for the Interstate Commerce Commission ever to make a certificate which would be final.

The direction contained in the proposed amendment that the Comptroller of the Treasury countersign a warrant without exercise by him of discretion is at variance with the present structure of the accounting system of the United States and the nature of the duties of the Comptroller as provided by statutes of long standing. The proposed provision would constitute a most undesirable precedent leading toward the disruption of the present accounting system under which warrants are issued by the Secretary of the Treasury and countersigned by the Comptroller only upon the Auditor's certificate. It cannot be supposed that the proposed amendment is intended to direct the

Secretary of the Treasury to issue and the Comptroller of the Treasury to countersign, a warrant pursuant to a certificate issued by the Interstate Commerce Commission if not issued in accordance with law. The Secretary of the Treasury has not hitherto failed to issue a warrant pursuant to a certificate legally made by the Interstate Commerce Commission, nor has the Comptroller of the Treasury failed to countersign a warrant issued under such a certificate. There is no reason to suppose that they will fail to do so in the future. The guaranty provided in Section 209 for the six months following the return of the roads to private control is not a compensation for any services rendered by the carriers to the Government or people of the United States which the carriers would not have been bound to render without the guaranty. The compensation to which the carriers may be entitled for the use of their property during the period of Federal control is adequately provided for elsewhere. I can think of no reason why the claims of the carriers in respect to this bountiful act of the Government should be relieved from the application of the safeguards erected for the benefit of the Government in its accounting system and its usual and orderly procedure for payment of claims in the same manner as such safeguards and procedure are applied to claimants for compensation for property or services rendered the Government. I do not understand that the Interstate Commerce Commission suggests that its acts in connection with the guaranty should not be subjected to the usual scrutiny of the accounting officers of the Government as to

legality in the same manner as the acts of the Secretary of the Treasury and all other officers of the Government. If the method is followed of amending paragraph (g) as suggested on page 8 of this letter, the mere insertion in that paragraph of authority to make partial certificates will result in the issue by the Secretary of the Treasury and countersignature by the Comptroller of the Treasury of warrants pursuant to every certificate for a partial payment issued in accordance with law. The proposed mandatory provision directed at the Comptroller of the Treasury appears to be analagous to the futile but world old endeavor of defeated litigants to devise a statutory direction to the judicial officer to decide all cases in their favor.

The provision contained in the proposed amendment for permitting, as the basis of making with the public moneys partial payments to the railroads, the use of mere estimates which shall nevertheless be binding in final settlement deprives the Government of any element of certainty or safety. The estimates can be used only when agreed to by the carrier interested. The carrier can be expected to agree only when the doubt in the estimate is against the Government. For such estimate, although ultimately it might be found to be disadvantageous to the Government, is made binding in final settlement. On the other hand, should the estimate ultimately be found to be less than the amount properly due the carrier, the carrier need only apply for an additional partial payment sufficient to make up to it the difference. In the absence of a limit on the time within which claims may be made by

the carrier, the proposed amendment permitting the Commission to make more than one certificate on account of payment renders it impossible for the Commission to make a certificate which shall be final as against a subsequent claim of the carrier. The reference to final settlement in the last line of the proposed amendment has only the effect of preventing the Commission from setting off against such an additional claim by the carrier the amount of any previous overpayment made pursuant to an erroneous estimate. It will be seen that this provision taken together with the first paragraph of the proposed amendment is wholly disadvantageous to the Government and is effective only as an instrument to be used against the Government. It should, therefore, be eliminated.

It has been my understanding of paragraph 209 that by subdivision (3) of paragraph (f) Congress delegated to the Commission complete power to determine the amount to be included in operating expenses for maintenance of way and structures or for maintenance of equipment; that the adjustments, restatements and eliminations of account provided for in Section 209 are necessary and usual safeguards properly required by the Government in guaranteeing the results of the operation by the railroads of their business and are for the benefit of the Government and not of the roads; that these provisions do not amount to a mandatory audit by the Commission and that the Commission may satisfy itself by any method which it sees fit as to the correctness of claims by a carrier for the guaranty. In these circumstances, I believe the Commission has wide powers enabling it rapidly to reach final settlement with the carriers.

If I am not correct in this understanding of the Act, I am strongly of the opinion that broad powers should be conferred upon the Commission to make with any carrier such settlement of its claim under Section 209 as the Commission may in its discretion approve provided there may be made with any carrier only one such settlement and provided further that such settlement shall be a complete bar to any further claim by the carrier under Section 209. I assume such grant of power can be drawn without limiting the great powers already reposed in the Commission or investing the carriers with additional claims.

In case in the opinion of the Commission final settlement with the carriers can be expedited if the appropriations available to it and the staff which it is authorized to employ in the performance of its administrative duties are increased, I should warmly support a request of the Commission for the necessary increases of appropriation and staff. I am convinced that if all questions between the carriers and the Government growing out of Federal control and the guaranty can be settled promptly, the necessary payments made, and that chapter of our history finally closed, it will ultimately be an economy for the Government and people of the United States, even though for the sake of accomplishing it somewhat increased expenditures have to be made now in defraying the cost of the administrative work involved and in making liberal settlements.

Section 204 provides for the reimbursement out of the public money to railroads of deficits incurred by them during the period of Federal control while they were not themselves under Federal control. It is my understanding that the purpose of this section was to benefit

the short lines which were not taken over by the Director General of Railroads or which were surrendered by him before the end of Federal control. Paragraph (g) as it now stands provides that the Interstate Commerce Commission shall promptly certify to the Secretary of the Treasury the several amounts payable to carriers under section 204. Under this authority the Commission had power to make certificates immediately after March 1, 1920. The Commission estimated that the amount required would not greatly exceed \$10,000,000. Although more than ten months have now elapsed since March 1, 1920, the Treasury has received from the Commission unqualified certificates for payments to only two carriers in a total amount of less than \$60,000. The Commission has, however, made a number of qualified certificates for partial payments. When one of these was brought to the attention of the Comptroller of the Treasury he decided that under the terms of section 204 the Secretary of the Treasury was not authorized to draw a warrant in favor of the carrier mentioned in the certificate on the ground that section 204 contained no provision for qualified certificates or partial payments but only for a single final certificate. I enclose for the information of the Committee a copy of the decision of the Comptroller of the Treasury dated October 22, 1920. A copy will also be found at page 156 of the Annual Report of the Secretary of the Treasury for the fiscal year 1920. I understand from the Commission that it has been its practice before making even a qualified certificate for a partial payment to require the carrier to present the amount, together with the supporting facts and figures, of its entire claim. It would appear, therefore, that such obstacles as there may be to the immediate issue

of final certificates lie in the difficulties encountered by the Commission in making the audits deemed by it necessary to satisfy itself as to the correctness of the respective claims. In these circumstances, the bill proposes to amend paragraph (g) so that it shall read as follows:

"(g) The commission shall promptly certify to the Secretary of the Treasury the several amounts payable to carriers under paragraph (f). The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States for the amount shown in such certificates as payable thereto, it being the true intent and meaning hereof that whenever, and as often as, the commission shall certify to the Secretary of the Treasury an amount payable hereunder to any carrier, the Secretary of the Treasury is hereby authorized and directed, upon receipt of such certificate, to draw a warrant in favor of such carrier upon the Treasury of the United States for the amount shown in such certificate as payable to it under this section, whether such amount is in final settlement or in partial payment, and the Comptroller of the Treasury is hereby directed to countersign the same forthwith. The Secretary of the Treasury shall thereupon deliver the said warrant to such carrier, and the Treasurer of the United States is hereby directed to pay the same, upon presentation, out of the appropriation made in this subdivision therefor. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated.

"In ascertaining the several amounts payable hereunder, the commission is further authorized, in the case of debits and credits to railway operating income, which can not at the time be definitely determined, to make, whenever in its judgment practicable, a reasonable estimate of the net effect of any such items, and, when agreed to by the carrier interested, to use such estimate as a definitely ascertained amount in certifying the amounts payable hereunder, and such estimates, so agreed to, shall be binding in final settlement."

In my opinion this amendment should be modified. In view of the nature of the difficulty confronting the Interstate Commerce Commission under this section, I do not understand how it can make partial certificates except by the use of estimates as provided by the second paragraph of the

amendment. Since, however, in reaching a determination of the deficit to be reimbursed to any carrier all the items for the entire period involved must be taken together and since it is proposed that the estimate is to be binding in final settlement, I see no object to be gained by authorizing certificates for partial payment and suggest that the result apparently desired can better be obtained by conferring upon the Commission broad power (if it does not already have it) to make with each carrier a final settlement provided only one such settlement may be made with any carrier and provided further that a settlement thus made shall be a complete bar to all further claims of the carrier under section 204. If I am not correct in my understanding that all claims under section 204 have been presented, I venture to suggest that Congress fix an early date before which all claims must be presented or be forever barred. The views expressed as to the provisions concerning the Comptroller of the Treasury in the proposed amendment to section 209 apply also to the proposed amendment to section 204. The views expressed as to the authorizing of the use of estimates also apply in part.

Yours cordially,

(Signed) D. F. HOUSTON.

Honorable John J. Esch,
Chairman, Committee on Interstate and Foreign Commerce,
House of Representatives.

SPECIAL INSTRUCTIONS TO COLLECTORS OF INTERNAL REVENUE
IN THE STATES OF
ARIZONA, CALIFORNIA, IDAHO, NEVADA, OREGON, UTAH and WASHINGTON.

January 17, 1921.

Under the provisions of Treasury Decision 3115, collectors of internal revenue are instructed, unless otherwise notified by the Secretary of the Treasury, not to accept in payment of income and profits taxes payable in the calendar year 1921 interim receipts issued by Federal Reserve Banks in lieu of definitive Treasury certificates of indebtedness acceptable in payment for such taxes. In order to make provision for special conditions prevailing in the San Francisco Federal Reserve District, however, collectors of internal revenue in the States of Arizona, California, Idaho, Nevada, Oregon, Utah and Washington are hereby specifically authorized to accept during the calendar year 1921, subject to verification by the Federal Reserve Bank of San Francisco, in payment of income and profits taxes payable at the respective dates of maturity of the certificates which they represent, interim receipts issued by the Federal Reserve Bank of San Francisco for Treasury certificates of indebtedness by their terms acceptable in payment of income and profits taxes at maturity. Except as herein otherwise provided, such interim receipts will be accepted on the same terms and conditions as definitive certificates under the provisions of said T. D. 3115. Inasmuch as interim receipts have no interest coupons attached, accrued interest to the respective dates of maturity of the certificates will in every case be remitted by check to the taxpayer by the Federal Reserve Bank or branch bank with which the collector deposits the interim receipts. Separate schedules to accompany deposits of interim receipts must be prepared in duplicate by collectors, so as to show in each case

the name and address of the taxpayer, the face amount and serial numbers of the interim receipts deposited, and the serial designation and dates of issue and maturity of the Treasury certificates represented thereby. Interim receipts accepted by collectors hereunder must be forwarded with the original schedule to the Federal Reserve Bank or branch with which the collector deposits definitive certificates, with the request that the Federal Reserve Bank or branch make remittances to taxpayers by check for the amount of accrued interest due at the maturity of the certificates. Collectors shall in no case pay interest on interim receipts, nor accept them for amounts other or greater than their face value. Tax receipts given by collectors to taxpayers should describe the amounts of interim receipts, if any, accepted in payment of the taxes.

Collectors of internal revenue in the above-mentioned districts are not authorized hereunder to accept in payment of income or profits taxes interim receipts issued by Federal Reserve Banks other than the Federal Reserve Bank of San Francisco, and collectors of internal revenue in other districts than those mentioned are not authorized hereunder to accept interim receipts issued by the Federal Reserve Bank of San Francisco.

By direction of the Secretary:

S. P. GILBERT, JR.

Assistant Secretary of the Treasury.

For release, morning papers,
Thursday, February 10, 1921.

The Secretary of the Treasury, under the authority of the act approved September 24, 1917, as amended, offers for subscription, at par and accrued interest, through the Federal Reserve Banks, Treasury certificates of indebtedness, Series G 1921, dated and bearing interest from February 15, 1921, payable July 15, 1921, with interest at the rate of five and one-half per cent per annum.

Applications will be received at the Federal Reserve Banks.

Bearer certificates will be issued in denominations of \$500, \$1,000, \$5,000, \$10,000, and \$100,000. The certificates will have one interest coupon attached, payable July 15, 1921.

The certificates of said series shall be exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of bonds and certificates authorized by said act approved September 24, 1917, and amendments thereto, the principal of which does not exceed in the aggregate \$5,000, owned by any individual, partnership, association, or corporation, shall be exempt from the taxes provided for in clause (b) above.

The certificates of this series do not bear the circulation privilege and will not be accepted in payment of taxes.

The right is reserved to reject any subscription and to allot less than the amount of certificates applied for and to close the subscriptions at any time without notice. Payment at par and accrued interest for certificates allotted must be made on or before February 15, 1921, or on later allotment. After allotment and upon payment Federal Reserve Banks may issue interim receipts pending delivery of the definitive certificates. Any qualified depository will be permitted to make payment by credit for certificates allotted to it for itself and its customers up to any amount for which it shall be qualified in excess of existing deposits, when so notified by the Federal Reserve Bank of its district.

As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive subscriptions and to make allotment in full in the order of the receipt of applications up to amounts indicated by the Secretary of the Treasury to the Federal Reserve Banks of the respective districts.

The issue will be for \$100,000,000, or thereabouts.

TREASURY DEPARTMENT.

FOR RELEASE, MORNING PAPERS,
Wednesday, March 9, 1921.

In connection with the March 15th offering of Treasury
Certificates, Secretary Mellon is sending to the banking institutions
throughout the country the following letter:

"March 9, 1921.

Dear Sir:

At the outset of my administration of the Treasury I am addressing this letter to the banking institutions of the country to inform them of the state of the Nation's finances, the probable requirements of the Treasury for the coming months, and its financial plans for the immediate future.

About \$500,000,000 of Treasury certificates of indebtedness mature on March 15, 1921, and about \$118,000,000 additional on April 15, 1921. On March 15, 1921, there will become payable the semiannual interest on the Third Liberty Loan, amounting to about \$75,000,000. The Treasury must also make large payments under the recent legislation authorizing partial payments on account of the railroad guaranty, which may amount to as much as \$200,000,000 during the course of the next month. In order to meet these heavy requirements and at the same time provide for the current expenses of the Government, the Treasury relies in large part upon the quarterly installment of income and profits taxes due March 15, 1921. Advance payments of March taxes have been up to expectations, and though it is impossible to forecast the results with certainty, the Treasury has good reason to hope that income and profits tax payments during March will about balance the March 15 maturities of principal and interest. To provide for its further requirements, the Treasury has decided, on the basis of the best available estimates, to offer Treasury certificates of indebtedness in the amount of \$400,000,000, or thereabouts, in two series, both dated March 15, 1921, one series designated T S 2-1921, bearing 5 1/2 per cent interest, maturing September 15, 1921, and the other series designated T M-1922, bearing 5 3/4 per cent interest and maturing March 15, 1922. Applications for Treasury certificates of these series will be received in regular course through the several Federal Reserve Banks, as fiscal agents of the United States, from which full particulars concerning the offering may be obtained. Treasury certificates of the series which mature on March 15, 1921, and April 15, 1921, will be accepted at par with an adjustment of accrued interest in payment for any certificates of the two series now offered which may be subscribed for and allotted.

On the basis of the Treasury Daily Statements, the current operations of the Government during the first eight months of the fiscal year through February 28, 1921, show a net current surplus (excess of ordinary receipts over ordinary disbursements) amounting to \$186,115,505.53.

This showing is particularly encouraging in view of the fact that during these eight months there have been extraordinarily heavy expenditures but only two quarterly payments of income and profits taxes. Ordinary receipts up to February 28, 1921, have amounted to \$3,433,411,141.36, as against ordinary disbursements during the same period of \$3,247,295,635.83 (or at the rate of almost 5 billions a year). Of these disbursements about \$750,000,000 have represented expenditures of the War Department, about \$450,000,000 expenditures of the Navy Department, about \$475,000,000 payments to the railroads under the Transportation Act, 1920, and about \$550,000,000 payments of interest on the public debt -- a total of about \$2,225,000,000 under these four main headings. In the four months which remain of the fiscal year there will be two further quarterly payments of income and profits taxes, both based on the business of the calendar year 1920. While it is impossible to estimate these tax payments with accuracy, and the prospects are that expenditures will continue heavy for some time to come, the Treasury expects that the operations of the first three quarters of the year, through March 31, 1921, as well as the completed year's operations, will show some surplus of receipts over expenditures.

The gross debt of the Government on February 28, 1921, amounted to \$24,051,684,728.28, on the basis of Treasury Daily Statements, while on the same date the floating debt (loan and tax certificates unmatured) amounted to \$2,484,032,000. These figures contrast with a gross debt on December 31, 1920, of \$23,982,224,168.16, and a floating debt on the same date of \$2,300,656,000. As a result of the Treasury's operations on March 15, 1921, these increases in gross debt and floating debt (which are to be expected in the odd months when no quarterly income and profits tax payments are made) should be largely offset and perhaps overcome. The progress to be made during the balance of the current year in the retirement of gross debt and floating debt will depend, of course, upon the extent of the demands made upon the Treasury and the volume of its receipts from taxes and salvage. This progress is likely to be seriously limited by reason of the heavy railroad payments to be expected during the next two or three months.

These figures as to the public debt and the current operations of the Treasury show that the country's finances are sound, but that the situation calls for the utmost economy. The Nation can not afford extravagance, and so far as possible it must avoid entering upon new fields of expenditure. The heavy requirements of the Government on account of necessary expenditures, including interest and sinking fund on the public debt, and the maturity of $7\frac{1}{2}$ billions of short-dated debt within the next two years or thereabouts make it imperative that the greatest care and economy be exercised in matters affecting Government expenditure. The people generally must become more interested in saving the Government's money than in spending it. A thoroughgoing National budget system must be established, and the Government's expenses brought into relation to its income.

The period which has elapsed since the last quarterly installment of income and profits taxes has been marked by important developments in the market for Treasury certificates of indebtedness. On January 15, 1921, the Treasury successfully sold an offering of three-months 5 1/2 per cent certificates and nine-months 5 3/4 per cent certificates. On February 15, 1921, an offering of five-months 5 1/2 per cent certificates was likewise promptly oversubscribed. Treasury certificates of indebtedness now enjoy a broad and active market, on a straight investment basis, and all issues now outstanding are quoted in the open market either at par or at a premium. The last three months have also been marked by still further distribution of Treasury certificates among investors and a reduction in holdings of Treasury certificates by banks. The reporting member banks of the Federal Reserve System (about 825 banks in leading cities, which are believed to control about 40 per cent of the commercial bank resources of the country and to have subscribed in the first instance for about 75 per cent of the Treasury certificates of indebtedness now outstanding) held on February 25, 1921, only about \$235,000,000 of Treasury certificates as compared with reported holdings on November 26, 1920, of about \$313,000,000, and on February 27, 1920, of about \$673,000,000. On March 4, 1921, the Federal Reserve Board reported that there were pledged with the Federal Reserve Banks only about \$110,000,000 of Treasury certificates to secure loans and discounts, or less than 5 per cent of the aggregate amount of loan and tax certificates then outstanding. These figures strikingly show the success of the efforts which have been made for the past year or more to secure distribution of Treasury certificates among real investors, and to keep them out of the banks.

The two series of six months and twelve months certificates now offered are both acceptable in payment of income and profits taxes, and should prove peculiarly attractive to taxpayers as well as to persons having idle funds awaiting investment. I know that I can count, like my predecessors in office, on your hearty cooperation in the distribution and sale of Treasury certificates, and hope that, as in the past, you will subscribe liberally in the first instance for the certificates and use your best efforts to resell them to investors.

Cordially yours,

A. W. MELLON

Secretary of the Treasury.

To the President
of the Bank or Trust Company addressed."

TREASURY DEPARTMENT.

For release, morning papers,
Wednesday, March 9, 1921.

The Secretary of the Treasury, under the authority of the act approved September 24, 1917, as amended, offers for subscription, at par and accrued interest, through the Federal Reserve Banks, Treasury certificates of indebtedness, in two series, both dated and bearing interest from March 15, 1921, the certificates of Series T S 2-1921 being payable on September 15, 1921, with interest at the rate of five and one-half per cent per annum semiannually, and the certificates of Series T M-1922 being payable on March 15, 1922, and bearing interest at the rate of five and three-quarters per cent per annum, payable semiannually.

Applications will be received at the Federal Reserve Banks.

Bearer certificates will be issued in denominations of \$500, \$1,000, \$5,000, \$10,000, and \$100,000. The certificates of Series T S2-1921 will have one interest coupon attached payable September 15, 1921, and the certificates of Series T M-1922 two interest coupons attached, payable September 15, 1921, and March 15, 1922.

The certificates of both said series shall be exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of bonds and certificates authorized by said act approved September 24, 1917, and amendments thereto, the principal of which does not exceed in the aggregate \$5,000, owned by any

individual, partnership, association, or corporation, shall be exempt from the taxes provided for in clause (b) above.

Certificates of these series will be accepted at par, with an adjustment of accrued interest, during such time and under such rules and regulations as shall be prescribed or approved by the Secretary of the Treasury, in payment of income and profits taxes payable at the maturity of the certificates, respectively. The certificates of these series do not bear the circulation privilege.

The right is reserved to reject any subscription and to allot less than the amount of certificates of either or both series applied for and to close the subscriptions as to either or both series at any time without notice. Payment at par and accrued interest for certificates allotted must be made on or before March 15, 1921, or on later allotment. After allotment and upon payment Federal Reserve Banks may issue interim receipts pending delivery of the definitive certificates. Any qualified depository will be permitted to make payment by credit for certificates allotted to it for itself and its customers up to any amount for which it shall be qualified in excess of existing deposits when so notified by the Federal Reserve Bank of its district. Treasury certificates of indebtedness of Series T M-1921, Series T M2-1921, Series T M3-1921, and Series T M4-1921, all maturing March 15, 1921, and of Series E 1921, maturing April 15, 1921, with any unmatured interest coupons attached, will be accepted at par, with an adjustment of accrued interest, in payment for any certificates of the Series T S2-1921 or T M-1922 now offered which shall be subscribed for and allotted.

As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive subscriptions and to make allotment in full in the order of the receipt of applications up to amounts indicated by the Secretary of the Treasury to the Federal Reserve Banks of the respective districts.

The combined issue will be for \$400,000,000, or thereabouts.

March 31, 1921.

In connection with the March 15th issue of Treasury certificates it is interesting to note that Treasury certificates of indebtedness of all issues now outstanding are quoted in the open market at par or at a premium. Quotations on Treasury certificates now appear daily in the leading newspapers, and the certificates enjoy a broad and active investment market. Out of two and one-half billions of Treasury certificates outstanding less than \$100,000,000 are pledged with the Federal Reserve Banks to secure loans and discounts. Only \$94,500,000 of certificates were so pledged at the close of business Friday, March 25, 1921, according to the latest statement of the Federal Reserve Board.

TREASURY DEPARTMENT

For release, morning papers,
Monday, April 11, 1921.

The Secretary of the Treasury, under the authority of the act approved September 24, 1917, as amended, offers for subscription, at par and accrued interest, through the Federal Reserve Banks, Treasury certificates of indebtedness, Series H 1921, dated and bearing interest from April 15, 1921, payable October 15, 1921, with semiannual interest at the rate of five and one-half per cent per annum.

Applications will be received at the Federal Reserve Banks.

Bearer certificates will be issued in denominations of \$500, \$1,000, \$5,000, \$10,000, and \$100,000. The certificates will have one interest coupon attached, payable October 15, 1921.

The certificates of said series shall be exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of bonds and certificates authorized by said act approved September 24, 1917, and amendments thereto, the principal of which does not exceed in the aggregate \$5,000, owned by any individual, partnership, association, or corporation, shall be exempt from the taxes provided for in clause (b) above.

The certificates of this series do not bear the circulation privilege and will not be accepted in payment of taxes.

The right is reserved to reject any subscription and to allot less than the amount of certificates applied for and to close the subscriptions at any time without notice. Payment at par and accrued interest for certificates allotted must be made on or before April 15, 1921, or on later allotment. After allotment and upon payment Federal Reserve Banks may issue interim receipts pending delivery of the definitive certificates. Any qualified depository will be permitted to make payment by credit for certificates allotted to it for itself and its customers up to any amount for which it shall be qualified in excess of existing deposits, when so notified by the Federal Reserve Bank of its district. Treasury certificates of indebtedness of Series E 1921, maturing April 15, 1921, and of Series D 1921, maturing May 16, 1921 (with any unmatured interest coupons attached), will be accepted at par, with an adjustment of accrued interest, in payment for any certificates of the Series H 1921 now offered which shall be subscribed for and allotted.

As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive subscriptions and to make allotment in full in the order of the receipt of applications up to amounts indicated by the Secretary of the Treasury to the Federal Reserve Banks of the respective districts.

The issue will be for \$150,000,000, or thereabouts.

LETTER FROM THE SECRETARY OF THE TREASURY TO THE CHAIRMAN OF THE COMMITTEE ON
WAYS AND MEANS.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, April 30, 1921.

DEAR MR. CHAIRMAN:

In accordance with your request, as communicated in your letter of April 25, 1921, I am glad to present for your consideration and that of the Committee on Ways and Means, revised estimates of receipts and expenditures for the fiscal years 1921 and 1922, and to indicate in that connection what revenues must be provided for the fiscal years 1922 and 1923 in order to carry on the Government's business and meet its current requirements and fixed debt charges, including interest and sinking fund.

In order that the Congress may have the latest available information before it, I hand you herewith the following statements:

(A) Statement giving revised estimates of receipts and disbursements for the fiscal years 1921 and 1922, with a supplemental statement classifying the estimated disbursements. This statement is made up on the basis of actual receipts and disbursements for the first three quarters of the fiscal year 1921, and the best estimates of the Treasury and the spending departments as to receipts and disbursements during the last quarter of 1921 and the fiscal year 1922. It supersedes the estimates of receipts and expenditures for the fiscal years 1921 and 1922 which appear on pages 273 to 278 of the Annual Report of the Secretary of the Treasury for 1920.

(B) Preliminary statement showing classified expenditures of the Government for the period from July 1, 1920, to March 31, 1921, with comparative figures and total expenditures for the fiscal year 1920, on the basis of daily Treasury statements (exclusive of postal expenditures, except postal deficiencies, etc.).

(C) Preliminary statement showing ordinary receipts of the Government for the period from July 1, 1920, to March 31, 1921, with comparative figures and total ordinary receipts for the fiscal year 1920, on the basis of daily Treasury statements (exclusive of postal revenues).

(D) Preliminary statement of the public debt on March 31, 1921, on the basis of daily Treasury statements, with a quarterly comparative public debt statement which shows the figures for August 31, 1919, when the war debt was at its peak.

(E) Statement showing comparative figures as to the outstanding short-dated public debt, on the basis of daily Treasury statements, from August 31, 1919, to March 31, 1921.

Ordinary expenditures for the first three quarters of the fiscal year 1921 have been \$3,783,771,996.74, or at the rate of about \$5,000,000,000 for the year. Of these expenditures about \$850,000,000 have been expenditures of the War Department, about \$500,000,000 expenditures of the Navy Department, about \$600,000,000 payments to the railroads, and about \$650,000,000 interest on the public debt, an aggregate of \$2,600,000,000 under these four headings in nine months, or at the rate of about \$3,500,000,000 for the year. According to the latest estimates of the spending departments, as set forth in Statement A—Supplemental, ordinary expenditures during the fiscal year 1922, including interest on the public debt, will be over \$4,000,000,000.

The Nation can not continue to spend at this shocking rate. As the President said in his message, the burden is unbearable, and there are two avenues of relief. "One is rigid resistance in appropriation and the other is the utmost economy in administration." This is no time for extravagance or for entering upon new fields of expenditure. The Nation's finances are sound and its credit is the best in the world, but it can not afford reckless or wasteful expenditure. New or enlarged expenditures can not be financed without increased taxes or new loans. Expenditures should not even be permitted to continue at the present rate. The country is staggering under the existing burden of taxation and debt and clamoring for gradual relief from the war taxation. It may be counted upon not only to exert effective pressure against increased expenditures but also to give its whole-hearted support to all sincere efforts to reduce expenditures.

The last Congress made a creditable record in reducing appropriations, and it effected substantial economies. Notwithstanding the reduced appropriations, however, expenditures have continued unexpectedly high, and the reduction in expenditures has barely kept pace with the shrinkage in receipts. Reduction of appropriations, moreover, will not of itself be effective to reduce expenditures unless at the same time the Congress avoids or controls measures which result in expenditure without an apparent appropriation. Reappropriations of unexpended balances, revolving-fund appropriations and appropriations of receipts, and other indefinite authorizations of expenditure have in the past been responsible for hundreds of millions of dollars of actual cash outgo.

The estimates for the fiscal year 1922 are subject to great uncertainty as to both receipts and expenditures. The estimated collections of \$3,700,000,000 of internal taxes are based on the provisions of existing law, and are \$850,000,000 less than the estimated collections for 1921, chiefly because of the shrinkage in business. They are liable to be somewhat further reduced from the same cause. The estimated ordinary expenditures of \$4,014,000,000 will on their part be affected by appropriations which are still to be made. The estimated expenditures of the War Department and the Navy Department, aggregating over \$1,100,000,000 for 1922, will depend largely upon the military and naval policy adopted by the Congress at the present session. The estimate of about \$545,000,000 for payments to the railroads in 1922 is made necessary by the provisions of the Transportation Act, 1920, and increased estimates from the Director General of Railroads. In the absence of drastic cuts in military and naval expenditures, there is almost no prospect, according to the estimates, of any substantial available surplus even in the fiscal year 1922.

The estimates of receipts and expenditures for both 1921 and 1922 show clearly that while this Government has definitely balanced its budget, the surplus of current receipts over current expenditures will not quite provide for what may be termed the fixed public debt redemptions, and that unless expenditures are sharply reduced there will be practically no funds available in these years for the retirement of the floating debt represented by loan and tax certificates outstanding. The estimated current surplus in both 1921 and 1922 will be absorbed (1) by current redemptions of War-Savings securities, redeemable substantially on demand, (2) by purchases for the cumulative sinking fund, (3) by acceptance of Liberty bonds and Victory notes for estate taxes, and (4) by miscellaneous other debt retirements which must be made each year in order to comply with existing law or with the terms of outstanding securities. This means that the Treasury's earlier expectations as to the retirement of the floating debt have been upset by the continuance of unexpectedly heavy current expenditures during the past 12 months, particularly on account of the Army and Navy and the railroads, and that the Government can not now expect to retire any material portion of the two and one-half billions of floating debt now outstanding during the fiscal years 1921 and 1922 out of current revenues. It means also that the country can not look to any plan for funding the floating debt to reduce the burden of internal taxes during the next two years. Substantial cuts in current expenditures offer the only hope of effective relief from the tax burden.

Within the next two years, or thereabouts, there will mature about seven and one-half billions of short-dated debt (including the outstanding floating debt), and it is to the gradual retirement of this debt that the bulk of the current surplus is necessarily applied, in large part through the miscellaneous debt retirements described in the preceding paragraph. Substantial progress has already been made in the retirement of the short-dated debt. Statement E, for example, shows that the short-dated debt aggregated \$7,578,954,141.89 on March 31, 1921, as against \$9,248,188,921.12 on August 31, 1919, when the war debt was at its peak, a reduction of about one and two-thirds billions in the 19 months' period. This reduction was due in large part to the reduced balance in the general fund and the application of receipts from war salvage, and only in small measure to surplus tax receipts. In view of its early maturity, the Treasury must regard the short-dated debt as a whole, and within the next two years may expect to reduce it by perhaps one billion dollars through the continued operation of the sinking fund and the miscellaneous annual debt retirements. The remainder of this short-dated debt, amounting to over six billions, will have to be refunded. It will therefore be the Treasury's policy to

vary its monthly offerings of Treasury certificates of indebtedness from time to time when market conditions are favorable with issues of short-term notes in moderate amounts with maturities of from three to five years, with a view to the gradual distribution of the short-dated debt through successive issues of notes in convenient maturities extending over the period from 1923 to 1928, when the Third Liberty Loan matures. Treasury certificate offerings will continue to be made from time to time as in the past, in order to meet the Treasury's current requirements. This program will make the short-dated debt more manageable and facilitate the refunding operations which will be necessary in connection with the maturity of the Victory Liberty Loan.

This analysis of the condition of the Treasury and of the burdens which it must face within the next two fiscal years shows clearly, as the President stated in his message, that—

unless there are striking cuts in the important fields of expenditure, receipts from internal taxes can not safely be permitted to fall below four billions in the fiscal years 1922 and 1923. This would mean total internal tax collections of about one billion less than in 1920, and one-half billion less than in 1921.

The most substantial relief from the tax burden must come for the present from the readjustment of internal taxes, and the revision or repeal of those taxes which have become unproductive and are so artificial and burdensome as to defeat their own purpose. A prompt and thoroughgoing revision of the internal tax laws, made with due regard to the protection of the revenues, is, in my judgment, a requisite to the revival of business activity in this country. It is earnestly hoped, therefore, that the Congress will be able to enact without delay a revision of the revenue laws and such emergency tariff measures as are necessary to protect American trade and industry.

Now that the House of Representatives has passed the emergency tariff legislation, I hope that the Congress will soon undertake the revision of the revenue laws, with due regard to the protection of the revenues and at the same time with a view to "the readjustment of internal taxes and the revision or repeal of those taxes which have become unproductive and are so artificial and burdensome as to defeat their own purpose." The higher rates of income surtaxes put constant pressure on taxpayers to reduce their taxable income, interfere with the transaction of business and the free flow of capital into productive enterprise, and are rapidly becoming unproductive. The excess-profits tax is artificial and troublesome. Taxes of this extreme character are clogs upon productive business and should be replaced by other and more equitable taxes upon incomes and profits. An intelligent revision of these taxes should encourage production and in the long run increase rather than diminish the revenues. Early action is necessary, for unless a revision is adopted within a few months it could not in fairness apply to income and profits arising from the business of the present calendar year.

With these considerations in mind, I venture to make the following principal suggestions with regard to the revision of the internal tax laws:

1. Repeal the excess-profits tax, and make good the loss of revenue by means of a modified tax on corporate profits or a flat additional income tax upon corporations, and the repeal of the existing \$2,000 exemption applicable to corporations, to yield an aggregate revenue of between \$400,000,000 and \$500,000,000. The excess-profits tax is complex and difficult of administration, and is losing its productivity. It is estimated that for the taxable year 1921 it will yield about \$450,000,000, as against \$2,500,000,000 in profits taxes for the taxable year 1918, \$1,320,000,000 for the taxable year 1919, and \$750,000,000 for the taxable year 1920. In fairness to other taxpayers, and in order to protect the revenues, however, the excess-profits tax must be replaced, not merely repealed, and should be replaced by some other tax upon corporate profits. A flat additional tax on corporate income would avoid determination of invested capital, would be simple of administration, and would be roughly adjusted to ability to pay. It is estimated that the combined yield to accrue during the taxable year 1921 from a tax of this character at the rate of 5 per cent and the repeal of the \$2,000 exemption would be about \$400,000,000.

2. Readjust the income-tax rates to a maximum combined normal tax and surtax of 40 per cent for the taxable year 1921, and of about 33 per cent thereafter, with a view to producing aggregate revenues substantially equivalent to the estimated receipts from the income tax under existing law. This readjustment is recommended not because it will relieve the rich, but because the higher surtax rates have already passed the collection point. The higher rates constitute a bar to transactions involving turnovers of securities and property, which with

lower surtax rates would be accomplished and thus yield substantial new revenue to the Government. The total net income subject to the higher rates is rapidly dwindling, and funds which would otherwise be invested in productive enterprise are being driven into fields which do not yield taxable income. The total estimated revenue from the surtaxes under existing law is about \$500,000,000 for the taxable year 1921. The estimated yield for the year from the surtax rates above 32 per cent would be about \$100,000,000. The immediate loss in revenue that would result from the repeal of the higher surtax brackets would be relatively small, and the ultimate effect should be an increase in the revenues.

3. Retain the miscellaneous specific-sales taxes and excise taxes, including the transportation tax, the tobacco taxes, the tax on admissions, and the capital-stock tax, but repeal the minor "nuisance" taxes, such as the taxes on fountain drinks and the miscellaneous taxes levied under section 904 of the Revenue Act, which are difficult to enforce, relatively unproductive, and unnecessarily vexatious. The repeal of these miscellaneous special taxes would, it is estimated, result in a loss of about \$50,000,000 in revenue. The transportation tax is objectionable and I wish it were possible to recommend its repeal, but this tax produces revenue in the amount of about \$330,000,000 a year and could not safely be repealed or reduced unless Congress is prepared to provide an acceptable substitute. The Treasury is not prepared to recommend at this time any general sales tax, particularly if a general sales tax were designed to supersede the highly productive special sales taxes now in effect on many relatively nonessential articles.

4. Impose sufficient new or additional taxes of wide application, such as increased stamp taxes or a license tax on the use of automobiles, to bring the total revenues from internal taxes after making the changes above suggested, to about \$4,000,000,000 in the fiscal years 1922 and 1923. The only way to escape these additional internal taxes, to an aggregate amount of between \$250,000,000 and \$350,000,000, will be to make immediate cuts in that amount in current expenditures. In the event that this should prove impossible, it might be feasible to provide perhaps as much as \$100,000,000 or \$150,000,000 of the necessary revenue from new duties on staple articles of import, and the balance by taking more effective steps to realize on back taxes, surplus war supplies, and other salvageable assets of the Government.

5. Adopt necessary administrative amendments to the Revenue Act in order to simplify its administration and make it possible, among other things, for the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury and the consent of the taxpayer, to make final determination and settlement of tax cases. In this connection it would be well, in the interest of fairness and in order to simplify the administrative problem, to provide, under proper safeguards, for carrying forward net losses of one year as a deduction from the income of succeeding years.

I suggest for the consideration of Congress that it may also be advisable to take action by statute or by constitutional amendment, where necessary, to restrict further issues of tax-exempt securities. It is now the policy of the Federal Government not to issue its own obligations with exemptions from Federal surtaxes and profits taxes, but States and municipalities are issuing fully tax-exempt securities in great volume. It is estimated that there are outstanding perhaps \$10,000,000,000 of fully tax-exempt securities. The existence of this mass of exempt securities constitutes an economic evil of the first magnitude. The continued issue of tax-exempt securities encourages the growth of public indebtedness and tends to divert capital from productive enterprise. Even though the exemptions of outstanding securities can not be disturbed, it is important that future issues be controlled or prohibited by mutual consent of the State and Federal Governments.

I am sending a copy of this letter to Senator Penrose as Chairman of the Committee on Finance.

I shall, of course, be glad to hold myself and the Treasury experts in readiness to answer any call from the committee and to supply such further information with regard to the condition of the Treasury and the Treasury's revenue recommendations as the committee may desire.

Very truly yours,

A. W. MELLON,

Secretary.

HON. JOSEPH W. FORDNEY,

Chairman, Committee on Ways and Means, House of Representatives.

A.

*Statement of Estimated Receipts and Disbursements for Fiscal Years 1921 and 1922.
(Revised April 27, 1921.)*

	Fiscal year 1921.	Fiscal year 1922.
RECEIPTS.		
Customs.....	\$300,000,000	\$300,000,000
Internal revenue:		
Income and profit taxes.....	\$3,150,000,000	\$2,350,000,000
Miscellaneous internal revenue.....	1,400,000,000	1,350,000,000
	4,550,000,000	3,700,000,000
Miscellaneous revenue:		
Sales of public lands.....	1,500,000	1,500,000
Federal Reserve Bank franchise tax.....	60,724,500	60,000,000
Interest on foreign obligations.....	28,331,000	225,026,000
Repayments of foreign obligations.....	100,000,000	30,500,000
Sales of surplus war supplies.....	280,000,000	60,000,000
Panama Canal.....	11,800,000	14,530,000
Other miscellaneous.....	174,711,500	156,087,000
	637,067,000	547,643,000
Total.....	5,487,067,000	4,547,643,000
DISBURSEMENTS.		
Ordinary.....	5,005,545,496	4,014,522,168
Public debt:		
Sinking fund.....	253,404,865	265,754,865
War-Savings securities (net).....	140,000,000	100,000,000
Miscellaneous debt redemptions.....	350,000	100,000
Purchases of Liberty bonds from foreign repayments.....	85,000,000	30,500,000
Redemptions of bonds and notes from estate taxes.....	20,000,000	25,000,000
	498,754,865	421,354,865
Retirement of Pittman Act certificates.....	37,000,000	70,000,000
Retirement of Treasury certificates from Federal Reserve Bank franchise tax receipts.....	60,724,500	60,000,000
	97,724,500	130,000,000
Total debt retirements.....	596,479,365	551,354,865
Total disbursements.....	5,602,024,861	4,565,877,033
Excess of disbursements over receipts.....	114,957,861	18,234,033

A-(Supplemental).

Classification of Estimated Disbursements for Fiscal Years 1921 and 1922.

	Fiscal year 1921.	Fiscal year 1922.
Legislative.....	\$16,833,723	\$17,213,813
Executive.....	2,094,256	1,897,751
State Department.....	10,320,000	10,344,000
Department of Justice.....	17,300,000	17,000,000
Post Office Department.....	2,097,200	2,200,000
Interior Department (including pensions and Indians).....	323,500,000	322,000,000
Department of Agriculture.....	107,000,000	123,000,000
Department of Commerce.....	23,333,300	19,923,000
Department of Labor.....	5,281,621	5,252,887
Independent offices.....	112,459,569	133,391,516
District of Columbia.....	21,510,938	22,187,663
Miscellaneous.....	81,501,330	60,407,500
	\$723,231,937	\$734,818,139
Postal deficiency.....	65,097,796	43,512,000
Treasury Department:		
Bureau of War Risk Insurance.....	\$233,074,884	\$262,917,900
Public Health Service.....	50,000,000	51,325,000
Collecting the revenue.....	51,944,134	53,110,139
All other.....	112,565,886	99,457,795
	447,584,904	466,810,834
War Department.....	1,027,750,000	569,750,000
Navy Department.....	697,500,000	545,225,000
Shipping Board.....	103,345,000	124,200,000
Railroads (transportation act and Federal control).....	803,551,212	545,206,204
Interest on public debt.....	975,000,000	975,000,000
Panama Canal.....	13,000,000	10,000,000
Purchase of foreign obligations.....	132,703,326	-----
Purchase of farm loan bonds.....	16,781,321	-----
	4,282,313,559	3,279,704,038
Total ordinary.....	5,005,545,496	4,014,522,168
Public debt:		
Sinking fund.....	253,404,865	265,754,865
War-savings securities (net).....	140,000,000	100,000,000
Miscellaneous debt redemptions.....	350,000	100,000
Purchases of Liberty bonds from foreign repayments.....	85,000,000	30,500,000
Redemptions of bonds and notes from estate taxes.....	20,000,000	25,000,000
	498,754,865	421,354,865
Retirement of Pittman Act certificates.....	37,000,000	70,000,000
Retirement of Treasury certificates from Federal Reserve Bank franchise tax receipts.....	60,724,500	60,000,000
	97,724,500	130,000,000
Total debt retirements.....	596,479,365	551,354,865
Aggregate.....	5,602,024,861	4,565,877,033

B.

Preliminary Statement Showing Classified Expenditures of the Government from July 1, 1920, to Mar. 31, 1921; with Comparative Figures and Total Expenditures for the Fiscal Year 1920.

[On basis of daily Treasury statements.]

	July 1 to Sept. 30, 1920.	Oct. 1, to Dec. 31, 1920.	Jan. 1 to Mar. 31, 1921.	Total July 1, 1920, to Mar. 31, 1921.	July 1 to Sept. 30, 1919.	Oct. 1 to Dec. 31, 1919.	Jan. 1 to Mar. 31, 1920.	Total July 1, 1919, to Mar. 31, 1920.	Total July 1, 1919, to June 30, 1920.
Ordinary:									
Legislative establishment.....	\$4,930,391.02	\$4,908,522.01	\$4,806,483.14	\$14,645,396.17	\$5,116,000.53	\$5,216,888.01	\$4,706,854.98	\$15,039,743.52	\$19,327,708.72
Executive proper.....	¹ 542,757.71	587,421.88	248,846.64	293,510.81	52,260.96	5,532,641.73	593,056.90	6,177,959.59	6,675,517.58
State Department.....	2,322,749.39	1,827,909.99	2,242,127.40	6,392,786.78	4,085,594.80	3,776,718.74	3,249,647.95	11,111,961.49	13,589,024.42
Treasury Department.....	96,098,410.19	82,724,413.76	181,790,477.00	360,613,300.95	102,695,955.91	41,329,800.46	120,478,294.40	264,504,050.77	322,315,627.43
War Department.....	274,367,808.97	268,000,064.23	307,518,350.95	849,886,224.15	653,552,919.09	397,718,762.29	250,334,207.14	1,301,605,888.52	1,610,587,380.86
Department of Justice.....	4,183,089.23	3,958,629.16	4,425,703.15	12,567,421.54	4,178,182.91	4,529,518.97	4,280,667.05	12,988,368.93	17,814,398.18
Post Office Department.....	1,407,168.05	10,602,201.47	25,956,317.37	37,965,686.89	813,691.33	18,397,559.58	9,493,485.56	28,674,736.47	50,049,295.07
Navy Department.....	161,294,823.36	166,805,503.61	177,462,791.62	505,563,118.59	286,496,326.16	174,495,117.79	160,373,006.63	621,364,450.58	736,021,456.43
Interior Department.....	87,118,246.55	82,244,026.35	82,520,943.00	251,883,215.90	70,176,555.60	70,726,075.22	69,374,034.98	210,276,665.80	279,244,660.87
Department of Agriculture.....	33,993,228.76	28,975,392.46	32,494,508.75	95,463,129.97	12,362,197.17	19,508,039.63	18,538,376.20	50,408,613.00	65,546,293.14
Department of Commerce.....	10,708,625.62	7,150,954.20	6,966,718.38	24,886,298.20	4,775,580.53	5,021,360.10	8,872,799.87	18,669,740.50	30,010,737.75
Department of Labor.....	2,153,590.97	2,783,299.26	1,977,469.34	6,914,359.57	1,494,698.48	1,169,488.51	1,985,647.11	4,649,834.10	5,415,358.40
United States Shipping Board.....	33,986,454.67	61,402,975.86	2,225,335.06	97,614,765.59	234,702,016.82	106,028,170.88	92,370,446.40	433,100,634.10	530,565,649.61
Federal control of transportation systems and transportation act, 1920....	193,583,743.50	185,186,288.24	214,217,272.44	592,987,304.18	431,756,376.71	82,036,307.93	262,797,518.56	776,590,203.20	1,036,672,157.53
War Finance Corporation.....	22,238,355.21	¹ 23,510,031.64	¹ 6,367,886.74	¹ 7,639,563.17	¹ 9,475,735.42	158,043,854.33	¹ 3,605,406.26	144,962,712.65	¹ 228,472,186.61
Grain Corporation.....	90,353,411.42	.....	.....	90,353,411.42	204,062,450.80	¹ 95,356,575.54	¹ 91,002,300.12	17,703,575.14	350,328,494.70
Other independent offices and commissions.....	20,458,185.12	24,678,628.71	34,138,426.34	79,275,240.17	12,345,102.35	8,756,299.05	20,213,867.98	41,315,269.38	59,469,305.17
District of Columbia.....	5,015,212.98	5,899,200.33	5,226,871.18	16,141,284.49	5,778,521.84	4,933,274.01	4,804,866.59	15,516,622.44	19,987,898.41
Interest on public debt.....	136,351,254.07	342,067,610.37	171,909,101.93	650,324,966.37	136,902,789.29	330,048,776.70	197,971,746.28	664,923,312.27	1,020,251,622.28
Total.....	¹ 1,180,081,991.37	¹ 1,256,293,010.25	¹ 1,249,756,856.95	¹ 3,686,131,858.57	¹ 2,161,871,485.86	¹ 3,341,912,078.39	¹ 1,135,800,818.20	¹ 4,639,584,332.45	¹ 5,945,397,399.94
Deduct unclassified repayments, etc..	² 898,151.75	8,457,743.63	² 2,571,299.54	4,988,292.34	8,014,830.75	² 5,189,657.34	4,970,611.11	7,795,784.52	4,399,847.00
Total.....	¹ 1,180,980,143.12	¹ 1,247,835,266.62	¹ 1,252,328,156.49	¹ 3,681,143,566.23	¹ 2,153,856,655.11	¹ 3,347,101,735.73	¹ 1,130,830,207.09	¹ 4,631,788,597.93	¹ 5,940,997,552.94
Panama Canal.....	2,965,341.14	3,063,500.56	5,921,480.58	11,950,412.28	1,504,343.86	3,701,460.35	3,461,482.71	8,667,286.92	11,365,714.01
Purchase of obligations of foreign Governments.....	57,201,633.53	.....	16,695,063.91	73,896,697.44	253,931,945.99	86,788,968.10	47,000,000.00	387,720,914.09	421,337,028.09
Purchase of Federal farm-loan bonds..	9,702,438.86	6,265,919.22	812,962.71	16,781,320.79	.....	.....	.....	29,643,546.17	.....
Total ordinary.....	¹ 1,250,849,556.65	¹ 1,257,164,776.40	¹ 1,275,757,663.69	¹ 3,783,771,996.74	¹ 2,409,292,944.96	¹ 4,377,592,164.18	¹ 1,181,291,689.80	¹ 5,028,176,798.94	¹ 6,403,343,841.21
Public debt:									
Certificates of indebtedness redeemed..	2,290,363,000.00	2,498,094,500.00	1,447,722,500.00	6,236,180,000.00	5,715,445,820.00	2,104,387,882.97	4,548,931,700.00	12,368,765,402.97	15,589,117,458.53
War-savings securities redeemed.....	38,170,798.30	41,757,783.44	46,103,171.32	126,031,753.06	52,650,333.07	48,180,599.48	50,391,557.58	151,222,460.13	200,982,934.62
Old debt items retired.....	68,581.81	43,760.59	18,368.69	130,711.09	156,150.00	258,940.28	47,608.19	462,698.47	509,165.97
First Liberty bonds retired.....	49,500.00	55,050.00	41,750.00	146,300.00	13,000.00	20,463,100.00	4,015,450.00	24,491,550.00	32,336,700.00
Second Liberty bonds retired.....	1,070,900.00	1,102,450.00	1,410,450.00	3,583,800.00	40,090,000.00	99,940,900.00	22,731,500.00	162,732,400.00	241,144,200.00
Third Liberty bonds retired.....	12,782,950.00	3,094,150.00	1,789,800.00	17,666,900.00	27,895,550.00	150,117,850.00	61,009,350.00	239,022,750.00	296,300,800.00
Fourth Liberty bonds retired.....	28,110,450.00	2,528,950.00	3,369,200.00	34,008,600.00	120,005,100.00	105,666,300.00	41,061,400.00	266,732,800.00	405,222,800.00
Victory notes retired.....	5,268,450.00	15,177,350.00	125,488,350.00	145,934,150.00	.....	.....	72,500,000.00	72,500,000.00	249,001,500.00
National-bank notes and Federal reserve bank notes retired.....	3,923,636.00	3,615,105.00	6,616,060.00	14,154,801.00	6,081,472.50	6,530,034.25	4,615,535.00	17,227,041.75	23,424,164.50
Total public debt.....	² 2,379,808,266.11	² 2,555,469,099.03	¹ 1,632,559,650.01	¹ 6,577,837,015.15	¹ 5,962,307,425.57	² 2,533,545,576.98	¹ 4,805,304,100.77	¹ 13,303,157,103.32	¹ 17,038,039,723.62

¹ Deduct excess of credits.² Add.

C.

Preliminary Statement Showing Classified Receipts of the Government, from July 1, 1920, to Mar. 31, 1921; with Comparative Figures and Total Receipts for the Fiscal Year 1920.

[On the basis of daily Treasury statements.]

Receipts.	July 1 to Sept. 30, 1920.	Oct. 1 to Dec. 31, 1920.	Jan. 1 to Mar. 31, 1921.	Total, July 1, 1920, to Mar. 31, 1921.
Customs.....	\$84,058,024.90	\$66,039,240.83	\$67,842,176.13	\$217,939,441.86
Internal revenue:				
Income and profits tax.....	840,653,320.81	787,550,609.73	852,277,918.48	2,480,481,849.02
Miscellaneous.....	399,726,191.93	370,338,119.27	318,900,145.87	1,088,964,457.07
Miscellaneous revenue.....	214,542,816.77	200,909,310.39	142,840,458.13	558,292,565.29
Panama Canal tolls, etc.....	1,093,908.53	2,607,734.32	5,058,787.99	9,360,430.84
Total.....	1,540,074,262.94	1,427,445,014.54	1,387,519,466.60	4,355,038,744.08

Receipts.	July 1 to Sept. 30, 1919.	Oct. 1 to Dec. 31, 1919.	Jan. 1 to Mar. 31, 1920.	Total, July 1, 1919, to Mar. 31, 1920.	Total, July 1, 1919, to June 30, 1920.
Customs.....	\$66,276,122.37	\$75,492,351.93	\$89,785,412.17	\$231,553,886.47	\$322,902,650.39
Internal revenue:					
Income and profits tax.....	1,017,553,092.72	985,767,736.31	1,014,882,285.08	3,018,206,114.11	3,944,949,287.75
Miscellaneous.....	364,612,848.61	379,027,175.30	372,004,615.02	1,115,644,638.93	1,460,082,286.91
Miscellaneous revenue.....	189,401,006.28	149,171,837.94	106,017,662.41	444,590,506.63	960,966,422.38
Panama Canal tolls, etc.....	1,029,909.17	1,728,013.29	1,216,016.52	3,973,938.98	5,664,741.45
Total.....	1,638,875,979.15	1,591,187,114.77	1,583,905,991.20	4,813,969,085.12	6,694,565,388.88

D.

Preliminary statement of the public debt Mar. 31, 1921.

[On the basis of daily Treasury statements.]

Total gross debt Feb. 28, 1921.....	\$24,051,634,728.28
Public-debt receipts Mar. 1 to 31, 1921.....	\$891,017,911.58
Public-debt disbursements Mar. 1 to 31, 1921.....	962,598,242.03

Decrease for period..... 71,580,330.45

Total gross debt Mar. 31, 1921..... 23,980,104,397.83

NOTE.—Total gross debt before deduction of the balance held by the Treasurer free of current obligations, and without any deduction on account of obligations of foreign Governments or other investments, was as follows:

Bonds:

Consols of 1930.....	\$599,724,050.00	
Loan of 1925.....	118,489,900.00	
Panama's of 1916-1936.....	48,954,180.00	
Panama's of 1918-1938.....	25,947,400.00	
Panama's of 1961.....	50,000,000.00	
Conversion bonds.....	28,894,500.00	
Postal savings bonds.....	11,718,240.00	\$883,728,270.00

First Liberty loan.....	1,952,313,700.00	
Second Liberty loan.....	3,321,731,300.00	
Third Liberty loan.....	3,645,081,350.00	
Fourth Liberty loan.....	6,360,364,000.00	15,279,490,350.00

Total bonds..... 16,163,218,620.00

Notes: Victory Liberty loan..... 4,100,453,105.00

Treasury certificates:

Tax.....	1,643,886,000.00	
Loan.....	830,726,000.00	
Pittman Act.....	247,375,000.00	
Special issues.....	32,854,450.00	2,754,841,450.00

War savings securities (net cash receipts)..... 723,659,586.89

Total interest-bearing debt..... 23,742,172,761.89

Debt on which interest has ceased..... 10,537,310.26

Noninterest-bearing debt..... 227,394,325.68

Total gross debt..... 23,980,104,397.83

Quarterly Comparative Public Debt Statement, Showing also Figures for Aug. 31, 1919, when War Debt was at its Peak.

[On the basis of daily Treasury statements.]

	Aug. 31, 1919.	Mar. 31, 1920.	June 30, 1920.	Sept. 30, 1920.	Dec. 31, 1920.	Mar. 31, 1921.
*Gross debt.....	\$26,596,701,648.01	\$24,698,671,584.52	\$24,299,321,467.07	\$24,087,356,128.65	\$23,982,224,168.16	\$23,980,104,397.83
Net balance in general fund.....	1,118,109,534.76	251,622,588.19	357,701,682.23	434,961,050.10	504,951,394.20	614,593,426.78
Gross debt less net balance in general fund...	25,478,592,113.25	24,447,049,046.33	23,941,619,784.84	23,652,395,078.55	23,477,272,773.96	23,365,510,971.05
*Includes Treasury certificates (unmatured):						
Loan and tax.....	3,938,225,000.00	2,278,259,000.00	2,485,552,500.00	2,347,791,000.00	2,300,656,000.00	2,474,612,000.00
Pittman Act and special.....	262,914,050.39	388,961,055.56	283,375,000.00	292,229,450.00	292,229,450.00	280,229,450.00
Total.....	4,201,139,050.39	2,667,220,055.56	2,768,927,500.00	2,640,020,450.00	2,592,885,450.00	2,754,841,450.00

E.

Statement Showing Comparative Figures as to Short-dated Public Debt, Aug. 31, 1919, to Mar. 31, 1921.

[On the basis of daily Treasury statements.]

	Aug. 31, 1919.	Dec. 31, 1919.	June 30, 1920.	Dec. 31, 1920.	Mar. 31, 1921.
Victory notes.....	\$4,113,402,679.65	\$4,494,114,007.07	\$4,246,385,530.00	\$4,225,970,755.00	\$4,100,453,105.00
Treasury certificates:					
Loan and tax.....	1,938,225,000.00	1,262,184,500.00	2,485,552,500.00	2,300,656,000.00	2,474,612,000.00
Pittman Act and special issues.....	262,914,050.39	316,301,300.37	283,375,000.00	292,229,450.00	280,229,450.00
War-Savings securities (net cash receipts)...	933,647,191.08	897,143,389.27	828,739,702.09	760,953,780.53	723,659,586.89
Total.....	9,248,188,921.12	8,969,743,196.71	7,844,052,732.09	7,579,809,985.53	7,578,954,141.89

May 14, 1921

SUPPLEMENTAL REGULATIONS GOVERNING SALES OF SILVER TO THE
DIRECTOR OF THE MINT UNDER THE PITTMAN ACT.

Paragraph 5 of the Regulations of the Director of the Mint, approved August 30, 1920, as amended under date of October 6, 1920, with reference to the proof required to be submitted in connection with purchases of silver under the authority of the Pittman Act, approved April 23, 1918, is hereby amended to read as follows:

" (5) The Director of the Mint will purchase under the Pittman Act silver which forms a part of a mixture of domestic and foreign silver up to the proportion of such mixed product which represents silver wholly produced from mines situated in the United States and reduction work so located; provided, however, that no mixed silver which was refined on or before June 17, 1920, shall be purchased unless, and to the extent that, the domestic silver contained therein was delivered to reduction works located in the United States since January 17, 1920, as shown by the liquidation sheets of said reduction works, filed with the Director of the Mint as above required, and the supporting affidavits of the miners who delivered said silver to said reduction works; and provided further, that the aggregate amount of the total refined mixed product purchasable by the Director of the Mint under the Pittman Act shall not exceed the proportionate part thereof corresponding to the proportion in which silver actually produced from mines located within the United States entered into the aggregate amount of domestic and foreign silver received by the smelters concerned since January 17, 1920, as shown by the liquidation

sheets of such smelters, filed with the Director of the Mint as above required. All sales of mixed silver by the vendor prior to May 15, 1920, and all sales of mixed silver by the vendor after that date at a price exceeding \$1 per ounce, 1,000 fine, shall be deemed to be made out of domestic and foreign silver in the same proportion in which domestic and foreign silver are found to have entered into the mixed product pursuant to these regulations."

Revised form of vendor's affidavit is attached hereto and marked Exhibit A.

(Signed) R. T. BAKER

Director of the Mint.

Approved: May 14, 1921

(Signed) S. P. GILBERT

Assistant Secretary of the Treasury.

Exhibit A.

VENDOR'S AFFIDAVIT (Mixed Silver)

State of)
) ss.
County of)

In order to make a sale of silver to the Director of the Mint in accordance with the provisions of the Pittman Act approved April 23, 1918, the undersigned hereby represents and certifies under oath that he is the _____ of _____, owner of
(Title of office) (Name of vendor)
certain silver to the amount of _____ fine ounces more or less, forwarded to the United States Mint at _____, on the _____ day of _____, 192____, and delivered for sale to the Director of the Mint under the provisions of said Act for account of said vendor; and that said silver is the produce of mines situated in the United States and of reduction works so located, being either* (1) wholly without admixture of the product of foreign mines or reduction works, or (2) part of a mixture of foreign silver and domestic silver delivered to domestic reduction works since _____, 19____, and within the proportionate part of such mixed product which represents the product of mines located within the United States and of reduction works so located, delivered by such mines to such reduction works since January 17, 1920, after taking into account sales heretofore made to the Director of the Mint under said act. Payment for said silver was made to the miners at the fixed price of \$1.00 per ounce, adjusted to the equivalent price for silver 999 fine and to the cost of delivery, refinery

* Strike out whichever clause is inapplicable.

to mint. The vendor will forthwith file with the Superintendent of said mint such statements and exhibits from its books of account and also such supporting affidavits and sworn statements or exhibits by itself and by the miner, smelter, and refiner, as may be demanded by the Director of the Mint under said Act.

(Signature of vendor or duly authorized officer)

Subscribed and sworn to before me this _____ day of _____, 192__.

Notary Public.

TREASURY DEPARTMENT

FOR RELEASE MORNING PAPERS,
Tuesday, May 17, 1921.

Secretary Mellon announced that subscriptions for the $5\frac{1}{2}$ per cent Treasury certificates of indebtedness of Series A-1922, dated May 16, 1921, maturing February 16, 1922, closed at the close of business on May 16, 1921, the date of issue. Preliminary reports received from the twelve Federal Reserve Banks indicate that the issue, which was for \$200,000,000 or thereabouts, has been largely oversubscribed, and that the total subscriptions aggregate over \$475,000,000. Ten Federal Reserve Districts have reported oversubscriptions of their quota. Further details as to the subscriptions will be announced when final reports are received from the Federal Reserve Banks.

FEDERAL RESERVE BOARD

X-3133

STATEMENT FOR THE PRESS

For release in morning papers,
Monday, June 6, 1921.

Governor Harding, of the Federal Reserve Board, left Sunday night for a two weeks' trip through the cattle producing sections of the country. Stopping enroute at Des Moines, Iowa, he will visit Cheyenne, Wyoming; Denver, Colorado; Albuquerque, New Mexico; El Paso, San Angelo, San Antonio and Dallas, Texas; returning thence direct to Washington.

Before leaving, Governor Harding gave out the following authorized statement from the Federal Reserve Board:

"It is the opinion of the Federal Reserve Board that the country is approaching a new crop season with underlying conditions far sounder than they were a year ago. While there are still large amounts of staple products being carried over, financed partly on bank credit, the reserves of the twelve Federal Reserve Banks combined are nearly 40% higher than they were at this time last year, standing at about 57.5% as against 42%. There is no ground for apprehension regarding the ability of the banks to meet the requirements of both agriculture and industry.

"The Federal Reserve System now holds the largest amount of gold in its entire history, more than \$2,400,000,000, and the inflow from other countries still continues. While the loans and invested assets of the Federal Reserve Banks have been reduced since the peak on November 5th last by more than \$1,000,000,000, most of this liquidation has come about in an orderly and natural way. Liquidation has been most pronounced in financial and industrial centers rather than in agricultural sections, as is evidenced by the fact that while the rediscounts held by the Federal Reserve Banks are materially less than at this time a year ago, these banks are now carrying more than twice as much agricultural and live stock paper (maturities from ninety days to six months) as they had on hand a year ago.

"It should be understood that until there is a broadening of the market for agricultural products many farmers will have to be granted extensions on loans already made them and will, in many cases, require additional credits pending the making and marketing of the new crops. The Federal Reserve Board is gratified to know that the Federal Reserve Banks are prepared to extend liberal credits to member banks, and through them to non-member banks, for these and other productive requirements of their customers, and the Board urges all banks to aid in easing along the situation in the agricultural districts until normal and regular processes of production and distribution can be further developed. The Board feels that the financial emergency which menaced the country during the year 1920 has definitely passed.

"There is, however, in some sections a situation which affects seriously producers of some highly essential products. In the stock raising industry particularly, additional credit facilities are urgently needed. Live stock paper running not longer than six months is eligible for rediscount at Federal Reserve Banks and loans for the purpose of feeding and fattening cattle are, therefore, more easily obtained than the longer time loans for breeding cattle and young calves. The banks of the country are urged to bear in mind the needs of the live stock industry and to extend as liberal accommodations to those engaged in the industry as circumstances will permit.

"The Board does not believe that it would be advisable to amend the law by making one and two year paper eligible for rediscount at the Federal Reserve Banks but in view of the emergency which threatens the entire live stock industry recommends, with the concurrence of the Secretary of the Treasury, that Congress authorize the Secretary of the Treasury to make available to the War Finance Corporation \$50,000,000 and that said Corporation be empowered to make advances up to this amount on live stock paper. These loans could be made through the Federal Reserve Banks as fiscal agents of the War Finance Corporation rather than as banks of discount. This recommendation is made in order to meet the peculiar emergency existing in the live stock industry, where the process of production is unusually long and requires longer term credit facilities than can be afforded by means of paper with six months maturity. The Board would suggest, however, that the time for making such loans be limited to three years from the passage of the necessary legislation, with a view of having the funds thus advanced ultimately returned to the Treasury.

"This legislation, in the Board's opinion, will meet the present emergency and should give ample time for the development of permanent plans for the financing of the live stock industry. It would also tend to stabilize the credits affecting this industry and serve to demonstrate the value, to those desiring short time investments, of cattle paper running longer than six months."



THE SECRETARY OF THE TREASURY
WASHINGTON, D. C.

June 8, 1921.

Dear Sir:

In accordance with the Treasury's practice to advise the banking institutions of the country from time to time of its plans and policies, I am addressing this letter to you in order to inform you of the state of the National finances and indicate the Treasury's financial program for the immediate future. The condition of the Treasury, its estimates of receipts and expenditures for the fiscal years 1921 and 1922, and its recommendations as to the revision of the internal tax laws have recently been set forth at some length in my letter of April 30, 1921, to the Chairman of the Committee on Ways and Means, a copy of which has been sent you. In that letter I announced also that it would be the Treasury's policy to vary its monthly offerings of Treasury certificates of indebtedness from time to time with issues of short-term notes in moderate amounts with maturities of from three to five years, with a view to the gradual distribution of the short-dated debt through successive issues of notes in convenient maturities extending over the period from 1923 to 1928.

Pursuant to this program, the Treasury is announcing to-day a combined offering of three-year 5½ per cent Treasury notes, dated June 15, 1921, due June 15, 1924, and one-year 5½ per cent Treasury certificates of indebtedness, dated June 15, 1921, due June 15, 1922. The combined offering will be for \$500,000,000, or thereabouts. The Treasury notes thus offered will be straight three-year notes, designated Treasury Notes of Series A--1924, will not be subject to call for redemption before maturity, and will be acceptable in payment of income and profits taxes payable at or within six months before maturity. The notes are exempt from the normal Federal income tax and the corporation income tax and from all State and local taxation (except estate and inheritance taxes), but not from Federal income surtaxes or profits taxes. The Treasury certificates will be tax certificates, designated Series T J--1922, and will be acceptable in payment of income and profits taxes payable at maturity. Definitive notes and certificates will, it is expected, be available for delivery on or about June 15th, but wherever necessary Federal Reserve Banks will be prepared to issue interim receipts pending delivery of the definitive securities.

Applications for the notes and certificates will be received in regular course through the several Federal Reserve Banks, as fiscal agents of the United States, from which full particulars concerning the offering may be obtained. Banking institutions which are duly qualified as special depositaries of public moneys will be permitted to make payment by credit upon the usual terms for notes and certificates allotted to them for themselves and their customers. Treasury certificates of indebtedness of the series which mature on June 15, 1921, July 15, 1921, and August 16, 1921, will be accepted at par with an adjustment of ac-

crued interest in payment for any notes or certificates of the series now offered which may be subscribed for and allotted.

Treasury certificates of indebtedness to the amount of about \$430,000,000 mature on June 15, 1921, and on the same date there will become payable the semiannual interest on the First Liberty Loan and the Victory Liberty Loan, amounting in the aggregate to about \$130,000,000. On July 15, 1921, there will mature about \$132,000,000, and on August 16, 1921, about \$156,000,000 of additional Treasury certificates. Against these heavy maturities of principal and interest the Treasury expects to receive during June about \$575,000,000 on account of the quarterly payment of income and profits taxes. To provide for its further requirements, including current disbursements and increased payments incident to the close of the fiscal year, the Treasury will need in the neighborhood of \$500,000,000, and has therefore decided to make the combined offering of notes and certificates above described.

In consequence of the issue of Treasury notes and Treasury certificates on June 15th, and the retirement of maturing Treasury certificates, the Treasury expects to show important progress in the execution of its plan to make the short-dated debt more manageable and gradually distribute it over the period from 1923 to 1928. The Victory Liberty Loan, which matures on May 20, 1923, amounted when originally issued to \$4,495,374,300. Through the operation of the bond purchase fund and the cumulative sinking fund, and the miscellaneous retirements of the public debt, the amount of Victory notes outstanding on May 31, 1921, had been reduced to \$4,022,116,555, according to the preliminary statement of the public debt for that date. This means a total reduction to date in the amount of the Victory Loan of about half a billion dollars. As similar retirements of Victory notes are effected from time to time pursuant to the Treasury's program, there should be important further reductions in the Victory Loan maturity. The result of this and succeeding issues of short-term notes, and of the debt retirements which the Treasury expects to make from time to time out of its current surplus, should be to spread the $7\frac{1}{2}$ billions of short-dated debt, which is now concentrated in relatively few maturities, into a progressively smaller aggregate amount of better diversified maturities extending over the period from 1923 to 1928.

The current operations of the Government during the first eleven months of the fiscal year, through May 31, 1921, show a net current surplus (excess of ordinary receipts over ordinary disbursements) amounting to \$228,602,077.55. During June there will be paid the second quarterly installment of income and profits taxes for the calendar year. The result of the completed fiscal year's operations, according to the best information now available, should be a net current surplus of about \$500,000,000, substantially in accordance with the estimates set forth in the letter of April 30th to the Chairman of the Committee on Ways and Means. This current surplus will have been applied for the most part to the retirement of the short-dated debt, chiefly through the operation of the cumulative sinking fund, the current redemptions of War-Savings securities, and the miscellaneous retirements of the public debt required to be made by law.

The gross debt of the Government on May 31, 1921, on the basis of daily Treasury statements, amounted to \$23,952,741,592.43, of which about \$7,558,447,589.40 represents short-dated debt. These figures contrast with a gross debt at the beginning of the fiscal year 1921 of \$24,299,321,467.07, of which \$7,844,052,732.09 constituted short-dated

debt. This means that in the first eleven months of the fiscal year there has been a reduction in the gross debt of about \$350,000,000, of which substantially the whole amount represents retirement of short-dated debt. When the operations incident to the June 15th offering of notes and certificates and the quarterly payment of income and profits taxes on the same date shall have been completed, there should be important further reductions in the gross debt and the short-dated debt, as well as better distribution of the short-dated debt.

The progress of these operations and the development of the Treasury's program for dealing with the short-dated debt should mean improved market conditions for Government securities. Treasury certificates of indebtedness already enjoy a countrywide investment market, and the last three months have been marked by continued improvement in their distribution. The past three offerings of Treasury certificates have been promptly oversubscribed. On March 15, 1921, the Treasury successfully sold an offering of six months 5½ per cent certificates and one year 5¾ per cent certificates. On April 15, 1921, an offering of six months 5½ per cent certificates was quickly absorbed. On May 16, 1921, the Treasury sold an offering of nine-months 5½ per cent certificates, with the largest oversubscription yet received. The market for outstanding Treasury certificates has continued strong and active, and all issues now outstanding are quoted in the open market at a premium. The wide distribution of the certificates among investors is particularly noteworthy. On May 25, 1921, according to the latest report from the Federal Reserve Board, the reporting member banks of the Federal Reserve System held only about \$203,000,000 of Treasury certificates as against \$235,000,000 on February 25, 1921, and \$609,000,000 on May 28, 1920. On May 25, 1921, only about \$55,000,000 of Treasury certificates were pledged with the Federal Reserve Banks to secure loans and discounts. Substantial progress has also been made in the distribution of Victory notes among investors. According to the latest figures, the reporting member banks of the Federal Reserve System held on May 25, 1921, only \$188,000,000 of Victory notes out of about \$4,000,000,000 outstanding. The market position of Victory notes has correspondingly improved, and should show further improvement as the maturity of the notes approaches and is gradually distributed.

The fortunate position of the market for Treasury certificates is due in no small measure to the constant cooperation which the Treasury has had from the banking institutions of the country in the distribution of certificates among investors. Upon this first offering of short-term notes in pursuance of the Treasury's new program I look forward with confidence to your continued cooperation and support, and hope that, as with Treasury certificates, you will subscribe liberally for the new Treasury notes and devote your best efforts to their resale to ultimate investors.

Cordially yours,

A. W. Mellon

Secretary of the Treasury.

To the President
of the Bank or Trust Company addressed.

TREASURY DEPARTMENT

For release morning papers,
Monday, July 11, 1921.

The Secretary of the Treasury announces that the first fiscal year's operations under the cumulative sinking fund established by the Act approved March 3, 1919, were completed June 30, 1921, and that \$261,250,250 face amount of Victory notes were purchased and retired for account of the sinking fund during the fiscal year. The total principal cost of the notes purchased was \$254,844,576.50.

C O P Y

STOCK GROWERS' FINANCE CORPORATION

1054 Continental & Commercial Bank Building

Chicago, Ill.

Officers

M. L. McClure, President,
F. H. Connor, Vice President,
John R. Washburn, Treasurer,
John Fletcher, Secretary,

Executive Committee

M. A. Traylor,
John R. Washburn,
John Fletcher,
F. H. Connor
M. L. McClure
S. T. Kiddoo

July 12, 1921

Gentlemen:

We are pleased to announce that this organization is ready to receive applications for rediscount from banks and cattle loan companies who file with the corporation a satisfactory financial statement.

Loans offered must be secured by mortgage on live stock, showing a substantial equity in value over the amount advanced, and all loans must be accompanied by the following: Report of an inspector showing number and quality and his estimate of the value of the security; original chattel mortgage or certified copy showing recorder's certificate; office copy of the chattel mortgage (need not be certified); financial statement of the maker of the paper and abstract of the records. All loans must be eligible for rediscount with the Federal Reserve Banks, and the papers should be prepared accordingly.

On all notes, the last as well as all previous endorsements, must waive demand notice and protest.

Loans will be accepted with date of maturity running six months or less, and if found satisfactory will be extended or renewed for periods of six months or less, not exceeding a total length of time of thirty months from date of loan, at which time payment will be required.

Please submit applications for loans a few days in advance of the need for the money, giving sufficient time for our organization to act on applications intelligently. Not having the organization to properly inspect and investigate loans, and recognizing that the situation requires that the funds be made available promptly, the policy of making no direct loans has been adopted. The rate of discount to be charged for the present is fixed by the Executive Committee at seven per cent.

Many banks who have never handled live stock loans are participating in this movement to assist the live stock interests and not just to relieve the banks and loan companies; therefore, it is expected that the banks and loan companies will use the privileges of the organization freely, and having been provided a method to carry this class of loans, they will continue their efforts to support the industry by making new loans. We feel if this policy is faithfully carried out, satisfactory results will immediately follow, and to that end we ask the co-operation of the friends of the live stock industry.

All correspondence should be addressed to the Stock Growers' Finance Corporation, Room 1054, Continental & Commercial Bank Building, Chicago, Illinois.

Yours truly,

STOCK GROWERS' FINANCE CORPORATION

M. L. McCLURE, President.

JUL 23 1921

The accomplishments of the last four months by various branches of the government, in the direction of relieving financial conditions, in making provision for the government's short-dated debt, in assisting both industry and agriculture to better markets, and in providing for the financial necessities of the railroads, constitute in the aggregate an achievement of the largest importance to the country.

Perhaps the most important development has been the action taken by the Federal Reserve Banks in reducing discount rates. This action is calculated to relieve the stagnation of business, and at the same time it gives authoritative recognition of the improvement in credit conditions justifying the policy of reduced rates. During the latter part of 1919, and from time to time in the year 1920, increases of rates of discount had been made by the Federal Reserve Banks in order to meet then existing conditions. There had also been introduced in several reserve districts so-called progressive discount rates, under which, after the member bank had discounted its paper with its Federal Reserve Bank up to a certain point, it was then required to pay progressively higher rates for further discounts in order to check excessive borrowings. These rates have recently been entirely abolished, again indicating improved credit conditions.

The first of the successive reductions in discount rates came on April 15 when the Boston Federal Reserve Bank reduced its rate on commercial paper from 7 to 6 per cent, and made a like reduction on agricultural paper.

A reduction from 7 per cent to $6\frac{1}{2}$ per cent on commercial paper was made by the New York Bank on May 5, while that on agricultural paper was likewise reduced from 7 to $6\frac{1}{2}$ per cent.

On May 6 the Atlanta Bank reduced the commercial paper rate and also the rate on agricultural paper from 7 to 6 per cent.

On May 7 the Chicago Bank reduced the commercial paper rate from 7 to $6\frac{1}{2}$ per cent, and the rate of agricultural paper from 7 to $6\frac{1}{2}$ per cent.

On May 10 the Minneapolis Bank reduced the commercial paper rate from 7 to $6\frac{1}{2}$ per cent, and the rate on agricultural paper from 7 to $6\frac{1}{2}$ per cent.

On May 16 the Dallas Bank reduced the commercial paper rate, and also the rate on agricultural paper from 7 to $6\frac{1}{2}$ per cent.

On June 16 the New York Bank again reduced the rate on commercial paper from $6\frac{1}{2}$ to 6 per cent, and the rate on agricultural paper from $6\frac{1}{2}$ to 6 per cent.

On June 25 the Dallas Bank made its second reduction, lowering the rate on both commercial paper and agricultural paper from $6\frac{1}{2}$ to 6 per cent.

On July 21, or thereabouts, the Boston, New York, Philadelphia and San Francisco Banks reduced the commercial paper rate from 6 to $5\frac{1}{2}$ per cent. At the same time these banks made a like reduction in the rate on agricultural paper.

It is unsafe to prophesy concerning conditions in the future, but it may be expected that recognition will be given to further improvements in conditions in accordance with the dictates of sound banking practice.

It will not have escaped attention that the rates of discount of the Bank of England have also been successively reduced and that these reductions have been substantially ~~xxxx~~ coincident with the reductions in Federal Reserve Rates in this country. This would appear to be a frank recognition of the intimate relation between the money markets in this country and of Europe, and a recognition as well of the improvement in world credit conditions. The importance of coincident reduction by these two leading banking systems lies chiefly in the fact that it indicates a mutual desire to reopen the international channels of credit upon which international trade depends.

The Treasury on its part has, during the past four months, successfully inaugurated its new policy of refunding the short-dated debt of the government and distributing the early maturities over the period between the maturity of the Victory Loan in 1923 and the Third Liberty Loan in 1928. The first offering of Treasury notes pursuant to this policy met with a most enthusiastic response, and the further development of the program should bring about a better distribution of the public debt and much improved market conditions for government securities. There has already been a marked improvement in the market prices of Liberty bonds and Victory notes, and the market for all outstanding issues of short-term government securities is in better shape than at any time since the depression.

Along with these accomplishments must be mentioned the resumption of active operations by the War Finance Corporation, which ~~xxxxxx~~ had ceased operations in May, 1920. Since its active resumption of operations, this corporation has now agreed to make advances to finance large quantities of cotton aggregating nearly a million bales, while the Federal Reserve System is giving attention to cotton financing through its banking facilities. General assistance to foreign trade is also being extended through the War Finance Corporation, principally for the purpose of moving general agricultural products to foreign markets, for which many millions have been allocated. The renewed activity of the War Finance Corporation is not to be measured simply by the resultant restoration of confidence or by the amount of its advances. Its intervention in aid of the export trade and in making advances to carry American agricultural products pending or awaiting export has been, according to many evidences received, an inspiring and heartening factor in the whole agricultural situation. Besides the loans actually undertaken many important transactions involving American agricultural products are under immediate consideration. An enlargement of the powers of the War Finance Corporation has recently been recommended by the President to the Congress in connection with financing of agricultural products. It is believed that the adoption of these recommendations will mean that adequate financing of the new crop for purposes of foreign trade and also in domestic business may be reasonably expected.

On the initiative of the Secretary of the Treasury a banking loan fund has been organized, which will afford relief to the live stock industry. Advances up to \$50,000,000 may be made in the aggregate. About \$5,000,000 has already been advanced.

The Federal Farm Loan Banks have been enabled to resume lending operations, as a result of the successful sale of Federal Land Bank bonds. Additional authority for temporary Government advances to these banks to facilitate their operations has also been granted. The Curtis-Nelson Bill, which made this operation possible, became a law on July 1, 1921.

The financial necessities of the railroads have long been recognized as of imminent concern to the entire country, not only because efficient transportation is vitally necessary, but also because there is hope for a resumption of industrial activity when the railroads are put in funds and enabled to begin buying the vast quantities of material which they need. In order to make this possible, the administration has put forth a program which contemplates the early and rapid settlement of the accounts between the railroads and the Government, growing out of the period of Federal control and operation. This settlement should enable the roads to become extensive purchasers of materials and thus greatly improve industrial conditions. In this connection the President has recommended to Congress that the War Finance Corporation should be given power to purchase railroad securities from the Director General of Railroads in order to finance the settlements by the Railroad Administration. This proposal is merely a revival of the war-time powers of the Corporation, under which it made advances of about \$205,000,000 to the Director General of Railroads and the railroad companies. Of this amount, about \$160,000,000 has been repaid. In connection with the advances previously made the War Finance Corporation was able to give effective assistance to the general railroad credit situation by means of its intervention and the cooperation it was able to secure from bankers. It is expected that its intervention at this time will again have a beneficial effect on general railroad credit, and also that the Corporation will again be able to secure the whole-hearted cooperation of the bankers of the country, in developing the market for railroad securities.

Speaking in the broadest way, it is felt that the series of measures, of which the foregoing is not by any means a complete statement, constitute a truly constructive effort for the amelioration of business and financial conditions, and there are already many evidences of beneficial effects. With a generally excellent agricultural production now assured for the season, there is every reason for confidence that a steady improvement of general business conditions may be anticipated.

August 4, 1921.

REVISION OF INTERNAL TAXES.

Summary of Statement by the Secretary of the Treasury for the
Committee on Ways and Means.

REVENUE NEEDS.

Taxation and tax revision depend upon public expenditures. According to the latest advices received from the spending departments and after taking into account all estimated reductions in expenditure reported to date, the Treasury estimates that the total expenditure for the fiscal year 1922 for which provision should be made out of the current revenues of the Government will be about \$4,550,000,000. This in itself would mean a substantial reduction in current revenues and expenditures below the fiscal year 1921. The total ordinary revenues for 1921 amounted to about \$5,625,000,000, or over \$1,000,000,000 in excess of the revenues estimated to be necessary for 1922. The estimate for 1922, moreover, does not mean that \$4,550,000,000 must be provided by taxation. It is estimated that there will be miscellaneous revenues during the year from salvage and sources other than taxation amounting to about \$350,000,000. This would leave \$4,200,000,000 to be provided from customs and internal revenue. It is estimated that the revenues from customs under existing law would be about \$300,000,000 for the year, and that these might be increased by about \$70,000,000 if a revised tariff law should become effective about December 31, 1921. The balance, about \$3,830,000,000 (as against estimated internal revenue yield for the year under existing law of \$3,570,000,000) should be provided out of internal revenue. This revenue can be safely reduced only if and to the extent that further reductions are enforced in the spending departments of the Government. This means that if additional taxes are to be avoided, there must be additional effective cuts in ordinary expenditure of over \$250,000,000, and that even if such cuts were assured the internal revenue yield for the year could not safely be permitted to fall below \$3,570,000,000, the estimated yield under existing law. The reductions in expenditure reported up to date have been taken into account in framing the estimates.

Table I, which follows, shows the estimated receipts and expenditures for the fiscal year 1922 under existing law:

TABLE I.

STATEMENT OF ESTIMATED RECEIPTS AND EXPENDITURES FOR FISCAL YEAR 1922,
ON BASIS OF EXISTING LAW. (Revised August 3, 1921).

RECEIPTS (Existing Law).

Customs		\$ 300,000,000
Internal revenue:		
Income and profits taxes	\$2,235,000,000	
Miscellaneous internal revenue	1,335,000,000	
	-----	3,570,000,000
Miscellaneous revenue:		
Sales of public lands	1,500,000	
Federal Reserve Bank franchise tax	60,000,000	
Interest on foreign obligations	25,026,000	
Repayments of foreign obligations	30,500,000	
Sales of surplus war supplies	60,000,000	
Panama Canal	14,530,000	
Other miscellaneous	156,087,000	
	-----	347,643,000
Total		\$4,217,643,000

EXPENDITURES*

Ordinary		\$4,002,657,952
Public Debt Expenditures required by law:		
Sinking fund	\$ 265,754,865	
War-Savings securities (net).	100,000,000	
Miscellaneous debt redemptions.	100,000	
Purchases of Liberty bonds from foreign repayments.	30,500,000	
Redemptions of bonds and notes from estate taxes	25,000,000	
Retirement of Pittman Act certificates	70,000,000	
Retirement from Federal Reserve Bank franchise tax receipts	60,000,000	
	-----	551,354,865
Total debt expenditures		
Grand total ordinary expenditures (including sinking fund and miscellaneous debt retirements)		\$4,554,012,817
Excess of expenditures over receipts		\$ 336,369,817

* See page 3 for classification of expenditures.

CLASSIFICATION OF ESTIMATED EXPENDITURES FOR FISCAL YEAR 1922.
(Based on latest estimates from the spending offices, with allowances for all reductions reported to date).

Legislative	\$ 17,213,813	
Executive	1,897,751	
State Department.	10,344,000	
Department of Justice	17,000,000	
Post Office Department.	2,200,000	
Interior Department (in- cluding pensions and Indians)	322,000,000	
Department of Agriculture	123,000,000	
Department of Commerce	19,923,000	
Department of Labor	5,252,887	
Independent offices	13,484,516	
District of Columbia.	22,187,663	
Miscellaneous	62,500,000	

Postal deficiency	70,000,000	\$ 617,003,630
Treasury Department:		
Bureau of War Risk Ins.	\$286,000,000	
Public Health Service	47,000,000	
Collecting revenue	53,110,139	
All other	99,457,795	

Federal Board for Voca- tional Education	\$485,567,934	
War Department	162,655,184	
Navy Department	450,000,000	
Shipping Board	487,225,000	
* Railroads (Transportation Act and Federal Control).	200,000,000	
	545,206,204	
Interest on public debt	975,000,000	
Panama Canal	10,000,000	

		3,385,654,322

Total ordinary		\$ 4,002,657,952
Public debt expenditures required by law:		
Sinking fund	265,754,865	
War-Savings securities (net)	100,000,000	
Miscel. debt redemptions	100,000	
Purchases of Liberty Bonds from foreign repayments.	30,500,000	
Redemptions of bonds and notes from estate taxes	25,000,000	
Retirement of Pittman Act certificates	70,000,000	
Retirement from F. R. B. franchise tax receipts	60,000,000	

Total retirements.		551,354,865

Grand total ordinary expenditures (including sinking fund and miscellaneous debt retirements).		\$4,554,012,817

* No allowance is made for possible cash expenditures resulting from withdrawals by the War Finance Corporation, which has a credit balance of about \$400,000,000 with the Treasurer and may draw down its balance, at least temporarily, in connection with the railroad financing proposed under pending legislation.

REVENUE YIELD OF REVISED LAW.

Estimates of the expected revenue under the suggested revised law (with comparative figures for the present law) are furnished in Table II below. The changes upon which the estimates for the revised law are based are briefly summarized on page 7 hereof, and further comment will be found on pages 8 ff. The grounds on which the more important recommendations are based, were presented in my letter of April 30, 1921, to the Chairman of the Committee on Ways and Means, and need not be repeated in detail here. For the fiscal year 1922 the present law, it is estimated, would yield \$3,870,000,000 in internal revenue and customs. Under the revised law the estimated collections from these sources would amount to \$3,935,000,000, assuming that the revision of the corporation income and excess-profits taxes is made effective as of Jan. 1, 1921. These figures do not include the estimated proceeds of the suggested one cent tax on first class mail matter and the suggested 2 cent tax on bank checks. These taxes, it is estimated, would yield about \$117,000,000 a year, or about \$58,500,000 for the fiscal year 1922.

Table II follows, on pages 5, 6 and 7 hereof:

TABLE II.

ESTIMATED RECEIPTS FROM INTERNAL REVENUE AND CUSTOMS
UNDER PRESENT AND REVISED LAWS.

(Figures in parentheses show results if the revision of the corporation income and excess-profits tax is made effective as of Jan. 1, 1922).

Source of Revenue	Fiscal Year 1922		Fiscal Year 1923	
	Present Law	Revised	Present Law	Revised
Customs	\$ 300,000,000	\$ 370,000,000	\$ 300,000,000	\$ 450,000,000
Income Tax:				
Individual	875,000,000	875,000,000	850,000,000	850,000,000
Corporation	456,000,000	657,000,000	415,000,000	748,000,000
		(456,000,000)*		(562,000,000)*
Profits tax	669,000,000	413,000,000	485,000,000	0
		(669,000,000)*		(192,500,000)*
Back taxes - In-				
come and Profits	235,000,000	235,000,000	335,000,000	335,000,000
Miscellaneous				
Internal Revenue	1,335,000,000	1,385,000,000	1,349,000,000	1,345,000,000
Total	\$3,870,000,000	\$3,935,000,000	\$3,734,000,000	\$3,728,000,000
		(3,990,000,000)*		(3,734,500,000)*

*Revision as of January 1, 1922.

Note: 1. The revision upon which the estimates under revised law are based is outlined on Page 7. For detail of miscellaneous revenue, see Page 6.

Note: 2. An additional revenue tax of 1¢ on first class mail would yield, it is estimated, about \$72,000,000 annually (\$36,000,000 for fiscal year 1922).

Note: 3. A stamp tax of 2¢ on each bank check would yield, it is estimated, about \$45,000,000 annually (\$22,500,000 for fiscal year 1922).

ESTIMATED MISCELLANEOUS INTERNAL REVENUE.

Source of Revenue	Fiscal Year 1922		Fiscal Year 1923	
	Present Law	Revised	Present Law	Revised
Estate Tax	\$ 150,000,000	\$ 150,000,000	\$ 150,000,000	\$ 150,000,000
Transportation	262,000,000	200,000,000	265,000,000	85,000,000
Tel. and telegraph	28,000,000	28,000,000	29,000,000	29,000,000
Insurance	19,000,000	19,000,000	20,000,000	20,000,000
Alcoholic spirits etc.	75,000,000	75,000,000	75,000,000	75,000,000
Beverages, Sec. 628	35,000,000	35,000,000	35,000,000	35,000,000
Soft drinks, etc., Section 630	25,000,000	12,000,000	25,000,000	.....
Tobacco:				
Cigarettes	136,000,000	155,000,000	138,000,000	180,000,000
Smoking and chewing	60,000,000	66,000,000	60,000,000	75,000,000
All other	59,000,000	59,000,000	60,000,000	60,000,000
Admissions and Dues	96,000,000	96,000,000	100,000,000	100,000,000
Automobiles:				
Present tax	115,000,000	115,000,000	116,000,000	116,000,000
Federal License Tax	.....	85,000,000	.....	100,000,000
Pianos, Organs, etc	50,000,000	50,000,000	50,000,000	50,000,000
Motion Picture Films	6,000,000	6,000,000	6,000,000	6,000,000
Sculptures, Paintings, etc	1,200,000	1,200,000	1,250,000	1,250,000
Carpets, etc., Section 904	20,500,000	5,000,000	20,500,000	.....
Jewelry, Watches, etc.	25,000,000	25,000,000	25,000,000	25,000,000
Perfumery, Cosmetics, Medicines, etc.	6,000,000	6,000,000	6,000,000	6,000,000
Corporation Capital Stock	80,000,000	80,000,000	80,000,000	80,000,000
Issues and Conveyances, of capital stock, bonds, etc.	55,000,000	80,000,000	55,000,000	105,000,000
Capital stock transfer	8,800,000	12,000,000	9,000,000	17,000,000
Sales of Produce on Exchanges	7,600,000	10,000,000	8,000,000	15,000,000
Miscellaneous Taxes	15,590,000	15,590,000	15,590,000	15,590,000
Total	\$1,335,690,000	\$1,385,790,000	\$1,349,340,000	\$1,345,840,000

NOTE: - The revision upon which the above estimates are based assumes the following changes:

1. A new tariff law in effect about December 31, 1921.
2. The increase of the corporation income tax to 15%, as of January 1, 1921 (or January 1, 1922), and the repeal of the \$2,000 exemption.
3. The repeal of the excess profits tax, as of January 1, 1921 (or January 1, 1922).
4. Increased collections of back income and profits taxes.
5. An increase in the tax on cigarettes and smoking and chewing tobacco.
6. The repeal of the transportation tax upon freight and passengers; the tax to be reduced one-half January 1, 1922, and entirely repealed January 1, 1923.
7. Certain of the stamp taxes, as carried in Title XI of the Revenue Act of 1918, to be materially increased.
8. An annual Federal license tax upon motor vehicles, averaging about \$10 apiece, and to be graded according to power.
9. The repeal of Section 630 of the Revenue Act of 1918, as of January 1, 1922 (the tax on ice cream and fountain drinks, etc.).
10. The repeal of miscellaneous taxes levied under Section 904 of the Revenue Act of 1918, as of January 1, 1922.
11. A revision of the income tax rates, with the maximum sur-tax rate reduced to 32%.

COMMENT ON SUGGESTED REVISIONS.

1. Customs. The estimates of revenue under the revised law assumes that a more productive tariff law will be adopted, capable of yielding about \$70,000,000 additional revenue for the fiscal year 1922, and \$150,000,000 additional for the fiscal year 1923.

2. Individual income tax. The total net income subject to the higher surtax rates is rapidly dwindling, and funds which would otherwise be invested in productive enterprise are being driven into fields which do not yield taxable income. The total estimated revenue from the surtaxes under existing law is about \$500,000,000 for the taxable year 1921. The estimated yield for the year from the surtax rates above 32 per cent would be less than \$100,000,000. The immediate loss in revenue that would result from the repeal of the higher surtax brackets would be relatively small, and the ultimate effect should be an increase in the revenues. It is suggested that the normal and surtax rates be limited to a combined maximum rate not exceeding 40 per cent for the taxable year 1921 and 33 per cent thereafter. I am confident that in a short time the Treasury would actually collect more under the lower rates than under the higher rates if continued.

3. Corporation taxes. I approve the repeal of the excess-profits tax, which is rapidly becoming unproductive. I suggest as a substitute an increase of 5 per cent in the rate of the corporation income tax, and the repeal of the specific exemption of \$2,000 now accorded to corporations. This would greatly simplify the problem of administration and collection, without substantial loss of revenue.

4. Back taxes. Collections of back taxes are estimated to yield net about \$235,000,000 in the year 1922, and about \$335,000,000 in the year 1923. It may be possible to secure some additional revenue from this source, perhaps as much as \$100,000,000 additional in the year 1922.

5. Miscellaneous taxes - Suggested reductions. It is suggested that the following miscellaneous taxes be repealed or reduced:

(a) The transportation tax on freight and passengers, it is suggested, might be reduced one-half by January 1, 1922, and repealed entirely at the close of the calendar year 1922. The resulting loss of revenue would be approximately \$62,000,000 for the fiscal year 1922, and \$180,000,000 for the fiscal year 1923.

(b) The taxes on ice cream and fountain drinks imposed by Section 630, now collected from consumers in such a way as to cause unnecessary irritation and material evasion, should be repealed. For similar reasons the excess-price taxes now imposed by Section 904 upon articles of wearing apparel should be repealed, and the other articles included under Section 904 should be taxed at appropriate rates to the producer or importer under the general provisions of Section 900. The maximum loss in revenue estimated to result from these changes would be less than \$25,000,000 in the fiscal year 1923.

(c) The tax on perfumes, cosmetics and proprietary medicines (Section 907) also results in unnecessary irritation and is widely evaded. I suggest that this tax be imposed upon the producer or importer as are most of the sales or excise taxes now imposed by the Revenue Act of 1918. This could be done without any loss in revenue.

6. Suggested additional taxes. Shrinkage in the yield of existing taxes, the gaps resulting from the suggested reduction and repeal of the transportation tax and the changes in other taxes, and the pressure of expenditures upon the Treasury, make necessary the consideration of additional taxes. These taxes are, of course, not suggested as desirable in themselves; but in my opinion they are less objectionable than some other new or additional taxes which have been proposed.

(a) Increase the documentary stamp taxes, by approximately doubling the present rates, so as to increase the revenue from this source by approximately \$30,000,000 for the fiscal year 1922 and \$70,000,000 for the fiscal year 1923. These estimated additional proceeds are included in Table II.

(b) The proposed stamp tax of 2 cents on each check (payable on sight or on demand) would yield, it is believed, about \$45,000,000 a year. The estimated proceeds of this tax have not been included in the main totals of Table II.

(c) I suggest also as a convenient method of taxation an increase of one cent in the rate of postage on first class mail matter, to 3 cents per ounce or fraction thereof on all except drop letters and to 2 cents per ounce or fraction thereof on postal cards. Such a tax would yield, it is estimated, about \$72,000,000 a year (not included in Table II).

(d) An annual federal license tax upon motor vehicles, averaging about \$10 per vehicle, and to be graded according to power, would yield approximately \$100,000,000 a year, or about \$85,000,000 the first year (1922) of its imposition. The estimated proceeds of this tax are included in Table II.

(e) An increase in the tax on cigarettes from \$3 to \$5 per M, and a slight increase in the other taxes on tobacco products would yield additional revenue of \$25,000,000 in the fiscal year 1922 and approximately \$57,000,000 in the fiscal year 1923, (included in Table II).

FISCAL YEAR 1923

The foregoing recommendations take into account probable reductions in current expenditure for the fiscal year 1923, when, for example, it is expected that there will be relatively small payments to make to the railroads as against estimated payments in the fiscal year 1922 of \$545,000,000. Against these reductions, however, it is expected that there will be shrinkages in receipts. The suggestion that the transportation tax be repealed, effective in part January 1, 1922, and in its entirety January 1, 1923, would alone involve a loss of revenue of about \$300,000,000 for a full year. It is also necessary to bear in mind that the estimated income and profits tax receipts for the fiscal year 1922 include two quarterly installments of income and profits taxes based on the business of the calendar year 1920, and that a substantial shrinkage below the 1922 figures for these receipts is to be expected during the fiscal year 1923 as a result of the shrinkage in incomes and the depression in business in 1921. In the fiscal year 1923, moreover, the Victory Liberty Loan and the 1918 series of War Savings certificates become due. With these extraordinary maturities of the public debt to meet, it is important that the Treasury have some margin of current revenue over current expenditure for the year, in order that the vast refunding operations which will have to be carried on during the year in any event may not be complicated or embarrassed by additional borrowings to meet current expenditures which ought to be provided for out of current revenues.

THE WHITE HOUSE

FOR RELEASE EVENING PAPERS, SATURDAY, AUGUST 13, 1921.

During the consideration of the revenue revision program of which an outline has heretofore been given to the public, the effort was to devise a measure of practicable, workable tax reform. The aim was to establish methods that would raise the needed revenue within reasonable certainty, that would make collection sure and inexpensive, and that would properly adjust the burden among all classes of the community. It is felt that highly important progress has been made along these lines.

The social and economic bearings of the new proposals are significant. There has been no effort to relieve the rich of their share of burdens, but rather to insure that no class will be left an avenue of escape from these. A casual analysis of the proposal shows that what may be described as "the rich man's taxes" will produce about \$1,800,000,000, while the balance will be distributed over the entire community, rich and poor; the rich being certain, because they are proportionately the greatest consumers, to pay a proportionately much greater share.

For example, the reduction to 32 per cent of the highest income and surtax brackets is expected by the experts to produce actually more revenue from these sources than do the present much higher rates. The present rates prevent transactions which would involve application of the high rates, and thus keep taxes away from the government. Also, they drive money into tax-free securities, to the distress of business; and they lead to fraud and evasions. It has been calculated that aside from customs, half the Treasury personnel is engaged in collection of these taxes, and that their readjustment will permit the reduction of this force by several thousand.

The basis of the program of course is economy in expenditure. The tax burden is to be reduced \$550,000,000 by cutting that amount off the government's requirements. To do this requires rigid and rapidly executed economies, which the government departments have undertaken to effect.

Experience has shown, in dealing with the excess profits taxes, that where there is periodic selling, this tax is pyramided, multiplying the burden of the consumer, and inducing speculation and waste. It has been largely responsible for the intense speculation that followed the war. It is an unsatisfactory tax on which to base revenue estimates because its product of revenue is so extremely variable, and in the present epoch of reduced earnings it would utterly fail to produce the amount needed.

The alternative to this tax is the increase of the direct tax on all corporation earnings, rather than on excess profits. The present corporation tax is 10 per cent. It is proposed to increase this to 12½ or 15 per cent, and through this increase to produce \$222,500,000 more.

In increasing the tax on corporation earnings, an exemption is made of those having earnings of \$2,000 or less - the poor man's corporations. The number that would thus be exempted would exceed 300,000.

The reduction, and ultimate wiping out, of the transportation tax will bring relief to both producer and consumer. The farmer, as a producer, finds this tax deducted from the value of what he produces; the consumer, as to other articles finds it added to the price of what he buys. It reaches both, and its abolition would be a great relief to both.

The so-called "nuisance taxes" are to be done away with. They are a source of constant annoyance to the public, of expense to dealers who must make minute change over their counters, and are easily and constantly evaded. It is proposed to substitute for these an increase in the imposition through a taxation mechanism already established, functioning efficiently, and sure to produce what is demanded.

In short, the whole tax reform program contemplates freeing business from what have been found paralyzing and exasperating restrictions, encouraging to the utmost the resumption of enterprise and business, removing every possible incentive to evasion and fraud, and distributing the tax burden with the greatest possible equity among all classes of people, keeping in mind the purpose to impose the larger share on those best able to pay. It is believed that as the proposals are studied and it is increasingly realized to what extent they are adapted to these ends, they will be recognized as a long step toward restoration of improved conditions of general business.



THE SECRETARY OF THE TREASURY
WASHINGTON, D. C.

September 9, 1921.

Dear Sir:

With the announcement of the second issue of short-term Treasury notes pursuant to the program for handling the short-dated debt outlined in my letter of April 30, 1921, to the chairman of the Committee on Ways and Means, I am writing to inform you of the state of the finances and the development of the Treasury's financial program.

Treasury certificates of indebtedness to the amount of about \$535,000,000 will mature on September 15, 1921, and about \$382,000,000 additional certificates will mature on October 15, 1921. On September 15, 1921, there will also become payable the semiannual interest on the Third Liberty Loan, which with other interest maturing on that date will amount to about \$100,000,000, while on October 15, 1921, there will become payable semiannual interest on the Fourth Liberty Loan and other interest aggregating about \$145,000,000. These maturities of principal and interest amount to over \$1,150,000,000. Against these payments the Treasury expects to receive during September about \$525,000,000 on account of the quarterly payment of income and profits taxes, in addition to ordinary revenues from other sources. The current operations of the Government for the first two months of the current fiscal year through August 31, 1921, on the basis of the Treasury daily statements, show a net current deficit (excess of ordinary disbursements over ordinary receipts) of \$161,464,774.96. With the payment of income and profits taxes in September, however, there should be, according to the best information now available, a small net current surplus for the quarter.

To provide for its further requirements, including current disbursements, and in furtherance of its announced plan for dealing with the short-dated debt, the Treasury is announcing to-day an offering of three-year $5\frac{1}{2}$ per cent Treasury notes dated September 15, 1921, due September 15, 1924, and of one-year $5\frac{1}{4}$ per cent Treasury certificates of indebtedness dated September 15, 1921, due September 15, 1922, and six months 5 per cent Treasury certificates dated September 15, 1921, due March 15, 1922. The combined offering is for \$600,000,000, or thereabouts. The Treasury notes will be designated Treasury notes of Series B-1924, and like those of Series A-1924, offered in June, will be straight three-year notes, will not be subject to call for redemption before maturity, and will be acceptable in payment of income and profits taxes payable at or within six months before maturity. The notes will be exempt from the normal Federal income tax and the corporation income tax and from all State and local taxation (except estate and inheritance taxes), but not from Federal income surtaxes or profits taxes. The Treasury certificates will be tax certificates, designated Series TS-1922 and Series TM3-1922, respectively, and will be acceptable in payment of income and profits taxes payable at maturity. Definitive notes and certificates will, it is expected, be available for delivery on or about September 15th, but wherever necessary Federal Reserve Banks will be prepared to issue interim receipts pending delivery of the definitive securities.

Applications for the notes and certificates will be received in regular course through the several Federal Reserve Banks, as fiscal agents of the United States, from which full particulars concerning the offering may be obtained. Banking institutions which are duly qualified as special depositories of public moneys will be permitted to make payment by credit upon the usual terms for notes and certificates allotted to them for themselves and their customers. Treasury certificates of indebtedness of the series which mature September 15, 1921, and October 15, 1921, will be accepted at par, with an adjustment of accrued interest, in payment for any notes or certificates of the series now offered which may be subscribed for and allotted.

With the completion of the September 15th operations, the Treasury expects to show further substantial progress in the execution of its plans for distributing the short-dated debt over the period from 1923 to 1928. This program was successfully launched with the first offering of Treasury notes in June, and is more fully described in my letter of June 8th to the banking institutions of the country. The notes then offered immediately proved attractive to investors, and from the outset have enjoyed a broad and active market, which has greatly facilitated their secondary distribution by subscribing banks. According to the latest reports of the Federal Reserve Board, only \$52,019,000 of the \$311,191,600 of Treasury notes issued on June 15th were held by the reporting member banks of the Federal Reserve system on August 24, 1921, and on August 31, 1921, only \$3,200,000 were pledged with the Federal Reserve Banks to secure loans and discounts. The market for Treasury certificates has likewise continued to develop. The latest reports from the Federal Reserve Board show that on August 24, 1921, reporting member banks held only \$171,383,000 of Treasury certificates, as against \$203,000,000 on May 25, 1921, and \$235,000,000 on February 25, 1921, and that on August 31, 1921, only \$26,800,000 of the \$2,542,000,000 loan and tax certificates outstanding were pledged with Federal Reserve Banks to secure loans and discounts, as against \$53,400,000 on May 25, 1921.

Important progress has also been made in the distribution of the Victory Liberty Loan maturity. The amount of Victory notes outstanding has been reduced from \$4,022,116,555 on May 31, 1921, to \$3,806,172,250 on August 31, 1921, on the basis of Treasury daily statements. The amount of Victory notes originally issued was \$4,495,374,300, so that this represents a total reduction of about \$689,000,000.

These satisfactory results have been due in no small measure to the effective cooperation of the banking institutions of the country in the distribution of short-term Treasury securities among investors. I am confident that the Treasury can count on your continued cooperation and support in the furtherance of its plans for dealing with the short-dated debt, and hope that you will subscribe liberally for the new issues and continue your successful efforts to distribute them among investors.

Cordially yours,

A. W. Mellon

Secretary of the Treasury.

To the President
of the Bank or Trust Company addressed.

September 23, 1921.

My dear Mr. Chairman:

I received your letter of August 27, 1921, enclosing a copy of H. J. Resolution 102, which proposes an amendment to the Constitution of the United States restricting the issue of tax-exempt securities by the Federal Government and States and municipalities, and have noted your request for my opinion with respect to this resolution and the subject in general.

As you know, in my letter of April 30, 1921, to the Chairman of the Committee on Ways and Means, a copy of which I enclose, I recommended to Congress that it consider the advisability of taking action by statute, or constitutional amendment where necessary, to restrict further issues of tax-exempt securities. The ever-increasing volume of tax-exempt securities (issued for the most part by States and municipalities) represents a grave economic evil, not only by reason of the loss of revenue which it entails to the Federal Government but also because of its tendency to encourage the growth of public indebtedness and to divert capital from productive enterprise. The issue of tax-exempt securities has a direct tendency to make the graduated Federal surtaxes ineffective and nonproductive because it enables taxpayers subject to surtaxes to reduce the amount of their taxable income by investing it in such securities; and at the same time the result is that a very large class of capital investments

escape their just share of taxation.

Of course, the voluntary withdrawal of the tax exemptions from securities to be issued by or under the authority of the Federal Government would require no constitutional amendment, but to do this as to Federal securities alone would unjustly discriminate against the National Government and leave a clear field for the State and local governments. In general, moreover, the policy of the Federal Government has been not to issue its own obligations with exemptions from Federal surtaxes and excess-profits taxes, and the great bulk of the Liberty Loans and other war debt have no such exemption. As to State and municipal securities, I assume it is clear, since the decision in *Evans v. Gore* (253 U. S. 245), that the Sixteenth Amendment does not permit the Federal Government to tax income derived from State or municipal securities and that the only effective means of restricting the further issue of tax-exempt securities by State or municipal governments would be by constitutional amendment. Such an amendment would doubtless meet with considerable opposition on the part of the States, and for that reason, as well as from considerations of equality and fairness, it is the better view, I should say, that any restrictions on the further issue of tax-exempt securities should be mutual and should apply as well to securities issued by the Federal Government as to State and municipal securities. It is important, however, not to lose sight of the real basis for the existing constitutional principle under which securities issued by the State and municipal governments are now held free from taxation by the Federal Government, and Federal securities from taxation by State and local authorities,

and at the same time to provide proper safeguards against any possible discrimination in taxation by the Federal Government against State and municipal securities or by the State governments against Federal securities. It is also important, in order to avoid any question of bad faith, that the amendment should not apply to outstanding issues which now enjoy tax exemptions. For these reasons, I think that some modifications of H. J. Resolution 102 are desirable.

In the first place, I think that the resolution should be so modified as to make it perfectly clear that the right of the Federal Government to tax the income derived from State and municipal securities and of any State to tax the income derived from Federal securities, shall exist only to the same extent that each government taxes the income derived from its own securities. This would prevent any discrimination by either government against the securities issued by the other. In the second place, it is noted that while the first part of the resolution subjecting the income from securities issued by State and municipal governments to taxation by the United States applies only to securities issued after the ratification of the amendment, the proviso subjecting the income from securities issued by the United States, its possessions and territories, to taxation by the States is not similarly limited. Such a limitation is, of course, necessary. Furthermore, the language of the proviso subjecting income from issues of Federal securities to taxation by the several States is not expressly limited to the income derived from securities held by residents of the State and should be modified so as to avoid any possible interpretation which would allow a State to tax the income derived from Federal securities not held

within the State.

I might also suggest that the language of the amendment be made broad enough to include all securities issued by or under the authority of the Federal Government or of any State. This would apply, for example, to securities issued by Federal Land Banks and other so-called instrumentalities of the Federal and State governments, which might not be considered as coming within the terms of the resolution as it now stands.

In this connection I am taking the liberty of enclosing a draft of a proposed amendment to the Constitution along the lines of H. J. Resolution 102, modified as I have suggested.

Very truly yours,

(Signed) A. W. Mellon

Secretary.

Hon. Louis T. McFadden,
Chairman, Committee on Banking and Currency,
House of Representatives.

2 enclosures.

JOINT RESOLUTION.

Proposing an amendment to the Constitution of the United States.

1. Resolved by the Senate and House of Representatives
2. of the United States of America in Congress assembled (two-
3. thirds of each House concurring therein), That the following
4. article be submitted to the legislatures of the several
5. States, which, when ratified by the legislatures of three-
6. fourths of the States, shall be valid and binding as a part
7. of the Constitution of the United States:

8. "ARTICLE XX.

9. "The United States shall have power to tax incomes
10. derived from securities issued after the ratification of
11. this article by or under the authority of the several States
12. to the same extent that incomes derived from securities
13. issued after the ratification of this article by or under
14. the authority of the United States are taxed by the United
15. States. Any State shall have power to tax incomes derived
16. by residents thereof from securities issued after the
17. ratification of this article by or under the authority of
18. the United States to the same extent that incomes derived
19. by residents of such State from securities issued after
20. the ratification of this article by or under the authority
21. of such State are taxed by such State."

Comparative Prices of Liberty Bonds and Victory Notes.

(Closing Quotations)

Issue	May 15 1920	Sept. 15 1920	Dec. 15 1920	May 16 1921	Sept. 15 1921	Oct. 15 1921
First 3½'s	90.90	90.00	90.12	88.28	88.08	90.82
First 4's	84.60	85.70	86.02	87.72	88.28	92.66
First 4½'s	85.74	85.76	86.12	87.62	88.42	93.14
Second 4's	84.10	84.90	85.10	87.30	88.28	92.40
Second 4½'s	84.40	84.98	85.36	87.36	88.44	92.72
Third 4½'s	87.98	88.38	87.90	90.72	92.42	94.82
Fourth 4½'s	85.04	85.18	85.90	87.40	88.62	93.02
Victory 4¾'s	95.52	95.46	95.00	97.90	99.04	99.44
Victory 3¾'s	95.50	95.42	95.00	97.92	99.04	99.40

Treasury Department,
October 17, 1921.

TREASURY DEPARTMENT

For release, Morning Papers,
Thursday, October 27, 1921.

The Secretary of the Treasury, under the authority of the act approved September 24, 1917, as amended, offers for subscription, at par and accrued interest, through the Federal Reserve Banks, Treasury certificates of indebtedness, in two series, both dated and bearing interest from November 1, 1921, the certificates of Series C-1922 being payable on April 1, 1922, with interest at the rate of four and one-quarter per cent per annum, and the certificates of Series TS2-1922 being payable on September 15, 1922, with semiannual interest at the rate of four and one-half per cent per annum.

Applications will be received at the Federal Reserve Banks.

Bearer certificates will be issued in denominations of \$500, \$1,000, \$5,000, \$10,000, and \$100,000. The certificates of Series C-1922 will have one interest coupon attached, payable April 1, 1922, and the certificates of Series TS2-1922 two interest coupons attached, payable May 1, 1922, and September 15, 1922.

The certificates of said series shall be exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of bonds and certificates authorized by said act approved September 24, 1917, and amendments thereto, the principal of which does not exceed in the aggregate \$5,000, owned by any individual, partnership, association, or

corporation, shall be exempt from the taxes provided for in clause (b) above.

The certificates of these series do not bear the circulation privilege, and the certificates of Series C-1922 will not be accepted in payment of taxes. The certificates of Series TS2-1922 will be accepted at par, with an adjustment of accrued interest, during such time and under such rules and regulations as shall be prescribed or approved by the Secretary of the Treasury, in payment of income and profits taxes payable at the maturity of the certificates.

The right is reserved to reject any subscription and to allot less than the amount of certificates of either or both series applied for and to close the subscriptions as to either or both series at any time without notice. Payment at par and accrued interest for certificates allotted must be made on or before November 1, 1921, or on later allotment. After allotment and upon payment Federal Reserve Banks may issue interim receipts pending delivery of the definitive certificates. Any qualified depository will be permitted to make payment by credit for certificates allotted to it for itself and its customers up to any amount for which it shall be qualified in excess of existing deposits when so notified by the Federal Reserve Bank of its district.

As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive subscriptions and to make allotments in full in the order of the receipt of applications up to amounts indicated by the Secretary of the Treasury to the Federal Reserve Banks of the respective districts.

The combined offering will be for \$200,000,000, or thereabouts.

Extract from Commerce Reports, November 7, 1921.

SPECULATION IN SECURITIES PAYABLE IN DEPRECIATED CURRENCY.

Prepared in the Eastern European Division.

Certain concerns in the United States are at present advertising for sale various foreign bonds, which are payable in currencies that are at present greatly depreciated. National, municipal, and industrial issues are included. The present exchange value of the currency in which some of them are payable represents a very small fraction of its normal exchange value. This is, for example, the case with the currency of Germany, Austria, Poland, Czechoslovakia, Rumania, Jugoslavia, and Hungary. Bonds thus expressed in depreciated currency are, in some of the advertising literature of these concerns, listed side by side with the bonds expressed in currency which is much less depreciated.

Concerns offering such securities for sale hold forth to prospective investors the possibility, if not probability, of enormous profits on the ground that the currency in which the securities are expressed may rise greatly in value and approach, if not equal, the normal exchange value. It is, of course, impossible to foresee what will take place with respect to the currency of the countries in question, but it is only proper that American investors should carefully study the facts as regard the changes in the rate of exchange, the quantity of paper money in circulation, and the recent changes in that quantity, before they judge the probable future value of any security given in that currency.

SECURITIES OFFERED AT UNDULY HIGH PRICES.

The attention of American investors should also be called to the fact that in some cases the prices at which these securities are offered are unduly high, in view of the actual exchange rate of the given currency. It is evident that for a bond promising to pay 1,000 units in a given kind of money at some future time, and bearing a normal rate of interest, the investor ought not to pay much more, and possibly should pay less, than the current equivalent in dollars of 1,000 units of that money. If \$10 in the actual exchange market will buy 1,000 such units, it is not necessary for the investor to pay \$20 for the bond. In some cases which have come to the attention of the Bureau the disparity between the sale price of the advertised securities, in terms of dollars, and the price at which they could be purchased with American money in the foreign country itself is much greater than that indicated in this hypothetical illustration.

To put the matter in another way, the purchase of bonds expressed in depreciated currency is virtually a speculation, not in bonds, but in currency. If the investor is counting on his profit from the advance in the value of the currency in which the bonds are payable, it is evident that he can ordinarily expect to obtain the same profit by buying currency itself, instead of bonds. If the investor pays \$20 for a bond of 1,000 units, when he could buy 2,000 of those units in the form of currency for \$20, it is clear that he is making an unwise choice. Any steps which may

hereafter be taken by countries with depreciated currency to reduce the volume of their paper money, to convert it to the new basis, or to enhance its value in any other way, will probably, if not certainly, affect the value of the currency itself equally with the value of bonds expressed in the currency.

FOREIGN-CURRENCY INFORMATION.

The essence of the matter is that the American investor buying any security expressed in depreciated currency should know exactly what the exchange rate of that currency is in dollars at the time he makes his purchase. Otherwise, he may pay a price which involves an unreasonable margin to the agency offering the security for sale.

It may be added that it is decidedly against the interest of any foreign country, municipality, or corporation that its securities should be offered for sale in the United States at prices widely out of line with the current rate of exchange. The disappointment which the purchaser is likely to suffer later on will tend to injure the credit of the issuing country or municipality. It is probable that in most cases where an American concern offers securities of the character discussed at unreasonably high prices it is not being done on the initiative of the country, municipality, or concern issuing the security.

The Department of Commerce has always refrained from expressing opinions with regard to the future of the currency of any country, and in the nature of things it can not advise the American public with regard to any particular investment. The Department publishes from time to time, however, information regarding the volume of currency in the principal countries and also the rate of exchange and its fluctuations. The public will also find similar information in current publications of the Federal Reserve Board, as well as in reliable financial periodicals and other sources.

Comparative Prices of Liberty Bonds and Victory Notes.

(Closing Quotations)

Issue	May 15 1920	Sept. 15 1920	Dec. 15 1920	May 16 1921	Sept. 15 1921	Oct. 15 1921	Nov. 15 1921
First $3\frac{1}{2}$'s	90.90	90.00	90.12	88.28	88.08	90.82	95.10
First 4's	84.60	85.70	86.02	87.72	88.28	92.66	94.30
First $4\frac{1}{4}$'s	85.74	85.76	86.12	87.62	88.42	93.14	94.20
Second 4's	84.10	84.90	85.10	87.30	88.28	92.40	94.20
Second $4\frac{1}{4}$'s	84.40	84.93	85.36	87.35	88.44	92.72	94.22
Third $4\frac{1}{4}$'s	87.98	88.33	87.90	90.72	92.42	94.82	96.20
Fourth $4\frac{1}{4}$'s	85.04	85.18	85.90	87.40	88.62	93.02	94.34
Victory $4\frac{3}{4}$'s	95.52	95.46	95.00	97.90	99.04	99.44	99.68
Victory $3\frac{3}{4}$'s	95.50	95.42	95.00	97.92	99.04	99.40	99.68

Treasury Department,
November 16, 1921.

SYNOPSIS OF THE ANNUAL REPORT OF THE
SECRETARY OF THE TREASURY ON FINANCES
FOR THE FISCAL YEAR 1921.

TREASURY DEPARTMENT,
Washington, November 28, 1921.

"From the point of view of the Treasury the past year has been marked by important developments. It has been, first of all, a period of pronounced economy and retrenchment in Government expenditure. The war brought with it a new scale of expenditure, and for some time after actual hostilities ceased the Treasury had heavy obligations to meet on account of the war. Expenditures in the fiscal year ended June 30, 1920, amounted to almost \$6,500,000,000, while for the fiscal year ended June 30, 1921, ordinary expenditures, including sinking fund and miscellaneous fixed-debt charges, still ran over \$5,500,000,000. This cash outgo it has been the constant endeavor of the administration to reduce, and it now expects to hold expenditures on the same basis for the fiscal year 1922 down to \$4,000,000,000, or thereabouts, a reduction of about \$1,500,000,000 below the year 1921. In some measure this reduction reflects the liquidation of war liabilities, but to an important extent it represents a reduction in the cost of Government. From either aspect it means a reduction in the tax burden. On June 10, 1921, the act to create a Budget system became a law, and by the end of the fiscal year 1921 the Bureau of the Budget was organized and established. It has already proved to be a most effective arm of the Executive to enforce the determination to bring about a reduction in Government expenditures. Through the Bureau of the Budget and the heads of the several departments and establishments it has been possible to exert continued pressure for economies in administration, and by this means as well as through the

coordination of Government activities under the general supervision of the Bureau of the Budget important savings have been accomplished. For the first time in its history the Government has an agency equipped to put pressure upon the spending offices to reduce expenditures, and the results already accomplished constitute one of the most encouraging developments of the year.

Another effective force which has made for continued reduction in Government expenditures has been the shrinkage in current revenues, coupled with the necessity of a thoroughgoing revision of the internal-tax laws so as to reduce the burden of taxation on the community. At the outset it appeared from the estimates that additional taxes might be necessary to supply deficiencies in the revenues unless there were striking cuts in expenditure. The determined efforts for economy, however, have resulted in cutting expenditures for the current fiscal year over \$400,000,000 below the amount originally estimated to be necessary by the spending departments, and this in turn has made it possible to proceed with the revision of internal taxes on the basis of a substantial cut in revenues. The result is that the revenue act of 1921, approved November 23, 1921, has made a substantial reduction in the tax burden, running over \$800,000,000 for the fiscal year 1923, as compared with the old law, and at the same time has provided for the repeal or reduction of several of the most vexatious and burdensome taxes and for the simplification of the taxes that remain in force.

During the past year, furthermore, the Treasury has made substantial progress in the refunding of the short-dated debt and has already succeeded in bringing about a better distribution of the early maturities of the debt, which should greatly facilitate the refunding operations incident to the maturity of the Victory Liberty loan.

The Treasury announced in April that it would be the policy to vary its issues of Treasury certificates from time to time with issues of short-term notes in moderate amounts, and two issues of Treasury notes have already been successfully floated, on June 15 and September 15, 1921. In consequence of these operations it has been possible to refund about \$700,000,000 of the short-dated debt into later maturities, to reduce the Victory notes outstanding to about \$3,600,000,000, and at the same time to bring the outstanding amount of Treasury certificates down to about \$2,300,000,000. With this better distribution of the debt and with lower rates for money, the market prices of outstanding Liberty bonds and Victory notes have shown marked improvement during the last six months. Victory notes have touched par and are consistently quoted at about par, while the several issues of Liberty bonds are now selling at prices ranging from about 95 to about 97, or on an average about 10 points higher than a year ago. Treasury certificates of indebtedness which a year ago the Government was selling at interest rates of $5\frac{3}{4}$ and 6 per cent, have recently been sold for $4\frac{1}{4}$ and $4\frac{1}{2}$ per cent, and all issues outstanding are quoted at par or above. These developments in respect to the public debt are most encouraging and indicate that the Treasury should be able to proceed in an orderly way and without undue disturbance to business with the great refunding operations that will be needed in connection with Victory Liberty loan and other short-dated debt outstanding. The maturity within the next 18 months of almost \$6,750,000,000 of short-dated debt still dominates the situation, however, and makes it imperative that the Government pursue a policy of the utmost economy and avoid new undertakings that would throw additional burdens on the Treasury and embarrass the refunding operations. The 1918 series of war-savings certificates matures on January 1, 1923, and the Victory Liberty loan on May 20, 1923. Treasury certificates of various series, aggregating about \$2,300,000,000, will also mature within the year. The greater part of this debt

will have to be refunded, and the orderly conduct of the refunding operations will require the Treasury's best attention for some time to come.

At the outset of the present administration of the Treasury steps were taken toward making the short-dated debt more manageable. Earlier plans for the gradual retirement of loan and tax certificates had been disarranged because of continued heavy current expenditures, particularly on account of the Army and Navy and the railroads. The Treasury, therefore, announced the policy of issuing from time to time short-term notes in moderate amounts with maturities of from three to five years, in order to distribute the short-dated debt over a series of years ranging from 1923 to 1928. * * * *

The first offering of Treasury notes was made on June 15, 1921, coincident with an offering of Treasury certificates, and met with a hearty response. * * * With the program thus successfully launched the Treasury was able on September 15, 1921, to make a second offering of short-term notes at a lower rate in connection with the offering of Treasury certificates on that date. * * * The total Treasury notes outstanding now amount to \$701,897,700, and with the proceeds of sale the Treasury has already been able to effect a material improvement in the distribution of the short-dated debt. The Victory Liberty loan maturity has been substantially reduced and the outstanding loan and tax certificates are at the lowest figure in several years. * * *

REVENUE REVISION

One of the most important developments of the year, both from the point of view of the business and industry of the country and from the point of view of the administration of the Treasury, has been the revision of the internal tax laws, which has engaged the attention of the Treasury and of Congress almost continuously since the beginning of the present administration. The result

has been a revision of taxes which not only grants an important measure of relief to business but also accomplishes a substantial reduction in the total tax burden for all classes of the community. The earlier plans submitted by the Treasury were founded upon estimated expenditures of about \$4,500,000,000 for the fiscal year 1922 and about \$4,000,000,000 for the fiscal year 1923, but as time went on and the results of the executive pressure to reduce expenditures became apparent it proved possible to proceed with the revision on a basis of about \$4,000,000,000 of expenditures for the present fiscal year and about \$3,500,000,000 for the fiscal year 1923. This change in the revenue requirements has made it possible to dismiss from consideration some of the additional taxes suggested by the Treasury at the outset, but has not affected the main outlines of the Treasury's recommendations, particularly as regards the income surtaxes and profits taxes. * * *

Real progress along the lines of this program has been made by the revenue act of 1921, as finally enacted and approved November 23, 1921. The surtaxes have been reduced to a maximum of 50 per cent, effective January 1, 1922, and at the same time have been readjusted in the lower brackets. The excess-profits tax has been repealed, effective at the close of the calendar year 1921, and a flat additional tax of $2\frac{1}{2}$ per cent on the net income of corporations has been substituted, with the repeal of the \$2,000 exemption for corporations with incomes of over \$25,000. The new law also limits the tax upon capital gains and embodies administrative provisions which permit business reorganizations and readjustments to go forward without premature taxation of paper profits or deduction for unreal losses. It allows net losses sustained by trade or business in one year to be deducted from the profits of the two succeeding years, and authorizes final settlement of tax claims and assessments. It contains many other provisions which are designed to simplify the law and improve its administration.

Taken all in all, the effect of these changes is to give substantial relief to business and industry and to restore in some measure the freedom of business transactions. It is estimated, moreover, that the result is a net reduction of the tax burden on account of income and profits taxes alone of about \$410,000,000 a year. Reductions in other taxes, amounting to about \$425,000,000, are also made by the revenue act of 1921. The transportation and insurance taxes imposed by Title V of the old law, the nuisance tax on toilet and medicinal articles, and the specific sales taxes on musical instruments, sporting goods, motion-picture films, articles made of fur, toilet soaps, and other articles, are repealed, while the taxes on soft drinks, candy, so-called luxuries and works of art are markedly reduced or restricted. On this basis it is estimated the new law reduces the aggregate tax burden by about \$835,000,000 for the first full fiscal year of its operation, the year 1923.***

TAXATION AND REVENUE.

The sudden and great increase in the governmental expenditures, due to the World War, made it necessary that the revenues raised by taxation should be increased as quickly and to as great an extent as possible, and the methods adopted for this purpose were necessarily of an emergency character. Now that the war has ended and sufficient time has elapsed to enable us to forecast with reasonable accuracy the probable needs of the Government in the way of revenue for some years to come, it is of primary importance that careful consideration be given to the permanent methods of taxation to be adopted, so that our revenue needs may be met with as little interference as possible with the prosperity and the well-being of the people of the whole country.

As already shown much has been accomplished in the passage of the revenue act of 1921, but our system of taxation still requires careful and thoughtful consideration. * * *

We must now face the fact that the ordinary disbursements of the Government, by reason of the war, increased from approximately \$700,000,000 per year for the prewar years to over \$6,000,000,000 for the year 1920, and while we have been able to reduce the expenditures for the fiscal year 1923, as now estimated, to approximately \$3,500,000,000, for many years to come Government expenditures must continue at an extraordinarily high rate. * * *

The matter is of exceptional importance at this time. In the past year we have suffered an industrial and business depression that has affected every class of our people and reached into every part of the country. How far-reaching the consequences may be, no one can as yet safely predict. Unemployment in all classes has been very great. If these conditions continue, our present burden of taxation must seriously increase the troubles of our people. The hardship and suffering resulting from business depression and unemployment inevitably fall most severely not upon those paying high income taxes, but upon the great body of the people of small incomes. Under our form of government there is, and very rightly so, little danger of any undue burden from the taxes imposed directly upon those of small means, but there is danger of serious hardship and suffering to them because of high prices, unemployment, and high living costs resulting from unjust or unwise tax laws. Our very best thought, therefore, should be directed to seeing that our system of taxation shall interfere to the least possible extent with the return of the country at least to such normal conditions and reasonable business activity as will prevent hardship to those least able to bear it.

There are certain features of our present taxation to which attention should be directed; principally the high surtaxes, the taxation of business profits and the estate taxes.

SURTAXES

The usual argument in favor of high surtaxes is that taxation should be according to "ability to pay." The theory of taxation according to "ability to pay," like all other general statements, has its limitations and its qualifications: In the first place, the tax must be productive, otherwise the whole purpose of the tax is lost. Again, it must not be unreasonable or oppressive, for in that case it will be avoided or evaded and thereby cease to be productive. Again, the tax must not be one the result of which is to interfere with productive industry; it must not dry up the very source out of which revenue is expected to come. If it does, not only will the tax cease to be productive but it will also result in lessened production, unemployment, arrest of the country's growth and serious injury to the people least able to bear these consequences.

That the higher surtax rates are rapidly ceasing to be productive of revenue is apparent from a study of the statistics published by the Bureau of Internal Revenue. That these taxes are being evaded or avoided, no one of any experience doubts. It is usual to put the blame for this upon the so-called tax-exempt securities. There is no doubt that a large and steadily increasing amount of money formerly invested in productive industry is now going into tax-exempt securities. * * *

The amount of such tax-exempt securities now outstanding is estimated by the Treasury at approximately \$10,000,000,000. The exact figures seem difficult to ascertain and much higher estimates are made. The amount of new securities of this character issued during the first eight months of the present year is said to be \$800,000,000. Of the total amount of tax-exempt securities

now outstanding, approximately \$2,500,000,000 have been issued by the United States or under its authority, including such securities as Federal farm-loan bonds. * * *

While tax-exempt securities afford an easy means to a large class of investors of avoiding payment of the high surtax rates, they constitute only one of many ways that can be and are availed of to avoid such taxation. * * *

There are, however, other results flowing directly from these high rates of taxation which are still more serious in their consequences to the people of the country.

The tremendous development of the resources and of the industries of our country, resulting in our present wealth, has been brought about within a comparatively brief period of time, measured in the life of nations, and has been primarily due to three things: (1) The industry of our people and the opportunity and incentive afforded to everyone, whatever his place, to acquire in a greater or less degree some share or portion for himself of that which we call wealth; (2) the steady accumulation of capital resulting from the industry and the thrift of our people, whereby productive industry in every line on a constantly expanding scale was made possible; (3) the very moderate Federal taxation, whereby the free flow of capital, wherever it was needed, and freedom of legitimate commercial transactions was not interfered with, the natural laws of trade being allowed full play.

The result has been a prosperity general throughout the whole people of the country, and unexampled elsewhere. We have a standard of living higher than that prevailing in any other country, and are proud to speak of ourselves as the wealthiest nation in the world.

Does anyone believe that if our policy in the past as respects taxation had been for the Government to take away from successful effort one-third, one-half, or three-fourths of the gains resulting therefrom we would have accumulated the wealth which we now possess, or have achieved our present position? Does anyone believe for a moment that without this wealth when drawn into the World War we could have so quickly put forth the marvelous strength which we did and thereby have enabled the bringing of the war to a speedy and successful conclusion? * * *

In the past we were proud of the opportunities enjoyed by our people because we were free from high taxation, as compared with the peoples of Europe, who, even before the war, were struggling under a burden of taxation which in our wildest fancy it never occurred to us that we would approach.

THE DESTRUCTION OF INCENTIVE.

Another serious effect of these high tax rates is the destruction of incentive - the drying up of the activities of individuals in trade operations - with consequent lessening of business transactions, the slowing down of production, and ultimately a loss of revenue to the Government.

There is not much incentive to men to take risks in any line of industry when all the risk must be borne by the individual, and, if ultimately success comes, a large part of the gain is taken away by the Government in taxes.

In business life, success and profit are not always the result of individual effort; in many cases the result is loss. All great success - especially in new productive enterprise - when ultimately gained, is most frequently built upon many previous failures and comes only after a considerable period of time during which there was no profit. So that, when success comes, the profit or gain to be real must be such as to compensate for these previous failures and losses, and without this incentive there is no inducement to anyone to incur the risks involved. Then, too, in productive enterprise, the merchant, the manufacturer, the farmer, profits vary from year to year, and periods of lean years follow good years. High taxation which seizes upon gains as quickly as realized, taking a large part thereof, and making no allowance for the previous failures and losses

which have had to be endured before success came, or for lean years, is utterly destructive of individual incentive.

In speaking of individual incentive, it should be clearly understood that reference is not made only to individuals of large incomes. On the contrary, reward for successful effort must be held out to those of moderate incomes, because it is upon the younger men of strength and courage and vision that a great deal of the burden must fall in the way of initiating and carrying on the productive industries of the country. Large incomes, and the individuals receiving them, play a very important part, but only a part, in the whole general scheme of maintaining and carrying forward the productive industries upon which the prosperity of the country depends. Successful taxation after all rests upon a prosperous people, not any one class, but the people as a whole.

THE NEED FOR NEW CAPITAL.

There are three things which may be noticed as bringing immediately to mind how essential new capital is in order that the country may be prosperous.

1. We have a steadily increasing population, and that means an increased need of everything that enters into human consumption.

2. Our standard of living steadily rises. This is no new thing; it seems always to have been true of every people of whom we know. The luxury of to-day is soon a necessity. To provide for these added needs requires more capital.

3. The waste and loss which goes on all the time must be made good. There is the destruction of property by fire and other casualty. Buildings, machinery, houses, furniture, everything that man makes for his own use, wear out and disappear. Year by year this amounts to a vast sum and must constantly be made good, otherwise the world goes backward.

The accumulation of this necessary additional capital from year to year can come about only through the savings of the people, and the amount which any individual can save and add to the capital of the Nation, of course, increases progressively with the amount of his income. The larger the income the larger the possibility of saving, because of the larger margin over reasonable living expenditures.

When it is sought to justify very high surtaxes on the ground of ability to pay the tax, we should remember that ability to pay the tax also means ability to save and to add to the needed capital of the country, so that the theory of ability to pay, when carried to such limits, destroys the ability to save, and thereby diminishes the capital available for productive industry.

The nation has no wealth other than that owned by its citizens. All productive wealth is owned by individuals and managed by them. So, when we speak of the wealth of the country, we are in fact referring to the aggregate wealth of the people of the country. The amount held by each individual does vary, but the statement is true from the smallest amount in a child's savings bank to the largest fortune.

The idea seems prevalent that in taxing large incomes, only the person receiving the income, and who is to pay the tax, is really concerned. This is a mistake. For whatever the Government takes, in the way of tax, out of any income, which would otherwise be saved and invested, and thereby become a part of the capital and of the wealth of the nation, affects not so much the individual from whom it is taken as it does the whole people of the country, in the direct loss of productive capital. So that in considering the effect

of high taxes upon incomes, particularly on very large incomes, it is not so much a question of the effect on the individual who is called upon to pay the tax as it is the effect upon the whole community. The man receiving a large income may not himself suffer any hardship because a great part of it is seized and taken for taxes, but the effect upon the community - upon the people of the whole country - is serious indeed. * * *

THE DIVERSION OF CAPITAL

It must be perfectly clear to anyone who gives serious thought to the subject that the theory that high income taxes put the burden of taxation on the rich and relieve the poor is a fallacy. Take as an illustration the present housing situation. The capital for building operations has come from people having incomes large enough to provide a surplus for investment. Real-estate mortgages were always considered a sound investment for this class, and capital usually was available at a moderate rate of interest. Since the policy of high surtaxes this class of loans has largely disappeared. The investors who formerly put their money in such loans now find it more profitable to go elsewhere. The result is that capital has been diverted from building operations, there has been a great shortage of houses, rents have enormously increased, and people of small or moderate means living in rented houses have been compelled to pay greatly increased rents, so that in the end the burden has fallen upon the very class sought to be relieved. Of course, it is not meant that the whole blame for this situation rests upon the diversion of capital due to high income taxes. Other factors contributed. But after making allowance for these the fact remains that a very substantial part of the difficulty has been brought about by the diversion of capital into other channels, and the situation is mentioned only to bring home in a specific way how directly the diversion of capital affects the people of small incomes.

The consequence of this diversion of capital is at once greatly to increase interest rates upon the capital which productive industry is able to obtain, and this in time means lessened production and increased costs. The less capital there is available the greater the struggle to get it and the higher the price paid therefor, which means, of course, increased cost of production. At the same time the less capital there is available the more production is prevented or diminished, and lessened production in itself means increased cost.

While everything that increases the cost of production naturally and inevitably increases the cost to the consumer, yet it does not seem reasonable to believe that all taxes are necessarily passed to the consumer in the form of increased prices, for naturally there comes a place where the price is such that the consumer can no longer afford to buy, or must buy less, and in the end both the producer and the consumer share in the disastrous consequences of such taxation.

The point now emphasized is that the evil effects of high surtaxes fall not upon the individual whose income is seized and taken, but ultimately almost entirely upon the mass of the people who are thereby deprived of the benefits which would result from the free flow of commercial transactions and the use of the additional capital which would be available for productive enterprise.

FREEDOM OF BUSINESS TRANSACTIONS ESSENTIAL.

The revenue to be obtained by the Government from this class of taxes depends upon transactions in trade and commerce which bring about income available for payment of taxes. It is highly desirable, in the interest of the production of revenue, that the volume of business transactions giving rise to gain shall be as great as possible, and to this end it is essential that the natural laws of trade and commerce and the free flow of business shall not be interfered with or prevented.

But the direct effect of these very high taxes is to hinder and prevent business transactions which would otherwise take place. A man may have property which he has held for years and which has greatly increased in value, and he would like to sell it, but if he does a large part of the gain would have to be paid out in taxes. He would rather keep the property than sell it, pay the tax, and invest what is left in something else. At the same time the party desiring to buy this property, if he obtained it, would improve it with buildings. What is the result? The transaction does not take place, and the community loses the advantage which would come in the stimulation that would arise from the transactions resulting from the buyer's improvement of the property, and it also loses the advantage of the sellers putting his money into some other form of investment, which in turn would give rise to business transactions. The same thing on a much greater scale is true in manufacturing and mercantile lines. Men have built up enterprises to the point where they are highly successful. They would like to take their profit and turn the business over to younger men to carry on. These transactions are highly desirable not only for the parties but for the community, yet they are absolutely stopped, because if made the seller would have to pay in one year a tax on a gain which has been the result of perhaps the better part of a lifetime of effort. And in all such cases the Government gets no tax, whereas if the rates were reasonable the transactions would take place and the Government's revenues would benefit accordingly.

The free interchange of property in business transactions is essential to the normal prosperity of the country, and each such transaction has a direct tendency to bring about others of like character with the result of increasing the amount of gain or income available for taxation; but when the tax is so high as to act as a deterrent against usual and desirable business transactions, and the volume of such transactions is thereby lessened, the inevitable result is for the tax to become less and less productive.

It is for these reasons that, particularly in the higher brackets, a lower tax rate will produce more revenue in the long run than excessive rates. So long as the high rate stands in the way of accomplishing bargains and sales, the Government receives no tax; but at a lower rate the transactions proceed and the Government shares in the profits.

THE INJURIOUS EFFECT OF HIGH RATES ON THE REVENUES

The actual effect of the high surtaxes can readily be seen in the statistics published by the Bureau of Internal Revenue.

The following table shows in comparative form, for the years 1916 to 1919, inclusive, the total number of returns of all classes and the returns of incomes over \$300,000; the total net income in the same way, and also the investment income.

Table showing decline of taxable incomes over \$300,000.

	Number of returns.		Net incomes.		Income from dividends, interest, and investments.	
	All classes	Incomes over \$300,000	All classes.	Incomes over \$300,000	All classes.	Incomes over \$300,000
1916...	437,036	1,296	\$6,298,577,620	\$992,972,986	\$3,217,348,030	\$706,945,738
1917...	3,472,890	1,015	13,652,383,207	731,372,153	3,785,557,955	616,119,892
1918...	4,425,114	627	15,924,639,355	401,107,868	3,872,234,935	344,111,461
1919...	5,332,760	679	19,859,491,448	440,011,589	3,954,553,925	314,984,884

The years under consideration, 1916 to 1919, inclusive, were, on the whole, years of unexampled prosperity, and of earnings and profits beyond those ever known before in any like period in the history of the country. Notwithstanding this, and while the total income of all classes increased, at the same time there was a striking decrease in taxable incomes of \$300,000 and over - the drop being from \$992,972,986 in 1916 to \$440,011,589 in 1919.

The effect of the high surtaxes in the other brackets is apparent from a brief study of the statistics regarding taxable investment income.

In the bracket "Incomes of \$300,000 and over," the taxable investment income declined from \$746,614,591 in 1916 to \$328,360,613 in 1919; in the bracket "\$100,000 to \$300,000," the decline was from \$602,853,543 in 1916 to \$427,910,905 in 1919; and in the bracket "\$60,000 to \$100,000," the decline was from \$366,614,917 in 1916 to \$323,743,874 in 1919.

If we take the taxable income from interest, exclusive of interest on Government obligations, the decline is still more striking, the figures being as follows:

Incomes, \$300,000 and over:

1916-----	\$165,733,900
1917-----	111,468,127
1918-----	74,610,507
1919-----	60,087,093

Incomes, \$100,000 to \$300,000:

1916-----	158,870,428
1917-----	119,539,786
1918-----	91,030,392
1919-----	91,467,182

Incomes, \$60,000 to \$100,000:

1916-----	93,280,583
1917-----	75,375,484
1918-----	65,784,062
1919-----	68,814,933

The foregoing brackets represent the incomes subject to surtaxes under the revenue act of 1918, respectively, at 63 to 65 per cent, 52 to 63 per cent, and 29 to 48 per cent. To these figures should be added the normal tax of 8 per cent in order to find the total tax obligation.

In view of these figures, is it not clear that these high surtax rates are rapidly ceasing to be productive of revenue to the Government? And is it not equally clear that their effect has been to divert into unproductive channels not merely the income on the old investments, but to force a large part of the old investment capital into unproductive channels?

BUSINESS PROFITS.

The revenue act of 1921 has repealed the excess-profits tax law, effective December 31, 1921. While this law was justified as a war measure, its continuance in time of peace, and particularly under

present conditions, would have been indefensible. During the war period, when every line of industry was running at full capacity and prices and profits were highly inflated, the act served to produce a large revenue for the Government and its inequalities were not so much felt by the taxpayers. Its burden, however, fell very unequally upon the business interests of the country. The higher rates of tax were imposed, generally speaking, upon the small or moderate-sized corporations rather than upon the large ones. Owing to the difficulty of determining the capital actually used to carry on any industry, it was impossible to apply the act without very great hardship in many cases. The administration of the act also was extremely difficult, and the department even yet has not been able to dispose of all the cases arising under the law for the year 1917, the first year of its operation.

The repeal of the excess-profits tax has made necessary a very considerable increase in the flat tax on net corporate income, the rate under the new law being $12\frac{1}{2}$ per cent. In addition there is the capital-stock tax, which amounts, roughly speaking, to about 2 per cent of the net income. This makes a total tax equivalent to nearly 15 per cent on corporate net income; and when we remember that the great bulk of the business of the country, both large and small, is carried on under corporate form and that the net income must largely be distributed in dividends, and that these dividends are then in turn subject to surtax in the hands of persons receiving them, it is at once seen that the resulting taxation to persons engaged in productive business is very heavy. For instance, a stockholder subject to surtax at 10 per cent really pays about 25 per cent, 15 per cent through the corporation and 10 per cent as surtax on his dividends; while a stockholder subject to 50 per cent surtax would be taxed about 65 per cent on such profits.

ESTATE TAX.

Much of what has been said respecting the high surtaxes applies equally to the high rates of taxation upon estates. The continuance in time of peace of the very high estate taxes imposed during the emergency of war should receive serious consideration. * * *

The first objection is that taxes at such rates, which seize upon and take away so much of the capital of the country, are fundamentally wrong. The Nation, just as the individual, should not use up its capital in payment of its ordinary expenses. The money which is taken by way of such taxes is, to a large extent, the capital which is in use and necessary in carrying on the business of the country, and just to the extent that the Government seizes upon and takes this capital for its own income its loss must be made good out of the thrift and savings of the people of the country.

The more serious difficulty, however, in this respect is with the high rates. Where the rates are moderate and thereby are widely spread and take but a moderate amount of capital from each estate, their effect is not so great; but when the rate is high and falls heavily in a few places, and the amount of capital seized and taken away from certain lines of industry, or certain particular industries, is large, the evil effects are very harmful.

In the second place, there is the destructive effect upon values. If all the wealth of an estate consisted of money, the evil results of such taxes would be much less. But the wealth of estates does not consist of money, nor, in fact, in most cases, of property readily convertible into money. An estate consisting principally of Government bonds or municipal securities is of less real value to the community than is the estate that is invested in property in any line of productive industry giving useful employment to large numbers of people. And yet, the estate invested in tax-free securities would be much less affected by the tax than the estate invested in real estate, in manufacturing plants, in merchandising, in farming, or in any line of productive industry.

Again, when a man actively engaged in business dies, leaving an estate of considerable size, his family is called upon to provide for the payment not merely of the Federal estate tax, but, in many cases, an inheritance tax to the State in which he lived. There is also frequently a tax to be paid to the State where some part of the property is located, and often a tax must be paid upon the value of shares of stock to the State where the company is incorporated. So that, there may be as many as four different taxes to be paid upon the same property. In addition, there is usually a greater or less amount of indebtedness existing which must be met. These obligations can be met only by payment in money. The estate can not take its property and simply divide it up, giving to the Nation, to the State, and to the creditors a proportionate share of the actual property. Those ultimately entitled to share in the distribution may take their portions in property, but, before that can be done, actual cash must be found for the payment of the taxes and the debts; and the larger these are in proportion to the amount of the estate, the more difficult the task becomes.

In the ordinary course of business, there is just a certain amount of property that changes hands from year to year. There is a market for a certain amount and no more. The extent of this market, that is, the buyers who are willing to buy at fair prices, is dependent largely upon the amount and character of the property coming upon the market. There may be a ready market at a reasonable price for a limited amount of the shares of an industrial company, or for a medium-size manufacturing property, or for residence or business property of moderate price. But the larger the amount of property that must be sold, the more difficult it becomes to find buyers for it; and if the sellers are under some absolute need to sell, as is the case where the money must be provided within a limited time to pay taxes and debts, then just that much less ready and willing are bidders to buy, and just so much greater is the

sacrifice that the sellers must make in order to obtain cash. The same thing is seen constantly in the commercial world. If a large amount of any of the staple commodities, even such as cotton, wheat, or any article of consumption, is suddenly pressed upon the market, and the holder's needs force him to sell, there is an immediate and great decline in the price which he is able to obtain. What is true of articles of daily consumption is very much more true as respects investments in property, such as largely makes up the estates called upon to pay these taxes.

It has become notorious in recent years, whenever a man of means dies, leaving his estate obligated to pay a large amount by way of taxes or debts, or both, that there is an immediate decline in all classes of securities in which he is known to be interested. And when, under these conditions, the estate is required to make a sale of its property, of whatever class it may be, there is not merely a large loss to the estate—a large shrinkage in the value of the property below its real worth—but there is also a loss inflicted upon everyone else who is interested in these properties, especially if at the same time they desire to, or must, sell.

The extent of the shrinkage of values and the losses caused by the forced liquidation of many estates is not generally realized, for the present high rates have been in existence but a short time and their evil effects, which will naturally increase if these rates continue, are only gradually coming to be recognized.

The effect of this breaking down of values tends directly toward making the tax less productive of revenue, and the longer these rates continue with the successive coming upon the market of estates, the more their effect will be felt in the revenues, for each forced liquidation tends to make a new and lower value upon which all taxes must be based.

A large part of the revenue now derived from the estate tax comes from the more moderate rates. Taxation which is destructive of that basis of value on which all taxes rest is neither logical nor wise in principle, and in any revision of our tax laws serious attention should be given to this subject.

THE REMEDY.

It would not seem either wise or necessary suddenly to change from our present system of taxation to new and untried plans; and the evils which have been discussed can be corrected without doing anything of this sort. The necessary adjustments can readily be made by retaining most of the present taxes, but substantially reducing the rates, and supplementing the revenues by some additional taxes.

The income tax is firmly embedded in our system of taxation and the objections made are not to the principle of the tax but only to the excessively high rates. We hear much of the need of simplifying our tax laws and there is room for this. The greatest simplification that can be made is in the reduction of the rates. So long as the rates were low, there was not much difficulty in the administration of the law, even though the system was entirely new and the organization administering it unfamiliar with the operation of such a law. The complexity of the law, so far as concerns the income tax itself, has arisen largely out of the high rates which make every point that arises involve substantial amounts of money, and which means that each possible question is contested by the taxpayer and by the Government, with resulting delay in the collection of the revenue, irritation and annoyance and expense on the part of the taxpayer, and costly litigation. With moderate rates, very much of this difficulty would disappear.

The amount of revenue involved in any such reform is not nearly so great as is generally supposed.

To reduce the surtax rates to a maximum of 25 per cent, and grading the reductions through all the brackets, would mean an apparent loss of about \$130,000,000 in revenue. A 20 per cent maximum rate on the same basis would involve a revenue loss of about \$200,000,000. Other adjustments which should be made would probably involve an amount equal to that made in the surtax rates. This loss of revenue, however, would not be permanent, for the reduced rates would ultimately be productive of more revenue than higher rates, due to the increase in taxable transactions.

If this loss of revenue could not be met by rigid economy in expenditures, the revenue required could be raised either by placing a tax on certain specific articles, or by a low-rate general tax on a broad class of articles or transactions. Such taxes as those now imposed on automobiles and tires have been found simple and inexpensive of administration, and the collection is always substantially current; they have been steadily productive of revenue, and have been without injurious effects upon the country. In view of past experience, a general tax either of this or like character upon a broad class of articles or transactions could be readily administered; and the rate could be made sufficiently low as not to bear unduly upon any class and at the same time produce a large amount of additional revenue. By retaining the income tax with reasonable surtax rates, which in peace times ultimately should not rise above 10 per cent, taxpayers would still be required to contribute in proportion to their ability to pay; while by placing a certain amount of tax on specific articles, or classes of articles, or transactions, at so low a rate that they could readily be borne without injury, the income tax could be materially simplified, the tax laws could be more readily administered, and at the same time the needed revenues would be raised without the evil effects now resulting from the present excessive rates of taxation.

BUREAU OF INTERNAL REVENUE.

Progress has been made in the audit and settlement of income and profits tax returns for past years, but there is still a vast amount of accumulated cases to be disposed of before the work can be brought to a current basis.

The magnitude of the task placed upon the bureau by the income, war profits, and excess profits taxes can hardly be exaggerated. Under these laws it became necessary, beginning with the returns for the year 1917, to make a careful examination, and in most cases an audit, of the returns for every financial, trading, and industrial concern in the United States, with the result that, whereas prior to 1917 the bureau had been able to keep reasonably abreast of its work, since that time it has fallen further and further behind. The most difficult problems were those arising in connection with the excess profits tax, and particularly the question of invested capital as applied to the widely varying conditions in which different corporations were placed. The rule prescribed by the act for ascertaining invested capital was necessarily an arbitrary one, involving in many cases great hardship and serious discrimination between corporations in similar lines of business. As a result the work of the bureau has become more and more congested, the expense to the taxpayers of handling the cases has been enormous, while the cost to the Government has steadily increased.

The repeal of the excess profits tax, effective at the end of the present calendar year, will, of course, afford great relief in this respect and makes it easier to formulate practical plans for disposing of the accumulated work.

The condition of the work in the bureau has been the subject of much thought and consideration and a careful study has been in progress for several months, and is still going on, for the purpose of determining the amount of the accumulated work, the progress being made, and what steps it is practicable to take for the purpose of cleaning up this accumulation and bringing the work of the bureau to a current basis.

As a result of this study it was found that for the years 1917 to 1920, inclusive, there remained undisposed of at August 31, 1921, the audit of 1,488,950 personal returns and of 689,425 corporation returns.

The following table indicates approximately the condition of the work in the bureau on August 31, 1921:

Statement of condition of work, income-tax unit, Aug. 31, 1921.

	Total returns filed or to be han- dled	Total returns audited		Balance to be audited	
		Number	Per cent	Number	Per cent.
Personal:					
1917	830,000	827,702	99.7	2,298	0.3
1918	660,000	627,227	95	32,773	5
1919	850,000	285,953	34	564,047	66
1920	890,000	168	.....	889,832	100
Total.....	3,230,000	1,741,050	54	1,488,950	46
Corporation:					
1917	323,138	305,417	94.5	17,721	5.5
1918	368,290	278,323	75.6	89,967	24.4
1919	363,322	133,351	36.2	234,971	63.8
1920	349,500	2,734	.8	346,766	99.2
Total	1,409,250	719,825	51.1	689,425	48.9

NOTE.-- The personal returns do not include the smaller returns which are handled largely in the collectors' offices. Many of the returns shown as "to be audited" were in various stages of progress.

Generally speaking, of course, the tax shown by the face of these accumulated returns has been collected currently when due, and there remains only such additional tax as may be developed by the audit and investigation. The cases remaining are largely the ones less productive of revenue and more difficult to handle, due to the fact that heretofore, in order to get as much revenue as possible, the cases most easily handled and yielding the largest revenue were, to a great extent, given earliest attention.

It was found that the work of the bureau had been much interfered with by war conditions, by lack of adequate office space, by the fact that such space as could be had was widely scattered, and by the difficulty of obtaining and keeping an efficient personnel; that there were now engaged in the work making audits, examinations, assessments, and settlements a total force of approximately 8,000 persons; that the work on the cases in hand was in all stages of progress, and that assessments for additional taxes were being made at an average rate of over \$30,000,000 per month. It was apparent that no sudden or radical changes in plans or methods of handling work were either practicable or advisable, since it was important to maintain a steady progress of work. As a result, the study and plan being pursued are on the lines of the gradual introduction of such changes in methods as can be introduced without interfering with or breaking down the existing organization and at the same time bring about greater efficiency in the work and increased expedition in the disposition of cases. This is being done with the cooperation of those engaged in the work, and has already resulted in very considerable improvement and increased production.

The situation as regards claims made by taxpayers by way of abatement, or for credit, or for refund in respect of taxes claimed to have been erroneously or illegally assessed may be taken as typical, although this presented one of the greatest points of congestion and accumulation of work. A thorough and careful investigation of the pending claims showed that on October 21, 1921, there were pending claims filed by taxpayers as follows:

	Number of claims.	Amount
Abatement of taxes assessed but not paid.....	57,519.	\$615,181,744
Credit claimed on account of alleged previous over- payments	26,146	138,097,506
Refund of taxes paid	79,612	253,689,606
Total	163,277	1,006,968,856

Many of these claims have been pending for a considerable period of time and it is manifestly unfair to the taxpayers and to the Government that this condition should continue.

As a result of the study that has been made, plans have been formulated and put into effect for the handling and disposition of these claims which it is expected will enable the pending claims substantially to be disposed of by the end of the present fiscal year. The prompt disposition of the abatement claims will result in the collection of a large amount of taxes now being held up by the pendency of these claims.

As rapidly as it can be done, consistently with the proper consideration of the cases, both from the standpoint of the taxpayer and of the Government, it is proposed to expedite the disposition of the work which has accumulated from past years, but the progress which can be made in this respect can only be determined by actual experience in the future.

The work involved is of a complicated and difficult character, particularly in the cases involving large amounts of money, and requires special training and skill, so that additional personnel is not readily or quickly available. In addition to this the bureau must keep within the limit of its appropriation for this work, and it does not seem advisable greatly to expand the permanent organization to any greater extent than is absolutely required, especially as the excess profits tax ends with the present year. However, the problem will continue to receive the very best thought of the department to the end that taxpayers may know as promptly as possible their tax liability, and that the work shall be handled with expedition and promptness and be as nearly current as this class of work can be made. * * *

ECONOMY IN GOVERNMENT EXPENDITURES: BUDGET SYSTEM.

In connection with the revision of the internal-tax laws and on other occasions the Treasury has frequently emphasized the vital importance of reductions in Government expenditures.

The year under review has shown extraordinary progress toward the reduction of Government expenditure, and striking cuts in expenditure have been made for the current fiscal year. The estimates for the fiscal year 1923, as presented in the budget and indicated elsewhere in this report, show a

tentative excess of expenditures over receipts in the amount of about \$167,000,000, due in large part to the reduction in estimated revenues. It is confidently expected, however, that with continued economy and effective pressure for reduced expenditures in all quarters it will be possible to overcome this threatened excess of expenditure and go through the year with a balanced budget. * * *

The progress which has been made in the reduction of Government expenditures is shown by the following table:

	Actual, fiscal year 1920.	Actual, fiscal year 1921.	Estimated, fiscal year 1922.	Estimated, fiscal year 1923.
Ordinary Expenditures...	\$6,403,343,841.21	\$5,115,927,689.30	\$3,604,980,166	\$3,143,415,927
Public debt ex- penditures charge able against ordinary receipts	78,733,400.00	422,113,000.00	387,942,200	369,338,800
Total ordinary expenditures (in- cluding public debt expenditures chargeable against ordinary receipts).....	6,482,077,241.21	5,538,040,689.30	3,992,922,366	3,512,754,727

* * * * *

THE INTERNATIONAL FINANCIAL SITUATION.

The values of foreign currencies as measured in dollars have shown great fluctuations during the year, and this instability, taken in connection with the recession in general business, has been unfavorable to the development of the foreign and domestic trade of this country. It is not necessary to discuss the many factors which have contributed to this situation. The interdependence of

the industry of all nations has been brought out very clearly by the developments since the war. It is fully understood to-day that the business of the United States depends in part upon the business activity of other nations.

The foreign obligations held by the United States, nearly all payable on demand, add to the uncertainty in international trade, particularly between the United States and its debtor nations, and increase the difficulty of a resumption of credit operations by these nations in the investment markets of the world. Many of them need capital for reconstruction, the purchase of raw material, and the rehabilitation of their railways and factories. Until their financial position is made clear, their ability to place loans will be affected, their industrial recovery will be retarded, and our own prosperity will suffer. The funding of these demand obligations and placing them in a businesslike form is one of the outstanding needs of the present economic situation. It is essential that some definite arrangement should be made as to the terms of payment both of the principal and interest. This is a problem which the country must face and must deal with in a broad, far-sighted way. * * *

WAR FINANCE CORPORATION.

The Agricultural Credits Act, approved August 24, 1921, broadened the powers of the War Finance Corporation and gave it authority to make advances not only to exporters and banking institutions but also to dealers in, and handlers of, agricultural products, including cooperative associations, for the purpose of advancing the carrying of such products until they can be exported or sold for export in an orderly manner. * * * *

At the time of this report the machinery for the administration of the agricultural credits act is in full operation. The agricultural loan committees in the various sections of the country are functioning actively and large numbers of applications are being received. Many loans already have been announced and there is every indication that, with the whole-hearted cooperation of public-spirited citizens and business men which the corporation is receiving everywhere, it will accomplish a great deal toward bringing about more stabilized conditions in the agricultural industry.

The following table shows the advances approved by the corporation from January 4, 1921, to November 15, 1921:

1. Export advances approved by War Finance Corporation:

Cotton-----	\$47,527,598.00
Tobacco-----	2,399,369.00
Wheat-----	11,500,000.00
Condensed Milk-----	1,000,000.00
Canned fruit and vegetables-----	400,000.00
Dried fruit-----	1,250,000.00
Meat products-----	1,000,000.00
Railroad equipment-----	2,925,000.00
Copper-----	145,600.00
Sugar-mill machinery-----	317,140.00
Agricultural machinery-----	500,000.00
<hr/>	
Total-----	68,964,707.00

2. Advances for agricultural purposes approved by War Finance Corporation:

Wheat-----	15,000,000.00
Cotton-----	13,025,214.50
Live stock-----	5,920,016.89
General agricultural purposes-----	16,172,844.82
<hr/>	
Total-----	50,118,076.21

Grand total-----119,082,783.21

Of the total amount, \$6,052,882.53 represents advances to exporters, \$63,700,000 to cooperative associations, and \$49,329,900.68 to banking institutions. These figures, of course, represent only advances approved by the corporation and do not include many transactions now in the process of negotiation. Furthermore, it must be remembered that the agricultural credits act did not become law until August 24. As the act is nation-wide in its application, some time necessarily was required to set up the machinery for its administration. With the completion of the task of organization, it is to be expected that there will be a large and steady increase in the usefulness of the corporation, especially in connection with advances for agricultural purposes under section 24. * * *

TREASURY SAVINGS SECURITIES FOR 1922.

During the calendar year 1922 the Treasury Department will continue to issue Treasury savings certificates in the denominations of \$25, \$100, and \$1,000, maturity value, but on a new basis, with a fixed issue price at the rate of \$80 for a \$100 certificate, or at the rate of $4\frac{1}{2}$ per cent compounded semi-annually. The \$1 Treasury savings stamp, first issued in 1921, will be continued.

For some time past the Secretary of the Treasury and the Postmaster General have been developing means of coordinating the savings operations of the Treasury and of the Post Office Departments. Through these conferences a unified Government savings program has been effected, with the result that during 1922 postal savings will be advanced for the deposit of savings and Treasury savings securities for investment. This program will be promoted jointly by the savings organizations of both departments. Pursuant to this plan, the Treasury Department will discontinue, at the close of the calendar year 1921, the issuance of the 25-cent thrift stamp and the \$5 war savings stamp, on the ground that the 10-cent postal savings stamp, the \$1 Treasury savings stamp, and postal savings deposits will provide adequate means of saving money in small installments, while the Treasury savings certificates above referred to will provide means of investment.

The new \$25 Treasury savings certificate will bear the portrait ~~head~~ of Roosevelt; the \$100 certificate that of Washington; and the \$1,000 certificate that of Lincoln. These certificates will be issued at a flat price, instead of at prices varying monthly as in previous years. They will mature five years from date of issue. The terms of the issues for 1922 will appear in detail in formal Treasury Department announcements to be issued at a later date. * * *

THE FEDERAL FARM LOAN SYSTEM.

In the last annual report allusion was made to the litigation then pending which challenged the constitutionality of the farm loan act. On February 28 of the present year the Supreme Court of the United States rendered a decision in the case upholding the constitutionality of the act in every respect. The effect of this decision was to establish the Federal Farm Loan System firmly as a part of our financial system and to clear away the legal difficulties which had impeded the operation of the system and the sale of land-bank bonds. Shortly after the decision of the Supreme Court, Congress further amended the Federal farm loan act and changed the optional call period so that the banks might issue bonds which could not be callable until 10 years from the date of issue. This amendment was deemed desirable in order to add to the attractiveness of the bonds to investors, and it is believed that it has proven exceedingly helpful in the sale of Federal land-bank bonds. * * *

The Federal Farm Loan System seems now to have become thoroughly established in the confidence of investors and in the minds of agricultural borrowers. Indeed, the demand for loans, owing to the general stress among the agricultural interests, has been for the time being in excess of the supply of funds and in excess of the physical capacity of the Federal land

banks. The system is functioning smoothly, however, and loaning funds to American farmers on very favorable terms at a rate exceeding \$150,000,000 per year, which, no doubt, exceeds any anticipations as to its service, and would in normal times fully respond to the calls upon it. * * *

HOSPITALIZATION.

The Sixty-sixth Congress of the United States passed Public Act 384, appropriating \$18,600,000 for the provision of hospitals for the veterans of the World War. This was signed by the President on the 4th of March, and made the Secretary of the Treasury responsible for the provision of these hospitals.

On the 16th of March the Secretary appointed a small group of consultants, composed of Dr. William Charles White, chairman, representing the National Tuberculosis Association; Dr. George H. Kirby, representing the National Mental Hygiene Association; Dr. Frank Billings, representing the American Medical Association; and Mr. John G. Bowman, who, as executive officer of the American College of Surgeons, had visited and inspected most of the hospital institutions in the United States.

These consultants met immediately and made a careful study of the hospital needs of the Bureau of War Risk Insurance. They took into their counsel an advisory committee of expert men loaned to them by the National Tuberculosis Association, the National Mental Hygiene Association, the Public Health Service, the National Home for Disabled Volunteer Soldiers, and the Bureau of War Risk Insurance. They heard all claims for hospitals from different parts of the country. They secured advice from members of the Army medical service, the Navy medical service, the Catholic Hospital Association, and numerous other interested bodies and individuals.

While these hearings were proceeding, a corps of workers was busy

plotting the various existing hospitals and other institutions being used for the care of ex-service men throughout the United States. Careful studies were also made of lines of transportation, distribution of ex-service men, special climates, ebb and flow of the sick population, types of disease represented among the beneficiary group, and other factors of importance, and these were carefully prepared in chart and map form as a basis for location of new hospitals. * * *

It was an early conclusion of the consultants, approved by the Secretary, that in the face of the emergency need for hospitals no delay should be tolerated, and that therefore each project as it was decided upon should go ahead with the utmost possible speed. * * *

Standard plans of nine types were prepared, (1) sanatoria for the tuberculous, with three types of buildings, infirmaries for advanced cases and buildings for ambulant and semiambulant groups; and (2) hospitals for mental diseases, with six types, diagnostic units, buildings for continued treatment, disturbed cases, reeducation, tuberculous mental and convalescent cases. Forty per cent working drawings for each of these with preliminary specifications were prepared to serve as models. In this way a great saving of time was secured, and when institutions were decided upon and sites chosen these standard plans were used with such modifications as were necessary for contour of ground, preexisting utilities where these already existed, etc., and thus speed in advertising and securing contracts of building and final erection was obtained.

In the study which has been made of the whole problem of hospitals a great deal of information has naturally been gathered. This is now being prepared as a guide in shaping any future hospital program of the Government.

FINANCES

ESTIMATED RECEIPTS AND EXPENDITURES, FISCAL YEAR 1922

Receipts:

Ordinary--

Customs		\$ 275,000,000
Internal revenue -		
Income and profits taxes.....	\$ 2,110,000,000	
Miscellaneous.....	1,104,500,000	
		<u>3,214,500,000</u>

Miscellaneous--

Sales of public lands.....	1,500,000	
Federal reserve bank franchise tax..	60,000,000	
Interest on foreign obligations.....	25,000,000	
Repayments of foreign obligations...	30,500,000	
Sales of surplus war supplies.....	141,200,000	
United States Grain Corporation.....	25,000,000	
Panama Canal.....	11,760,000	
Other miscellaneous.....	183,993,663	
		<u>478,953,663</u>

Total..... 3,968,453,663

Expenditures:

Ordinary.....	3,604,980,166
Public debt expenditures chargeable against ordinary receipts-	
Sinking fund.....	272,442,200
Purchases of Liberty bonds from foreign repayments.....	30,500,000
Redemptions of bonds and notes from estate taxes.....	25,000,000
Retirements from Federal reserve bank franchise tax receipts.....	60,000,000
	<u>387,942,200</u>

Total ordinary expenditures (including sinking fund and other debt expenditures chargeable against ordinary receipts)..... 3,992,922,366

Excess of expenditures over receipts..... 24,468,703

ESTIMATED RECEIPTS AND EXPENDITURES, FISCAL YEAR 1923.

Receipts:

Ordinary--

Customs		\$ 330,000,000
Internal revenue --		
Income and profits taxes	\$ 1,715,000,000	
Miscellaneous	896,000,000	
		<u>2,611,000,000</u>

Miscellaneous revenue --

Sales of public lands	1,500,000	
Federal reserve bank franchise tax..	30,000,000	
Interest on foreign obligations.....	25,000,000	
Repayments of foreign obligations...	30,500,000	
Sale of surplus war supplies	100,500,000	
United States Grain Corporation	7,000,000	
Panama Canal	13,315,000	
Other miscellaneous	196,367,750	
		<u>404,182,750</u>

Total ordinary receipts	<u><u>3,345,182,750</u></u>
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Expenditures:

Ordinary	1. 3,143,415,927
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Public debt expenditures chargeable against ordinary receipts -

Sinking fund	283,838,800	
Purchases of Liberty bonds from foreign repayments.....	30,500,000	
Redemption of bonds and notes from estate taxes	25,000,000	
Retirements from Federal reserve bank franchise tax receipts	30,000,000	
		<u>369,338,800</u>

Total ordinary expenditures (including sinking fund and other debt redemptions chargeable against or- dinary receipts).....	1. <u><u>3,512,754,727</u></u>
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Excess of expenditures over receipts	167,571,977
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1. This amount does not include \$125,000,000 of accumulated interest on war-savings certificates, representing discount accrued on certificates of the series of 1918, which mature Jan. 1, 1923.

SUPPLEMENTAL REGULATIONS GOVERNING SALES
OF SILVER TO THE DIRECTOR OF THE MINT
UNDER THE PITTMAN ACT.

Dec. 2, 1921.

Paragraph 5 of the Regulations of the Director of the Mint, approved August 30, 1920, as amended under date of October 6, 1920, and May 14, 1921, with reference to the proof required to be submitted in connection with purchases of silver under the authority of the Pittman Act, approved April 23, 1918, is hereby amended to read as follows:

"(5) Subject to the limitations of law as to the amount of silver purchaseable under the Pittman Act to replace silver dollars broken up and melted thereunder, the Director of the Mint will purchase under the Pittman Act silver which forms a part of a mixture of domestic and foreign silver produced by reduction works located in the United States up to the amount of such mixed product which represents the amount of silver wholly produced from mines situated in the United States and reduced in reduction works so located; provided, however, that the aggregate amount of refined mixed silver purchased hereunder as domestic silver shall not exceed the amount of silver actually produced from mines situated in the United States and delivered to reduction works so located, for which settlement was made with the miner, as shown by the liquidation sheets of said reduction works and the vendors' affidavits and supporting affidavits of the miners who delivered said silver to said reduction works, filed with the Director of the Mint as herein required; and provided further that no amount of mixed silver which was

-2-

refined on or before June 17, 1920, shall be purchased unless and to the extent that the domestic silver contained therein was delivered to reduction works located in the United States since January 17, 1920, as shown by such liquidation sheets and affidavits. All sales of refined mixed silver by the vendor prior to May 15, 1920, and all sales of refined mixed silver by the vendor after that date at a price exceeding \$1 per ounce, 1,000 fine, and all silver lost in process, must be apportioned between domestic and foreign silver for the purposes of settlements on account of silver purchased hereunder according to the amounts of domestic and foreign silver received for reduction as shown by the records filed under paragraphs (3) and (4) of these regulations."

Revised forms of vendor's and miner's affidavits are attached hereto and marked Exhibit A and Exhibit B, respectively.

R. T. BAKER

Director of the Mint.

Approved: December 2, 1921.

S. P. GILBERT, Jr.,

Under Secretary of the Treasury.

EXHIBIT A.

VENDOR'S AFFIDAVIT (MIXED SILVER).

State of _____ }
County of _____ } ss.

In order to make a sale of silver to the Director of the Mint under the provisions of the Pittman Act, approved April 23, 1918, and the regulations of the Director of the Mint issued thereunder, the undersigned hereby represents and certifies under oath that he is the _____ of
(Title of office)

_____, owner of certain silver to the
(Name of Vendor)
amount of _____ fine ounces more or less, forwarded to the
United States Mint at _____, _____, on the
_____ day of _____, 192__, and delivered for sale to the
Director of the Mint under the provisions of said Act for account of said vendor;
and that said silver is the product of mines situated in the United States and
of reduction works so located; being either * (1) wholly without admixture of
the product of foreign mines or reduction works, or (2) part of a mixture of
foreign silver and domestic silver delivered to domestic reduction works since
_____, 19__, and that the amount of such mixed product
tendered for sale as domestic silver does not exceed the amount which represents
the product of mines located within the United States and of reduction works so
located (after taking into account sales heretofore made to the Director of
the Mint under said Act, and excluding from the account silver refined on or
before June 17, 1920, which was delivered to such reduction works on or before
January 17, 1920). Settlement has been made for said silver with the miners to
the amount of _____ fine ounces on the basis of \$1.00 per ounce,
1000 fine, adjusted to the equivalent price for silver 999 fine and to the cost

* Strike out clause (1) or (2), whichever is inapplicable.

of delivery, refinery to mint. The vendor will promptly file with the Superintendent of said mint such statements and exhibits from its books of account and such supporting affidavits and sworn statements or exhibits by itself and by the miner, smelter, and refiner, as may be demanded by the Director of the Mint from time to time.

(Signature of vendor or duly authorized officer)

Subscribed and sworn to before me this _____ day of _____, 192__.

(Notary Public)

EXHIBIT B

MINER'S SUPPORTING AFFIDAVIT (MIXED SILVER).

STATE OF
COUNTY OF

}
} ss.
}

The undersigned, being duly sworn, deposes and says:

That he is the _____ of _____,
(Title of officer) (Name of mine owner)

owner of the _____ mine, situated in the County of
(Name of mine)

_____, State of _____;

that the said _____ has sold and delivered to
(Name of mine owner)

_____ on the _____ day of

_____, 192____, at its smelting plant known as the _____

Smelter, situated in the County of _____, State of _____,

_____ fine ounces of silver, which was produced at the said

mine located as aforesaid and contained in certain parcels of ore as

described in settlement or liquidation sheet No. _____ of said

_____, and that settlement has been made for

said silver to the amount of _____ fine ounces on the basis of not

less than \$1.00 per ounce, adjusted to the equivalent price for silver 999 fine

and to the cost of delivery refinery to mint.

Subscribed and sworn to before me this _____ day of _____, 192____.

Notary Public.

CONFIDENTIAL

The attached synopsis, containing important extracts from the Annual Report of the Secretary of the Treasury, is handed you for your convenience and accepted with the understanding that it shall not be published, given out, or used in any way, in whole or in part, until the Annual Report shall have been presented to the Congress of the United States, which probably will be at 12 o'clock noon (Washington time) of WEDNESDAY, DECEMBER 7 (seven), 1921.

A. W. MELLON

Secretary of the Treasury.

TREASURY DEPARTMENT

For release, morning papers,
Monday, December 12, 1921.

The Secretary of the Treasury, under the authority of the act approved September 24, 1917, as amended, offers for subscription, at par and accrued interest, through the Federal Reserve Banks, Treasury certificates of indebtedness, in two series, both dated and bearing interest from December 15, 1921, the certificates of Series T J2-1922 being payable on June 15, 1922, with interest at the rate of four and one-quarter per cent per annum semiannually, and the certificates of Series T D-1922 being payable on December 15, 1922, with interest at the rate of four and one-half per cent per annum, payable semiannually.

Applications will be received at the Federal Reserve Banks.

Bearer certificates will be issued in denominations of \$500, \$1,000, \$5,000, \$10,000, and \$100,000. The certificates of Series T J2-1922 will have one interest coupon attached, payable June 15, 1922, and the certificates of Series T D-1922 two interest coupons attached, payable June 15, 1922, and December 15, 1922.

The certificates of said series shall be exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of bonds and certificates authorized by said act approved September 24, 1917, and amendments thereto, the principal of which does not exceed in the aggregate \$5,000, owned by any individual, partnership, association, or corporation,

shall be exempt from the taxes provided for in clause (b) above.

The certificates of these series will be accepted at par, with an adjustment of accrued interest, during such time and under such rules and regulations as shall be prescribed or approved by the Secretary of the Treasury, in payment of income and profits taxes payable at the maturity of the certificates. The certificates of these series do not bear the circulation privilege.

The right is reserved to reject any subscription and to allot less than the amount of certificates of either or both series applied for and to close the subscriptions as to either or both series at any time without notice. Payment at par and accrued interest for certificates allotted must be made on or before December 15, 1921, or on later allotment. After allotment and upon payment Federal Reserve Banks may issue interim receipts pending delivery of the definitive certificates. Any qualified depository will be permitted to make payment by credit for certificates allotted to it for itself and its customers up to any amount for which it shall be qualified in excess of existing deposits, when so notified by the Federal Reserve Bank of its district. Treasury certificates of indebtedness of Series T D-1921, maturing December 15, 1921, will be accepted at par, with an adjustment of accrued interest, in payment for any certificates of the Series T J2-1922 or T D-1922 now offered which shall be subscribed for and allotted.

As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive subscriptions and to make allotments on the basis and up to the amounts indicated by the Secretary of the Treasury to the Federal Reserve Banks of the respective districts.

The combined offering will be for \$250,000,000, or thereabouts.

December 15, 1921.

My dear Mr. Chairman:

I received your letter of December 10, 1921, and in accordance with your request have been glad to examine the provisions of the enclosed bill H. R. 8905, introduced by Mr. Strong, of Kansas, to set aside the earnings of the Federal Reserve Banks as a special fund for agricultural loans. I have already expressed my general views as to additional credits for agricultural purposes in my other letter of this date as to H. R. 8906, and believe that most of the observations made in that letter apply equally to H. R. 8905.

The Treasury has a special objection to H. R. 8905, in that it would take public funds out of the Treasury indirectly without an appropriation, by withholding them for special purposes before they are covered into the Treasury. If the public funds are to be used for direct agricultural loans, I think it is of the utmost importance that Congress make direct and specific appropriation of such public funds as may be needed for the purpose and avoid measures which do not appear to be appropriations but nevertheless effectively take money out of the Treasury. The Federal Reserve Act now provides, as you know, that the net earnings derived by the United States from the operations of the Federal Reserve Banks shall be applied in the discretion of the Secretary to the outstanding indebtedness of the United States or the increase of the gold reserve behind United States notes. It is the policy of the Treasury

to apply the amounts so received from the Federal Reserve Banks to the retirement of outstanding indebtedness, and all amounts received by the Treasury to date on this account have already been applied to the reduction of debt. The next payments of the Federal Reserve Bank franchise taxes will be made at the end of the present calendar year, and the Treasury has already made arrangements for the application of these payments when received to the retirement of bonds and notes. These items have been incorporated on this basis in the Budget for the fiscal years 1922 and 1923, as submitted to Congress by the President December 5, 1921.

Very truly yours,

(Signed) A. W. Mellon

Secretary.

Hon. Louis T. McFadden,
Chairman, Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

December 15, 1921.

My dear Mr. Chairman:

I received your letters of November 16, and December 10, 1921, and have been glad, in accordance with your request, to examine the enclosed copy of H. R. 8906, to amend Section 14 of the Federal Reserve Act so as to enlarge the open market powers of the Federal Reserve Banks by permitting them on certain terms and conditions to purchase agricultural and live-stock paper running beyond the six months' limitation imposed by existing law in respect to paper eligible for discount at the Federal Reserve Banks. I have studied the bill with particular reference to the question of the wisdom of such legislation at this time. All things considered I believe that it is not necessary to meet existing conditions and that it would be unwise to enact it into law as a means of permanent relief. The bill is apparently designed as a temporary measure, and is necessarily so limited and restricted in its operation that I doubt whether it would be helpful in the present situation or give any important additional relief in the future.

To the extent that emergency relief is necessary, more comprehensive legislation has already been provided by means of the so-called Agricultural Credits Act, approved August 24, 1921, which took the form of amendments to the War Finance Corporation Act. Pursuant to this enlarged authority, the War Finance Corporation is actively engaged in making loans on live stock and staple agricultural products upon the terms and conditions set

forth in the amended act, and there is no doubt that its activities will go far to relieve the situation. The Federal Reserve Banks and commercial banks in many sections, moreover, are now in a better position to extend credits for agricultural purposes, and should be able more and more to provide for the financing of commodity and short-term live-stock paper on their own resources, without recourse even to the additional facilities which the War Finance Corporation offers.

I realize that there is some gap between the six months' agricultural credit provided for under the Federal Reserve Act and the long-time agricultural credits provided for under the Federal Farm Loan Act on the security of farm lands, and that by reason of the temporary nature of the War Finance Corporation's activities it may be necessary to provide by legislation for some additional credit facilities to fill this gap. I believe, however, that it should be possible to work out whatever legislation is necessary for this purpose on a basis that will be both sound and permanent. The general lines which such legislation might take have been expressed in the statement issued by the Chairman of the Joint Commission of Agricultural Inquiry under date of September 1, 1921, a copy of which is enclosed for your ready reference. I understand that a bill which will embody the substance of these recommendations is now in course of preparation and that it has already had consideration by the Commission. Conditions are still so abnormal that it is difficult for anyone to say what additional legislation is necessary to provide for agricultural credits

in normal times. As a matter of fact, I am inclined to believe that when the existing situation has passed it will be found that the need is not so much for further financial relief as for better machinery for distribution and marketing, and that in more normal times the ordinary banking facilities of the country will provide for the necessary financing. The next six months will see the situation further developed and should give a better indication as to what permanent measures of relief ought to be adopted. In the meantime the situation is covered not only by the activities of the War Finance Corporation but also to a large extent by the credits which the Federal Reserve Banks are already authorized and prepared to extend.

I suggest that in these circumstances the best course of procedure would be for the Treasury, the Federal Reserve System and the Federal Farm Loan Board, and others interested in providing better machinery for agricultural credits of the intermediate character, to keep in close touch with both the Joint Commission of Agricultural Inquiry and the Committees on Banking and Currency, and for all concerned to endeavour to work out together a satisfactory measure that may be expected to develop along sound lines and to fill whatever gap there may be in the existing system.

I think it would be a mistake, with the temporary situation covered by the activities of the War Finance Corporation, to adopt as a measure of relief a bill like H. R. 8906, which is necessarily limited in its scope and operation and at the same time calculated

to endanger the liquidity of the Federal Reserve System if ever extended to cover the general situation. The need appears to be for longer time credits for some agricultural purposes, and this need should be met so far as possible on an investment basis, to the extent that it cannot be covered by ordinary banking facilities.

Very truly yours,

(Signed) A. W. MELLON

Secretary.

Hon. Louis T. McFadden,
Chairman, Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

1 enclosure.



THE SECRETARY OF THE TREASURY

WASHINGTON, D. C.

December 15, 1921.

Dear Sir:

In transmitting to you herewith Treasury Department Circular No. 270, dated December 15, 1921, which states the terms and methods of distribution of the new Treasury Savings Certificates, offered for sale beginning December 15, 1921, I invite your attention particularly to the following features of the new issue which are described more at length in the circular:

Treasury Savings Certificates, New Issue, are offered for sale at a flat issue price, which until further notice will be \$20 for the \$25 certificate, \$80 for the \$100 certificate, and \$800 for the \$1,000 certificate. The certificates will mature five years from the date of issue in each case, and will be redeemable before maturity at the redemption values stated thereon, upon presentation and surrender to the Treasury Department, Washington. The certificates are issued only in registered form, and the name and address of the owner and date of issue will be inscribed on each certificate by the issuing agent at the time of issue.

The new certificates at the price offered yield about $4\frac{1}{2}$ per cent per annum compounded semiannually if held to maturity, and about $3\frac{1}{2}$ per cent compounded semiannually if redeemed before maturity.

The limit of holdings has been increased by the Act of Congress approved November 23, 1921, from \$1,000 to \$5,000, and it is now possible therefore to hold Treasury (War) Savings Certificates of any one series up to an aggregate maturity value not exceeding \$5,000.

Incorporated banks and trust companies and such other agencies as may be designated for the purpose may qualify as collateral agents for the sale of Treasury Savings Certificates, New Issue, upon application to the Federal Reserve Bank of the district and the deposit of collateral. Collateral agents will be required to render a monthly account and to remit the proceeds of sales made during each calendar month by the 20th day of the succeeding month. There will be no cash agencies or sales stations for the sale of the new certificates.

Treasury Savings Stamps in the \$1 denomination, noninterest bearing, will continue on sale until further notice in order to provide facilities for the accumulation, on Treasury Savings Cards, of the purchase price of the new certificates.

The sale of Treasury Savings Certificates of the old series and of all War Savings Stamps and Thrift Stamps will cease absolutely on December 31, 1921.

The new certificates are issued in attractive form and in convenient denominations. The \$25 denomination will bear the portrait head of Roosevelt, the \$100 denomination the portrait head of Washington, and the \$1,000 denomination the portrait head of Lincoln. The terms of the certificates have been much simplified as compared with previous issues, and the offering is on a basis which should prove particularly attractive to small investors.

The certificates now offered will be sold at post offices and at banks and trust companies and such other agencies as may qualify for the purpose in accordance with the provisions of the enclosed circular. Upon application to the Federal Reserve Bank of your district, and deposit of the requisite collateral, you may obtain on consignment the desired quantity of certificates to sell to your customers.

Cordially yours,

Secretary of the Treasury.

To the President
of the Bank or Trust Company Addressed.

Enclosure: Treasury Department Circular
No. 270, dated December 15, 1921.

December 19, 1921.

Dear Mr. Chairman:

I received your letter of December 10, 1921, and have been glad, in view of your request, to give consideration to H. R. 9381, the bill to provide for the extension to July 1, 1923, of the time within which loans may be made by the War Finance Corporation, and the time when the Corporation shall proceed to liquidate its assets and wind up its affairs. The situation at the present time is so abnormal that it is almost impossible to say what should be done with regard to this bill, and in my judgment the best course would be to wait for two or three months before taking any definite action. By that time conditions will have had a better opportunity to adjust themselves and it should be possible to form a more intelligent judgment as to what, if any, further provision should be made for agricultural credits.

The general views of the Treasury as to further credits for agricultural purposes have already been outlined in my two letters of December 15, 1921, with regard to H. R. 8905 and 8906, and I should say that consideration ought to be given to the problem along the lines there indicated. The War Finance Corporation, of course, I regard as a temporary agency, designed to meet emergency conditions, and I believe it would be a grave mistake to convert it into anything like a permanent institution, through successive renewals, or otherwise. It now constitutes, in effect, a

special Government bank to provide credit for agriculture, and is clearly on a temporary or emergency basis. As conditions become more normal, the ordinary banking facilities of the country, with the help of the Federal Land Banks and other established agencies, ought to provide the necessary credit machinery for agriculture without the necessity of this special Government assistance. No man can tell, of course, how long it will take to work out of the existing situation, but I am hopeful that with the additional relief that will be afforded between now and July 1, 1922, through the War Finance Corporation and other agencies, and with the liberal provisions carried in the War Finance Corporation Act, as amended August 24, 1921, for the renewal and extension of outstanding loans and advances, it will not be necessary to extend again the power of the Corporation to make new advances or purchases for agricultural purposes. The next few months should give a better index to the situation and the remedy, and in the meantime I should say that it was desirable to leave as they stand the existing limitations of law on the life of the Corporation.

Very truly yours,

(Signed) A. W. Mellon

Secretary.

Hon. Louis T. McFadden,
Chairman, Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

Extract from Commerce Reports, December 26, 1921.

SALE OF SECURITIES PAYABLE IN DEPRECIATED CURRENCY.

Prepared in the Eastern European Division.

In an article in COMMERCE REPORTS of November 7, 1921, caution was advised in the purchase of national, municipal, and industrial bonds and other securities, the principal and interest of which are payable in greatly depreciated currency. Numerous inquiries received by the Bureau indicate that this matter is not yet fully understood, and misleading advertisements of such securities are still being widely circulated.

The main point in that article is: If a foreign bond - whether of a nation, a city or other local government, or of a corporation - merely promises to pay a given amount of foreign currency, with interest in the same currency, its value is necessarily dependent upon the present exchange value of this currency. Speculation in such^a security is virtually speculation in the currency itself.

The question is not as to the solvency and reliability of the Government, municipality, or corporation issuing the security. It is as to the value of what it promises to pay. Often there is little doubt that the principal and interest will be paid promptly. Payment may be adequately secured by a mortgage on valuable physical assets. But the buying power, in terms of American money, of the currency thus paid back may prove to be much less than the investor has put in.

ELEMENTS GOVERNING PRICES OF BONDS.

The price one is justified in paying for a bond promising the payment of foreign paper money at some future time does not depend even on the probability of a future rise in the exchange value of that currency. It depends rather on its exchange value at the time the bond is purchased. If one wishes to speculate on the future rise in a foreign currency he would be hardly wise to pay for such currency to-day far more than the market price. A bond - a promise to pay money in the future - (unless with an abnormally high annual interest) can hardly have a materially greater value than the same amount of the same kind of money actually in hand to-day. The actual money in hand has the same likelihood of rising (or falling) in value in the future as the bond has. In numerous cases which have come to the attention of the Bureau concerns in the United States are offering for sale foreign bonds at prices several times higher than the same amounts of the given paper money could be bought for immediately. For example, a certain bond is being offered at nearly \$20, although the same amount of the currency in which it is payable can be bought for about \$3.

Putting the matter another way, the prices at which certain of these securities are being offered in the United States are several hundred per cent more than the prices at which they could be bought in the country where they are issued. There is no reason to suppose that the bond of a given city, for example, promising to pay 1,000 units of currency at some future time, would cost to-day, in the country where issued, much more than par - that is, more than 1,000 of such units. A small premium on such bonds is possible, but a discount is not uncommon. The would-be American buyer, by using his dollars to buy the foreign money itself, could with it buy the bonds in the foreign country. If the amount of the foreign currency which he would obtain for, say, \$100, is several times greater than the par value of the bonds offered in the United States for \$100, he is evidently being mulcted in buying them in this country.

GROUP OFFERS SHOULD BE SCRUTINIZED.

Of course, the above considerations would not apply to a bond promising to pay gold, or dollars, or some other stable currency, or to a bond containing special provisions which would assure payment in a currency having a greater value than the paper money of the country now possesses. They would also apply with somewhat less force to a bond containing special provisions to protect the investor against a fall in the value of the money, but without assuring an increase. Such special provisions are not, in fact, found in most of the foreign securities, expressed in terms of paper money, which are offered in this country.

All the leading financial periodicals and many of the daily newspapers publish from day to day the exchange value of foreign currencies, and the American investor need not be in ignorance as to how many units of any foreign money a dollar will buy.

Certain concerns, in offering to the public securities payable in greatly depreciated currency, have adopted the practice of combining these in groups with other foreign securities payable in gold, or in entirely sound currency, or at least in currency which is little depreciated. A group of several different securities is made up and offered at a lump sum. The only way in which the significance of such a group offer can be understood is by carefully figuring the dollar exchange value of the amount of paper money of each of the different countries which the par of the bonds represents. It will sometimes be found that while several of the securities offered in a group may have a high value one or more of them have a very low value, as judged by the current rates of exchange.

RECENT CABLE-TRANSFER RATES.

To sum up, the price of a bond or other security promising to pay a given amount of paper money ought not, normally, to be much more - and sometimes ought to be less - than the cost of that amount of paper money itself, at current rates of exchange, unless some special provision, written into the bond itself, positively assures it a higher value. The Bureau of Foreign and Domestic Commerce in making this suggestion does not express any opinion, favorable or unfavorable, regarding the desirability of buying such securities at reasonable prices or the desirability of buying foreign currency itself as a speculation.

The following table shows for July and December, 1921, the cost in dollars of 1,000 units of the principal European currencies which are greatly depreciated, and the amount of each which \$100 would buy. It should be remembered, however, that rates of exchange are constantly fluctuating. Current rates should be consulted, if purchase of foreign securities is contemplated. For comparison, the exchange value of the pound sterling and the French franc, which are much less depreciated, is shown in the table.

Prices of certain foreign currencies (cable transfers at New York).

Currency.	Prices per 1,000 in dollars.		Amount \$100 would buy	
	July 1, 1921	Dec. 1, 1921	July 1, 1921	Dec. 1, 1921
Pound Sterling.....	\$3,733.50	\$4,037.50	26.8	24.8
French francs	82.30	72.30	1,215	1,383
German mark	13.44	5.45	7,440	18,365
Austrian crown	1.64	.37	60,827	268,096
Czecho-Slovak crown	13.44	11.07	7,440	9,034
Hungarian crown	3.80	1.79	26,316	55,897
Roumanian leu.....	15.10	7.34	6,622	13,628
Bulgarian lev	10.80	6.89	9,259	14,510
Jugo-Slav (Siberian) dinar ...	27.20	14.73	3,676	6,789
Polish mark .....	.45	.29	222,222	342,466
Finnish mark	16.60	17.34	6,024	5,765