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U. S. Treasury Dept.

Press Releases

REMARKS OF
S. P. GILBERT, JR.,
UNDER SECRETARY OF THE TREASURY,
AT THE ANNUAL MEETING OF THE
PHILADELPHIA BANKERS, JANUARY 12, 1922.

THE TREASURY'S CURRENT PROBLEM

Mr. Chairman and Gentlemen:

The fundamentals of the Treasury's problem are not difficult to understand, and it would be helpful if people generally understood them better. Like everyone else, the Government has the problem of living within its income, and as you all know this Government is now doing it. The Government's income arises chiefly from taxation, with important additions from customs revenue and salvage, and the problem there is to provide sufficient revenue to meet the needs of the Treasury and at the same time to adjust the system of taxation in such a way as to avoid imposing undue burdens on the country, particularly on productive industry. Then the Government has debts, chiefly as the result of the war, and these debts mature from time to time. It is the problem of the Treasury to finance these maturities and to provide for the funding of such as have to be refunded. And at the same time it is the Treasury's business to frame a program, with regard to both receipts and expenditures and the debt, that will provide in orderly course for the retirement of the public debt, for it is the traditional policy of this Government to set about paying its debts.

To be more specific, the Treasury's ever-present problem, of course, is the public debt, which now amounts to almost 23½ billion dollars. Of this great debt, about 6½ billion dollars falls due within the next 17 months, over 3½ billions of it in the form of Victory notes, which mature May 20, 1923, about \$2,200,000,000 in the form of Treasury certificates, which mature at various dates within a year, and nearly \$700,000,000 in the form of War-Savings Certificates, which mature January 1, 1923, or may be redeemed before that time. Within but little more than a year later there

will mature about \$800,000,000 additional of debt, of which short-term Treasury notes make up about \$700,000,000 and War-Savings Certificates about \$100,000,000. This summary of the early maturities of the debt shows that the Treasury has its work to do for the next few years, and that with these vast operations to conduct it is of more than ordinary importance that the budget should balance year by year, ordinary receipts against ordinary expenditures, and leave no deficit to be covered by new borrowings.

The essence of the Government's policy with respect to the short-dated debt, as expressed by the President in his first address to Congress, is "orderly refunding and gradual liquidation". It is clear that the greater part of the \$5 billions of debt which is about to mature will have to be refunded, and the Treasury's effort is to fund it in such a way as to distribute the debt in the most convenient maturities and at the same time avoid spectacular refunding operations that would disturb business and upset the financial markets. It is easier to appreciate what a task this is if one recalls that the First and Second Liberty Loans together amounted to only about \$5,800,000,000, that these loans were floated through stirring campaigns of about one month each, under the stimulus of war enthusiasm, and that several million people as a matter of patriotic duty devoted the best part of their time for several months to assure the successful flotation of the offerings. Now the war is over, the last Liberty Loan campaign is almost three years behind us, and we could not revive the Liberty Loan organization or reproduce the Liberty Loan campaigns if we would. Nor would it be advisable in peace time, if it can possibly be avoided, to carry on country-wide popular drives to sell Government securities that would interfere with the normal activities of the people and disturb the financial markets.

The Government is of necessity the largest borrower in the country, and its operations in the course of a year run into many billions of dollars. It is accordingly a matter of the first importance to the general welfare that the Treasury conduct those operations with the minimum of financial strain, and, so far as possible, without interfering with the normal demands of business and industry. At the same time it is important that the Treasury appear in the market as infrequently as possible and that its borrowings of all kinds be at the lowest rate consistent with the distribution of its securities among investors; not only because of the necessity of economy in Government expenditure, but also because of the relation between the Treasury rate and the general level of interest rates on other obligations and securities throughout the country.

With these considerations in mind, the Treasury has developed during the years which have followed the Liberty Loan campaigns a system of distribution of its short-term notes and certificates through the Federal Reserve Banks which depends in large measure upon the purchase of the securities in the first instance by banks throughout the country and their resale to intending investors. From small beginnings this system has developed into a most effective agency for the orderly distribution of Government securities among investors, and it has proved quite as adaptable to the sale of short-term Treasury notes as to Treasury certificates. At the same time it is a system of nice adjustments, which requires the Treasury to gauge market conditions accurately, as to time, rate and amount. The Treasury has squarely adopted the policy of selling its securities on an investment basis, at rates to meet the market and without artificial assistance

from Federal Reserve Bank discount rates or otherwise. In this connection there has developed an active open market for short-term Treasury notes and certificates and all outstanding issues are now quoted and actively bought and sold on the markets. In the remote sections of the country the Federal Reserve Banks themselves act as the chief markets, but generally speaking the Treasury and the Federal Reserve Banks have endeavored to encourage transactions in the open market. The result has been to make the short-term obligations of the Treasury instantly salable anywhere in the country and to establish them as the safest and most liquid of short-term investments, particularly available for the investment of idle funds on the part of individuals and corporations. The result has also been in the course of a year and a half, or thereabouts, to relieve the banks of an important part of their holdings of Government securities and to free the funds previously absorbed for the ordinary purposes of business and industry. Thus on December 28, 1921, the holdings of Treasury certificates by the reporting member banks of the Federal Reserve System amounted to only about 223 millions, as compared with about 420 millions a year and a half ago. During the same period Treasury certificates pledged with the Federal Reserve Banks to secure loans and discounts have fallen from 356 millions to 49 millions, a reduction of over 307 millions, while Victory notes similarly pledged have fallen from about 304 millions to about 67 millions, with Treasury notes to the amount of 26 millions likewise pledged at the same time.

Interest rates on the Treasury certificates have fallen during this same period of a year and a half from $5\frac{3}{4}$ and 6 per cent for six months and one year maturities in June, 1920, to $4\frac{1}{4}$ and $4\frac{1}{2}$ per cent for similar maturities in December, 1921. This has been due for the most part

to easier money conditions and the accumulation of funds as a result of business conditions, but to a large extent also it comes from the improved distribution of the debt among investors as well as improved distribution as to maturity.

It is important in this connection to note one special factor in the Treasury's public debt operations since August 31, 1919, when the gross debt reached its peak, namely, that with relatively small fluctuations the operations have been accompanied by gradual debt retirement. Generally speaking, the Treasury has been floating a constantly decreasing total volume of securities, and its operations have accordingly not taken new money or absorbed funds that would otherwise go into business. On the contrary, a considerable volume of funds has been freed for ordinary commercial uses, and the Treasury has been slowly but surely paying its debts. This makes an enormous difference in the character of the operations, which it is easy but dangerous to overlook. If the tables were reversed and the Treasury were each month putting out increasing amounts of securities, quite different problems would arise. Treasury offerings would then take up new money, and there would be danger of inflation and of strain on the investment markets, with consequent prejudice to other operations. Fortunately, the prospects are that the process of orderly payment of the war debt will continue, but it is none the less important to keep in mind what the other course means.

At the same time it is necessary to avoid misunderstanding of the debt reduction that has occurred since the high point was reached on August 31, 1919. The decrease is substantial, but it is worth while to notice how it was accomplished. In the aggregate the reductions up to December 31, 1921, amounts to about \$3,150,000,000, that is to say, from

\$26,596,000,000 on August 31, 1919, to \$23,439,000,000 on December 31, 1921. The debt on August 31, 1919, however, was unnaturally inflated, partly because of temporary borrowings incident to heavy maturities of loan certificates and partly because no important payment of income and profits tax for that fiscal year had been received up to that date, leaving a large deficit in the first two months which was later overcome in the ordinary course of operations for the same fiscal year. This clearly appears from the fact that though the current surplus of receipts over expenditures for the whole fiscal year 1920 was only \$291,000,000, the apparent surplus for the 10 months from August 31, 1919, to June 30, 1920, was \$1,536,000,000. This makes up nearly half of the total reduction. Of the remainder, a large part comes from the net reduction of \$630,000,000 which it has been possible to make in the Treasury's general fund balances between August 31, 1919, and December 31, 1921, and the rest comes from a current surplus of \$509,000,000 in the fiscal year 1921, and of \$476,000,000 in the first six months of the present fiscal year. In other words, out of the total reduction of about \$3,150,000,000 in gross debt, about \$1,875,000,000 represents decrease in Treasury balances and the elimination of temporary items, while about \$1,275,000,000 represents actual retirements through surplus receipts. Even these retirements from surplus receipts have resulted for the most part from the application of the proceeds of war salvage (which probably aggregated at least as much during this period) and have not meant retirements out of tax receipts. The reduction is none the less real, and its effect on Treasury operations and on the general situation none the less helpful, but these figures make it clear that it has been an entirely natural reduction and not of a character calculated to throw undue burdens upon the taxpayer or upon the country. To state the matter in another way, beginning

with the fiscal year 1921, the sinking fund and various miscellaneous receipts which have to be applied each year to debt retirement account for the principal reductions in the debt. The retirements on this account are properly chargeable against ordinary receipts, and will in themselves provide for further gradual reduction at the rate of between \$500,000,000 and \$400,000,000 a year at least. The Treasury's estimates and the Budget for the current year and the ensuing year contemplate that these retirements will be made, of course, out of current receipts, and as the program develops the orderly retirement of the debt should continue from year to year.

It became clear early in this Administration, however, that the gradual reduction of the debt which might come about by this means in the next few years could not be expected to provide before the maturity of the Victory Liberty Loan for the retirement of much of the short-dated debt, and that accordingly most of the 7½ billions of the debt maturing within two years which was then outstanding would have to be refunded. Immediate steps accordingly had to be taken to make the short-dated debt more manageable, and to facilitate the refunding operations incident to the maturity of the Victory notes. Long-term operations then were not to be thought of. Over 15 billions of Liberty bonds were outstanding, all for relatively long terms, interest rates were high and obviously undergoing readjustment, and Liberty bond prices were far below par. It was clear, therefore, that the first refunding operations to be undertaken should be for a fairly short term, and on April 30, 1921, the Secretary announced that it would be the Treasury's policy to vary its offerings of certificates of indebtedness from time to time with offerings of short-term notes in moderate amounts at

convenient intervals, with maturities of from three to five years. The object was to distribute the short-dated debt over a longer period of years and to provide more convenient maturities. Two public offerings of notes have been made, with about 310 millions issued on the first, and about 390 millions on the second. Through these operations the Treasury has been able to transfer about 700 millions of the short-dated debt to somewhat later maturities, and with the help of the sinking fund has made some reductions in the short-dated debt and improved the distribution of that which remains. Victory notes outstanding have been reduced from about \$4,100,000,000 on March 31, 1921, before the refunding program began to operate, to about \$3,550,000,000 on December 31, 1921, a reduction of about 550 millions, and Treasury certificates of all classes outstanding from about \$2,750,000,000 on March 31, 1921, to about \$2,200,000,000 on December 31, 1921, a reduction of about 550 millions. The greater part of the ordinary receipts available for debt reduction during the current fiscal year accrued, however, during the first six months owing to the heavier tax receipts in that period, and for the rest of the year it is likely to be chiefly a refunding proposition.

The problem thus remains of providing for the $3\frac{1}{2}$ billions of Victory notes, the \$2,200,000,000 of Treasury certificates and the \$700,000,000 of War-Savings Certificates which are still outstanding and will mature within a year and a half. To refund this $6\frac{1}{2}$ billions of debt will not take new money, but it will involve operations of a magnitude unparalleled in time of peace, which will have to be carried on with the greatest skill in order to avoid financial strain or disturbance to the security markets. Treasury certificates have established a place for themselves, and a substantial part of the amount now outstanding can undoubtedly be carried along to good advantage

in the form of Treasury certificates. As a matter of fact, it is almost necessary to do this while Government operations are so large and tax payments so heavy, in order to carry on current operations without money strain. The maturity of War-Savings Certificates the Treasury has already begun to provide for through the new issue of Treasury Savings Certificates, placed on sale a few weeks ago in convenient denominations in terms which should make them particularly attractive to small investors throughout the country. The new Savings Certificates are finding a ready sale, and the Treasury hopes, as the program develops, to sell a substantial amount to help finance the maturity on January 1, 1923. In the most favorable circumstances, however, new sales will probably not provide for the whole maturity and the balance would then have to be refunded, at least temporarily, into other obligations.

The 3½ billions of Victory notes present the greatest problem. By reason of their early maturity the notes have now taken on almost the quality of short-term certificates and for some time to come will compete directly with Treasury certificates for this class of investment money. Three and one-half billions of debt, moreover, is too much to have to pay off or refund in one day, and it will not do to wait until maturity before taking steps to reduce still further the Victory notes outstanding. It is accordingly the Treasury's policy to retire Victory notes from time to time whenever the opportunity offers, through the sinking fund and other similar operations, through successive sales of short-term notes, and perhaps through longer-term operations, if market conditions should prove favorable. In this way the Treasury plans to spread the 6½ billions of short-dated debt, which is now concentrated in relatively few maturities within the next year and a half, into "a progressively smaller aggregate amount of better distributed

maturities" extending over a longer period. These refunding operations will necessarily be in active progress during the next year and a half, and will present a constant problem, but if not complicated with other borrowings, should assure the gradual refunding of the short-dated debt without spectacular refunding loans and without disturbance to the business of the country.

Inevitably related to the public debt is the problem of taxation. The Revenue Act of 1921 became a law on November 23, 1921, and with it comes a greater reduction in revenue than is generally appreciated. The shrinkage in business would of itself have resulted in a material shrinkage in revenue, but it is estimated that under the new law the internal revenue collections for the fiscal year 1923, the first full year of its operation, will be about \$800,000,000 less than would have been collected under the old law. The combined result is an important reduction in the total tax burden, with total estimated internal revenue collections for this fiscal year of \$3,214,000,000, and for the next year of \$2,611,000,000, as compared with \$4,596,000,000 actually collected in the fiscal year 1921. These reductions in taxation have been made possible by corresponding reductions in expenditure, and if there are to be further reductions in taxation there will have to be further reductions in expenditure.

The revision of the tax laws will no doubt receive renewed consideration in the near future, and the Treasury has already suggested the more important matters that should be kept in mind in that connection. The Government's current financing, however, is necessarily based on the Revenue Act recently enacted, and for this purpose it is necessary to keep in mind that even under the law as it now stands there will be a reduction of about 600 millions in tax collections in 1923 as compared with the present fiscal year.

In round numbers the Government's budget for the current year is on about a 4 billion dollar basis, and for the next fiscal year is expected to be on about a 3½ billion dollar basis. The estimates already submitted to Congress indicate total receipts for the current year of about \$3,968,000,000 as against total expenditures, including sinking fund and other debt retirements chargeable against ordinary receipts, of about \$3,992,000,000. On this basis there would be a deficit for the year of about 24 million dollars. For the next fiscal year total receipts are estimated at about \$3,345,000,000, as against total expenditures on the same basis of about \$3,512,000,000, leaving an apparent deficit of about 167 millions. It is still too early to tell how these estimates will work out, though the indications from the first six months of the present fiscal year are that the estimates for 1922 are substantially correct. It is hoped, however, that as the situation develops the estimated deficits for both years can be avoided, and that the budget can be made to balance or to show perhaps a small surplus. To accomplish this will require the concerted efforts of both Congress and the executive, and a constantly resistant attitude on all sides against appropriation and expenditure. The Bureau of the Budget is now well established, and for the first time in its history the Government has an organization equipped to bring effective executive pressure to bear upon all the spending departments and establishments to reduce expenditure. The Budget, it has been said, "has made economy popular and extravagance dangerous", and it can be counted upon to produce results. It is difficult, in fact, to overemphasize the importance of its accomplishment up to date, particularly in respect to the expenditures of the present fiscal year, which it is already clear will be about \$500,000,000 less than was originally estimated by the spending departments six or eight months ago.

The Appropriations Committees of Congress, on their part, are doing splendid work to reduce expenditures and are exercising extraordinary vigilance against new expenditure. The Committee in the House of Representatives is organized as a central committee to handle all appropriations and through appropriate sub-committees prepares the bills for the several departments and establishments. This year the appropriation bills will be divided according to departments, as recommended in the Alternative Budget submitted by the President, and it will thus be possible for the first time to get a clear view from each bill of the activities of each department and of its total appropriations and expenditures. Steps are also being taken to repeal or restrict the use of indirect and indefinite appropriations and revolving funds, which have in the past been responsible for much expenditure without the appearance of an appropriation. All things considered, it is an encouraging outlook, unless new expenditures are to be imposed by extraordinary legislation.

It may be interesting in this connection to indicate the main items of expenditure for the present fiscal year, which absorb almost 90 per cent of the total. Out of estimated total expenditures of \$3,992,000,000, it appears that about $3\frac{1}{2}$ billions fall under eight main heads, as follows: Interest on the public debt, 975 millions; sinking fund and other fixed debt charges, 388 millions; Navy, 479 millions; Veterans' relief, 450 millions; War Department, 389 millions; Railroads, 338 millions; Interior Department, consisting chiefly of payments on account of pensions and Indians, 327 millions; and Department of Agriculture, 154 millions, for the most part for good roads.

This outline of the Government's expenditures is enough to show that important items of war overhang still remain and that sufficient reductions ought to be possible in these items, as for example, in the expenditures for the railroads, army and navy, to make up for most of the certain shrinkage of revenue and balance the budget for the fiscal year 1923. The greatest difficulty will be with measures which do not originate in the Budget and which do not go through the committees on appropriations. Even these, however, can be effectively controlled if once the people recognize that expenditures for which provision is not made in the Budget, if of any substance, should be accompanied by simultaneous provision for the taxes necessary to meet the expenditure and must in any event ultimately be borne by the taxpayer.

TREASURY DEPARTMENT
WASHINGTON

January 16, 1922.

Dear Mr. Chairman:

I am glad, in accordance with the request of the Committee, to present the Treasury's views as to the issuance of tax-exempt securities and the latest available information as to the amounts now outstanding and their effects upon the revenues and the investment markets. The problem presented by these issues of tax-free securities is of growing importance and I think that it deserves the most serious attention.

The views of the Treasury on the subject, and its suggestions as to possible remedies, have already been set forth in my letter to you of April 30, 1921, and in my letter of September 23, 1921, to the Chairman of the Committee on Banking and Currency of the House of Representatives, a copy of which I sent to you with my letter of September 23, 1921. Copies of these letters are attached for ready reference. The further views of the Treasury have been indicated to some extent in my letter of November 4, 1921, to you, and in the Under Secretary's letter of November 10th to the Chairman of the Committee on Banking and Currency, copies of which are enclosed.

Since these letters the President, in his address to Congress on December 6, 1921, has emphasized the importance of action in the matter in the following words:

"There are a full score of topics concerning which it would be becoming to address you, and on which I hope to make report at a later time. I have alluded to the things requiring your earlier attention. However, I can not end this limited address without a suggested amendment to the organic law.

"Many of us belong to that school of thought which is hesitant about altering the fundamental law. I think our tax problems, the tendency of wealth to seek nontaxable investment, and the menacing increase of public debt, Federal, State and municipal - all justify a proposal to change the Constitution so as to end the issue of nontaxable bonds. No action can change the status of the many billions outstanding, but we can guard against future encouragement of capital's paralysis, while a halt in the growth of public indebtedness would be beneficial throughout our whole land.

"Such a change in the Constitution must be thoroughly considered before submission. There ought to be known what influence it will have on the inevitable refunding of our vast national debt, how it will operate on the necessary refunding of State and municipal debt, how the advantages of Nation over State and municipality, or the contrary, may be avoided. Clearly the States would not ratify to their own apparent disadvantage. I suggest the consideration because the drift of wealth into nontaxable securities is hindering the flow of large capital to our industries, manufacturing, agricultural, and carrying, until we are discouraging the very activities which make our wealth."

I should also like to call to your attention the statement as to the decline in taxable income, particularly from investments, which appeared in my Annual Report for 1921, on pages 20 - 21, as follows:

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 income.		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 obligations.

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?

I attach for the further information of the Committee in this connection the following tables which have been prepared by the Government Actuary:

1. Estimate of the total amount of wholly tax-exempt securities outstanding January 1, 1922.

2. Table showing advantage of investing in tax-free securities as compared with a like investment in taxable securities.

3. Estimate of revenue loss to Federal Government through wholly tax-exempt securities outstanding January 1, 1922.

According to reports, there were issued during the calendar year 1921 fully tax-exempt securities of States and municipalities to the aggregate amount of about \$1,100,000,000, and the indications are that further issues will follow during the current year in substantial volume. Fully tax-exempt land bank bonds, Federal and Joint Stock, to an amount exceeding \$100,000,000, were also issued during 1921, and further issues are in prospect. The Federal Government, on the other hand, has adopted the policy of not issuing fully tax-exempt obligations of its own, and its current offerings must be sold in competition with the fully tax-exempt offerings of States and cities.

The most important consideration is that the existence of the growing mass of tax-exempt securities, coupled with the extremely high surtax rates still imposed by law, tends to drive persons of large income more and more to invest in wholly exempt securities issued and still being issued by States and municipalities and heretofore issued by the Federal Government. The result is to impair the revenues of the Federal Government and to pervert the surtaxes, so that instead of raising revenue they frequently operate rather to encourage investment in wholly tax-exempt securities, and even to encourage the issue of such

securities by States and municipalities. This process tends to divert investment funds from the development of productive enterprises, transportation, housing, and the like, into non-productive or wasteful State or municipal expenditures, and forces both the Federal Government and those engaged in business and industry to compete with wholly tax-exempt issues and on that account to pay higher rates of interest.

The greatest value of the full exemption from taxation arises, of course, from the exemption it confers in respect to Federal income surtaxes, and the constantly increasing volume of tax-free securities therefore constitutes a real menace to the revenues of the Federal Government. At the same time it makes the high surtaxes operate as inducements to investment in non-productive public indebtedness and is gradually destroying them as revenue producers. As a consequence, the yield of the surtaxes is dwindling and there is a premium on the issue of bonds of States and cities. In the last analysis this is at the expense of the Federal Government, and it is having a most unfortunate and far-reaching effect upon the development of the whole country, because of the diversion of wealth from productive enterprise.

The problem is one of exceptional difficulty, and it is not easy to point to a practicable remedy. But the problem is none the less real, and it is important to do whatever can be done to meet it. One angle of approach is through the proposed Constitutional amendment; another is through the revision of the surtax rates to remove the heavy premium on tax-free securities. It will be helpful to the whole situation if the matter may have early consideration by the Committee,

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with a view to appropriate action.

Sincerely yours,

(Signed) A. W. Mellon,

Secretary.

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

7 enclosures.

inclosure to REPLY
dated 11/6/21

TREASURY DEPARTMENT
WASHINGTON

November 10, 1921.

My dear Congressman:

I received your letter of November 2, 1921, with the enclosed copy of the Joint Resolution (H. J. Res. 211), which you introduced on October 25th, proposing an amendment to the Constitution of the United States to restrict further issues of tax-exempt securities. I had already noted that this Joint Resolution followed the draft submitted with the Secretary's letter of September 23rd. In response to the request of the Chairman of the Committee on Ways and Means, to which the Joint Resolution was referred, the Secretary has now expressed his further views in the matter in a letter to the Committee dated November 4, 1921, a copy of which is enclosed for your information.

I have examined the suggested substitute resolution enclosed with your letter of November 2nd, and have several comments. I should say that the chief objection to the substitute was a practical one, namely, that it includes provisions with respect to the taxation of salaries of public officials of the several States and of the political subdivisions thereof which would tend to create opposition to the Constitutional amendment as a whole, entirely out of proportion to the benefits to be derived from this particular change. It may be that the salaries of such officials ought to be subject to the Federal income tax, and undoubtedly the present situation results in some discrimination in favor of State and municipal officials as against Federal officials and other individuals. It will be exceedingly difficult in any circumstances, however, to get three-fourths of the States to ratify a

Constitutional amendment to restrict the further issue of tax-exempt securities, and to add to these difficulties by giving the State and local officials who are likely to be most active in the several States a definite personal interest against the amendment might easily defeat the whole proposition. It may also be said that notwithstanding the present discrimination in favor of State and local officials, the tax-exempt status of their salaries results, after all, in only a slight increase in their compensation, and that for the most part the State and local officials are not so highly paid as to make this extra compensation any crying evil. In other words, while the proposed substitute may be entirely right in theory as to salaries of State and local officials, and conversely as to Federal officials in respect of State and local taxation, as a practical matter this feature of it would probably endanger the really important part of the amendment.

The substitute also inserts in the form of a proviso the condition that incomes derived from securities issued by or under the authority of the United States must be taxed by the United States before the United States has power to tax incomes from securities issued by or under the authority of the several States, and makes the same change with respect to the taxation by the States of incomes derived from securities issued by or under the authority of the United States. The provision as to taxation by the States has been altered, moreover, so as to remove the limitation to "residents thereof" in the two places where it appeared in the Secretary's draft, and under both provisos "incomes derived from all securities" issued by themselves after the ratification of the amendment would have to be taxed before there would

be power on the part of the Federal taxing authorities, or State and local taxing authorities, as the case might be, to tax incomes derived from securities issued by the other. The word "all" would seem to be unnecessarily restrictive, and the omission of the limitation of the taxing power of the States to incomes derived by "residents thereof" might open up securities issued by or under the authority of the Federal Government to double taxation by the States. I am therefore inclined to believe that the phraseology of the amendment proposed by H. J. Res. 211 is better, in that it makes more clear the reciprocal character of the change and gives better protection against discrimination. The intent of the conditions is to insure that there will be mutuality, and this is provided for best by words like "if, when and as" or "in the same manner and to the same extent that." As a matter of fact there is much to be said for making even H. J. Res. 211 more clear in this respect and using the words "if, when and as" or "in the same manner and to the same extent that" or other similar words. If the condition is stated simply in the form of a proviso, the power to tax might arise in favor of the Federal or State Governments from the mere fact of taxation of their own securities, though the taxation were not in any proper sense mutual, or were even discriminatory. It might thus be said, for example, that incomes from 4 and $4\frac{1}{2}$ per cent Liberty bonds are now "taxed by the United States," in that the Federal income surtaxes and profits taxes apply to such incomes, subject to certain limited exemptions.

Very truly yours,

(Signed) S. P. Gilbert, Jr.

Hon. Louis T. McFadden,
Chairman, Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

1 enclosure.

Inclosure to Memo
dated 1/16/22

TREASURY DEPARTMENT
WASHINGTON

September 23, 1921.

My dear Mr. Chairman:

I am enclosing herewith a copy of my letter of this date to Congressman McFadden in reply to his letter of August 27, 1921, requesting my opinion with respect to H. J. Resolution 102. I understand that this resolution is pending before the Committee on Ways and Means and I am, therefore, sending you the enclosed copy of my letter to Congressman McFadden for your information.

Very truly yours,

(Signed) A. W. Mellon,

Secretary.

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

1 enclosure.

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	\$282,917,900
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	3,270,704,038
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	2,379,026.23	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	13,586,024.42
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	1,610,587,380.88
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	9,483,485.56	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.....	10,768,625.62	7,150,954.20	6,966,718.38	24,886,298.20	4,775,590.53	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	1,494,698.43	1,169,488.51	1,985,647.11	4,649,834.10	5,415,358.40
United States Shipping Board.....	33,989,454.67	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	1,235,031.64	1,636,788.74	1,769,875.59	1,947,735.42	158,043,854.33	1,305,406.26	144,962,712.65	1,228,472,186.61
Grain Corporation.....	90,353,411.42			90,353,411.42	204,062,450.80	1,953,556,575.54	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	4,804,896.59	15,516,622.44	19,987,898.41
Interest on public debt.....	136,351,254.07	342,067,610.37	171,906,101.93	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.....	1,180,081,991.37	1,256,293,010.25	1,249,756,856.95	3,686,131,858.57	2,161,871,485.88	1,341,912,078.39	1,135,800,818.20	4,639,584,382.45	5,945,397,399.94
Deduct unclassified repayments, etc..	1,898,151.75	8,457,743.63	2,571,299.54	4,988,292.34	8,014,830.75	2,518,657.34	4,970,611.11	7,795,784.52	4,399,847.00
Total.....	1,180,980,143.12	1,247,835,266.62	1,252,328,156.49	3,681,143,566.23	2,153,856,655.11	1,347,101,735.73	1,130,830,207.09	4,631,788,597.93	5,940,997,552.94
Panama Canal.....	2,965,341.14	3,063,590.56	5,921,480.58	11,950,412.28	1,504,343.86	3,701,460.85	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.....	1,250,849,556.65	1,257,164,776.40	1,275,757,663.69	3,783,771,996.74	2,409,292,944.96	1,437,592,164.18	1,181,291,689.80	5,028,176,798.94	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	48,180,569.48	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	1,789,900.00	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.....	2,379,808,266.11	2,565,469,099.03	1,632,559,650.01	6,577,837,015.15	5,962,307,425.57	2,535,545,576.98	4,805,304,100.77	13,303,157,103.32	17,088,039,723.62

¹ Deduct excess of credits.

² Add.

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.....	\$40,653,320.31	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	142,840,438.13	558,292,565.29
Panama Canal tolls, etc.....	1,093,908.53	2,607,734.32	5,658,787.99	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.....	189,401,005.28	149,171,837.94	106,017,662.41	444,590,506.63	960,968,422.38
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.....	\$24,051,684,728.28
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	251,622,538.19	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.....	3,938,225,000.00	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

Inclosure to Memo
dated 1/10/21
Encl. to S. 1/16/22

TREASURY DEPARTMENT
WASHINGTON

November 4, 1921.

Dear Mr. Chairman:

I received your letter of October 27, 1921, with the enclosed copy of the Joint Resolution introduced by Mr. McFadden (H.J. Res. 211), proposing an amendment to the Constitution of the United States to restrict the further issuance of tax-exempt securities. This amendment is in the form suggested by the Treasury in my letter of September 23, 1921, to Congressman McFadden, a copy of which is enclosed for your information. This letter outlines the Treasury's general views with regard to the proposed Constitutional amendment.

I think it would be helpful if the present Congress, as a part of the tax revision program, would take some action to propose to the States a Constitutional amendment to restrict future issues of tax-exempt securities, and that the amendment in the form introduced by Mr. McFadden merits the serious consideration of the Committee on Ways and Means. At the least, it offers the basis for a thoroughgoing treatment of the tax-exempt security problem. The existence of the present great mass of about \$10,000,000,000 of fully tax-exempt securities, with the prospect of continued issues of tax-exempt securities unless some restrictive amendment is adopted, necessarily tends to defeat the surtaxes imposed by the revenue laws, while the combined effect of the high surtaxes and the unlimited volume of tax-exempt securities is inevitably to

divert capital which would otherwise be employed in productive enterprise into relatively unproductive public expenditure. I believe that there would be nothing in the long run more helpful to the recovery of business and industry in the country, and at the same time nothing better calculated to protect the Government's own revenues, than a revised system of taxation which not only moderates the surtaxes but also takes steps to stop the diversion of investment funds into tax-exempt securities.

Very truly yours,

(Signed) A. W. MELLON

Secretary.

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

1 enclosure.

Inclosure to Memo
dated 11/4/21
Encl. to R. 11/6/22

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."

January 12, 1922.

MEMORANDUM FOR SECRETARY:

(In re tax-exempt securities).

The Bureau of the Census reports that for the years 1913 and 1919, the total indebtedness of the States was as follows:

1913 - - - - -	\$422,796,525
1919 - - - - -	744,582,933

This would indicate a total indebtedness of the States, as of January 1, 1920, of about \$775,000,000.

The Bureau of the Census reported the total indebtedness of County and minor civil divisions of the States, which includes all cities, towns, etc., as of 1913, at \$4,075,152,904. This included \$3,475,954,353 exclusive of Sinking Fund assets. This indebtedness probably increased by January 1, 1920 to about \$5,595,000,000. That is, the total indebtedness of the States and their minor civil divisions as of January 1, 1920, was about \$6,370,000,000.

According to the financial press, about \$672,000,000 of new indebtedness was added during the year 1920, and about \$1,100,000,000 for the year 1921. This would make the total indebtedness of the States and minor political subdivisions thereof as of January 1, 1922, \$8,142,000,000.

From this the estimated total tax-free securities outstanding, as of January 1, 1922, may be tabulated as follows:

State, County and minor political subdivisions of the States, - - - - -	\$8,142,000,000
U. S. tax-free bonds (net outstanding) - - - - -	2,184,000,000
Federal Farm Loan Bonds (net outstanding) - - -	284,000,000
* Bonds of Insular possessions (net outstanding) -	50,000,000
Total: - - - - -	\$10,660,000,000

This estimate may be fairly taken as a maximum, as no allowance is made in the computation for any debt maturing since July 1st, 1919.

(*Philippine Islands, Hawaii and Porto Rico.)

(Sgd.) Jos. S. McCoy

Government Actuary.

January 14, 1922, Inclosure to Memo

dated 1/16/22

MEMORANDUM FOR SECRETARY;

LOSS TO GOVERNMENT THROUGH TAX-FREE SECURITIES.

Estimated total of all tax-free securities issued in the United States,
outstanding January 1, 1922, - - - - - \$10,660,000,000

Of this amount it is probable that say \$5,660,000,000 is held by Corporations, such as Insurance, Surety and Bonding companies, Banks and Trust companies, etc., which are required to retain certain reserves. Many States require these reserves held by concerns doing business therein to be in the form of local state and municipal securities. A taxable security to yield the same revenue, after paying a tax of $12\frac{1}{2}\%$, as does a 5% tax-exempt security, must yield 5.714%. That is, on an investment of \$100,000 by a corporation, the advantage of a tax-free investment would be \$714.00 per year, as compared with a taxable investment. As a large percentage of insurance, banking and surety companies are required to invest in these tax-free securities, they would still be obliged to invest in them if they were taxable, so it would seem safe to say that, if they were all made taxable, the gain to the Federal Government in tax from corporation-held tax-exempt securities would be not in excess of \$35,000,000 per annum. We must also remember that all commercial stocks are now tax-exempt in the hands of corporations, without materially reducing their taxes. Of the remaining \$5,000,000,000 in tax-exempt securities, held by individuals, partnerships and abroad, it is safe to say that upon about \$2,500,000,000 the gain in tax would be nil, and that upon the remaining \$2,500,000,000, about \$85,000,000. That is, if all tax-exempt securities outstanding January 1, 1922 were made taxable, the gross increase in revenue to the Government would be approximately \$120,000,000.

There is little doubt that under these conditions the future investor in what are now tax-exempt securities, would demand that they bear a higher rate of interest or be sold at a discount, sufficient at least to meet this tax.

(Sgd.) Jos. S. McCoy

Government Actuary.

January 14, 1922.

ADVANTAGE OF INVESTING IN TAX-FREE SECURITIES AS COMPARED WITH A LIKE INVESTMENT IN TAXABLE SECURITIES.

- I. In each case \$40,000 is assumed to be invested in a tax-free 5% security and by comparison in a taxable stock bearing the necessary rate of interest so as to yield the same income, after paying the income tax of the existing law.

Net income of investor exclusive of that from the above investment.	Net income of investor from the above investment.	TAX. Sur-tax on dividends.	Income from taxable stock before paying tax.	Necessary rate of interest of taxable security.
	With tax-free security.	With taxable stock.		
\$4,000	\$2,000	\$2,000	\$0.00	\$2,000.00 5.00 %
16,000	2,000	2,000	105.26	2,105.26 5.26 %
28,000	2,000	2,000	272.73	2,272.73 5.68 %
40,000	2,000	2,000	439.02	2,439.02 6.10 %
60,000	2,000	2,000	777.78	2,777.78 6.94 %
80,000	2,000	2,000	1,225.81	3,225.81 8.06 %
100,000	2,000	2,000	1,846.15	3,846.15 9.62 %
200,000	2,000	2,000	2,000.00	4,000.00 10.00 %
500,000	2,000	2,000	2,000.00	4,000.00 10.00 %
1,000,000	2,000	2,000	2,000.00	4,000.00 10.00 %

- II. Advantage of investing in a tax-free security, as compared with any other form of investment when the income is subject to both normal and sur-tax, such as a mortgage, commercial bond, etc.:

In each case \$40,000 is assumed to be invested in a tax-free security, and by comparison, the same amount in the other form of investment, yielding the necessary rate of profit, so as to give the same income after paying the income tax of the existing law. The investor is assumed to be married, without dependents.

Net income of investor exclusive of that from the above investment.	: Net income of investor from the above investment, after paying income tax on same.	: Total tax on receipts from above investment	: Income from taxable security before paying tax.	: Necessary rate of interest of taxable security.	
	: With : tax-free : security	: With : taxable : security			
\$500	: \$2,000	: \$2,000	: \$0.00	: \$2,000.00	: 5.00 %
4,000	: 2,000	: 2,000	: 80.00	: 2,080.00	: 5.20 %
16,000	: 2,000	: 2,000	: 265.26	: 2,265.26	: 5.66 %
28,000	: 2,000	: 2,000	: 432.73	: 2,432.73	: 6.08 %
40,000	: 2,000	: 2,000	: 599.02	: 2,599.02	: 6.50 %
60,000	: 2,000	: 2,000	: 937.78	: 2,937.78	: 7.34 %
80,000	: 2,000	: 2,000	: 1,385.81	: 3,385.81	: 8.46 %
100,000	: 2,000	: 2,000	: 2,006.15	: 4,006.15	: 10.02 %
200,000	: 2,000	: 2,000	: 2,160.00	: 4,160.00	: 10.40 %
500,000	: 2,000	: 2,000	: 2,160.00	: 4,160.00	: 10.40 %
1,000,000	: 2,000	: 2,000	: 2,160.00	: 4,160.00	: 10.40 %

From these tables it is observed that there is an advantage to the investor in tax-exempt securities yielding a 5% income, as compared with an investment of the same sum in the stock of a corporation where the return from that stock is less than from 5% to 10%, depending upon the taxable net income of the investor. In case of an investment of the same sum in a mortgage, corporate bond, or other completely taxable form of investment the advantage exists, unless this latter investment yields from 5% to 10.40%, depending upon the net income.

Where the amount invested is greater than \$40,000, the upper limit will be the same, but the advantage will be somewhat extended where the net income from other sources is small or comparatively small, as is shown in the table below.

INVESTMENT OF \$1,000,000 IN A 5% TAX-EXEMPT SECURITY AS COMPARED WITH THE INVESTMENT OF THE SAME SUM IN COMMERCIAL STOCKS.

Net income of investor exclusive of that from the above investment	Net income of investor from the above investment, after paying income tax on same.	TAX. Sur-tax on dividends	Income from taxable stock before paying tax.	Necessary rate of interest of taxable security.
	: With : tax-free : security :	: With : taxable : stock :	:	:
\$4,000	: \$50,000 : \$50,000 :	\$7,611.11 :	\$57,611.11 :	5.76 %
16,000	: 50,000 ; 50,000 :	13,111.11 :	63,111.11 :	6.31 %
28,000	: 50,000 : 50,000 :	20,037.74 :	70,037.74 :	7.00 %
40,000	: 50,000 : 50,000 :	28,923.08 :	78,923.08 :	7.89 %
60,000	: 50,000 : 50,000 :	38,076.92 :	88,076.92 :	8.81 %
80,000	: 50,000 : 50,000 :	44,509.80 :	94,509.80 :	9.45 %
100,000	: 50,000 : 50,000 :	47,058.82 :	97,058.82 :	9.71 %
200,000	: 50,000 : 50,000 :	50,000.00 :	100,000.00 :	10.00 %
500,000	: 50,000 : 50,000 :	50,000.00 :	100,000.00 :	10.00 %
1,000,000	: 50,000 : 50,000 :	50,000.00 :	100,000.00 :	10.00 %

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

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, January 24, 1922.

DEAR MR. CHAIRMAN:

I received your letter of January 21, 1922, and am glad, in accordance with your request, to present the latest figures as to the probable receipts and expenditures of the Government for the fiscal years 1922 and 1923, and to indicate in that connection what public debt operations the Treasury will have to carry on between now and June 30, 1923, in order to finance its current requirements and provide for maturing obligations. I am at the same time transmitting for your information the four attached statements as to receipts and expenditures and the public debt.

It appears from these statements that for 1922 the budget estimates indicate a deficit of over 24 million dollars, and for 1923 a deficit of over 167 million dollars. These figures make no allowance for expenditures not covered by the budget, as, for example, 50 million dollars already requested by the United States Shipping Board for the settlement of claims, 7 million dollars to be spent by the United States Grain Corporation on account of Russian relief under the act approved December 22, 1921, \$5,000,000 to be paid as the 1923 installment under the treaty with Colombia, and a possible 50 millions on account of additional compensation to Government employees, a total of 112 millions, chiefly for 1923. The results of the first half of the fiscal year 1922, after making due allowance for extraordinary items, indicate that the budget estimates for the year are substantially correct. It is still too early to say whether deficits can be avoided, but it is almost certain that in neither 1922 nor 1923 will there be any surplus. At any rate, it is clear that in order to balance the budget, expenditures must be still further reduced, rather than increased, and that the net reductions below the budget figures within the two years must aggregate about 300 million dollars in order to overcome the indicated deficits. At the same time the Government faces a heavy shrinkage in receipts, and internal-revenue collections in particular are subject to great uncertainty. As a matter of fact, in view of the depression in business, there is grave doubt whether the estimates of receipts which appear in the budget can be realized, and up to date the shrinkage has rather more than kept pace with the shrinkage in expenditures. It is clear that under these conditions there is no room for new or extraordinary expenditures, and that if new items should be added which are not included in the budget, it would be necessary to make simultaneous provision for the taxes to meet them.

One of the chief factors in the gradual return to normal conditions throughout the country has been the marked reduction in Federal expenditures which has already occurred, and this has in turn permitted the lightening of the burden of taxation. What has been accomplished along these lines within less than a year, through the cooperation of the Congress and the Executive, makes a concrete record of achievement in economy which is worthy of our highest efforts to maintain. The economies effected, moreover, have been made without stinting in any way the relief of disabled veterans of the late war, for the figures show that the Federal Government spent for this purpose in the fiscal year 1921 about 380 million dollars and will spend for the same purpose in the fiscal year 1922, and again in the fiscal year 1923, about 450 millions a year, or more than will be spent for any other one purpose except interest on the public debt.

The overshadowing problem of the Treasury at this time, of course, is the handling of the public debt, and particularly the conduct of the refunding operations which will be necessary within the next year and a half on a scale unprecedented in times of peace. Some progress has been made in these operations, but the great bulk of the refunding still remains to be done. The gross public debt of the Government on December 31, 1921, on the basis of daily Treasury statements, amounted to \$23,438,984,351, of which almost 6½ billion dollars falls due within the next 16 months, over 3½ billions of it in the form of Victory notes, which mature May 20, 1923, about \$2,200,000,000 in the form of Treasury certificates, which mature at various dates within a year, and nearly 700 millions in the form of war savings certificates, which mature January 1, 1923, or may be redeemed before that time. The refunding of this vast maturity will require the Treasury's constant attention from now on. Altogether it makes up an amount almost as large as the Fourth Liberty Loan, and considerably more than the First and Second Liberty Loans combined. The Liberty Loans were floated during the stress of war, through great popular drives and with the help of a country-wide Liberty Loan organization that comprised perhaps 2 million persons. To conduct refunding operations on a similar scale in time of peace, to the amount of 6½ billions of dollars, is a task of unparalleled magnitude, and it is of the utmost importance to the general welfare that it be accomplished without disturbance to business or interference with the normal activities of the people. This can not be done if the refunding is embarrassed by other operations.

The greatest problem is the Victory Liberty Loan, which amounted to \$3,548,000,000 on December 31, 1921. A maturity of this size is too large to pay off or refund at one time, and it is accordingly necessary that the Treasury should adopt every means at its command to reduce the outstanding amount in advance of maturity. To this end it will be the Treasury's policy to continue to issue short-term notes from time to time when market conditions are favorable and to use the proceeds to effect the retirement of Victory notes, accomplishing this, if they can not be had otherwise, through the redemption of part of the notes before maturity. It will likewise be the policy, so far as possible, to apply the sinking fund and other special funds available for the retirement of debt to the purchase or redemption of Victory notes. The \$2,200,000,000 of Treasury certificates outstanding and the \$700,000,000, or thereabouts, of war savings certificates raise similar problems and will likewise require refunding operations on a large scale during the next year and a half. The Treasury has already placed on sale, on December 15, 1921, a new issue of Treasury savings certificates, which is designed to provide in part for the outstanding savings certificates to be redeemed. It is clear, however, that an important part of the maturity on January 1, 1923, will have to be refunded, at least temporarily, into other obligations. The bulk of the Treasury certificates of indebtedness will also have to be refunded, probably into other Treasury certificates, for it is almost necessary, while Government expenditures are so large and tax payments so heavy, to float a substantial amount of Treasury certificates in order to carry on current operations without money strain.

If the situation continues to develop in an orderly way, and no complications are introduced in the form of extraordinary expenditure which would force new borrowings, the Treasury expects to be able to proceed with the program already outlined, and such other refunding operations as may prove to be advisable, within the limits of its existing authority and without interference with the business of the country or disturbance to the investment markets. The time is coming, perhaps in the near future, when it will be possible to undertake refunding operations for a longer term with a view to the distribution of the debt among investors on a more permanent basis. It is important in this connection, however, not to overlook one special characteristic of the Treasury's public debt operations since August 31, 1919, when the gross debt reached its peak, namely, that the operations since that date have been accompanied by gradual but steady debt retirement and that even the refunding operations now in prospect will not increase the public debt. Generally speaking, the Treasury has been floating a constantly decreasing total volume of securities and its borrowings have accordingly not taken new money or absorbed funds that would otherwise go into business. If the Government, on the other hand, were increasing the public debt, quite different problems would arise. Treasury offerings

would then take up new money and there would be danger of inflation, of higher rates for money, and of strain on the investment markets, with consequent prejudice to the Government's own inevitable refunding operations and to business and industry generally. The whole character of the operations would be altered.

The estimates which have been given as to the prospects for the fiscal years 1922 and 1923 and the program which has been outlined for the refunding of the short-dated debt do not make allowance for any extraordinary expenditures within the next few years for a soldiers' bonus or so-called adjusted compensation for veterans of the World War. The figures show that there will be no available surplus, but more probably a deficit, and that with the enormous refunding operations which the Treasury has to conduct it would be dangerous in the extreme to attempt to finance the expenditures involved in the bonus through new borrowings. The position of the Treasury remains unchanged, but if there is to be a soldiers' bonus, it is clear that it must be provided for through taxation, and through taxation in addition to the taxes imposed by existing law.

It is difficult to estimate how much additional taxation would be necessary, for the last bonus bill considered was S. 506, reported by the Committee on Finance of the Senate on June 20, 1921. From the report of the committee and the estimates of the Government Actuary it would appear that the total cost of the bonus under this bill would be about \$3,330,000,000, of which at least \$850,000,000 would fall in the first two years of its operation, with varying amounts over intervening years and an ultimate payment in the twentieth year of over \$2,114,000,000. The minimum cost would apparently be about \$1,560,000,000, in case substantially all the veterans should take the cash plan, and the maximum cost about \$5,250,000,000, in case substantially all of the veterans should elect to take the certificate plan in lieu of cash. If an unexpectedly large proportion of the veterans should choose cash, the cost within the first two years might run well over \$1,000,000,000. It would seem reasonably certain, however, that at least one-half would elect the cash-payment plan, in which event the cost in the first two years would be about \$850,000,000 and the total cost would fall between the two extremes, or at about \$3,330,000,000. These estimates take no account of expenses of administration or the possible cost of vocational training aid, farm or home aid, or land settlement aid to veterans who elect such benefits, which would involve substantial additional cost. The expenditures involved, moreover, would be in addition to already substantial expenditures on account of veterans of the World War, chiefly for relief to disabled veterans, which amount to about \$450,000,000 a year according to the estimates for 1922 and 1923. The Government's obligation to the disabled veterans is continuing and paramount, and heavy expenditures for their relief will be necessary for many years to come.

On the most conservative estimates, therefore, the cost of a soldiers' bonus in the first two years would probably be not less than \$850,000,000. This would necessitate additional tax levies to a corresponding amount during the same period. The taxes already in force are too onerous for the country's good and are having an unfortunate effect on business and industry. The field of taxation, moreover, has already been so thoroughly covered, owing to the extraordinary revenue needs growing out of the war, that it is exceedingly difficult to discover new taxes that could properly be levied to yield as much as 850 millions within two years. In these circumstances, should Congress determine to adopt the policy of paying a soldiers' bonus, it would become necessary to impose general taxes on broad classes of articles or transactions in order to pay it. For such taxes, in their nature of wide application, much might be said as substitutes for existing taxes, but the Treasury would hesitate to recommend them as additional taxes, except to meet some extraordinary purpose.

Whatever additional taxes might be levied, provision for them would have to be made in the same bill with the bonus. The budget system is now firmly established, and the budget already submitted has pointed out the relation between receipts and expenditures for this year and next year. If the Congress decides to authorize large expenditures outside of the budget, it is fundamental that it should make simultaneous provision for the additional taxes necessary to meet them.

It is also well to keep in mind that no indirect means of financing the bonus could make it any less an expense that will have to be borne in the long run by the taxpayer. Thus it would be futile, as well as unwise, to attempt to provide for the bonus through the use of the principal or interest of the foreign obligations held by the United States or through the sale of any such obligations to the public. For the most part, the foreign obligations are still in the form of demand obligations and it is impossible in the present state of international finance and in advance of funding arrangements to estimate what may be collected on them in the near future by way of principal or interest. The obligations are not in shape, moreover, to sell to the public, and to offer them to investors with the guaranty of this Government would seriously interfere with our own refunding operations, upset the security markets, and in the long run prove more expensive to this Government than would the sale of its own direct obligations. At the same time, it would enormously complicate the international situation and certainly embarrass the funding negotiations. Even if enough could be realized on the foreign debt in time to pay the bonus, it would accomplish nothing to set it aside for that purpose. As the law now stands, and in justice to the millions of Liberty bond holders, the Government is bound to apply any principal payments by foreign Governments, as well as any proceeds of sale, to the retirement of outstanding Liberty bonds, about 10 billions of which were issued in the first instance to provide for the advances to foreign Governments. Interest collected on the foreign obligations should likewise go to provide for the interest on Liberty bonds, and it has been the Treasury's plan in the funding to adjust the dates and amounts of the interest payments as nearly as may be to the interest payments on our own bonds. In any event, it is clear that if the proceeds of the foreign obligations should be applied to different purposes, the Government of the United States to that extent would have to provide for payment of the principal and interest of the Liberty bonds from other sources, which means that the people would have to pay taxes for this purpose that would otherwise be unnecessary. The plan to use the foreign obligations to pay a soldiers' bonus, therefore, would still leave the burden on the shoulders of the American taxpayer.

I have made this extended analysis of the country's financial position and of the Treasury's plans and prospects for 1922 and 1923 in order that the Congress may have before it in definite form the facts as to what financial consequences the soldiers' bonus would entail and what added burdens it would inevitably place upon the country.

I am sending a copy of this letter to Senator McCumber, for the information of the Committee on Finance of the Senate.

Very truly yours,

A. W. MELLON,
Secretary of the Treasury.

Hon. J. W. FORDNEY,
*Chairman, Committee on Ways and Means,
House of Representatives.*

EXHIBIT A.

Receipts and expenditures for the fiscal year 1921, and estimated receipts and expenditures for the fiscal years 1922 and 1923.¹

[On the basis of daily Treasury statements.]

	Fiscal year 1921.	Fiscal year 1922.	Fiscal year 1923.
RECEIPTS.			
Ordinary:			
Customs.....	\$308,564,391.00	\$275,000,000.00	\$320,000,000.00
Internal revenue—			
Income and profits taxes.....	\$3,206,046,157.74	\$2,110,000,000.00	\$1,715,000,000.00
Miscellaneous internal revenue.....	1,390,389,823.28	1,104,500,000.00	896,000,000.00
Miscellaneous revenue—	4,596,426,981.02	3,214,500,000.00	2,611,000,000.00
Sales of public lands.....	1,530,439.42	1,500,000.00	1,500,000.00
Federal reserve bank franchise tax.....	60,724,742.27	60,000,000.00	30,000,000.00
Interest on foreign obligations.....	31,142,982.51	25,000,000.00	25,000,000.00
Repayments of foreign obligations.....	83,678,223.38	30,500,000.00	30,500,000.00
Sale of surplus war supplies.....	183,602,848.69	141,200,000.00	100,500,000.00
Retirement of capital stock of Grain Corporation.....	100,000,000.00	25,000,000.00	7,000,000.00
Panama Canal.....	12,280,741.79	11,760,000.00	13,315,000.00
Other miscellaneous.....	246,891,610.83	183,993,663.00	196,367,750.00
Total ordinary receipts.....	719,941,588.89	478,953,663.00	404,182,750.00
	5,624,932,960.91	3,968,453,663.00	3,345,182,750.00
EXPENDITURES.			
Ordinary.....	5,115,927,689.30	3,604,980,166.00	3,143,415,927.00
Public debt expenditures chargeable against ordinary receipts:			
Sinking fund.....	261,100,250.00	272,442,200.00	283,838,800.00
Purchases of Liberty bonds from foreign repayments.....	73,939,300.00	30,500,000.00	30,500,000.00
Redemptions of bonds and notes received for estate taxes.....	26,348,950.00	25,000,000.00	25,000,000.00
Retirements from Federal reserve bank franchise tax receipts.....	60,724,500.00	60,000,000.00	30,000,000.00
Total ordinary expenditures (including public debt expenditures chargeable against ordinary receipts).....	422,113,000.00	387,942,200.00	369,338,800.00
	5,538,040,689.30	3,992,922,366.00	3,512,754,727.00
Excess of receipts over expenditures.....	86,892,271.61		
Excess of expenditures over receipts.....		24,468,703.00	167,571,977.00

¹ On same basis as given in Annual Report of the Secretary of the Treasury for 1921 and in the Budget for 1923. The estimates do not include expenditures not covered by the Budget, as, for example, \$50,000,000 requested by United States Shipping Board for settlement of claims, \$7,000,000 to be spent by United States Grain Corporation on account of Russian relief under act approved December 22, 1921, \$5,000,000 to be paid as the 1923 installment under the treaty with Colombia, and a possible \$50,000,000 on account of additional compensation to government employees.

EXHIBIT B.

Preliminary statement showing classified receipts and expenditures of the Government from July 1, 1921, to Dec. 31, 1921, with comparative figures for the fiscal year 1921.

[On the basis of daily Treasury statements.]

	July 1 to Sept. 30, 1921.	Oct. 1 to Dec. 31, 1921.	Total July 1 to Dec. 31, 1921.	July 1 to Sept. 30, 1920.	Oct. 1 to Dec. 31, 1920.	Total July 1 to Dec. 31, 1920.	Jan. 1 to Mar. 31, 1921.	Apr. 1 to June 30, 1921.	Total July 1, 1920, to June 30, 1921.
RECEIPTS.									
Ordinary:									
Customs.....	\$69,602,044.73	\$77,406,316.57	\$147,008,361.30	\$84,058,024.90	\$66,039,240.83	\$150,097,265.73	\$67,842,176.13	\$90,624,949.14	\$308,564,391.00
Internal revenue—									
Income and profits tax.....	632,089,027.52	607,327,104.03	1,239,416,131.55	840,653,320.81	787,550,609.73	1,628,203,930.54	852,277,918.48	725,584,308.72	3,206,046,157.74
Miscellaneous internal revenue.....	364,401,943.96	324,343,658.63	688,745,602.59	399,726,191.93	370,338,119.27	770,064,311.20	318,900,145.87	301,416,366.21	1,390,380,823.28
Miscellaneous revenue.....	71,902,681.12	161,352,750.52	233,255,431.64	214,542,816.77	200,909,310.39	415,452,127.16	142,840,438.13	149,368,281.81	707,660,847.10
Panama Canal tolls, etc.....	2,844,204.37	3,193,325.92	6,037,530.29	1,093,908.53	2,607,734.32	3,701,642.85	5,658,787.99	2,920,310.95	12,280,741.79
Total.....	1,140,839,901.70	1,173,623,155.67	2,314,463,057.37	1,540,074,262.94	1,427,445,014.54	2,967,519,277.48	1,387,519,466.60	1,269,894,216.83	5,624,932,960.91
Excess of ordinary receipts over ordinary expenditures.....	261,339,552.33	215,216,072.24	476,555,624.57	289,224,706.29	170,280,238.14	459,504,944.43	111,761,802.91	.....	509,005,271.61
Excess of ordinary expenditures over ordinary receipts.....	.....	.....	.....	.....	.....	.....	.....	62,261,475.73	.....
Excess of ordinary receipts over total expenditures (public debt and ordinary) chargeable against ordinary receipts.....	173,753,452.33	43,650,472.24	217,403,924.57	241,942,456.29	148,322,288.14	390,264,744.43	.....	.....	86,723,771.61
Excess of total expenditures (public debt and ordinary) chargeable against ordinary receipts over ordinary receipts.....	.....	.....	.....	.....	.....	.....	81,092,247.09	222,478,725.73	.....
EXPENDITURES.									
Ordinary:									
Legislative establishment.....	4,422,186.94	4,524,830.93	8,947,017.87	4,927,391.02	4,905,522.01	9,832,913.03	4,803,483.14	4,346,169.00	18,982,565.17
Executive proper.....	57,002.42	56,302.45	113,304.87	54,853.70	50,913.84	105,767.54	49,260.76	55,028.49	210,056.79
State Department.....	2,048,133.03	2,314,077.43	4,362,210.46	2,322,749.39	1,827,909.99	4,150,659.38	2,242,127.40	2,388,010.06	8,780,796.84
Treasury Department.....	80,653,168.46	62,927,875.05	143,581,043.51	96,098,410.19	82,724,413.76	178,822,823.95	181,790,477.00	128,023,532.15	488,636,833.10
War Department.....	142,412,828.14	102,082,570.14	244,495,398.28	274,367,808.97	268,000,064.23	542,367,873.20	307,518,350.65	251,728,789.17	1,101,615,013.32
Department of Justice.....	3,928,980.20	4,597,859.62	8,526,839.82	4,183,089.23	3,958,629.16	8,141,718.39	4,425,703.15	4,638,996.49	17,206,418.03
Post Office Department.....	23,876,077.43	10,707,289.90	34,583,367.33	1,407,168.05	10,602,201.47	12,009,369.52	25,956,317.87	97,393,421.28	135,359,108.17
Navy Department.....	148,290,248.45	122,453,736.65	270,743,985.10	161,294,823.36	163,805,503.61	325,100,326.97	177,462,791.62	144,810,716.99	650,373,835.58
Interior Department.....	85,889,600.83	85,289,416.67	171,179,017.50	87,118,246.55	82,244,026.35	169,362,272.90	82,520,943.00	105,931,677.11	357,814,893.01
Department of Agriculture.....	40,231,388.97	43,901,523.24	84,132,912.21	33,993,228.76	28,975,392.46	62,968,621.22	32,494,508.75	24,374,629.44	119,837,759.41
Department of Commerce.....	6,306,073.59	5,140,372.43	11,446,446.02	10,768,625.62	7,150,954.20	17,919,579.82	6,996,718.38	5,942,463.35	30,828,761.55
Department of Labor.....	1,525,882.17	1,499,420.75	3,025,302.92	2,783,299.26	4,936,890.23	7,720,189.49	1,977,469.34	1,588,149.98	8,502,509.55
Veterans' Bureau*.....	61,353,749.17	113,331,361.80	174,685,110.97	.....	.....	.....	.....	.....	.....
United States Shipping Board.....	51,784,131.28	28,362,085.95	80,146,218.23	33,983,454.67	61,402,975.86	95,386,430.53	2,225,335.06	33,108,502.67	130,723,268.26
Federal control of transportation systems and transportation act, 1920.....	82,615,617.38	180,710,527.15	263,326,144.53	193,583,743.50	185,186,288.24	378,770,031.74	214,217,272.44	137,724,365.80	730,714,669.98
War Finance Corporation.....	132,974,238.61	52,317,650.61	185,291,889.22	22,238,355.21	123,510,031.64	11,271,676.45	16,367,886.74	114,388,888.95	122,028,452.12
Grain Corporation.....	.....	25,000,000.00	25,000,000.00	90,353,411.42	.....	90,353,411.42	.....	.....	90,353,411.42
Other independent offices and commissions*.....	22,665,823.08	6,214,333.41	28,880,156.49	19,863,573.71	25,218,136.75	45,081,710.46	34,341,012.22	40,519,794.05	119,942,516.73
District of Columbia.....	5,651,582.60	6,350,051.44	12,001,634.04	5,015,212.98	5,899,200.33	10,914,413.31	5,226,871.18	6,573,874.11	22,715,158.60
Interest on public debt.....	147,324,108.68	360,915,199.15	508,239,307.83	136,351,254.07	342,067,610.37	478,418,864.44	171,906,101.93	348,819,764.98	999,144,731.35
Total.....	878,112,344.21	957,275,501.47	1,835,387,845.68	1,180,081,991.37	1,256,293,010.25	2,436,375,001.62	1,249,756,856.95	1,323,578,906.17	5,009,710,854.74
Deduct unclassified repayments, etc.....	260,977.03	2419,300.24	2,480,277.30	2,898,151.75	8,457,743.63	7,559,591.88	2,571,299.54	2,406,699.20	922,593.14
Total.....	878,173,321.27	957,694,801.71	1,835,838,122.98	1,180,980,143.12	1,247,835,266.62	2,428,815,409.74	1,252,323,156.49	1,327,644,695.37	5,008,788,261.60
Panama Canal.....	1,327,028.10	712,281.72	2,039,309.82	2,965,341.14	3,063,590.56	6,028,931.70	5,921,480.58	4,510,997.19	16,461,409.47
Purchase of obligations of foreign Governments.....	.....	.....	.....	57,201,633.53	.....	57,201,633.53	16,695,063.91	.....	73,896,697.44
Purchase of Federal Farm Loan Bonds.....	.....	.....	.....	9,702,438.86	6,265,919.22	15,968,358.08	812,962.71	.....	16,781,320.79
Total ordinary.....	879,500,349.37	958,407,083.43	1,837,907,432.80	1,250,849,556.65	1,257,161,776.40	2,508,014,333.05	1,275,757,663.69	1,332,155,692.56	5,115,927,689.30

Panama Canal	878,173,321.27	957,694,801.71	1,835,838,122.08	1,180,980,143.12	1,247,835,266.62	2,428,815,409.74	1,252,328,156.49	1,327,644,695.37	5,008,788,261.60
Purchases of obligations of foreign Gov- ernments	1,367,028.10	712,281.72	2,539,500.82	2,935,341.14	3,063,590.56	6,028,931.70	5,921,480.58	4,510,997.19	16,461,409.47
Purchase of Federal Paper Loan Bonds									
Total	879,540,349.37	958,407,083.43	1,838,377,622.90	1,183,915,484.26	1,250,898,857.18	2,434,844,341.44	1,258,249,636.97	1,332,155,692.56	5,025,249,671.07

Public debt expenditures chargeable against ordinary receipts:									
Sinking fund	81,066,000.00	146,980,700.00	228,046,700.00	5,261,250.00	15,129,000.00	20,390,250.00	124,956,000.00	115,754,000.00	261,100,250.00
Purchases of Liberty bonds from foreign repayments	518,700.00	15,628,650.00	16,147,350.00	38,002,050.00	2,028,250.00	40,030,300.00	475,000.00	33,434,000.00	73,939,300.00
Redemptions of bonds and notes from estate taxes	5,988,400.00	6,328,250.00	12,316,650.00	4,017,900.00	4,666,700.00	8,684,600.00	6,657,650.00	11,006,700.00	26,348,950.00
Retirements from Federal reserve bank franchise tax receipts		2,619,000.00	2,619,000.00				60,724,500.00		60,724,500.00
Retirements from gifts, forfeitures, and other miscellaneous receipts	13,000.00	9,000.00	22,000.00	1,050.00	134,000.00	* 135,050.00	10,900.00	22,550.00	168,500.00
Total public debt expenditures chargeable against ordinary receipts	87,586,100.00	171,565,600.00	259,151,700.00	47,282,250.00	21,957,950.00	69,240,200.00	192,824,050.00	160,217,250.00	422,281,500.00
Total expenditures (public debt and ordinary) chargeable against ordinary receipts	967,086,449.37	1,129,972,683.43	2,097,559,132.80	1,298,131,806.65	1,279,122,726.40	2,577,254,533.05	1,468,581,713.69	1,492,372,942.56	5,538,209,189.30

¹ Deduct excess of credits.

² Add.

* Payments on account of veterans' relief made prior to August 11, 1921, by the War Risk Insurance Bureau are included under "Treasury Department," while similar payments made prior to that date by the Federal Board for Vocational Education are included under "Other independent offices and commissions."

^a The expenditures on account of "Federal control of transportation systems and transportation act, 1920," above, have been reduced during the period from July 1 to Dec. 31, 1921, by \$142,374,992.85 on account of deposits to the credit of the appropriation for "Federal control of transportation systems" of the proceeds of sales of equipment trust notes acquired under the Federal control act approved Mar. 21, 1918, as amended, and the act approved Nov. 19, 1919.

^b Represents reduction in capital stock of United States Grain Corporation effected Oct. 17, 1921, and reflected in "Miscellaneous receipts" in an equal amount. (See note 2, page 2, of daily Treasury statement for Oct. 18, 1921.)

NOTE.—Because of legislation establishing revolving funds and providing for the reimbursement of appropriations, commented upon in the annual report of the Secretary of the Treasury for the fiscal year 1919, p. 126 ff., the gross expenditures in the case of some departments and agencies, notably the War Department, the Railroad Administration, and the Shipping Board, have been considerably larger than above stated. This statement does not include expenditures on account of the Postal Service other than salaries and expenses of the Post Office Department in Washington, postal deficiencies, and items appropriated by Congress payable from the general fund of the Treasury.

EXHIBIT C.

Preliminary statement of the public debt on Dec. 31, 1921.

[On the basis of daily Treasury statements.]

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.....	11,774,020.00		
		\$883,784,050.00	
First Liberty loan.....	1,952,123,150.00		
Second Liberty loan.....	3,313,261,100.00		
Third Liberty loan.....	3,592,593,750.00		
Fourth Liberty loan.....	6,349,411,400.00		
		15,207,389,400.00	
Total bonds.....			16,091,173,450.00
Notes:			
Victory Liberty loan.....			3,548,289,500.00
Treasury notes—			
Series A-1924.....	311,191,600.00		
Series B-1924.....	390,706,100.00		
			701,897,700.00
Treasury certificates:			
Tax.....	1,515,157,500.00		
Loan.....	567,437,500.00		
Pittman Act.....	113,000,000.00		
			2,195,595,000.00
Treasury (war) savings securities (net cash receipts).....			651,844,374.27
Total interest-bearing debt.....			23,188,800,024.27
Debt on which interest has ceased.....			11,867,140.26
Noninterest-bearing debt.....			238,317,186.83
Total gross debt.....			23,438,984,351.36

EXHIBIT D.

Statement showing comparative figures as to short-dated public debt, June 30, 1920, to Dec. 31, 1921.

[On the basis of daily Treasury statements, adjusted to include accrued discount on Treasury (war) savings securities].

	June 30, 1920.	Dec. 31, 1920.	June 30, 1921.	Dec. 31, 1921.
I. Maturities before June 30, 1923:				
Victory notes (mature May 20, 1923).....	\$4,246,385,530.00	\$4,225,970,755.00	\$3,913,933,350.00	\$3,548,289,500.00
Treasury certificates (maturing within a year)—				
Loan and tax.....	2,485,552,500.00	2,300,656,000.00	2,450,843,500.00	2,082,595,000.00
Pittman Act and special issues.....	283,375,000.00	292,229,450.00	248,729,450.00	113,000,000.00
Treasury (war) savings securities, series of 1918 (net cash receipts plus accrued discount to respective dates).....	758,996,409.08	702,520,765.18	675,449,577.13	1,644,090,608.33
	7,774,309,439.08	7,521,376,970.18	7,288,955,877.13	6,387,975,108.33
II. Maturities after June 30, 1923:				
Treasury notes.....			311,191,600.00	701,897,700.00
Treasury (war) savings securities (net cash receipts plus accrued discount to respective dates) series of 1919, 1920, and 1921, maturing, respectively, on Jan. 1, 1924, Jan. 1, 1925, Jan. 1, 1926, and later dates.....	143,172,726.64	143,524,053.78	120,570,010.85	1,118,662,982.07
Total.....	7,917,482,165.72	7,664,901,023.96	7,720,717,487.98	7,208,535,790.40

¹ Partly estimated. The estimated additional discount to accrue on Treasury (war) savings securities of the series of 1918 to Jan. 1, 1923, is about \$19,000,000, which should be added in computing the amount of the maturity.

SPECIAL INSTRUCTIONS TO COLLECTORS OF INTERNAL REVENUE
IN THE STATES OF
ARIZONA, CALIFORNIA, IDAHO, NEVADA, OREGON, UTAH and WASHINGTON.

February 7, 1922.

Under the provisions of Treasury Decision 3280, 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 1922 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 1922, 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. 3280. 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 bank 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.

Under Secretary.

THE TREASURY DEPARTMENT OF THE UNITED STATES.

Address by Eliot Wadsworth, Assistant Secretary of the Treasury,
before the National Civic Federation, Women's Department,
at the Waldorf-Astoria, New York City,
February 8, 1922.

Since Congress created the Treasury Department on September 2, 1789, many and various functions of the Federal Government have been placed in its charge. By reason of his position, the Secretary of the Treasury is Chairman of the Federal Reserve Board; Chairman of the Farm Loan Board, and Chairman of the War Finance Corporation. As the presiding officer of these Boards, his influence is felt in every financial relationship between the Government and the people. A long line of distinguished men beginning with Alexander Hamilton have served as Secretary of the Treasury, and by their upright, patriotic service have established a tradition which makes this position one of great distinction and trust.

The seal now in use by the Treasury was devised by a committee appointed by the Continental Congress in 1778, made up of John Witherspoon, Gouverneur Morris, and R. H. Lee. What the proceedings of this committee were is not related, but the Continental seal may be found on documents dated 1782, and when the Treasury Department was organized in 1789, the seal of the Confederation was continued in use. It bears the inscription in latin, "Seal of the Treasury of North America".

The Treasury of the United States is just a great family exchequer. Whether it is prosperous, or in debt, we are all interested and involved. The Treasury handles the fiscal affairs of the nation for all of us just as the Treasurer of the National Civic Federation handles its financial affairs for all the members. A report of finances is often dry reading, but it always gives facts which are vital to an organization and its members.

FINANCES.

So we will begin by looking at our financial position and operations in a broad way, and as is always well, take the debts first. The United States owes to-day as a public debt almost \$23,500,000,000, of which \$6,500,000,000 falls due within the next sixteen months. The largest maturity is the Victory notes, over \$3,300,000,000, which mature on May 20, 1923; next, the Treasury Certificates of \$2,200,000,000 payable at various dates within a year; and then, nearly \$700,000,000 in the form of War Savings Certificates due on January 1, 1923. Little more than a year later \$700,000,000 additional debt falls due. The promise of the United States to pay its debts when due has never been broken and these bonds and notes are considered to-day the premier security of the world. They must be taken care of and this is a problem of first importance to the Treasury.

FUNDING

The policy has been adopted of renewing these debts, from time to time, always with the effort of getting the due dates separated so that there will be no large maturity at any one time. Already \$700,000,000 notes have been sold maturing a year later than the Victory Loan. A few days ago, \$600,000,000 three-year notes were sold to pay off \$200,000,000 Victory bonds and extend an immediate liability of \$400,000,000 until 1925. This plan will be followed, from time to time, in the future, but to have such a great floating debt is not satisfactory and some day it must be funded. It is easier to appreciate what a task this will be if you recall the First and Second Liberty Loan Campaigns, which together raised \$5,800,000,000. Try to remember the stimulus of war enthusiasm; the two campaigns running each for a month; and then realize that even if they were both repeated with equal success, the results would not pay off the short-time debts of the nation.

INCOME AND EXPENSE (THE BUDGET)

As to the income collected and the expenses of the Government to be paid, here again the Treasury represents all the people and acts as their agent under the orders of Congress in collecting the taxes and in paying the bills.

Actual figures for the fiscal year ended June 30, 1921, and estimated figures for the next two years are as follows:

	Actual Fiscal Year 1921	Estimated Fiscal Year 1922	Estimated Fiscal Year 1923
Income.....	\$5,624,932,960.91	\$3,968,453,663	\$3,345,182,750
Expenditure	5,538,040,689.30	3,992,922,366	3,512,754,727
Excess of receipts over expenditures....	86,892,271.61		
Excess of expenditures over receipts.....		24,468,703	167,571,977

Income which means taxes is down nearly \$2,300,000,000, a great saving to the tax payer.

The reduction in expenses looks like good housekeeping and it is. The greatest effort has been made by the present Administration in that direction. Yet, in spite of a reduction between 1921 and 1923 of over \$2,000,000,000, or nearly 40%, we are facing in 1923 a deficit of \$167,000,000. You might say if there is a deficit, cut the expenses some more. That will be done if possible, but where? Study the figures and you find a large proportion of our expenditures are fixed by definite commitments and can not be reduced.

The largest items are these:

Interest on public debt.....	\$975,000,000
Sinking Fund and other debt charges...	369,000,000
Veterans' Relief.....	455,000,000
Pensions	252,000,000
Total.....	\$2,051,000,000

Here we have nearly 58% of our 1923 budget which can not go down. The War Department, Navy Department and Good Roads account for nearly 27% more. The other 15% carry on the work of the State, Treasury, Justice, Interior, Agriculture and Commerce Departments, together with 21 independent establishments - such as the Shipping Board, Interstate Commerce Commission, Railway Labor Board and others. If we did away with them all, the saving would be little more than 15% of our annual expenditures. It has been said that the budget "has made economy popular and extravagance dangerous". I can assure you that with these facts staring us in the face, economy is popular in the Treasury to-day.

One special point about our federal budget is interesting: 64 widows of the War of 1812 are still receiving pensions; 109 survivors and 2,135 widows of the Mexican war are on the pension roll. If the total cost of the War of 1812 is not yet known, who would dare to estimate the ultimate cost to this country of the great World War.

Already, we are spending 450,000,000 a year to meet a debt of honor to disabled soldiers and sailors and this will continue for many years and probably grow. No one grudges a cent of expense to make life possible and happy to those men, or would consider trying to save on this item.

We now face a bonus bill, of which the minimum cost, if all veterans take the cash payment, is estimated at \$1,560,000,000; the maximum cost may be \$5,250,000,000 in the next twenty years. If that bonus is paid with a deficit already in sight, the cost should be provided by the tax payers now, not later. There should be a tax which will bring the money in as fast as it goes out. We must pay as we go. Unbalanced national budgets are seriously menacing the financial structure of many nations. This nation with all its riches need not and must not drift into such a position and allow its debt to roll up. We have borrowed enough against the future.

One other question of general interest in connection with our expenses, namely, the rate of pay received by Government employees. The Civil Service recorded on November 11, 1918, 917,000 employees, the highest figure ever reached, and on July 31, 1921, 597,000 - a reduction of 320,000. Is there a chance of saving money here, either in the rate of pay or the number of employees? Perhaps a little, but not much. The rate of pay to-day is too low. Of the 63,000 employees in Washington, the average salary is \$1360 a year or \$113 a month. More than one-half of the Treasury employees receive less than \$100 a month. The war bonus of \$240 a year now added to salaries of less than \$2500, because of the high cost of living, will be in force until June 30 of this year unless legislation be passed extending it.

You know well from experience that \$113 a month can not be considered excessive for almost any type of employment. Government employees are allowed thirty days' annual leave with pay, which is rather more than in commercial life, and Government employment has some other attractive features, but in general the Government is not a liberal employer. An attempt to reduce pay would be unfair and unwise, and in my judgment the pay should be raised rather than lowered in many classes.

As to numbers, there has been a tremendous cutting in the last year, in some cases perhaps, more than is safe in view of the work that must be done. Still, there may be a little room for improvement here.

To sum up our expense account, it would appear that the Federal Government had been ordered by the Acts of Congress to carry on certain services for the people and that the services must be discontinued or be paid for from the one possible source of income, namely, taxes.

FOREIGN LOANS

During the war, the United States made advances to foreign governments under the Liberty Bond Acts and holds their notes for \$9,434,774,829.24. Under the Relief Act and under the Act authorizing the sale of surplus war materials by the Secretary of War and the Secretary of the Navy, notes of foreign governments amounting to approximately \$658,000,000 have been received by the Treasury.

A large proportion of these notes are payable on demand with interest over due. The United States is in the position of a creditor holding over-due paper, while the European nations, debtors to the United States, owe each other large amounts and together owe England nearly as much as England owes the United States. Germany, through the reparation agreement, is a large debtor to all of the debtor countries.

This is a tangled situation and such international liabilities, particularly in their present unbusinesslike form, create uncertainty and make the resumption of normal business impossible.

There is no officer in the government with adequate authority to deal with this asset, and the Treasury recommended legislation to cover this need which has now been passed. A commission of five to be known as the World War Foreign Debt Commission with the Secretary of the Treasury as chairman will take up the question of refunding these debts. The work of the Commission will involve perhaps the most intricate and far-reaching financial negotiations that have ever been undertaken and the duties devolving upon the Secretary of the Treasury will be added to in no small measure.

ADVANCES AND LOANS TO RAILROADS.
Under the Transportation Act of 1920

Upon receipt of certificates from the Interstate Commerce Commission, the Treasury pays out funds to the railroads under the Transportation Act, and acts as custodian for the notes and collateral received.

Securities costing over \$300,000,000 are now held.

OPERATIONS

In general, the Treasury Department is charged with the collection of the Federal income, the disbursing of all Federal funds in accordance with the appropriations made by Congress and the issue and retirement of Government securities, currency, paper money, and savings certificates. The custody of the securities and money held by the Government is in the hands of the Treasury and, under its supervision, the manufacture of currency, bank notes, liberty bonds, and other bonds is carried on with all the usual business problems of a manufacturing operation.

The office of the Supervising Architect, the Coast Guard, and the Public Health Service - none of which can in any way be considered as connected with finance - are also in the Treasury organization. Their transfer to other departments has been much discussed and there can be no doubt that this should be done.

TREASURY ORGANIZATION.

Under the supervision of the Secretary, the detailed work is divided between an Under Secretary and three Assistant Secretaries. The Bureaus and Divisions of the Department are allocated to these four men, who direct some 70,000 employees, 20,000 in Washington and 50,000 scattered throughout the country.

BUREAUS AND DIVISIONS

A brief description of the bureaus and divisions of the Treasury follows, and to give some idea of the relative size of the operation, the approximate number of employees is shown. The bureaus which carry on our national financial operations are grouped together, followed by the collecting bureaus. The activities which are not financial are the last three described.

PUBLIC DEBT SERVICE

The Commissioner of Public Debt has under his supervision certain fiscal offices which form one group: the Division of Loans and Currency; the Register of the Treasury; Division of Public Debt Accounts and Audit; Division of Paper Custody; and Savings Division. All transactions in the public debt and paper currency of the United States are handled through these offices with 2,900 employees at an annual cost of about \$4,000,000.

DIVISION OF LOANS AND CURRENCY

Employees - 1678

The issues of bonds, notes and certificates of the United States, with all subsequent transactions in such securities, including exchanges, transfers, conversions and final payment, are handled in this Division. This includes public debt issues of the Philippines, Porto Rico, and the District of Columbia.

During the last fiscal year the turn-over in the public debt amounted to \$19,400,000,000 of issues and \$19,700,000,000 of retirements. Excluding war savings securities, this included the issue of 23,315,735 pieces and the retirement of 41,034,297.

The Division maintains approximately 3,500,000 individual accounts with holders of registered bonds and notes, aggregating more than \$4,100,000,000. Interest checks were made out to these holders in number, 6,700,407, in amount \$164,489,816. Changes of address numbered 111,951.

This Division also is charged with certain matters relating to the issue and redemption of United States paper currency, handling several hundred million pieces each year. The notes unfit for further circulation are destroyed, and a circulation statement issued monthly. On January 1, 1922, there was in circulation \$5,775,400,315, equivalent to \$53.03 per capita.

REGISTER OF THE TREASURY
Employees - 962

This office acts as security auditor and receives every public debt security retired or canceled. The Register receives and examines not only the securities evidencing the public debt, but interest coupons which have been paid by the Treasurer of the United States. During the past year 107,921,393 security pieces were handled and 119,929,574 interest coupons.

DIVISION OF PUBLIC DEBT - ACCOUNTS AND AUDIT
Employees - 144

On the books of this Division all transactions as reported by the various agencies are aggregated and the necessary controls are maintained over public debt transactions.

DIVISIONS OF PAPER CUSTODY
Employees - 34

The distinctive paper used in printing the public debt obligations and the paper currency of the United States, revenue stamps, and other securities is in the custody of this Division from the time it is received from the various contractors until it becomes a finished product.

SAVINGS DIVISION
Employees - 17

This is the organization covering the country with a sub-division in each Federal Reserve district, which sells Treasury savings certificates. Recently the activities of the Post Office and the Treasury Departments have been, in effect, consolidated. Thrift stamps and war savings stamps have been

withdrawn and in co-operation with the Post Office, a campaign for thrift and saving by the purchase of the new baby bonds in denominations of \$25, \$100 and \$1,000 is being carried on.

DIVISION OF ACCOUNTS AND DEPOSITS

Employees - 103

(Division of Deposits, Division of Bookkeeping & Warrants)

The Commissioner of Accounts and Deposits is a comparatively new office created in 1920 because of the large increase in the accounting transactions of the Treasury. He has administrative supervision over the Division of Bookkeeping and Warrants and the Division of Deposits.

The Commissioner is charged with the duty of preparing estimates as to the future cash position of the Treasury; estimates in connection with the income and profits tax payments; and general supervision over balances in the Federal Reserve Banks and the requisite daily inter-bank transfers of funds.

The Commissioner also handles the investment and re-investment of trust funds, such as the deposits with the Treasury of the Alien Property Custodian, premiums on converted insurance and on account of Civil Service Retirement and Disability Fund.

The Commissioner is charged with keeping the individual accounts with the railroads under the various railroad acts and the sending out of notices of interest and principal due.

DIVISION OF DEPOSITS.

Through the Division of Deposits the administrative work is carried out in connection with the designation of Government depositaries under many different accounts, over 10,000 in number, and amounting to something over \$500,000,000; and the duty of seeing that proper security is obtained for such deposits.

DIVISION OF BOOKKEEPING AND WARRANTS

This division carries on the Treasury analysis of all the appropriation acts of Congress; the issuing of warrants to Disbursing Officers; bookkeeping in connection with the appropriation, disbursement and receipt accounts, and the preparation of regular estimates of appropriations for the service of the Treasury Department.

The compiling of the annual digest and appropriations made by Congress for the various Departments; the preparation of the annual statement of receipts, disbursements and unexpended balances required by Congress for its Committees; and many statistics relating to such receipts and disbursements are taken care of by this Division.

In this Division all warrants for the payment of money into or out of the Treasury, the setting up of appropriation accounts; and the transfer of accounts are prepared.

In a word, this Division is the official bookkeeping organization of the Government so far as it relates to appropriation accounts.

TREASURER OF THE UNITED STATES
Employees ~ 1250

This office acts as custodian for all securities and currency belonging to the United States held in Washington. The Treasurer's office pays Treasury warrants and all checks drawn by the disbursing officers of the Government and keeps an account with each disbursing officer.

The Treasurer holds in trust United States bonds and certificates of indebtedness pledged to secure bank circulation and public deposits amounting together to about \$1,000,000,000.

National bank notes and Federal Reserve notes are received, assorted, counted and, when fit for use, returned to banks of issue for

further circulation. This work involves handling about \$3,227,000,000 of currency during the year.

COMPTROLLER OF THE CURRENCY.

Employees - 827

The Comptroller of the Currency receives reports from 8,154 banks with aggregate resources on June 30, 1921 of \$19,638,446,000. The work of the Comptroller's office requires regular examinations of the national banks of the country, and he is required to report to Congress, in addition to data relative to the national banking system, information regarding State banking institutions.

BUREAU OF THE BUDGET.

The Director of the Budget is in charge of this Bureau. He is appointed directly by the President and reports to the President, but for the purposes of organization his office is connected with the Treasury Department.

It is the duty of this Bureau to assemble and revise the estimates of the Departments and Establishments of the Government and transmit them to the President in a form of a consolidated statement with supporting schedules.

Concurrently with the transmission of the estimates by the Bureau of the Budget, the Secretary of the Treasury transmits a statement for the information of the President showing, from the point of view of the Treasury, the relation between the estimated appropriations and expenditures and the estimated receipts of the Government.

The Cabinet head of each Department appoints a Budget Officer to co-operate with the Bureau of the Budget in obtaining information and presenting the views of the Department. The establishment of this Bureau is one of the greatest steps that has been taken for many years. Through its efforts,

the President may present to Congress and the people a complete statement in advance of the estimated income and expenditures of the Federal Government.

MINT BUREAU.
Employees - 1000

The manufacture of gold, silver and minor coins for the United States, and a number of South American countries, is carried on in the plants of this Bureau.

The first Mint was erected in Philadelphia in 1792, and is now the largest mint in the world. Other mints are located in Denver and San Francisco.

The stock of gold in the world is estimated to be approximately \$9,000,000,000; the Mint and Assay Service are custodian for approximately \$3,037,120,000 of this.

In 1806, the coinage produced was 1,111,000 pieces, in 1919, the production amounted to 738,642,000 pieces, the largest ever executed in the world in any one year. The weight of silver contained in this coinage was 304 tons; of nickel 421 tons, and of bronze 2,020 tons.

In 1921, 553,868,000 domestic coins were produced. In addition to this amount 91,448,000 pieces were coined for South American countries.

The profit made by seigniorage on domestic coinage totaled \$12,257,447. Seigniorage represents the difference between the face value of coins and the cost value of the metal content. The seigniorage on nickel and bronze coins alone amounted to over \$5,340,000.

During the war, to assist foreign countries to obtain silver, an Act was passed permitting the melting of \$350,000,000 standard silver dollars and over 270,000,000 standard silver dollars were melted. The bill made the recoinage of these dollars mandatory. To recoin the dollars destroyed will

require 209,000,000 ounces of silver of which to date approximately 90,000,000 have been purchased.

There had been no change in the design of the standard silver dollar since 1878 until in December 1921 the new Peace Dollar was adopted to commemorate the signing by President Harding of Peace treaties with Germany, Austria and Hungary. The dollar coins destroyed for war purposes will be replaced by Peace Dollars.

The establishments of the United States Mint Service include eight Assay Offices, established to purchase bullion in the various mining sections for shipment to the Mints. In the Assay Office at New York, there is now in storage gold amounting to over \$1,890,000,000.

The expense of the Mint Service during the fiscal year 1921 amounted to \$2,240,000; the income totaled \$13,355,000, of which \$12,257,000 was seigniorage.

SECRET SERVICE DIVISION.

The staff of this Division is charged with the duty of preventing counterfeiting of note issues, Government bonds, and revenue stamps. One thousand and twenty-five arrests were made by agents of this Service, or under their direction, during the past year, of whom 325 were note raisers and 259 check forgers. Counterfeit notes amounting to \$196,993 were captured or seized; counterfeit coins, or equipment for making the same, were taken possession of in large quantities; 3,500 forged check cases were investigated.

BUREAU OF ENGRAVING AND PRINTING.

Employees - 6,300.

In this Bureau are manufactured all notes and certificates, Liberty Bonds, Treasury Notes, National Bank Currency, Federal Reserve Bank Notes, Internal Revenue stamps, Customs stamps, and postage stamps. It is a manufacturing plant with all the problems of a production which must be maintained

at the highest standard.

CHIEF CLERK'S OFFICE.
Employees - 1042.

The Chief Clerk is charged with carrying on the general routine affairs of the Department, including the management and guarding of all Treasury Buildings in Washington.

GENERAL SUPPLY COMMITTEE.
Employees - 121.

The Committee's members, comprising representatives of all other Departments in Washington, constitute a central organization through which the Government prepares the specifications and contracts for a large proportion of its standard supplies and equipment.

APPOINTMENT DIVISION.
Employees - 34.

In this office is kept a list of every employee of the Treasury with a history of his entire connection with the Government.

Under this Division is the Section of Surety Bonds, which keeps a record of all indemnity bonds in which the Government is interested. As such bonds are required in connection with all positions of trust and the making of contracts in which the Government is interested, this record is of great importance. Approximately 500,000 bonds were on record on December 31, 1921.

DIVISION OF MAILS AND FILES
Employees - 13.

Is responsible for all incoming and outgoing mail.

DIVISION OF PRINTING AND STATIONERY.
Employees - 42.

Controls the distribution of all printed matter and office supplies to every branch of the Treasury.

DISBURSING CLERK
Employees 29

Through this office the Treasury pay roll and expense accounts are liquidated, the total sum checked out last year amounting to \$109,704,518.72.

BUREAU OF INTERNAL REVENUE
Employees - 20,000.

This Bureau collects the income and profits tax which provide the largest part of our income as shown by these figures:

	Fiscal year <u>1921</u>	Fiscal year <u>1922</u>	Estimates for Fiscal year <u>1923</u>
Customs	\$ 308,564,391.00	\$ 275,000,000.00	\$ 330,000,000.00
Internal Revenue			
Income and profit taxes	3,206,046,157.74	2,110,000,000.00	1,715,000,000.00
Miscellaneous internal revenue.....	<u>1,390,380,823.28</u>	<u>1,104,500,000.00</u>	<u>896,000,000.00</u>
	\$4,904,991,372.02	\$3,489,500,000.00	\$2,941,000,000.00

The income account is being reduced as well as the expense account, but we know that our tax bill is still a heavy burden.

The bureau received 8,382,903 tax returns last year of which 2,287,932 showed no taxes due. Incomes under \$5,000 were 5,248,819; over 5,000 were 702,056. The number of corporations taxable was 144,096; non-taxable 224,827. The auditing and the settlement of claims constitute an enormous piece of work and involve most intricate problems of accounting and law.

The greatest effort has been made to simplify the new tax return forms which you are now filling out and it is to be hoped that the aggregate saving of time to the tax payer, not to speak of mental wear and tear, will result in a great saving for the nation.

Part of the work of this Bureau is the enforcement of prohibition and narcotic laws, which cost last year \$6,700,000. You read of this work every day. There can be no question that it is not a fiscal activity and should be transferred out of the Treasury.

DIVISION OF CUSTOMS.

Employees - 6743

The Division of Customs needs little explanation. Those who have been abroad may well believe that the entire operation of this Division is confined to the examination of returning tourists but this is a small part. The main work lies in the collection of customs duties on imported articles which for the last year were valued at \$3,654,000,000, and the year before to over 5,000,000,000.

BUREAU OF THE PUBLIC HEALTH SERVICE

Employees - 17,639.

Under King George, the 3rd, the system of marine hospital relief of the British Empire was extended to include the American Colonies. In 1798, Congress established the Marine Hospital Service in the Treasury Department. In 1800, the first hospital was authorized at Norfolk, Va. and in 1802 another at Boston where the building still stands in the Charlestown Navy Yard.

Early in its development, public health duties were imposed upon this service, in connection with maritime quarantine. Later, it was used to control epidemics and, at the present, exercises practically all of the health functions of the Federal Government. With a corps of Experts, investigations are being carried on in tuberculosis, influenza, pneumonia, anthrox, hookworm, leprosy, malaria, pellagra, typhoid fever and many other diseases.

In March, 1919, Congress imposed upon this bureau the additional duty of operating hospitals for the sick and disabled veterans of the world war. At that time, its facilities in 21 marine hospitals provided 1500 beds. It now has 67 hospitals with a total of 21,300 beds, and is giving out-patient treatment to 10,000 cases a week.

The Public Health Service has played a great part in our national development. Its officers are constantly on the move to help meet local epidemics and have contributed largely to the elimination or control of yellow fever, smallpox, cholera, bubonic plague and typhoid fever.

UNITED STATES COAST GUARD
Employees - 4500

The Revenue-Cutter Service was established by an Act of Congress on August 4, 1790. Ten vessels were built and placed in commission on November 1, 1791 and, as we had no Navy until 1797, it was our only sea force during that time.

The Life Saving Service, established as a separate organization in 1878, was joined in 1915 with the Revenue-Cutter Service as the United States Coast Guard. The Revenue-Cutters, together with 273 Coast Guard Stations, render assistance to vessels in distress. In the past year, 621 people were rescued. Vessels with their cargoes, having a value of \$66,000,000, were given assistance and 19 derelicts removed or destroyed.

During the war, the Revenue-Cutters became part of the Navy whose largest individual loss, except for the U. S. S. CYCLOPS, which met an unknown fate, was in the sinking of the Coast Guard Cutter TAMPA by an enemy submarine, September 26, 1918. All on board, 115 officers and men, lost their lives. A new cutter has just been placed in commission named the TAMPA to perpetuate the name of the gallant little vessel that went down with all her crew, in defense of the country.

The motto of this service "Semper Paratus" - Always Ready - has been lived up to in peace and war through more than a century and a quarter.

SUPERVISING ARCHITECT
Employees - 5,900

In this office, all plans for public buildings are prepared and the work of construction is supervised. This office is further charged with the duty of furnishing, equipping, heating, lighting, repairing, cleaning and generally caring for Government buildings outside of Washington, some 1300 in number. The Treasury would appear to act as a national janitor.

Since the war, this office has been unusually busy in handling the construction of hospitals for disabled soldiers, 41 projects involving an expenditure of over \$18,000,000 of which 20 of the larger ones will provide 6,000 beds.

February 16, 1922.

My dear Mr. Fordney:

In accordance with the promise made to yourself and your associates on the Senate and House Committees, charged with the responsibility of formulating the proposed bonus legislation, I have carefully looked into the program of taxation which has been suggested. In addition thereto I have made inquiry into the feasibility of issuing either short-time Treasury notes or long-time bonds to meet the financial obligations which the proposed legislation will impose. It is not possible to commend to you either of the plans suggested.

It continues to be my best judgment that any compensation legislation enacted at this time ought to carry with it the provisions for raising the needed revenues, and I find myself unable to suggest any commendable plan other than that of a general sales tax. Such a tax will distribute the cost of rewarding the ex-service men in such a manner that it will be borne by all the people whom they served, and does not commit the Government to class imposition of taxes or the resumption of the burdens recently repealed, the maintenance of which can be justified only by a great war emergency.

It is fully realized how great is the difficulty which confronts the Congress in solving this difficult problem. I am aware of the strong sentiment in Congress in favor of this adjusted compensation. I have spoken approvingly myself, always with the reservation that the bestowal shall be made when it may be done without such injury to the country as will nullify the benefits to the ex-service men themselves which this expression of gratitude is designed to bestow.

It is not an agreeable thing to suggest that action be postponed again, but, frankly, I do not find myself favorable to the piece-meal payment plan, which is manifestly designed to avoid embarrassment to the Treasury. The long drawn out payments will not afford an effective helpfulness to the service men.

We have no serious problem in beginning the allotments of public lands and the immediate issue of paid-up insurance. The real difficulty lies in the payment of the cash bonus. Rather than provide that the maximum cash payments shall extend over a period of two and one-half years, it would be a vastly better bestowal if we could await the day when we may safely undertake to pay at once in full, so that the award may be turned to real advantage.

Inasmuch as the Treasury is to be called upon to meet more than six billion dollars of maturing obligations in the sixteen months immediately before us, it is not possible to recommend the issue of several hundred millions of additional short-time notes. Further excessive borrowing would likely undo all that has been accomplished in readjusting interest rates and stabilizing the financial world, both vitally essential to the resumption of industrial and commercial activities.

Granting that it is not fair to oppose any proposed plan without offering a substitute, let me repeat that I believe the American people will accept the levy of a general sales tax to meet the proposed bonus payments, and we should contribute thereby no added difficulties to the problems of readjustment. If Congress will not adopt such a plan, it would be wise to let the legislation go over until there is a situation which will justify the large outlay. We are driving for large economies, we are pushing the disposition of surplus war property, and have other transactions under consideration which ought to prove a great relief to the Federal Treasury. It is not consistent to enact legislation in anticipation of these things, but it would be a prudent plan to await the developments, and I can see in such a postponement no lack of regard for the service men in whom all the American people are so genuinely interested. I take it that the ex-service men themselves are no less concerned than others about the restoration of business and the return to abundant employment. Those of their wounded or sick comrades, who were impaired by their war service, are being cared for with the most liberal generosity the nation can bestow. There are here and there exceptional cases of neglect, and attending complaint, but we are seeking them out and correcting with all possible speed. It has not been possible to meet all the demands for special hospitalization but we are building to that end, without counting the cost. We are expending \$400,000,000 a year in compensation, hospitalization and rehabilitation. These things are recited to reassure you that such delay as will enable Congress to act in prudence for the common good, will have no suggestion of unmindfulness or ingratitude.

Very truly yours,

WARREN G. HARDING.

Hon. Joseph W. Fordney,
House of Representatives,
Washington, D. C.

February 21, 1922.

STATEMENT OF THE SECRETARY OF THE TREASURY BEFORE THE COMMITTEE
ON WAYS AND MEANS.

If Congress decides to impose a general sales tax in order to pay a soldiers' bonus, it will be necessary to determine first of all what kind of a general sales tax is to be adopted. Any general sales tax, in order to yield the revenue desired, will have to have broad application and the minimum of exemptions.

The term "general sales tax" suggests at least four classes of taxes which are widely different in their operation and effects, as follows:

First. - A general turnover tax, imposed upon every business transaction whether it involves a transfer of commodities or capital assets, or a wholesale or retail sale or a sale by the manufacturer or producer. The rate most often suggested for such a tax has been 1 per cent, and it has been estimated that at that rate it would yield approximately 1 billion dollars a year. A general sales tax of this character would apply not only to all turnovers of goods, wares, and merchandise, but also to all transfers of real estate, securities, and other capital assets. Since it would fall upon every business transaction, it would inevitably be pyramided upon successive turnovers. All in all, a general sales tax of this character would seem to be very difficult of application.

Second. - A limited turnover tax, which would apply to goods, wares, and merchandise, but not to capital assets. This tax would impose less of a burden upon business and industry, and it has been estimated that at 1 per cent it would yield about \$700,000,000. Like the general turnover

tax, however, it would be pyramided. If a tax of this character is to be imposed it would seem necessary to provide exemptions sufficient to cover the smaller operations, such as the corner grocery, the newsboy, and the like. The allowance of exemptions would, of course, correspondingly reduce the yield.

Third. - A manufacturers and producers sales tax, to apply at the time of sale by the manufacturer or producer. At one per cent it would yield, it is estimated, about \$250,000,000. This tax would probably be the simplest to administer, inasmuch as it would fall at the least number of collection points, and it would correspond in a general way to some of the specific sales taxes now imposed. A tax of this character would also tend to eliminate pyramiding since it would be collected but once. The tax might be either a general tax on all articles at a level rate, in which event it would fall as heavily upon food and all the necessities of life as it would upon luxuries, or it might be imposed under a schedule of specific or ad valorem rates applicable to listed articles. In order to avoid throwing too great a burden upon the consumption of necessities and, at the same time, in order to simplify administration, it would probably be advisable to adopt a definite schedule of articles and rates if any such tax is to be imposed.

Fourth. - A retail sales tax upon so-called final sales of articles for consumption. It is estimated that at a rate of 1 per cent such a tax would yield about \$350,000,000. A tax of this character would present two main problems, first, that it would have to be collected at the maximum number of collection points which would make its administration difficult, and second, that it is almost impossible to make a satisfactory definition

of final retail sales except on an arbitrary basis. If such a tax is to be imposed the specific sales taxes now imposed upon so-called luxuries might be extended to a more inclusive class of commodities sold at retail, or it might take the form of a general sales tax imposed on all articles of consumption, including food and necessities. A tax on a limited class of articles would not, of course, produce the revenue desired except at higher rates.

The sales tax in any form would require a large increase in force in the Bureau of Internal Revenue. The problem of administration would, of course, turn largely on the kind of sales tax adopted, but even in its simplest form I should say that it would require a force almost equivalent to the force now required for the income tax in order to administer a general sales tax effectively.

There is one other observation which I should like to make as to a general sales tax. The Treasury did not, as you know, recommend any general sales tax in connection with the revenue revision which was made in 1921, though the sales tax was suggested by others and considered by Congress. There was one important difference, however, between the sales taxes then considered and the general sales tax now under consideration as a means of raising revenue for a soldiers' bonus, namely, that sales taxes then were suggested as substitutes for existing taxes, and not as additional taxes.

Not knowing what kind of a general sales tax the Congress might wish to impose in order to pay a bonus, the Treasury has not worked out any one of the forms of general sales taxes in all its implications. Any form of a general sales tax presents complications with respect to both the incident of the tax and its administration. If the Committee will indicate what form

it has in mind to propose, the Treasury will be glad to give further study to a general sales tax along the lines desired and to work out what would seem to be the most feasible provisions for the purpose.

March 6, 1922.

Dear Mr. Treasurer:

In order to reestablish the unrestricted circulation of gold within the United States and restore payments by the Government to the basis which existed before the war, you will until further notice make payments of United States paper currency without distinction as between United States notes, silver certificates and gold certificates, except for the following restrictions as to denominations:

(1) Payments in denominations of \$1 and \$2 shall be made, so far as possible, in silver certificates, and if no silver certificates are available, then in United States notes, or, when available, Federal Reserve Bank notes.

(2) Payments in denominations of \$5 and \$10 shall be made, so far as possible, in United States notes and, when available, in silver certificates. If United States notes and silver certificates are not available in sufficient quantities, it will be the policy in the future as in the past to purchase Federal Reserve notes from the Federal Reserve Banks in the desired amounts. Nothing herein contained, however, shall be deemed to prohibit the payment of \$10 gold certificates on demand, or if no other kinds of currency in that denomination are available.

(3) Payments in denominations of \$20 and upwards shall be made, so far as possible, in gold certificates, or, when available, in United States notes and silver certificates. Federal Reserve notes

already on hand in these denominations may be paid out, but without specific authority therefor in writing Federal Reserve notes will not any longer be purchased from the Federal Reserve Banks for the purpose of making payments in denominations of \$20 and upwards.

It will continue to be the policy of the Treasury to deposit to the credit of the Federal Reserve Banks in the Gold Fund with the Federal Reserve Board the free gold which from time to time becomes available to the Treasury and is not required to make current payments.

The instructions heretofore given under date of June 30, 1920, as modified by the instructions of January 7, 1921, and the general instructions of August 30, 1920, as amended, as to Exchanges, Replacement and Redemption of United States paper currency are modified in accordance herewith.

The Treasury is notifying the Federal Reserve Board of these instructions and requesting that the Federal Reserve Banks follow similar procedure with respect to payments for account of the United States, whether on current payments or on exchange or redemption of United States paper currency.

Very truly yours,

(Signed) A. W. MELLON

Secretary.

The Honorable,
The Treasurer of the United States.

March 6, 1922.

My dear Governor Harding:

I am transmitting herewith, for the information and attention of the Federal Reserve Board, a copy of my letter of this date to the Treasurer of the United States which gives instructions as to payments of United States currency, with particular reference to the payment of gold certificates and the kinds of currency in which payments shall be made in the different denominations. The payments made by the Treasurer of the United States in Washington are relatively small, particularly since the system of distributing new currency through the Federal Reserve Banks was adopted under the general regulations governing Exchanges, Replacement and Redemption of United States paper currency, issued under date of August 30, 1920. In order that the policy embodied in the attached letter of instructions may be carried into effect throughout the country it is desirable that the Federal Reserve Banks should observe substantially the same instructions, and I accordingly have to request that the Federal Reserve Banks follow similar procedure with respect to payments for account of the United States, whether on current payments or on exchange or redemption of United States paper currency. It would be helpful if the Federal Reserve Banks would extend the same general policy to all payments, with such modifications as may be thought necessary with respect to payments for their own account.

The question of resuming payments of gold certificates was, as you will recall, suggested for consideration at the joint conference of the Governors and Chairmen of the Federal Reserve Banks held in Washington in October, 1921, and the Treasury's views in the matter were outlined in my letter to you of October 4, 1921. The joint conference of Governors and

Federal Reserve Agents did not at the time favor redemption of payments of gold certificates, but in the option of the Treasury the objections which were then raised to gold payments have been met by the developments which have occurred since October, 1921. (The total gold holdings of the Federal Reserve Banks as at the close of business on March 1, 1922, amounted, according to the statement issued by the Federal Reserve Board, to \$2,951,434,000, as compared with total gold holdings of \$2,163,090,000 on March 4, 1921. This increase of almost \$800,000,000 within the year is due for the most part to imports of gold into the United States, substantially all of which have been absorbed into the reserves of the Federal Reserve System. Within the same period the ratio of total reserves to deposit and Federal Reserve note liabilities has risen from 50.8 to 76.7, and Federal Reserve Bank discount rates have been materially reduced until now the rate of $4\frac{1}{2}$ per cent prevails in such Districts as New York, Boston, Philadelphia, Cleveland, and San Francisco, and 5 per cent in all of the other Districts. The low rate policy which has been put into effect by the Federal Reserve Banks was adopted in large part as a result of the October conference, and gives a complete answer, it seems to me, to any criticism that might be raised against payments of gold certificates on the theory that these payments were intended to reduce the reserves of the Federal Reserve System and furnish an excuse for high discount rates.) On the other hand, the vast accumulation of gold in the Federal Reserve System, though it may not yet have caused any inflation, offers a constant temptation to the adoption of unsound and inflationary credit policies, and unless some corrective action is taken may lead the country into another period of inflation and speculation. The Federal Reserve Board itself,

in the February issue of the Federal Reserve Bulletin, has recognized the dangers of our swollen gold reserves in the following comment which appears on page 128 of the Bulletin:

"At present, furthermore, the abnormal concentration of gold in this country is a source of danger, because it is a false guide in matters of credit policy -- no longer an index of the outside limit of legitimate credit expansion. Considerations of national interest alone are, therefore, a sufficient reason for a careful weighing of proposals looking to a redistribution of the gold supplies of the world and involving a return of some part of the gold held by the United States for use elsewhere. No proposals of any sort should, however, be entertained until far-reaching guaranties of fiscal reform have been secured from the countries that require aid. Otherwise the assistance would be detrimental to the extent that it would lead to the postponement of the necessary fiscal reforms which must be made preliminary to the rehabilitation of currency systems and the reestablishment of stabilized exchange relationships".

For the present at least, there seems to be little prospect that there will be any effective demand from the rest of the world for large amounts of the gold accumulated in our reserves. It has been suggested that loans to Europe or heavy investment in foreign obligations by citizens of this country might result in substantial exports of gold to other countries, but for some time to come it would seem that such loans as European governments may be able to offer in this country would have to be used for reconstruction and for the purchase of necessities rather than for the accumulation of gold reserves, and unless conditions should markedly change, I doubt whether there is much likelihood of important gold exports in the near future. Even though gold certificates are restored to circulation the accumulated reserves in this country are sufficiently strong to provide for substantial exports, and if it should ever become necessary to accumulate gold for this purpose, it will undoubtedly be feasible to do so through the banks and the Federal

Reserve Banks, in view of the system of currency distribution that has now become established. As a matter of fact, the restoration of gold certificates to circulation will build up again a secondary gold reserve which can be drawn upon in case of need.

It is interesting in this connection to bear in mind that in the present condition of the Federal Reserve Banks there can be substantial losses of gold without material effect upon the reserve position of the System. It has been estimated, for example, that about \$150,000,000 of gold certificates could be paid out without affecting the Federal Reserve combined ratio more than one full point, on the assumption, of course, that the gold certificates paid out would in due course replace a corresponding amount of Federal Reserve notes.

In these circumstances, I think that the sound and courageous thing to do is to reestablish the unrestricted circulation of gold which existed in this country before the war and to pay out gold certificates as a matter of course on payments which call for denominations of \$20 and upwards. This does not mean, of course, that Federal Reserve notes in denominations of \$20 and upwards will disappear from circulation. The statement of paper currency outstanding on December 31, 1921, issued by the Treasurer of the United States, shows that there were outstanding on that date about \$970,000,000 of Federal Reserve notes in the denomination of \$20, about \$245,000,000 of Federal Reserve notes in the denomination of \$50, and about \$259,000,000 of Federal Reserve notes in the denomination of \$100, and somewhat smaller amounts, aggregating nearly \$200,000,000, were outstanding in the other high denominations.

The resumption of payments of gold certificates should not, of course, displace more than a fraction of this great volume of Federal Reserve notes.

Very truly yours,

(Signed) A. W. MELLON

Secretary.

Hon. W. P. G. Harding,
Governor, Federal Reserve Board,
Washington, D. C.

1 enclosure.

April 4, 1922

C-441.

Washington, April 4. - Reports received by Lew Wallace, Jr., Director of Savings, Treasury Department, show that Treasury Savings Certificates to the amount of \$13,377,424 were sold during the month of March. This is the largest sale of any month since the certificates were offered, and Director Wallace attributed the increased demand to the fact that the people are beginning to realize that the certificates are such a very good investment. It has been figured out at the Treasury Department that these certificates, with their tax exemption and interest rate of $4\frac{1}{2}$ per cent, compounded semi-annually, are better paying securities than almost any of the bonds now on the market. These certificates were designed for the small investor, and issued in denominations of \$25, \$100 and \$1,000 and sold for \$20, \$80 and \$800. Many investors are buying the limit allowed which is \$5000 of any one issue.

April 14, 1922.

Dear Mr. Warburg:

I received your letter of March 21, 1922, with respect to payments of gold certificates by the Treasury, and am glad to tell you how the matter stands. I assume that you have already seen the Secretary's formal announcement on the subject, issued under date of March 18, 1922, but I am enclosing a copy herewith for your ready reference. From this you will see that it is a definite policy, but I think it is too early to say what proportions the payments of gold certificates may reach.

The first thing that the Treasury wanted to accomplish through the announcement was to make it clear that in so far as the Treasury is concerned there are no longer any restrictions on the free circulation of gold and that gold certificates would henceforth be available at the Treasury in the ordinary course of business without demand. To a large extent this object has already been achieved by the announcement itself, and the Treasury is itself making payments of gold certificates over the counter at Treasury offices without discrimination. The other consideration I had in mind was that the time had come for both the Treasury and the Federal Reserve Banks to drop the artificial policy of impounding all gold certificates and refusing to pay them out in any circumstances without specific demand. In other words, the Federal Reserve Banks were still mobilizing gold as enthusiastically as they did during the war, apparently without regard to the changes that have occurred in the general situation, and were still endeavoring to concentrate in their reserves all of the gold in the country. The policy of mobilizing gold in the Federal Reserve Banks was adopted as a war

measure, and with the war over and the pressure on the Federal Reserve Banks relieved there would seem to be no good reason for continuing what amounts to discrimination against gold certificates and in favor of other forms of currency in making current payments. This does not to my mind involve any attack on the amendment to the Federal Reserve Act which permits the issue of Federal Reserve notes against gold.

To a limited extent the Treasury has been through a somewhat similar situation with respect to legal tender notes and silver certificates. These were for a long time accumulated in the Federal Reserve Banks in substantial amounts and counted as reserve against deposit liabilities. The situation with respect to silver and legals, of course, is different, because after all they do not possess the peculiar characteristics of gold, and it was easier to handle because with the Federal Reserve Bank notes almost out of the way the country necessarily relies on these two classes of paper currency for its supply of one-dollar and two-dollar notes. Up to about a year ago, however, many of the Federal Reserve Banks were still reluctant to pay out even silver and legals because of their quality as reserve money, and it took something of a struggle for the Treasury to get them to release their hold.

With gold certificates the Treasury feels that it would be good policy for the Federal Reserve Banks to pay out gold certificates normally and in the ordinary course of business, to some extent at least, and without making any more discrimination with respect to gold certificates than it is the custom to make with respect to other forms of paper currency, except possibly on the question of denomination. This does not mean that

there should be any effort to force a given amount of gold out of the Federal Reserve System or to reduce the reserves of the System or the Federal Reserve note circulation to any arbitrary figures. On the other hand, the Federal Reserve note, of course, is the flexible element in the paper currency circulation, and it is inevitable that increased circulation of other forms of currency, as, for example, silver certificates, United States notes, and gold certificates, will, in the long run, reduce the circulation of Federal Reserve notes. The question of the extent to which the Federal Reserve Banks will pay out gold certificates in the ordinary course of business in making payments on their own account, is primarily a question of Federal Reserve policy, and this question the Treasury has only undertaken to suggest to the Federal Reserve Banks for their consideration.

I am personally of the opinion that without impairing the gold position of the Federal Reserve System and without any special effort to force gold certificates into circulation in place of Federal Reserve notes, it would be possible to restore to circulation enough gold certificates to constitute a valuable secondary reserve and that it would be helpful all around to put an end to the artificial impounding in the Federal Reserve Banks of all the monetary gold in the country. I do not believe that this involves, properly speaking, any dissipation of the gold reserves. The gold in circulation could again be mobilized, if necessary, and it could not properly be called lost or frittered away. On the other hand, if gold is to be exported or specifically loaned to Europe or other countries, it will go out in any event, whether or not

gold certificates circulate, presumably in consequence of loans floated in this market. The chief difference is that if gold certificates circulate freely and without demand there will gradually be built up some secondary reserve both in the banking institutions of the country and in the pockets of the people, while if it is not permitted to circulate, it will necessarily accumulate in the Federal Reserve Banks and give a swollen aspect to their reserves. Our experience during and since the war has shown that a secondary gold reserve is an important resource and that it can be made available in case of emergency. Without a war emergency it is difficult to see what is to be gained either by the Federal Reserve System or by the country through the impounding of all the monetary gold in the Federal Reserve Banks unless it is desired to use the gold as a basis for an unhealthful and artificial expansion of credit and currency. It creates an abnormal situation, and has many elements of danger. The vast accumulation of gold in the Federal Reserve System, with the increase of about \$800,000,000 within the past year, offers a constant temptation to unsound credit policies, and unless some corrective action is taken it might easily lead the country into another period of inflation.

No one, of course, can tell what may develop, and it is always well to be prepared for all eventualities, but for the present at least there seems to be little prospect of any effective demand from the rest of the world for large amounts of our gold. I know it is frequently suggested that loans to Europe or heavy investments in foreign obligations, or perhaps some international bank or similar project, might result in substantial exports of gold to other countries, but for some time to come it

would seem that such loans as European Governments may be able to place in this country would have to be used for reconstruction and the purchase of necessities, rather than for the accumulation of gold reserves. Our accumulated reserves, moreover, are sufficiently strong to provide for substantial exports, even with gold certificates in circulation, and if it should ever become necessary to accumulate gold again for this purpose, it should be possible to do so through the banks and the Federal Reserve System, particularly in view of the procedure for currency distribution that has now become established.

It is an absorbing question, and one that is worth a good deal of thought. I should like some time to have the opportunity of talking it all over with you, and hope that when you are next in Washington you will stop in to see me and let me have the benefit of your further views.

Sincerely yours,

(Signed) S. P. Gilbert, Jr.

Paul M. Warburg, Esq.,
31 Pine Street,
New York, N. Y.

1 enclosure.

(T. D. 3322)

April 18, 1922

Instructions as to acceptance of Victory notes in coupon form for income and profits taxes payable June 15, September 15, and December 15, 1922.

TREASURY DEPARTMENT
Office of Commissioner of Internal Revenue
Washington, D.C.

TO COLLECTORS OF INTERNAL REVENUE AND OTHERS CONCERNED:

1. Collectors of Internal Revenue are authorized and directed to receive at par, Victory notes of either the $4\frac{3}{4}$ per cent or the $3\frac{3}{4}$ per cent series, in coupon form, in payment of income and profits taxes payable on June 15, 1922, and Victory notes of the $4\frac{3}{4}$ per cent series, in coupon form, in payment of income and profits taxes payable September 15, and December 15, 1922. Victory notes of the $3\frac{3}{4}$ per cent series will not be acceptable in payment of income and profits taxes payable September 15 or December 15, 1922, and registered Victory notes are not acceptable on any payment. Coupon Victory notes tendered in payment of income and profits taxes payable June 15, September 15, and December 15, 1922, must have all unmatured interest coupons attached (that is to say, notes tendered in payment of income and profits taxes payable June 15 and September 15, 1922, coupons attached for December 15, 1922, and May 20, 1923; notes tendered in payment of income and profits taxes payable December 15, 1922, coupon attached for May 20, 1923), but all matured coupons must be detached and collected in ordinary course when due. The amount, at par, of the Victory notes 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 shall in no case pay interest on the notes or accept them for an amount other or greater than their face value. Accrued interest on the notes accepted in payment of income and profits taxes payable September 15, 1922, from June 15, 1922, to September 15, 1922, will be remitted to the taxpayer by the Federal Reserve Bank with which the collector makes his deposits, on the basis of the schedules furnished by the collector. Receipts given by collectors to taxpayers should show the amount of notes of each series received in payment of taxes.

2. Deposits of Victory notes received in payment of income and profits taxes hereunder 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 to collectors by the Secretary of the Treasury in certain instances for the deposit of the notes 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. Victory notes may be accepted hereunder by the collector prior to tax payment dates, and in that case should be forwarded by the collector to the Federal Reserve Bank or branch Federal Reserve Bank to be held for account of the collector until the tax payment date, and for deposit on such date.

3. Victory notes accepted hereunder should in all cases be indelibly stamped by the collector on the face thereof as follows, and when so stamped should be delivered to the Federal Reserve Bank in person if the collector is located in the same city, and in all other cases forwarded by registered mail uninsured:

" _____, 192__.

This note 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 _____."

Each unmatured coupon attached to each such Victory note must be indelibly stamped across the face by the collector with the word: "Paid", followed by his name and title.

4. Collectors should make in tabular form a schedule in duplicate of the Victory notes to be forwarded to the Federal Reserve Bank, showing the face amount transmitted, the serial number of each note, the series, the denomination, and the name and address of the taxpayer presenting the note. Notes accepted prior to the tax payment date must be scheduled separately, and Victory notes should in all cases be scheduled separately from Treasury certificates of indebtedness. At the bottom of each schedule there should be written or stamped, "Income and Profits Taxes \$ _____", which amount must agree with the total shown on the schedule. One copy of this schedule must accompany notes sent to the Federal Reserve Bank, and the other be retained by the collector. The income and profits tax deposits resulting from the deposits of such notes must in all cases be shown on the face of the certificate of deposit (National Bank Form 15) separate and distinct from the item of miscellaneous internal revenue collections (formerly called Ordinary). Until certificates of deposit are received from the Federal Reserve Banks, the amounts represented by the Victory notes forwarded for deposit must be carried by collectors as cash in bank, and not credited as collections, as the dates of certificates of deposit determine the dates of collections.

5. For the purpose of saving taxpayers the expense of transmitting such notes 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, taxpayers desiring to pay income and profits taxes by Victory notes should communicate with the collector of the district in which the taxes are payable and request from him authority to deposit such notes with the Federal Reserve Bank in the city in which the notes are held. Collectors are authorized to permit deposits of Victory notes in any Federal Reserve

Bank with the distinct understanding that the Federal Reserve Bank is to issue a certificate of deposit in the collector's name covering the amount of the Victory notes 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 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 statement 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.

6. Victory notes in registered form are not acceptable in payment of income and profits taxes under this decision. Holders of registered notes, however, may exchange them through the Federal Reserve Banks for coupon notes in accordance with the general regulations of the Treasury Department, and may, in accordance with this decision, present the coupon notes thus received in exchange in payment of income and profits taxes, provided, however, that such exchange is completed and tender made on or before the tax payment date.

D. H. BLAIR,
Commissioner of Internal Revenue.

APPROVED: April 18, 1922.

A. W. MELLON,
Secretary of the Treasury.

April 25, 1922.

Dear Mr. Treasurer:

The instructions given to you under date of March 6, 1922, with respect to payments of United States paper currency, are hereby modified so that paragraphs 2 and 3 thereof shall read as follows:

(2) Payments in denominations of \$5 and \$10 shall be made in United States notes and silver certificates, when available, or if United States notes and silver certificates are not available in sufficient quantities, in Federal Reserve notes or gold certificates in the denominations of \$10, without discrimination. Preference shall be given to United States notes and silver certificates in making payments in denominations of \$5 and \$10, but when United States notes and silver certificates are not available in sufficient quantities, you are authorized to pay out gold certificates in the denomination of \$10, and wherever necessary to purchase Federal Reserve notes from the Federal Reserve Banks in the usual manner in the desired amounts and denominations.

(3) Payments in denominations of \$20 and upwards shall be made in gold certificates, except that payments in denominations of over \$1,000 shall be made, so far as possible, in Federal Reserve notes. United States notes, silver certificates and Federal Reserve Notes on hand in Treasury cash in these denominations may be paid out as in the past, but you will not henceforth requisition any United States notes or silver certificates in denominations of \$20 and upward without express authority therefor from this office. You are

authorized wherever necessary, to purchase Federal Reserve notes from the Federal Reserve Banks in the usual manner for the purpose of making payments in denominations of over \$1,000.

The Federal Reserve Board is being notified of these modifications in the instructions, and it is expected that the Board will notify the Federal Reserve Banks.

Very truly yours,

(Signed) A. W. MELLON

Secretary.

The Honorable,
The Treasurer of the United States.

April 25, 1922.

My dear Governor:

In view of my letter of March 6, 1922, with respect to payments of United States paper currency, and our subsequent correspondence with respect to payments of gold certificates, I am enclosing for the information of the Federal Reserve Board and the Federal Reserve Banks, a copy of a supplemental letter of instructions which I am sending under this date to the Treasurer of the United States as to payments of United States paper currency.

I should like at the same time to clear up the misunderstanding which has apparently arisen in some of the Federal Reserve Banks as to the application of the Treasury's policy with respect to gold payments. I refer particularly to the letter of March 20th from the Governor of the Federal Reserve Bank of Boston and the letter of March 24, 1922, from the Governor of the Federal Reserve Bank of New York, copies of which you have sent to the Treasury. The Treasury has made a formal announcement of its policy in the statement of March 18, 1922, a copy of which was transmitted at the time to the Federal Reserve Board, and, I presume, to the Federal Reserve Banks. This announcement has made it clear that in so far as the Treasury is concerned there are no longer any restrictions on the free circulation of gold, and that gold certificates will henceforth be available at the Treasury in the ordinary course of business without demand. The Treasury is accordingly making payments of gold certificates over the counter at Treasury offices, and I am advised that several of the Federal Reserve Banks, in accordance with the Treasury's request, are

following a similar policy.

The Treasury has also felt that the time has come for both the Treasury and the Federal Reserve Banks to drop the artificial policy of attracting all gold and gold certificates into the reserves. The policy of mobilizing gold in the Federal Reserve Banks was adopted as a war measure, but with the war over and the pressure on the Federal Reserve Banks relieved there remained no good reason for continuing an artificial situation and making what amounted to a discrimination against gold certificates and in favor of other forms of currency in handling all current payments. The Treasury's general views in this regard were set out in my letter of March 6th to the Board, in which particular attention was also called to the tremendous increase in the gold reserves during the past year or more, chiefly as a result of gold imports. The Treasury has not had any thought that it was its function to attempt to force a given amount of gold out of the Federal Reserve System or to reduce the reserves of the System or the Federal Reserve note circulation to any arbitrary figures. The responsibility for such matters rests upon the governing authorities of the Federal Reserve System, though it was to be expected, of course, that payments of gold certificates for Government account would somewhat reduce the absolute reserves and perhaps affect the reserve ratio of the System. The question of the extent to which the Federal Reserve Banks will pay out gold certificates in the ordinary course of business on their own account is, however, a question of Federal Reserve policy, and this question the Treasury has only undertaken to suggest to the Federal Reserve Board and the Federal Reserve Banks

for their consideration. In this connection, I think there is some tendency on the part of the Federal Reserve Banks to overlook the fact that the Treasury now looks to the Federal Reserve Banks to perform the functions formerly performed by the Subtreasuries, and that in handling redemptions and replacements of United States currency and coin the Federal Reserve Banks act under regulations prescribed by the Secretary of the Treasury, under authority of the Federal Reserve Act and the Act approved May 29, 1920, providing for the discontinuance of the Subtreasuries.

I understand that at all Federal Reserve Banks it is now definitely understood that whenever gold is demanded, whether in the form of gold coin or in gold certificates, it will be paid out promptly as a matter of course, without inquiry and without hesitation. I understand also that consideration is being given at this time to the discontinuance of various artificial measures designed to encourage the accumulation of gold in the Federal Reserve Banks, as, for example, the offer which was made during the war to absorb the abrasion on gold coins deposited with Federal Reserve Banks. Some Federal Reserve Banks have already revoked this offer, and I assume that the question of making this change apply to all Federal Reserve Banks will be up for consideration at the forthcoming meeting of the Governors of the Federal Reserve Banks.

Very truly yours,

(Signed) A. W. MELLON

Secretary.

Hon. W. P. G. Harding,
Governor, Federal Reserve Board,
Washington, D. C.

1 enclosure.

TREASURY DEPARTMENT

FOR RELEASE Morning Papers,
Thursday, June 8, 1922.

STATEMENT BY SECRETARY MELLON.

The Treasury is to-day announcing, in pursuance of its plans for refunding the short-dated debt, an offering of three and one-half year $4\frac{3}{8}$ per cent Treasury notes, designated Series B-1925, dated June 15, 1922, due December 15, 1925, which can be obtained only in exchange for $4\frac{3}{4}$ per cent Victory notes. Applications will be received through the Federal Reserve Banks, and exchanges will be made as of June 15, 1922, at par without adjustments of accrued interest. Payment for the new notes cannot be made in cash or by credit, nor will either Treasury certificates or $3\frac{3}{4}$ per cent Victory notes be accepted in exchange.

The Treasury is not announcing any fixed amount for the offering of notes, but the Secretary of the Treasury reserves the right to reject any applications and to close the subscriptions at any time without notice. The $4\frac{3}{4}$ per cent Victory notes which will be received in exchange for the new notes mature on May 20, 1923, but may be called for redemption in whole or in part, at the option of the United States, on December 15, 1922, and it is the Treasury's intention to call a substantial amount for redemption on that date. This offering of Treasury notes, therefore, affords an opportunity to holders of $4\frac{3}{4}$ per cent

Victory notes to acquire by exchange a new obligation of the United States running for $3\frac{1}{2}$ years at an attractive rate of interest, in place of Victory notes which will be payable either December 15, 1922, or May 20, 1923, depending upon the call for redemption.

The Treasury is announcing at the same time an offering of one-year $3\frac{3}{4}$ per cent Treasury certificates of indebtedness in the amount of \$250,000,000, or thereabouts, on the usual terms. The certificates are designated Series TJ-1923, are dated June 15, 1922, and will be payable June 15, 1923. On June 15, 1922, there will become payable about \$380,000,000 of maturing Treasury certificates of indebtedness, about \$250,000,000 of $3\frac{3}{4}$ per cent Victory notes called for redemption on that date, and about \$125,000,000 of interest on the public debt. Against these payments the Treasury expects to receive during June about \$300,000,000 on account of income and profits tax collections, and according to the best estimates now available, it will need about \$250,000,000 additional, over and above existing balances with depositaries, to meet its current requirements.

The official texts of the offerings are as follows:

OFFERING OF TREASURY NOTES

Series B-1925.

The Secretary of the Treasury offers for subscription, at par, through the Federal Reserve Banks, in exchange for $4\frac{3}{4}$ per cent Victory notes, a limited amount of Treasury notes of Series B-1925, of an issue of gold notes of the United States authorized by the act of Congress approved September 24, 1917, as amended. The notes will be dated and bear interest from June 15, 1922, will be payable December 15, 1925, and will bear interest at the rate of four and three-eighths per cent per annum payable semiannually on December 15 and June 15 in each year.

Applications will be received at the Federal Reserve Banks.

Bearer notes with interest coupons attached will be issued in denominations of \$100, \$500, \$1,000, \$5,000, \$10,000, and \$100,000. The notes are not subject to call for redemption before maturity, and will not be issued in registered form. The principal and interest of the notes will be payable in United States gold coin of the present standard of value.

The notes 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.

Notes of this 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 or within six months before the maturity of the notes. Any of the notes which have been owned by any person continuously for at least six months prior to the date of his death, and which upon such date constitute part of his estate, shall, under rules and regulations prescribed by the Secretary of the Treasury, be receivable by the United States at par and accrued interest in payment of any estate or inheritance taxes imposed by the United States, under or by virtue of any present or future law upon such estate or the inheritance thereof. The notes of this series will be acceptable to secure deposits of public moneys, but do not bear the circulation privilege.

The right is reserved to reject any subscription and to allot less than the amount of notes applied for and to close the subscriptions at any time without notice. Payment for notes allotted must be made on or before June 15, 1922, or on later allotment, in Victory notes of the $4\frac{3}{4}$ per cent series, which will be accepted at the Federal Reserve Banks at par, without adjustments of accrued interest, as of June 15, 1922. Victory notes in coupon form must have interest coupons attached maturing December 15, 1922, and May 20, 1923, but interest coupons maturing June 15, 1922, must be detached and collected in ordinary course when due. Victory notes in registered form must be duly assigned to the Secretary of the Treasury for redemption, in accordance with the general regulations of the Treasury Department governing assignments. After allotment and upon payment Federal Reserve Banks may issue interim receipts pending delivery of the definitive notes. Payment

for the notes now offered can not be made in cash or by credit, nor will Treasury certificates of indebtedness of any series be accepted in payment.

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 the amounts indicated by the Secretary of the Treasury to the Federal Reserve Banks of the respective districts.

OFFERING OF TREASURY CERTIFICATES OF INDEBTEDNESS

Series TJ-1923.

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 TJ-1923, dated and bearing interest from June 15, 1922, payable June 15, 1923, with interest at the rate of three 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 will have two interest coupons attached, payable December 15, 1922, and June 15, 1923.

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 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 do not bear the circulation privilege.

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 June 15, 1922, 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 TJ-1922 and Series TJ2-1922, both maturing June 15, 1922, and Series B-1922, maturing August 1, 1922, with any unmatured interest coupons attached, and Victory notes of the $3\frac{3}{4}$ per cent series (which have been called for redemption on June 15, 1922), will be accepted at par, with an adjustment of accrued interest, in payment for any certificates of the Series TJ-1923 now

offered which shall be subscribed for and allotted. Victory notes of the $3\frac{3}{4}$ per cent series in coupon form must have all unmatured coupons attached, and if in registered form must be duly assigned to the Secretary of the Treasury for redemption, in accordance with the general regulations of the Treasury Department governing assignments.

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 SECRETARY OF THE TREASURY
WASHINGTON

June 8, 1922.

Dear Sir:

As a holder of $4\frac{3}{4}$ per cent Victory notes, you will, I believe, be interested in the inclosed Treasury Department Circular No. 292, dated June 8, 1922, announcing an issue of United States Treasury notes of Series B-1925, which are offered only in exchange for $4\frac{3}{4}$ per cent Victory notes. Treasury notes of Series B-1925 will be dated June 15, 1922, will be payable December 15, 1925, and will bear interest at the rate of $4\frac{3}{8}$ per cent per annum, payable semiannually on December 15 and June 15 in each year. The new notes are issued only in coupon form, in denominations of \$100 and upwards. As you know, $4\frac{3}{4}$ per cent Victory notes mature on May 20, 1923, but may be called for redemption in whole or in part, at the option of the United States, on December 15, 1922, and it is the Treasury's intention to call a substantial amount for redemption on that date. This offering of Treasury notes, therefore, affords an opportunity to holders of $4\frac{3}{4}$ per cent Victory notes to acquire by exchange a new obligation of the United States running for three and a half years at an attractive rate of interest, in place of Victory notes which will be payable either December 15, 1922, or May 20, 1923, depending upon the call for redemption.

Almost any banking institution in the United States will handle the exchange for you, or you may make application direct to the Federal Reserve Bank of your district. Victory notes tendered in exchange, if in registered form, must be duly assigned to "The Secretary of the Treasury for redemption," before some officer authorized to witness assignments of United States registered bonds and notes, in accordance with the general regulations of the Treasury Department governing assignments. Coupon Victory notes must have the December 15, 1922, and May 20, 1923, coupons attached, but the June 15, 1922, coupons should be detached and collected in ordinary course. No adjustments of interest will be necessary in any case, since exchanges will be made as of June 15, 1922, and interest due on that date will be paid in ordinary course.

As you will notice from the circular, the right is reserved to reject any subscription and to allot less than the amount of notes applied for and to close the subscriptions at any time without notice. You should therefore, if you desire to make the exchange, make prompt application for the new notes through your own bank, or direct to the Federal Reserve Bank of your district, and make arrangements, preferably through your own bank, for the surrender to the Federal Reserve Bank of the $4\frac{3}{4}$ per cent Victory notes tendered in exchange.

Very truly yours,

A. W. Mellon

Secretary of the Treasury.

To the Holder of

$4\frac{3}{4}$ per cent Victory Notes addressed.

Enclosure: Treasury Department Circular No. 292, dated June 8, 1922.

2-12079

ADDRESS OF
HON. S. P. GILBERT, JR.,
UNDER SECRETARY OF THE TREASURY ,
BEFORE THE
MAINE BANKERS' ASSOCIATION,
JUNE 17, 1922.

THE REFUNDING OF THE WAR DEBT

I come to you from the Treasury at a time when the vast financial operations incident to June 15th are drawing to a close. The maturities of principal and interest on the public debt amounting to three quarters of a billion dollars, which fell due on that date, have now been met, a new offering of one year Treasury certificates at $3\frac{3}{4}$ per cent has been closed with an over-subscription of almost one hundred per cent, and the Treasury has announced that its offering of the new $4\frac{3}{8}$ per cent Treasury notes which was made at the same time in exchange only for $4\frac{3}{4}$ per cent Victory notes is proceeding satisfactorily and will itself close on next Thursday, June 22nd. This means that the Government's financial operations for the fiscal year ending June 30, 1922, are substantially completed and with all but two weeks of the financial year behind us it is now possible to estimate the results of the year. It is accordingly an appropriate time to take stock of what has been accomplished and to indicate in what direction the Treasury's program is leading.

First and foremost, it is now clear that the Government will balance its budget this fiscal year, and that there will even be a small surplus over and above current expenditures. That this has been accomplished in the face of the unfavorable prospects that confronted us at the beginning of the year is due to the unremitting efforts of the Government departments and establishments under the firm leadership of the President to reduce current expenditures to the utmost limits consistent with proper administration. And it is no mean accomplishment, for according to the present outlook total current expenditures for the year will be less than \$3,900,000,000, or at least 500 million dollars less than the spending departments themselves estimated would be necessary at the outset of the year.

Included within these current expenditures, which in the fiscal year 1921 by the way, had amounted to about \$5,500,000,000 on the same basis, are about \$425,000,000 of public debt expenditures on account of the cumulative sinking fund and other debt retirements chargeable against ordinary receipts. In other words, the Government has during the year now closing made that much progress in the gradual liquidation of its war debt and with its budget definitely established on this basis it should look forward to substantially similar progress each year in the years to come.

As for the fiscal year 1923, which opens on July 1, 1922, the prospects are not good, and according to the best estimates now available there will be a budget deficit of perhaps as much as \$360,000,000, or rather \$485,000,000 if, as properly should be, the \$125,000,000 of accumulated interest on War Savings Certificates of the Series of 1918 is taken into account. The appropriation bills for next year have not yet all been passed, and many measures are pending in Congress which would greatly swell expenditures and still further increase the indicated deficit. Nothing can be clearer, however, than that this Government owes it to itself and to the rest of the world to keep its finances clean and balance its budget in 1923 as in the three previous fiscal years, and that the only way to accomplish this is to reduce expenditures already estimated, and avoid new avenues of expenditure to such an extent as may be necessary to wipe out the indicated deficit. It would be a national calamity to impose additional taxes, and yet if there were persistence in any program of expenditures beyond the limits of the Government's income there would be no other course open than the introduction of new taxes to

restore the balance. During the past year the record has been rather one of reduction of the tax burden, and there are still larger reductions for the fiscal year 1923, amounting to about \$800,000,000 as compared with what would have been levied under the previous law, but it will not be possible to hold to these reductions, and certainly not to make the further reductions that are so necessary to the restoration of normal conditions in business and industry, unless all hands unite to keep Government expenditures down to the minimum and to avoid all manner of useless and extravagant expenditure.

The fundamental condition of this Government's program with respect to the public debt has thus been a sound policy with respect to current receipts and expenditures, and having been able for the three full fiscal years since the cessation of hostilities to balance its budget the Government has been in a position to make important progress within that period in the handling of the public debt. The keynote of its policy in that regard, as the President stated in his first address to Congress, has been orderly funding and gradual liquidation. It has been the traditional policy of this Government since its very foundation to set about paying its debts, and that policy it has consistently followed since the ending of the World War, with results that have a far-reaching significance in the development of our economic and financial situation.

This country came through the war with a gross public debt at the high point, on August 31, 1919, of \$26,596,000,000, an increase of almost 25½ billion dollars during the war period. This war debt, however, stood in quite a different position than the debt which resulted from the Civil war, and from the outset it had been arranged, as to both maturities and redemption privileges, in such a way as to assure adequate control to the Treasury

over the refunding and liquidation of the debt. The war debt at this stage included over 4 billions of Victory notes maturing within about 4 years and redeemable at the end of 3 years; over 4 billion dollars of Treasury certificates of indebtedness, all maturing within a year; almost a billion dollars of War Savings certificates maturing within 5 years; and over 16 billion dollars of Liberty bonds maturing at various dates from 1928 to 1947, and redeemable at various dates from 1927 to 1933. With the debt in this shape the Treasury was in a position to apply to the retirement of early maturing debt any surplus revenues that might accrue to it, whether from salvage or taxation, as well as any surplus funds that it might be able to make available through economies in the conduct of the Treasury's balances. On August 31, 1919, as it happened, the balance in the general fund of the Treasury had been at a high figure in order to prepare for early maturities of certificates of indebtedness and with the gradual reduction in the amount of loan certificates outstanding and the falling off in Government expenditures it became possible within the ensuing year to reduce the average balances in the general fund and to run the Treasury on a balance averaging about 400 million dollars, as compared with the average balance of a billion dollars or more that had been necessary during the preceding period. By this factor alone the public debt was reduced within a year by as much as 800 million dollars, while the total net reduction in the Treasury balance between August 31, 1919, and June 15, 1922, amounted to about 1 billion dollars, which accounts for a corresponding reduction in the principal of the public debt within that period. On June 15, 1922, after taking into account the operations which fell on that date, the total gross debt of the United States was about \$22,950,000,000, a total reduction since the peak of over \$3,600,000,000. The balance of this reduction after allowing for the 1 billion dollar item on account of the reduced balance in the general fund,

represents first the application of about \$200,000,000 of repayments by foreign governments to the retirement of liberty bonds in accordance with the requirements of the liberty bond acts; second, the receipt of funds from salvage and other realization on assets remaining over from the war, aggregating about \$1,400,000,000, and finally the application to debt retirement of about 1 billion dollars of surplus tax receipts during the fiscal years 1920, 1921, and 1922, chiefly through the sinking fund and other debt redemptions which are chargeable against ordinary receipts.

From now on the liquidation of the debt will have to be accomplished chiefly from surplus revenue receipts, and particularly through the sinking fund and other similar accounts. The treasury balance has already been reduced to about as low a figure as is consistent with the proper conduct of the Government's business, and there is little expectation of being able to accomplish further debt reduction by cutting down the working balances in depositaries. Some further realization on war assets may be expected to a limited extent through the sale of surplus supplies and equipment still held by the War Department, the Navy Department and the Shipping Board, but for the most part from realization on the Government's investments in war emergency corporations, such as the War Finance Corporation, and in securities of various classes, particularly those of Federal Land Banks and the obligations of carriers acquired under the Railroad Control Act and the Transportation Act. Of the war emergency corporations, the War Finance Corporation is now the most substantial and since it is due to expire by limitation on May 31, 1923, the Treasury should be able to count on receiving within the next year or two the bulk of its remaining investment in this corporation, amounting to about

\$250,000,000. A good part of this sum is already taken up in the estimated ordinary receipts for 1923 but much of it ought to be applied in ordinary course to the reduction of the public debt since it is now reflected in the Treasury's borrowings. The sinking fund and other similar accounts must be relied on, however, to accomplish the most substantial retirements of debt in the years to come, and as to them, the Treasury has already established the proposition in the first Budget which was submitted to Congress by the President in the fall of 1921 that expenditures on this account must be made out of ordinary receipts and be included in the ordinary budget on that basis. This means that provision must be made for these items of expenditure before the budget can balance, and a balanced budget each year thus means a reasonable amount of debt retirement out of current revenues. To do otherwise, of course, would make a farce of the sinking fund, for on any other basis purchases of obligations for retirement on this account would accomplish no debt retirement whatever and would simply mean a shifting of borrowings from one form to another.

So much for the liquidation of the public debt which the Treasury is accomplishing. It became clear early in this administration, however, that the gradual retirement of the debt from year to year would not suffice to provide for the maturities which fell due within the next two years, and that some program of orderly funding had to be adopted in order to put the short-dated debt in manageable shape and protect both the Treasury and the financial markets of the country against undue concentration of public debt maturities. On March 31, 1921, for example, the Treasury faced maturities of debt within the next two years, or thereabouts, aggregating over \$7,500,000,000 and of this amount over \$4,000,000,000 was concentrated in the Victory Liberty Loan maturing on May 20, 1923. The remainder consisted of about \$2,750,000,000 in Treasury Certificates of Indebtedness maturing within a year and about \$750,000,000 in War Savings Certificates. It was clear that the great bulk of this early maturing debt would have to be

refunded, and the Secretary accordingly announced on April 30, 1921, that it would be the Treasury's policy thereafter to vary its offerings of certificates of indebtedness from time to time with offerings of short-term notes at convenient intervals, with maturities of from three to five years.

The object of this policy was to distribute the short-dated debt over a longer period of years, chiefly between the maturity of the Victory loan in 1923 and the maturity of the Third Liberty Loan in 1928, and to do this in such a way as to spread the maturities of debt over the period in manageable amounts that might be taken up to some extent at least out of surplus revenue receipts accruing to the Government in those years. Pursuant to this program, five public offerings of Treasury notes have now been made, two for cash, in June and September, 1921, one for cash and in exchange for 4 3/4 percent Victory notes in February, 1922, and the other two only in exchange for 4 3/4 per cent Victory notes, in March and June, 1922. Every offering of notes has met with a hearty response and the Treasury has been able by this means to place about \$2,200,000,000 of the early maturing debt into more convenient maturities, and to reduce the Victory loan to manageable proportions. At the same time it has taken advantage of its right to call Victory notes for redemption before maturity, and by calling all the 3 3/4 percent notes for redemption on June 15 it has entirely eliminated that tax-exempt series. In connection with the June 15 offering of Treasury notes, moreover, the Secretary has announced his intention of calling for redemption on December 15, 1922, a substantial amount of the 4 3/4 percent Victory notes still outstanding. In fact enough has already been accomplished to assure the success of the Treasury's plans for the refunding of the short-dated debt and to relieve the country of the fear of disturbance from spectacular refunding operations, unless by the imposition of new burdens on the Treasury, present plans and policies should be disarranged.

The refunding already effected, after taking into account in round figures the results of the June 15 operations, shows remarkable progress as compared with the situation on April 30, 1921, when the refunding program was first announced. Victory notes now outstanding amount to only about 2 billion dollars as compared with over 4 billion dollars at that time. Treasury certificates aggregate about \$1,830,000,000 as compared with about \$2,750,000,000 and War Savings Certificates maturing or to be redeemed within the year amount to about \$650,000,000 as compared with about \$750,000,000 when the program began to operate. There are now outstanding, of course, about \$2,200,000,000 of entirely new obligations in the form of Treasury notes, but these mature at various dates in the years 1924, 1925 and 1926, and the Treasury should, accordingly, be able to frame its plans so as to take care of them at maturity out of surplus revenues or through secondary refunding operations if necessary, without undue strain to the financial markets.

There still remains outstanding, however, about \$4,500,000,000 of obligations maturing within less than a year, \$2,000,000,000 of which is in the form of Victory notes, and their refunding presents a problem that will require the best attention of the Treasury for practically the whole of the next fiscal year.

Related to this general refunding program is the problem of refunding the large maturity of War Savings Certificates which falls on January 1, 1923. In this connection the Treasury has already offered to the public a new issue of Treasury Savings Certificates in convenient form and denominations and yielding an attractive interest return, and it is hoped that by this means among others it will be possible to refund a large part

of the War Savings maturity into obligations of the same general character and with the same appeal to the needs of the small investor.

This sketch of the Government's refunding operations shows the course of the Treasury's program and the general direction in which its policy of orderly funding and gradual liquidation is leading.

It has been the firm policy of this Government from its very beginning to provide for the gradual liquidation of the public debt, and thoughtful people, I believe, are coming more and more to realize that a sound policy in this regard is fundamental not only to the economic development of the country but also to its preparedness for future emergencies. Ever since the days of Alexander Hamilton, successive Secretaries of the Treasury, particularly those Secretaries who have had the responsibilities of office during the periods following great wars, have been concerned largely with the problem of the funding and liquidation of the public debt, and in his last report to Congress on the public credit, Alexander Hamilton stated the guiding policy. "It will be the truest policy of the United States," he said, "to give all possible energy to public credit, by a firm adherence to its strictest maxims; and yet to avoid the ills of an excessive employment of it by true economy and system in the public expenditures; by steadily cultivating peace; and by using sincere, efficient and persevering endeavors to diminish present debts, prevent the accumulation of new, and secure the discharge, within a reasonable period, of such as it may be at any time matter of necessity to contract." In the same report Hamilton had said what is even today too frequently overlooked, that "Public and private credit are closely allied, if not inseparable. There is, perhaps, no example of the one being in a flourishing, where the other was in a bad state.

A shock to public credit would, therefore, not only take away the additional means which it has furnished, but by the derangements, disorders, distrusts, and false principles which it would engender and disseminate, would diminish the antecedent resources of private credit."

In an earlier report, Hamilton, in opposition to a plan which involved Government borrowing for some emergency purpose, had said, "Nothing can more interest the national credit and prosperity than a constant and systematic attention to husband all the means previously possessed for extinguishing the present debt, and to avoid, as much as possible, the incurring any new debt." Probably never before has the world furnished so many examples of the soundness of these principles, and sound financial policy on the part of the Government has proved more than ever to be perhaps the most essential condition of healthy economic development and progress. The budgets of many of the countries of Europe are still in chaos, and this has led to corresponding disturbance in international financial relations and instability in the foreign exchanges. This, in turn, has proved one of the greatest obstacles to the reestablishment of normal relationships and the reconstruction of international commerce.

As for this Government, its effort since the beginning of the war has been to keep its own house in order, to maintain the gold standard unimpaired and unrestricted, to finance the war on sound lines through taxation and through the absorption of Government obligations out of savings, and after the cessation of hostilities to balance its budget, current expenses against current income, and, at the same time to carry out a reasonable program for the gradual liquidation and orderly funding of the

war debt. This policy the Government has persistently followed from the beginning of the war to this date, and as a result it has come through the greatest war in history and through the exceedingly difficult period of readjustment which followed the war, with its credit not only unimpaired but greatly improved, with the dollar recognized as a standard of value throughout the world and with its banking system in sound condition to meet the peace-time demands of business and industry. Thus there has been laid the foundation for a healthful revival of business in this country on normal levels. At the same time it is, I think, becoming more and more recognized that the best hope for the gradual restoration of business and industry in Europe lies not only in the maintenance of sound financial conditions in this country, but also in the gradual adoption of similar principles by the Governments of Europe, many of which still persist in the policy of budgetary deficits and currency inflation. With the financial markets in this country able to absorb new issues of securities on reasonable terms, the countries of Europe which are willing and able to put their own finances in order are gradually finding themselves in a position to get the necessary capital for their rehabilitation through the sale of obligations to investors in this country. Through this means rather than by spectacular gold loans or far-reaching intergovernmental operations, this country may be expected to contribute its share to the reconstruction of Europe, just as in the days after our Civil war, European investors through their investments in our railroads and industries, contributed their share to the reconstruction of this country after that war and stimulated the great development of its resources which has followed.



THE SECRETARY OF THE TREASURY
WASHINGTON

July 26, 1922.

Dear Sir:

The Treasury is announcing to-day a call for the redemption on December 15, 1922, of about half of the $4\frac{3}{4}$ per cent Victory notes which remain outstanding, and at the same time is offering on the usual terms a new issue of \$300,000,000, or thereabouts, of short-term Treasury notes bearing interest at $4\frac{1}{4}$ per cent, with provision for additional allotments up to a limited amount in exchange for $4\frac{3}{4}$ per cent Victory notes.

These two operations mark an important further step in the development of the Treasury's refunding program, and I am sending this letter to the president of every banking institution in the country in order to draw attention to the significance of the announcements and ask the cooperation of the banks in affording to their customers ample facilities for investing in the new notes. The call for the partial redemption of $4\frac{3}{4}$ per cent Victory notes affects about \$1,000,000,000 face amount of notes, and makes the notes thus called for redemption payable on December 15, 1922, leaving the balance of the Victory Liberty Loan to mature on May 20, 1923, according to its terms. The notes called for redemption bear the distinguishing letters A, B, C, D, E, or F prefixed to their serial numbers, and can thus be readily distinguished from the notes not affected by the call. Copies of the official circulars will come to you from the Federal Reserve Bank of your district and additional copies may be obtained upon application.

The notes now offered for subscription are designated Treasury notes of Series B-1926, are dated August 1, 1922, will mature September 15, 1926, and will not be subject to call for redemption before maturity. The amount of the offering is \$300,000,000, or thereabouts, but the Secretary of the Treasury reserves the right to allot additional notes up to a limited amount to the extent that $4\frac{3}{4}$ per cent Victory notes are tendered in payment. Subscriptions may be closed at any time without notice, and the right is reserved to reject any subscription and to allot less than the amount applied for. Holders of outstanding $4\frac{3}{4}$ per cent Victory notes, whether or not called for redemption, thus have an opportunity now, within the limitations of the offering, to exchange their notes for new securities of the Government bearing interest at $4\frac{1}{4}$ per cent and running for a period of over three years after Victory notes would mature or be redeemed. Applications for the Treasury notes now offered will be received in regular course through the several Federal Reserve Banks, as fiscal agents of the United States, from which further particulars concerning the offering may be obtained. This is the fourth exchange offering which the Treasury has made in order to facilitate the refunding of the Victory Liberty Loan, and on this offering, as on previous offerings, I hope that banks and trust companies throughout the country will extend to their customers every possible assistance in effecting exchanges.

The Treasury's program for dealing with the short-dated debt of the Government has now progressed to such a point that I believe it is worth while to recite what has already been accomplished and call attention to what remains to be done within the current fiscal year. On April 30, 1921, when the situation was first outlined in my letter of that date to the Chairman of the Committee on Ways and Means, the gross public debt, on the basis of daily Treasury Statements, amounted to about \$23,995,000,000, of which over \$7,500,000,000 was short-dated debt maturing within about two

years, made up of over \$4,050,000,000 in Victory notes, over \$2,800,000,000 in Treasury certificates of indebtedness, and about \$650,000,000 in War Savings Certificates. By June 30, 1922, the gross public debt had been reduced to about \$22,963,000,000, a reduction of about \$1,032,000,000 during the period of 14 months. This reduction has taken place, for the most part, in the short-dated debt, and has been accomplished through the operation of the sinking fund and other public debt expenditures chargeable against ordinary receipts, the application of surplus revenues to the retirement of debt, and the reduction of the balance in the general fund. At the same time the Treasury has been engaged, through its refunding operations, in distributing substantial amounts of the remaining short-dated debt into more convenient maturities, and in this manner has refunded about \$2,250,000,000 of early maturing debt into Treasury notes of various series maturing in 1924, 1925, and 1926. As a result of these operations the amount of outstanding Victory notes has been reduced from over \$4,050,000,000 on April 30, 1921, to about \$1,990,000,000 on June 30, 1922, and the amount of outstanding Treasury certificates from over \$2,800,000,000 to about \$1,825,000,000. In addition there are about \$625,000,000 of War Savings Certificates of the Series of 1918 which become payable on January 1, 1923, so that on June 30, 1922, there still remained outstanding about \$4,440,000,000 of short-dated debt, all of which matures in the current fiscal year.

The refunding of this debt, most of which will have to be accomplished within the next ten months, presents a problem of first importance. The \$300,000,000, or thereabouts, of Treasury notes offered for subscription on the usual terms will provide for the Treasury certificates maturing August 1 and for the Treasury's remaining cash requirements between now and September 15, 1922, while the offering to allot additional notes in exchange for 4½ per cent Victory notes should accomplish the refunding of some more of the Victory Liberty Loan and correspondingly reduce the amount of Victory notes to be provided for upon redemption or maturity. At the same time the call for the redemption of about half of the outstanding Victory notes before maturity will make that much of the Victory Loan payable on December 15 of this year, and enable the Treasury to deal with it before maturity by appropriate refunding loans. This will mean that by January 1, 1923, the outstanding Victory notes will have been reduced to about \$1,000,000,000, or, in other words, a manageable maturity which can be dealt with as opportunity offers without spectacular refunding operations that would upset the security markets and disturb the course of business and industry.

The current offering of notes is thus an essential part of the refunding program on which the Treasury is engaged, and the banking institutions of the country by extending their facilities for the exchange of outstanding 4½ per cent Victory notes for the new notes will be performing an important service for the country as well as for their customers.

Cordially yours,

A. W. Mellon

Secretary.

To the President
of the Bank or Trust Company addressed.

THE WHITE HOUSE
Washington

September 19, 1922.

TO THE HOUSE OF REPRESENTATIVES:

Herewith is returned, without approval H.R. 10874, a bill "to provide adjusted compensation for the veterans of the World War, and for other purposes."

With the avowed purpose of the bill to give expression of a nation's gratitude to those who served in its defense in the world war, I am in accord, but to its provisions I do not subscribe. The United States never will cease to be grateful, it cannot and never will cease giving expression to that gratitude.

In legislating for what is called adjusted compensation Congress fails, first of all, to provide the revenue from which the bestowal is to be paid. Moreover, it establishes the very dangerous precedent of creating a treasury covenant to pay which puts a burden, variously estimated between four and five billions, upon the American people, not to discharge an obligation, which the government always must pay, but to bestow a bonus which the soldiers themselves, while serving in the world war, did not expect.

It is not to be denied that the nation has certain very binding obligations to those of its defenders who made real sacrifices in the world war, and who left the armies injured, disabled or diseased, so that they could not resume their places in the normal activities of life. These obligations are being gladly and generously met. Perhaps there are here and there inefficiencies and injustices, and some distressing instances of neglect, but they are all unintentional, and every energy is being directed to their earliest possible correction. In meeting this obligation there is no complaint about the heavy cost. In the current fiscal year we are expending \$510,000,000 on hospitalization and care of sick and wounded, on compensation and vocational training for the disabled, and for insurance. The figures do not include the more than \$35,000,000, in process of expenditure on hospital construction. The estimates for the year to follow are approximately \$470,000,000, and the figures may need to be made larger. Though the peak in hospitalization may have passed, there is a growth in domiciliation, and the discharge in full of our obligations to the diseased, disabled, or dependent who have a right to the government's care, with insurance-liability added, will probably reach a total sum in excess of \$25,000,000,000.

More than 99,000 veterans are now enrolled in some of the 445 different courses in vocational training. Fifty-four thousand of them are in schools or colleges, more than 38,000 are in industrial establishments, and a few more than 6,000 are being trained in schools operated by the Veterans' Bureau.

Approximately nineteen thousand have completed their courses and have employment in all cases where they desire it, and 53,000 have deferred for the present time their acceptance of training. The number eligible under the law may reach close to 400,000, and facilities will continue to be afforded, unmindful of the necessary cost, until every obligation is fulfilled.

Two Hundred and seventy-six thousand patients have been hospitalized, more than a quarter of a million discharged, and 25,678 patients are in our hospitals today.

Four hundred and sixteen thousand awards of compensation have been made on account of death or disability, and \$480,000,000 have been paid to disabled men or their dependent relatives. One hundred and seventy-five thousand disabled ex-service men are now receiving compensation along with medical or hospital care where needed, and a quarter of a million checks go out monthly in distributing the eight-million dollar payment on indisputable obligations.

I recite the figures to remind the Congress how generously and how properly it has opened the treasury doors to discharge the obligations of the nation to those to whom it indisputably owes compensation and care. Though undying gratitude is the need of every one who served, it is not to be said that a material bestowal is an obligation to those who emerged from the great conflict not only unharmed, but physically, mentally and spiritually richer for the great experience. If an obligation were to be admitted, it would be to charge the adjusted compensation bill with inadequacy and stinginess wholly unbecoming our republic. Such a bestowal, to be worth while, must be generous and without apology. Clearly the bill returned herewith takes cognizance of the inability of the government wisely to bestow, and says, in substance, "we do not have the cash, we do not believe in a tax levy to meet the situation, but here is our note, you may have our credit for half its worth". This is not compensation, but rather a pledge by the Congress, while the Executive Branch of the government is left to provide for payments falling due in everincreasing amounts.

When the bill was under consideration in the House I expressed the conviction that any grant of bonus ought to provide the means of paying it, and I was unable to suggest any plan other than that of a general sales tax. Such a plan was unacceptable to the Congress, and the bill has been enacted without even a suggested means of meeting the cost. Indeed, the cost is not definitely known, either for the immediate future, or in the ultimate settlement. The treasury estimates, based on what seems the most likely exercise of the options, figures the direct cost at approximately \$145,000,000, for 1923, \$225,000,000 for 1924, \$114,000,000 for 1925, \$312,000,000 for 1926, making a total of \$795,000,000 for the first four years of its operation, and a total cost in excess of \$4,000,000,000. No estimate of the large indirect cost ever had been made. The certificate plan sets up no reserve against the ultimate liability. The plan avoids any considerable direct outlay by the government during the earlier years of the bill's proposed operations, but the loans on the certificates would be floated on the credit of the nation. This is borrowing on the nation's credit just as truly as though the loans were made by direct government borrowing, and involves a dangerous abuse of public credit. Moreover, the certificate plan of payment is little less than certified inability of the government to pay, and invites a practice on sacrificial barter which I cannot, sanction.

It is worth remembering that the public credit is founded on the popular belief in the defensibility of public expenditure, as well as the government's ability to pay. Loans come from every rank in life, and our heavy tax burdens reach, directly or indirectly, every element in our citizenship. To add one-sixth of the total sum of our public debt for a distribution among less than five millions out of one hundred and ten millions, whether inspired by grateful sentiment or political expediency, would undermine the confidence on which our credit is builded, and establish the precedent of distributing public funds whenever the proposal and the numbers affected make it seem politically appealing to do so.

Congress clearly appraised the danger of borrowing directly to finance a bestowal which is without obligation, and manifestly recognized the financial problems with which the nation is confronted. Our maturing promises to pay within the current fiscal year amount to approximately \$4,000,000,000, most of which will have to be refunded. Within the next six years more than \$10,000,000,000 of debt will mature, and will have to be financed. These outstanding and maturing obligations are difficult enough to meet without the addition of added borrowings, every one of which threatens higher interest, delays the adjustment to stable government financing and the diminution of federal taxes to the defensible cost of government.

It is sometimes thoughtlessly urged that it is a simple thing for the rich republic to add four billions to its indebtedness. This impression comes from the readiness of the public response to the government's appeal for funds amid the stress of war. It is to be remembered that in the war everybody was ready

to give his all. Let us not recall the comparatively few exceptions. Citizens of every degree of competence loaned and sacrificed, precisely in the same spirit that our armed forces went out for service. The war spirit impelled. To a war necessity there was but one answer, but a peace bestowal on the ex-service men, as though the supreme offering could be paid for with cash, is a perversion of public funds, a reversal of the policy which exalted patriotic service in the past, and suggests that future defense is to be inspired by compensation rather than consciousness of duty to flag and country.

The pressing problem of the government is that of diminishing our burdens, rather than adding thereto. It is the problem of the world. War inflations and war expenditures have unbalanced budgets and added to indebtedness until the whole world is staggering under the load. We have been driving in every direction to curtail our expenditures and establish economies without impairing the essentials of governmental activities. It has been a difficult and unpopular task. It is vastly more applauded to expend than to deny. After nearly a year and a quarter of insistence and persuasion, with a concerted drive to reduce government expenditures in every quarter possible, it would wipe out everything thus far accomplished to add now this proposed burden, and it would rend the commitment to economy and saving so essential to our future welfare.

The financial problems of the government are too little heeded until we are face to face with a great emergency. The diminishing income of the government, due to the receding tides of business and attending incomes, has been overlooked momentarily, but cannot be long ignored. The latest budget figures for the current fiscal year show an estimated deficit of more than \$650,000,000, and a further deficit for the year succeeding, even after counting upon all interest collections on foreign indebtedness which the government is likely to receive. To add to our pledges to pay, except as necessity compels, must seem no less than governmental folly. Inevitably it means increased taxation, which Congress was unwilling to levy for the purposes of this bill, and will turn us from the course toward economy so essential to promote the activities which contribute to common welfare.

It is to be remembered that the United States played no self-seeking part in the world war, and pursued an unselfish policy after the cause was won. We demanded no reparation for the cost involved, no payments out of which obligations to our soldiers could be met. I have not magnified the willing outlay in behalf of those to whom we have a sacred obligation. It is essential to remember that a more than four-billion-dollar pledge to the able-bodied ex-service men now will not diminish the later obligation which will have to be met when the younger veterans of today shall contribute to the rolls of the aged, indigent and dependent. It is as inevitable as that the years will pass, that pension provision for world war veterans will be made, as it has been made for those who served in previous war. It will cost more billions than I venture to suggest. There will be justification when the need is apparent, and a national financial policy today is necessary to make the nation ready for the expenditure which is certain to be required in the coming years. The contemplation of such a policy is in accord with the established practice of the nation, and puts the service men of the world war on the same plane as the millions of men who fought the previous battles of the republic.

I confess a regret that I must sound a note of disappointment to the many ex-service men who have the impression that it is as simple a matter for the government to bestow billions in peace as it was to expend billions in war. I regret to stand between them and the pitiably small compensation proposed. I dislike to be out of accord with the majority of Congress which has voted the bestowal. The simple truth is that this bill proposes a government obligation of more than four billions without a provision of funds for the extraordinary expenditure, which the Executive Branch of the government must finance in the face of difficult financial problems, and the complete defeat of our commitment to effect economies. I would rather appeal, therefore, to the candid reflections of Congress and the country, and to the ex-service men in particular, as to the course better suited to further the welfare of our country. These ex-soldiers who served so gallantly in war, and who are to be so conspicuous in the progress of the republic in the half century before us, must know that nations can only survive where taxation is restrained from the limits of oppression, where the public treasury is locked against class legislation, but ever open to public necessity and prepared to meet all essential obligations. Such a policy makes a better country for which to fight, or to have fought, and affords a surer abiding place in which to live and attain.

WARREN G. HARDING.

A Report to U. S. Stockholders

By S. P. GILBERT, Jr.

Undersecretary of the Treasury

THE TREASURY began the current fiscal year, on July 1, 1922, facing on the one hand an estimated deficit for the year, on the basis of the latest Budget figures, amounting to well over \$600,000,000, and on the other hand the necessity of refinancing about \$4,450,000,000 of short-dated debt maturing within the year, in the form of Victory notes, War Savings certificates and Treasury certificates of indebtedness. With these vast refunding operations to carry on, it is, of course, of the first importance that the Budget should balance for the year, making provision at the same time for meeting regular annual charges like the sinking fund and leaving no deficit to be financed by new borrowings. The primary problem of the year, therefore, has been to reduce expenditures to such an extent as to bring the Budget into balance, and to this problem the whole administration, under the leadership of the President, is addressing itself.

These efforts, under the Budget system, are concentrated and coordinated through the Bureau of the Budget, which has now become established as the arm of the Executive to enforce economies in the administrative expenditures of the Government.

The table on the next page, giving the latest Budget estimates of receipts and expenditures for the present fiscal year, shows the dimensions of the problem.

Eliminating the Deficit

THESE estimates, it will be noted, include among the receipts, payments of about \$225,000,000 as interest on foreign obligations, about \$200,000,000 of which represents interest on the British debt to the United States, and also \$100,000,000 of expected returns to the Treasury as a result of the gradual liquidation of the War Finance Corporation. On the other hand, the estimates of expenditures, which are based on the figures received from the several spending departments and establishments, make no allowance for extraordinary expenditures not already provided for by legislation, as, for example, a soldiers' bonus, and the indicated deficit of \$672,000,000 is entirely without regard to any charges of this character.

To reduce the deficit, and if possible eliminate it by the end of the year, is the end toward which the whole administration is striving, and the best hope of accomplishing it will be through increased revenues from realization on securities and surplus property, and more particularly in further reductions in expenditure.

An analysis of the figures given in the accompanying statement shows which direction these efforts can take and how difficult it is to deal with many items of expenditure. To a large extent, for example, expenditures are not subject to modification by executive control, particularly such items as interest on the public debt, \$975,000,000; trust fund investments, \$34,362,000; pensions, \$271,850,000; Indians, \$32,487,682; customs and internal revenue refunds, \$52,962,197; good roads, \$125,684,000; and, for the most part, veterans' relief, amounting to \$532,168,160. Of the remainder, \$349,706,000 represents estimated expenditures of the War Department, \$305,236,200 estimated expenditures of

THE BUSINESS MAN who, looking ahead for the year, sees an almost certain deficit facing his concern, calls in his associates and begins to plan radical measures. The United States Government, already heavily in debt, is looking ahead to an estimated deficit for the current fiscal year.

What is the Government doing about it? That is what the public wants to know; and in this article by a Treasury official you are given a complete financial statement, together with a frank discussion of the country's position and what the administration hopes to accomplish.

—THE EDITOR.

the War Department, \$284,453,847 for the railroads, and \$137,031,765 estimated expenditures of the Shipping Board and Emergency Fleet Corporation, leaving only a relatively small amount for all other departments and establishments subject to executive control.

The deficit, however, must be overcome, for nothing can be clearer than that this Government owes it to itself and to the rest of the world to keep its finances clean and to make every effort to balance its Budget in 1923 and in 1924 as successfully as in the three previous fiscal years. The sound way to accomplish this is to reduce expenditures and to avoid new avenues of expenditure to such an extent as may be necessary to wipe out the indicated deficits. It would be a national calamity to impose additional taxes, and yet if there were persistence in any program of expenditure beyond the limits of the Government's income there would be no other course open than the introduction of new taxes to restore the balance. During the fiscal year 1922 the Government made a record of reduction in the tax burden, and there are still larger reductions for the fiscal year 1923, amounting to about \$800,000,000 as compared with what would have been levied under the old law, but it will not be possible to hold to these reductions, and certainly not to make the further reductions that are so necessary to the restoration of normal conditions in business and industry, unless all hands unite to keep government expenditures down to the minimum and to avoid all manner of useless and extravagant expenditure.

The fundamental condition of the Treasury's program since the war has been a sound policy with respect to current receipts and expenditures, and having been able for the three full fiscal years since the cessation of hostilities to balance its Budget, the Treasury has been in a position to make important progress within the same period in the handling of the public debt. The keynote of its policy in that regard, as the President stated in his first address to Congress, has been orderly funding and gradual liquidation. It has been the traditional policy of

this Government since its very foundation to set about paying its debts, and that policy it has consistently followed since the ending of the World War, with results that have a far-reaching significance in the development of our economic and financial situation.

This country came through the war with a gross public debt at the high point, on August 31, 1919, of \$26,596,000,000, an increase of over twenty-five billion dollars during the war period. On August 31, 1922, the total gross debt stood at \$23,042,000,000, a reduction since the peak of about \$3,554,000,000. The greater part of this reduction has been accomplished through (1) the reduction in the balance in the general fund of the Treasury, (2) the operation of the sinking fund and other debt retirements chargeable to ordinary receipts, and (3) the application to debt retirement of receipts from salvage and other liquidation of war assets and, to a much smaller extent, through the use of ordinary revenues.

From now on the liquidation of the debt will have to be accomplished largely from surplus revenue receipts, through the operation of the sinking fund and other similar accounts. The Treasury balance has already been reduced to about as low a figure as is consistent with the proper conduct of the Government's business, and there is little hope of being able to accomplish further debt reduction by cutting down the working balances in depositaries. Some further realization on war assets may be expected, to a limited extent, through the sale of surplus supplies and equipment still held by the War Department, the Navy Department and the Shipping Board, and to a much larger extent through realization on the Government's investment in war emergency corporations, such as the War Finance Corporation, and in securities of various classes, particularly those of the Federal Land Banks and the obligations of carriers acquired under the Federal Control Act and the Transportation Act.

The Nation's Debt

THE sinking fund and other similar accounts must be relied on, however, to accomplish most of the debt retirement in the years to come, and the Treasury has already established the proposition, in the first Budget submitted to Congress by the President in the fall of 1921, that expenditures on these accounts must be made out of ordinary receipts and be included in the ordinary Budget on that basis. This means that provision has to be made for these items of expenditure before the Budget can balance, and a balanced Budget each year thus means a reasonable amount of debt retirement out of current revenues.

The most immediate problem affecting the debt has been, of course, the refinancing of the short-dated debt, and the Treasury's refunding program has now progressed to such a point that I believe it is worth while to recite what has already been accomplished and call attention to what remains to be done within the current fiscal year.

On April 30, 1921, when the situation was first outlined in the Secretary's letter of that date to the chairman of the Committee on Ways and Means, the gross public debt,

on the basis of daily Treasury statements, amounted to about \$23,995,000,000, of which over \$7,500,000,000 was short-dated debt maturing within about two years. By August 31, 1922, the gross public debt had been reduced to about \$23,042,000,000, a reduction of about \$953,000,000 during the period of 16 months. This reduction has taken place, for the most part, in the short-dated debt, and has been accomplished in the manner already outlined.

At the same time the Treasury has been engaged, through its refunding operations, in distributing substantial amounts of the remaining short-dated debt into more convenient maturities, and in this manner has refunded about \$2,742,000,000 of early maturing debt into Treasury notes of various series maturing in 1924, 1925 and 1926. As a result of these operations the amount of outstanding Victory notes has been reduced from over \$4,050,000,000 on April 30, 1921, to about \$1,838,000,000 on August 31, 1922, and the amount of outstanding Treasury certificates of the series of 1918 which become payable on January 1, 1923, so that on August 31, 1922, there still remained outstanding about \$4,000,000,000 of short-dated debt, all maturing in the current fiscal year, as compared with about \$4,450,000,000 outstanding when the fiscal year began.

As a result of short-term refunding operations already undertaken for September 15, in connection with the quarterly tax payment and Treasury certificate maturities falling on that date, about \$227,000,000 of this amount will be refunded into one year Treasury certificates maturing September 15, 1923, at 3 3/4 per cent, so that on September 30, 1922, the gross public debt ought to stand at about \$22,870,000,000, of which \$3,596,000,000 would be debt maturing within the fiscal year, \$1,805,000,000 of it in the form of Victory notes, \$1,160,000,000 in the form of Treasury certificates, and \$625,000,000 in the form of War Savings certificates.

Of the Victory notes still outstanding, about \$900,000,000 fall due on December 15, 1922, having been called for redemption on that date, while the balance becomes payable at maturity on May 20, 1923. The refinancing of these obligations will require important further refunding operations by the Treasury during the year, but enough progress has already been made in the handling of the Victory Liberty Loan to show that the Treasury's refunding program is well adapted to meet the needs of the situation. Its successful development should relieve the mar-

kets of the fear of spectacular refunding loans and permit necessary financing of business and industry to proceed without undue interference from government operations.

Related to this refunding is the problem of refunding the large maturity of War Savings certificates which falls on January 1, 1923. In this connection the Treasury is offering to the public a new issue of Treasury savings certificates in convenient form and denominations and yielding an attractive interest return, and hopes that by this means it will be possible to refund a large part of the War Savings maturity into obligations of the same general character and with the same appeal to the needs of the small investor.

This sketch of the Government's refunding operations shows the course of the Treasury's program and the general direction in which its policy of orderly funding and gradual

liquidation is leading. Thoughtful people, I believe, are coming more and more to realize that a sound policy in this regard is fundamental not only to the economic development of the country but also to its preparedness for future emergencies, and probably never before has the world furnished so many examples of its importance. The budgets and currencies of many of the countries of Europe are still in chaos, and this has led to corresponding disturbance in international financial relations and instability in the foreign exchanges. This, in turn, has proved one of the greatest obstacles to the reestablishment of normal relationships and rehabilitation of international trade.

It has been the constant effort of this government, on the other hand, to keep its own house in order, to maintain the gold standard unimpaired and unrestricted, to

finance the war on sound lines through taxation and through the absorption of government obligations out of savings, and after the cessation of hostilities to balance its Budget current expenses against current income, and, at the same time to carry out a reasonable program for the gradual liquidation and orderly funding of the war debt. This policy the Treasury has persistently followed from the beginning of the war to this date, and as a result this country has come through the greatest war in history and through the exceedingly difficult period of readjustment which followed the war, with its credit not only unimpaired but greatly improved, with the dollar recognized as the standard throughout the world and with its banking system in sound condition to meet the peace-time demands of business and industry. Thus there has been laid the foundation for a healthful revival of business on normal levels.

At the same time it is, I think, becoming more and more recognized that the best hope for the gradual restoration of business and industry in Europe lies not only in the maintenance of sound financial conditions in the United States but also in the gradual adoption of similar principles by the governments of Europe many of which still persist in policies of budgetary deficit and currency inflation. With the financial markets here able to absorb new issues of securities on reasonable terms, the countries of Europe which are willing and able to put their own finances in order and gradually finding themselves in a position to get the necessary capital for their rehabilitation through the sale of obligations to investors in this country.

Through this means rather than by spectacular gold loans or far-reaching inter-governmental operations, this country may be expected to contribute to the rebuilding of Europe.

Estimated Government Receipts and Expenditures, Fiscal Year 1923

(On Budget Basis, Revised)

RECEIPTS

Customs		\$375,000,000
Internal revenue:		
Income and profits taxes	\$1,300,000,000	
Miscellaneous internal revenue	900,000,000	2,200,000,000
Miscellaneous revenue:		
Sales of public lands	\$ 1,500,000	
Federal Reserve Bank franchise tax receipts	10,000,000	
Interest on foreign obligations	225,000,000	
Repayments of foreign obligations	31,300,000	
Sale of surplus war supplies	60,000,000	
Panama Canal	12,315,000	
Other miscellaneous	183,710,311	523,825,311
Total receipts		\$3,098,825,311

EXPENDITURES

Ordinary expenditures not subject to Executive control:		
Legislative		\$13,643,626
Ordinary expenditures for operation of the routine business of government generally subject to Executive control:		
Executive office	\$ 334,645	
State Department	16,207,193	
Treasury Department	132,356,986	
War Department, exclusive of Panama Canal	305,236,200	
Panama Canal	7,147,673	
Navy Department	349,706,000	
Interior Department proper	42,911,429	
Indian Service	32,487,682	
Department of Agriculture, exclusive of "Good Roads"	60,023,100	
Department of Commerce	19,200,360	
Department of Labor	7,192,558	
Department of Justice	4,834,450	
Judicial	14,979,891	
Independent offices:		
United States Veterans' Bureau	532,168,160	
Shipping Board and Emergency Fleet Corporation	137,031,765	
Federal Board for Vocational Education	5,711,042	
All other	16,825,989	
District of Columbia	23,908,012	1,708,263,135
Deficiencies in postal revenue		36,004,566
Operations in special funds:		
Railroad administration and transportation act ..	\$284,453,847	
War Finance Corporation	(a) 100,000,000	184,453,847
Expenditures not subject to modification by Executive control:		
Customs and internal revenue refunds	52,962,195	
Pensions	271,850,000	
Good roads	125,684,000	
Increase of compensation	38,735,173	489,231,368
Reduction in principal of public debt, chargeable to ordinary receipts:		
Sinking fund	284,000,000	
Purchase of Liberty bonds from foreign repayments	31,300,000	
Redemption of bonds and notes from estate taxes	5,000,000	
Redemption of securities from Federal Reserve Bank franchise tax receipts	10,000,000	330,300,000
Investment of trust funds:		
Government life insurance fund	26,162,000	
Civil Service retirement fund and District of Columbia teachers' retirement fund	8,200,000	34,362,000
Interest on the public debt		975,000,000
Total expenditures chargeable to ordinary receipts		\$3,771,258,542
Excess of expenditures		\$672,433,231
(a) Excess of credits, deduct.		



THE SECRETARY OF THE TREASURY
WASHINGTON

October 9, 1922.

Dear Sir:

I am sending you herewith a copy of the official Treasury Department Circular announcing the offering of $4\frac{1}{4}$ per cent Treasury bonds of 1947-52 for which subscription books open to-day. The offering is for \$500,000,000, or thereabouts, with the right reserved to the Secretary of the Treasury to allot additional bonds to the extent that $4\frac{3}{4}$ per cent Victory notes or Treasury certificates maturing December 15th are tendered in payment.

The new bonds will be 25/30 year bonds, dated October 16, 1922, maturing October 15, 1952, and redeemable at the option of the United States on and after October 15, 1947. The bonds will be issued in both coupon and registered form, in denominations of \$100 and upwards. Applications will be received through the Federal Reserve Banks, and the Treasury is prepared to make deliveries promptly upon allotment and payment. Subject to the limitations on the amount of the offering, allotments will be made in full, in the order of receipt of application, upon subscriptions for amounts not exceeding \$10,000 for any one subscriber, and upon subscriptions for which either $4\frac{3}{4}$ per cent Victory notes or Treasury certificates maturing December 15th are tendered in payment. Other applications for amounts exceeding \$10,000 for any one subscriber will be received subject to allotment.

This is a refunding issue, and it affords a particularly favorable opportunity to holders of $4\frac{3}{4}$ per cent Victory notes to acquire a long-time Government bond on attractive terms in place of Victory notes which will mature or be redeemed within the next few months. I am, therefore, addressing this letter to the heads of all banking institutions in the country, and asking you to provide every possible facility for investing in the new bonds. I hope that you will also make a special effort to bring the offering to the attention of your customers, large and small, for it is the Treasury's desire to secure the widest possible distribution of the bonds among investors.

I think you will be interested in this connection to know what has already been accomplished in the refunding of the short-dated debt, and what still remains to be done. On April 30, 1921, when the Treasury first announced its refunding program, the gross public debt, on the basis of daily Treasury statements, amounted to about \$24,000,000,000, of which over \$7,500,000,000 was maturing within about two years. On September 30, 1922, the total gross debt on the same basis stood at about \$22,800,000,000, and of the early maturing debt about \$4,000,000,000 had already been retired or refunded, chiefly into short-term Treasury notes with maturities spread over the next four fiscal years. There will fall due this fiscal year about \$1,100,000,000 of Treasury certificates of indebtedness, about \$625,000,000 maturity value of War-Savings Certificates of the Series of 1918, and about \$1,800,000,000 of Victory notes. Of the Treasury certificates, about \$48,000,000 represents Pittman Act certificates which will be retired this year through the recoinage of silver bullion, while about \$100,000,000 of loan certificates maturing October 16, 1922, will be paid out of funds already in hand. The retirement of these certificates will leave only tax certificates outstanding, and it will in any event continue to be desirable, with income and profits tax payments as large as they are, for the Treasury to have

outstanding at least \$1,000,000,000 of tax certificates in amounts and with maturities conforming to the quarterly tax payments. This correspondingly reduces the amount of necessary refunding into other securities.

After October 16, 1922, the next maturities fall on December 15th, and include about \$870,000,000 face amount of 4½ per cent Victory notes called for redemption, and about \$420,000,000 of maturing tax certificates of Series TD and TD2-1922, against which the Treasury will receive in December about \$250,000,000 of income and profits taxes. On January 1, 1923, the \$625,000,000 of War-Savings Certificates become payable, but the Treasury has already announced, as you know, a new offering of Treasury Savings Certificates with a view to refunding as much as possible of the maturity into obligations of the same general character and with the same appeal to the needs of the small investor. The Treasury will shortly announce special facilities for the exchange of maturing War-Savings Certificates for the new Treasury Savings Certificates, and plans in this manner to provide for a substantial part of the War-Savings maturity. The only Treasury certificates maturing in the second half of the fiscal year 1923 are about \$266,000,000 on March 15, 1923, and about \$273,000,000 on June 15, 1923, both of which are covered by the income and profits tax payments estimated for those dates. On May 20, 1923, the remaining \$930,000,000 of 4½ per cent Victory notes will mature according to their terms.

The maturities which remain and have to be refunded the Treasury will meet through issues of refunding securities, properly adjusted to market conditions, and I believe it will be able to meet them, as it has in the past, without disturbance to the markets and without strain on the financial machinery. During the course of the refunding operations which have been in progress the Treasury has issued from time to time Treasury certificates of indebtedness, Treasury notes and Treasury Savings Certificates, all relatively short-term. These operations have been successful and have been accomplished without disturbance to the market for outstanding securities. With the announcement of the bonds now offered, the Treasury is adding to its list a refunding issue of long-time bonds, on a basis which should prove particularly attractive to investors. These bonds will provide, through exchanges and otherwise, for a substantial part of the heavy maturities falling on December 15th, and the success of the offering will leave only a normal amount of financing to be placed on that date.

It is four years since the Treasury has offered to the people of the United States an issue of long-time Government bonds. During that period it has been financing itself on a short-term basis, and it has succeeded, with your cooperation, in placing with investors throughout the country a great volume of Treasury certificates and Treasury notes. Now that the time has come for a longer-term operation, I am looking forward with confidence to your continued support, and hope that, as with previous offerings of Government securities, you will give your best efforts to the distribution of the new Treasury bonds among investors.

Cordially yours,

A. W. Mellon

Secretary of the Treasury.

1 enclosure.

To the
President of the
Banking institution addressed.



THE SECRETARY OF THE TREASURY

WASHINGTON

October 9, 1922.

Dear Sir:

I am sending you herewith a copy of the official Treasury Department Circular announcing the new offering of $4\frac{1}{4}$ per cent Treasury bonds of 1947-1952. The subscription books open to-day, and $4\frac{3}{4}$ per cent Victory notes, whether or not called for redemption, and Treasury Certificates of the series maturing December 15, 1922, will be accepted in payment, on the terms stated in the circular. The new bonds will be 25/30 year bonds, dated October 16, 1922, maturing October 15, 1952, and redeemable at the option of the United States on and after October 15, 1947. The bonds will be issued in both coupon and registered form, in denominations of \$100 and upwards. The Treasury is prepared to make deliveries promptly upon allotment and payment.

This offering of Treasury bonds affords a particularly favorable opportunity to holders of $4\frac{3}{4}$ per cent Victory notes to acquire a long-time Government bond on attractive terms in place of Victory notes which will mature or be redeemed within the next few months. All $4\frac{3}{4}$ per cent Victory notes bearing the distinguishing letters A, B, C, D, E, or F prefixed to their serial numbers have, as you know, been called for redemption on December 15, 1922, and will cease to bear interest on that date, while the remaining $4\frac{3}{4}$ per cent Victory notes mature on May 20, 1923, according to their terms. Victory notes tendered in payment, if in registered form, must be duly assigned to "The Secretary of the Treasury for redemption," before some officer authorized to witness assignments of United States registered bonds, in accordance with the the general regulations of the Treasury Department governing assignments. Coupon Victory notes must have the December 15, 1922, and May 20, 1923, coupons attached.

Holders of Victory notes who wish to invest in the new bonds should make prompt application through their own banks, or, if desired, direct to the Federal Reserve Bank of the district.

Very truly yours,

A. W. Mellon

Secretary of the Treasury.

To the Holder of
Victory notes addressed.

Inclosure: Treasury Department Circular No. 307, dated October 9, 1922.

TREASURY DEPARTMENT.

FOR RELEASE, Morning papers,
Monday, November 20, 1922.

Washington, Nov. 19 - Secretary Mellon wants the spirit of thrift developed during the World War to continue. "War-Savings Stamps sold to help finance the war," said the Secretary, "started a savings movement which the Treasury Department hopes to see continue and expand. The first issue of these stamps, the Series of 1918, amounting to about \$625,000,000, will be due January 1, 1923. The Treasury Department could refund this part of the war debt into securities of a different character, but instead, it is offering in exchange a new issue of Treasury Savings Certificates, with the same general characteristics but in more convenient form, in the belief that large numbers of people who saved their money during the war by investing in War-Savings Stamps will wish to continue their investment and exchange their stamps for Treasury Savings Certificates. These certificates are even more attractive than the War-Savings Stamps which they superseded, and sell at a slightly lower price, with maturity in each case 5 years from the date of issue. It is the desire of the Department to have as many people as possible interested in the Government's finances, and particularly to share in the benefits of investment in its securities. Like good morals, honesty, and correct deportment, thrift takes its place among the standards which make for good living and contentment. The Government is endeavoring to carry its campaign of education along these lines to every household in the country, and the Treasury Department is urging the owners of War-Savings Stamps to reinvest the original principal and the interest which it has earned in another gilt-edged Government security, yielding a good interest return. For that reason special arrangements have been made for the exchange of War-Savings Stamps for the new Treasury Savings Certificates, information as to which is available at banks and post-offices throughout the country."

COMPTROLLER GENERAL OF THE UNITED STATES

A. D. 7243.

Washington

November 29, 1922.

The Honorable

The Secretary of the Treasury.

Sir:

I have your letter of November 2, 1922, requesting decision as to whether you are authorized to revoke certain allocations of silver made pursuant to the terms of the act of April 23, 1918, 40 Stat., 535, for subsidiary silver coinage.

The act of April 23, 1918, 40 Stat., 535, generally known as the Pittman Act, is entitled "An Act to conserve the gold supply of the United States; to permit the settlement in silver of trade balances adverse to the United States; to provide silver for subsidiary coinage and for commercial use; to assist foreign governments at war with the enemies of the United States; and for the above purposes to stabilize the price and encourage the production of silver".

Section 1 of the act, among other things, authorized the Secretary of the Treasury from time to time to melt or break up and sell as bullion, at prices not less than \$1 per ounce of silver one thousand fine, not in excess of three hundred and fifty million standard silver dollars then or thereafter held in the Treasury of the United States.

Section 2 of the act provided, among other things, upon every such sale of bullion from time to time, that the Secretary of the Treasury direct the Director of the Mint to purchase in the United States, of the product of mines situated in the United States and of reduction works so located, an amount of silver equal to three hundred

and seventy-one and twenty-five hundredths grains of pure silver in respect to every standard silver dollar as melted or broken up and sold as bullion, such purchases to be made at the fixed price of \$1 per ounce of silver one thousand fine.

Section 3 of the act provided, among other things, that the allocation of any silver to the Director of the Mint for subsidiary coinage shall, for the purposes of the act, be regarded as a sale or resale.

Section 4 of the act provided an appropriation to reimburse the Treasurer of the United States for the difference between the nominal or face value of all standard silver dollars so melted or broken up and the value of the silver bullion, at \$1 per ounce of silver one thousand fine, resulting from the melting or breaking up of such standard silver dollars.

In the submission it is stated that an allocation was made on September 7, 1918, for subsidiary coinage, of the silver bullion to be obtained from melting 1,000,000 standard silver dollars. The 1,000,000 standard silver dollars thus allocated produced 772,997.89 fine ounces of silver. The subsidiary silver account was charged therefor at the rate of \$1 per fine ounce, total \$772,997.89, and the loss occasioned by the transaction, the difference between the nominal or face value of the 1,000,000 standard silver dollars and the sale price of the ounces of fine silver produced therefrom, \$227,002.11, was accounted for as an expenditure chargeable under the appropriation contained in section 4 of the act.

On November 28, 1919, an allocation was made of 10,000,000 standard silver dollars (these were coins which had not been in circulation) and on November 6, 1920, an allocation was made of 111,168 standard silver dollars (these were old coins which had been in cir-

ulation). Both allocations were made on the basis of \$1.29+per fine ounce or the equivalent of the nominal or face value of the dollar. In melting or breaking up the 10,000,000 uncirculated standard silver dollars the legal weight in fine ounces was produced but in melting or breaking up the 111,168 standard silver dollars, which had been in circulation, the legal weight in fine ounces was not produced, there being a loss of 3,624.26 fine ounces, which loss was attributed to abrasion of the coins due to their circulation. The net fine ounces of silver thus produced were charged to the subsidiary silver account but the value charged was on the basis of the legal weight of the standard silver dollar at the rate of \$1.29+ per fine ounce. This constituted an overcharge of the value of 3,624.26 fine ounces at \$1.29+ per fine ounce, total \$4,685.91, against the subsidiary silver account. To adjust this matter the Treasury Department Division will state a settlement charging the loss of \$4,685.91, resulting from abrasion, under the appropriation contained in section 4 of the act and crediting a like amount to the subsidiary silver account, the necessary details, etc., for making the transfer to be furnished by the Treasury Department.

An allocation for subsidiary coinage of 3,000,000 fine ounces of silver at \$1 per fine ounce was made pursuant to letters of the Assistant Secretary of the Treasury of October 18 and December 18, 1920. Pursuant thereto 3,458,246.39 fine ounces and \$3,458,246.39 were actually charged to the standard silver account and the balance, 2,541,753.61 fine ounces and \$2,541,753.61, was held temporarily in abeyance; that is, the balance was not actually charged out of the standard silver dollar bullion account. On February 11, 1922, the balance of this allocation, 2,541,753.61 ounces, and \$2,541,753.61,

not actually charged to the subsidiary silver account, together with 1,800,000 fine ounces and \$1,800,000 actually charged to the subsidiary silver account, were revoked. Pursuant thereto 1,800,000 fine ounces and \$1,800,000 were credited to the subsidiary silver account and a like amount in fine ounces and dollars was charged to the standard silver dollar bullion account.

The following is a statement of the allocations, etc.:

Date of Allocation:	Standard Silver Dollars Allocated:	Net Ounces of Bullion Allocated:	Rate per Ounce:	Fine Ounces Produced:	Value Charged:
9/ 7/18	1,000,000	-----	\$1.00	772,997.89	\$ 772,997.89
11/28/19)	10,000,000)	-----	1.29+)	-	-
11/ 6/20)	111,168)	-----	1.29+)	7,816,732.24	10,111,168.00
10/18/20)					
12/18/20)	-----	1,658,246.39	1.00	1,658,246.39	1,658,246.39
					\$12,542,412.28
		Loss resulting from melting or breaking up, to be adjusted			4,685.91
				10,247,976.52	\$12,537,726.37

The precise questions of the submission are (1) whether you are authorized to revoke the remaining balance of all allocations, 10,247,976.52 fine ounces, if so (2) what amount is properly for credit to the subsidiary silver account, and (3) whether, if the revocation of the balance is authorized, there is authority of law for recoinning the bullion thus transferred to the standard silver dollar bullion account. The matters will be considered in the order stated:

(1) From information received from the office of the Director of the Mint the subsidiary silver account shows a balance of 12,944,786 fine ounces of silver on hand, and in the submission you state:

"In these circumstances to carry over 10,000,000 fine ounces of silver bullion in the subsidiary silver account means the carrying in the general fund of the Treasury of a dead asset which has no value for the purpose of making Government payments, with the result that the Treasury is obliged to borrow correspondingly larger amounts to meet its current requirements, at an interest cost ranging from $3\frac{1}{2}$ to $4\frac{1}{4}$ per cent. Assuming for the purposes of illustration an average interest rate on Government borrowings of about 4 per cent and that this amount of silver bullion were held as a dead asset for a period of even two years, the result would be a loss to the Government in interest charges amounting to about \$800,000 for the two year period.

"In these circumstances, and in order to avoid this loss in its current operations, the Treasury would like, if possible under the law, to revoke the allocation of the remaining 10,247,976.52 fine ounces of silver and restore this amount of silver bullion to the standard silver dollar account. The effect of this action would be to permit the Treasury to proceed with the coinage of this amount of silver bullion into standard silver dollars, against which silver certificates could be issued and paid out in the ordinary course of Government payments, * * *."

Section 2 of the act provides:

"* * * Such silver so purchased may be resold for any of the purposes hereinafter specified in section three of this Act, under rules and regulations to be established by the Secretary of the Treasury, and any excess of such silver so purchased over and above the requirements for such purposes, shall be coined into standard silver dollars held for the purpose of such coinage, and silver certificates shall be issued to the amount of such coinage. The net amount of silver so purchased, after making allowance for all resales, shall not exceed at any one time the amount needed to coin an aggregate number of standard silver dollars equal to the aggregate number of standard silver dollars theretofore melted or broken up and sold as bullion under the provisions of this Act, but such purchases of silver shall continue until the net amount of silver so purchased, after making allowance for all resales, shall be sufficient to coin therefrom an aggregate number of standard silver dollars equal to the aggregate number of standard silver dollars theretofore so melted or broken up and sold as bullion".

Nothing appears why the balance of the allocations may not be revoked if the silver allocated for subsidiary coinage is not now needed for that purpose. The revocation of the allocations not alone relieves against the carrying of a dead asset but reduces the quota of silver to be purchased under the act from the domestic producers, etc., the act providing that the necessary purchases to re-

instate the amount sold to be made at the rate of \$1 per fine ounce, a figure approximately 50 per cent higher than the present market price.

(2) The cost value of the reported balance of 12,944,786 fine ounces of silver now in the subsidiary silver account is given as \$11,994,224. This cost value after the credit thereto of the amount of \$4,685.91, loss due to abrasion, is \$11,994,224 less \$4,685.91, or \$11,989,538.09. The present balance reflects an average fine ounce value somewhat less than the fine ounce value at which the several allocations were made, hence it will be impracticable in revoking the allocations to transfer back to the dollar account the same value transferred therefrom to the subsidiary silver account. The present average fine ounce value resulted from the acquisition of silver at varying prices and the charging out of such of the silver as was used in subsidiary coinage at the average cost per fine ounce. The transfer pursuant to the revocation of the allocations of 10,247,976.52 fine ounces of silver may be made by crediting the subsidiary silver account with that many fine ounces at the rate of \$1 per fine ounce thus leaving in the account a balance of 2,696,810 fine ounces with a value of \$1,741,562.09 equal to an average fine ounce rate of approximately the present market value.

(3) The matter of coining into standard silver dollars of such of the bullion purchased under the act and of bullion produced by melting or breaking up standard silver dollars, which was allocated and charged to the subsidiary silver account and which allocations are authorized to be revoked and recharged to the standard silver dollar bullion account, is for administrative consideration.

- 7 -

There appears sufficient authority therefor under the act if you
conclude that this be done.

Respectfully,

(Signed) J. R. McCarl,

Comptroller General.

December 21, 1922.

Dear Mr. Green:

I received your letter of December 20, 1922, with respect to H. J. Res. 314, proposing an amendment to the Constitution of the United States to restrict further issues of tax-exempt securities, and note your statement that an amendment has been proposed by Mr. Garner, of Texas, which would strike out in Section 1, after the word "income", the following words: "derived from securities issued, after the ratification of this article, by or under the authority of the United States or any other State", and in Section 2, after the word "income", the words "derived from securities issued, after the ratification of this article, by or under the authority of such State". For the words thus stricken out the Garner amendment would, I understand, substitute the words "from any source" in both Sections. I note further that in support of his proposed amendment Mr. Garner has stated that under the resolution as reported by the Committee on Ways and Means the United States might discriminate against the bonds of a State and in favor of the bonds of a railroad or industrial corporation, and that his amendment is proposed in order to prevent such a result. I am glad to be able to write you, first, that in the judgment of the Treasury the resolution in the form reported by the Committee would not of itself prevent discrimination of this character, so that the amendment proposed by Mr. Garner is unnecessary, and, second, that to adopt the amendment proposed by Mr. Garner would probably nullify both Sections and make the whole Constitutional amendment ineffective.

Whatever opposition there is to the proposed amendment to restrict further issues of tax-exempt securities rests, I think, upon a misunderstanding of the object and effect of the amendment, and this, in turn, harks back to the old controversies about States' rights and the powers of the Federal Government. I can say without hesitation that, separated from these old prejudices and taken from the point of view of the facts as we have to face them to-day, the proposed Constitutional amendment involves no question whatever of States' rights and makes no attack whatever on the credit or borrowing power of the States or their political subdivisions. The amendment would apply with absolute equality to the Federal Government, on the one hand, and the States and their political subdivisions on the other, and in the interests of the general welfare would put exactly the same restrictions upon future borrowings by the Federal Government as upon future borrowings by the States and their political subdivisions. The constantly growing mass of tax-exempt securities threatens the public revenues, not only of the Federal Government, but of the States as well, and it is reaching such proportions as to undermine the development of business and industry.

The Federal Government, for the most part, has refused to have recourse to tax-exempt issues in financing its own operations, but the volume of tax-exempt securities of the States and their political subdivisions, and of other agencies, already outstanding and currently issued, is so large that the value of the exemption to the borrower issuing the securities has become relatively insignificant. Even now the States and their political subdivisions, notwithstanding the full tax exemptions

on their securities, are obliged to pay substantially the same rates on their tax-exempt borrowings as the Federal Government pays on securities without exemption from Federal income surtaxes. The facts are that under our system of graduated Federal income surtaxes the issue of tax-exempt securities, while of constantly diminishing advantage to the borrowing State or city, provides a perfect refuge for wealthy investors, being most valuable to the wealthiest taxpayer. The actuarial figures show that to taxpayers paying surtaxes in the highest brackets securities subject to Federal income surtaxes would have to yield about 10.4 per cent in order to be as attractive as a 5 per cent tax-exempt security. For this great advantage the State which issues the securities gets but very little compensating return, and certainly no greater return from the wealthiest investor than from the smallest investor (to whom the exemption is relatively worthless), while the United States, which imposes the surtaxes, loses its revenue without any compensating advantage whatever. It is the graduated surtax, of course, that gives the greatest value to the tax exemption, and viewed from this aspect the tax exemption, in substance, constitutes a subsidy from the Federal Government, the cost of which in the long run must fall on those taxpayers who do not or cannot take refuge in tax-exempt securities. Even from the point of view of the States themselves, I believe it is clear that the continued issuance of tax-exempt securities saves nothing to the tax-payers in the States and that in the long run it brings heavier taxes. The tax-exempt privilege, with the facility that it gives to borrowing, leads in many cases to unnecessary or wasteful public expenditure, and this in turn is bringing

about a menacing increase in the debts of States and cities. These debts constitute a constantly growing charge upon the taxpayers in the several States, and will ultimately have to be paid, principal and interest, through tax levies upon these very taxpayers. It is easy to overlook this when the debts are incurred, but it is none the less impossible to escape the facts when the time comes for payment. It is also necessary to bear in mind that in the long run all of these public debts, whether the debts of States and their political subdivisions or of the Federal Government itself, as well as the taxes which must be imposed to meet them, fall upon but one body of taxpayers, and that the apparent advantage of borrowing by States and cities at the expense of the Federal revenues is illusory, since any temporary advantages thus obtained will have to be paid for by the Federal Government at the expense ultimately of the great body of taxpayers. This is particularly true of tax-exempt securities, for their effect is to provide a refuge from taxation for certain classes of taxpayers, with correspondingly higher taxes on all the rest in order to make up the resulting deficiency in the revenues.

Once it is understood I think no one can raise any valid objection to the proposed Constitutional amendment restricting further issues of tax-exempt securities. As a matter of fact, it is almost grotesque to permit the present anomalous situation to continue, for as things now stand we have on the one hand a system of highly graduated Federal income surtaxes and on the other a constantly growing volume of securities issued by States and cities which are fully exempt from these surtaxes, so that taxpayers have only to buy tax-exempt securities to make the

surtaxes ineffective. The only way to correct this condition is by Constitutional amendment, accompanied, if possible, by a reduction in the rates.

To take up the Garner amendment more specifically, I believe that the changes it would make are very clearly unnecessary. The resolution reported by the Committee on Ways and Means expressly provides in Section 1 that Federal taxes on income derived from securities, issued after the ratification of the article, by or under the authority of any State, must be without discrimination against income derived from such securities and in favor of income derived from securities issued after the ratification of the article by or under the authority of the United States or any other State. The same protection for the Federal Government is accorded by the second Section, conferring power on the States to lay and collect taxes on income derived from securities issued after the ratification of the article by or under the authority of the United States. Under Section 1 as it stands it would be impossible for the Federal Government to impose an income tax on income from future issues of State or municipal bonds without imposing the same tax on income derived from future issues of its own bonds, and as a practical matter it is almost inconceivable that Congress would be willing to impose such a tax upon the income from both State and Federal securities and at the same time exempt from the tax income derived from securities issued by private corporations. Such a course would be repugnant to every Constitutional principle. Entirely apart from the practical impossibility of such a situation, however, I think it clear that the amendment in its present form would prohibit discrimination

against the bonds of a State and in favor of a railroad or industrial corporation. All corporations in this country are organized under either State or Federal law and derive their powers, including the power to borrow money, from charters issued by the State or Federal Governments, as the case may be. Securities issued by private corporations, therefore, may be said to be issued "under the authority of" the United States, in the case of a Federal corporation, or the State of incorporation, in the case of a State corporation. Section 1 of the Constitutional amendment as reported by the Committee expressly prohibits discrimination in favor of securities issued after ratification of the article under the authority of the United States or any other State. This in terms would prevent discrimination in favor of any bonds issued by a railroad or industrial corporation incorporated under the laws of the United States or of any other State, and likewise, it seems to me, by a corporation organized under the laws of the State concerned, for it would be Constitutionally impossible for the Federal Government to single out corporations of one State in the granting of tax exemptions. If there were any danger here, however, it could readily be corrected by striking out in the last line of Section 1 the word "other", and I suggest that this be done to remove any question in the matter.

The Garner amendment is not only unnecessary, -- it would defeat the entire Constitutional amendment and make it practically impossible for either the States or the Federal Government to proceed effectively under it. The Garner amendment by its terms forbids discrimination by either the Federal Government or the States, in favor of

"income derived from any source". This apparently covers all sources of income, including, for example, income from securities already issued and outstanding, and income from salaries of State and Federal officers. Even after the adoption of the proposed Constitutional amendment, neither the United States nor any State would have power to tax securities of the other already issued and outstanding, and under generally accepted Constitutional principles, which have been affirmed by the Supreme Court, the Federal Government cannot levy income taxes upon the salaries of State or municipal officers, nor can the States levy income taxes upon the salaries of Federal officers. To forbid discrimination in favor of these non-taxable sources of income would, in effect, make the Constitutional amendment inoperative. There are also other generally recognized distinctions, as, for example, between earned and unearned income, and miscellaneous special exemptions which it might be impossible to make under the form of wording proposed. These difficulties would embarrass the State Governments, in proceeding under the Constitutional amendment, quite as much as they would the Federal Government, and would make it impossible for the States to levy any income tax upon future issues of Federal securities without at the same time imposing an income tax on all outstanding issues of their own securities, and, in fact, a general income tax upon all sources of income subject to State taxation. Even if it could be Constitutionally done, to levy income taxes upon securities already issued as tax-exempt would constitute a gross breach of faith, while to require a general and uniform income tax, with exactly the same taxation of income from securities as of all

other sources of income, would involve almost insuperable practical difficulties and probably prove impossible.

I believe, therefore, that the Garner amendment would accomplish nothing but to defeat what is probably the most necessary reform in our system of taxation, and I hope that in the light of these comments as to the effect of the Constitutional amendment as reported by the Committee and the changes proposed, the Garner amendment will either be withdrawn or rejected. The Constitutional amendment as reported puts the Federal Government and the States on absolutely the same basis, and the very fact that the Federal Government is ready and willing, for the sake of the general welfare, to place itself under these restrictions as to future issues of tax-exempt securities, notwithstanding its own heavy debt and the practical certainty that it will always have obligations outstanding and to be financed, gives the best possible assurance that the States and their political subdivisions can place themselves under like restrictions without endangering their credit or embarrassing their necessary borrowings.

Very truly yours,

(Signed) A. W. MELLON

Secretary of the Treasury.

Hon. William R. Green,
Acting Chairman, Committee on Ways and Means,
House of Representatives,
Washington, D. C.

TAXATION AND REVENUE

BEING AN EXTRACT FROM THE REPORT
OF THE SECRETARY OF THE TREASURY
ON THE STATE OF THE FINANCES FOR
THE FISCAL YEAR 1922



WASHINGTON
GOVERNMENT PRINTING OFFICE
1922

TAXATION AND REVENUE.

The revenue act of 1921 was approved November 23, 1921, and did not become effective as to its most important changes until January 1, 1922. It repealed the old excess-profits tax as of that date and as a substitute imposed a 2½ per cent additional tax on the net income of corporations. It likewise repealed most of the transportation tax and some of the nuisance taxes, and made some adjustments in the income tax, including revisions of the rates and of the exemptions. These changes have been operating during the calendar year 1922, and the Treasury is able now to form some judgment as to their reaction upon the revenues and their relations to the Federal tax system as a whole. The changes are still so recent, however, that their full effect will not be apparent until the income-tax returns based on the business of the present calendar year are filed and examined, and in these circumstances the Treasury is not prepared at the present time to recommend any general revision of the internal-revenue laws. Nor will it be necessary at this time to consider any additional taxes, for the Treasury hopes to overcome any deficiencies in the revenue without recourse to new taxes.

The Treasury has already expressed its views, in the annual report for 1921, as to the direction which further tax revision should take, and in line with those general recommendations and in the light of its experience up to date with the revenue act of 1921, has some specific recommendations for revision to make at this time, particularly as to changes designed to close gaps in existing law which are causing substantial loss of revenue to the Government. These recommendations relate chiefly to the rates of surtax and the avenues of escape now open under the law. The higher surtax rates, which still run to 50 per cent, or a combined 58 per cent after including the normal tax, put such heavy pressure on the larger taxpayers to reduce their taxable income that these taxpayers inevitably seek every permissible means of avoiding the realization of income subject to surtax. The result is to create an artificial situation, which is not wholesome from the point of view of business or industrial development. At the same time it is impairing the revenues of the Government, for under existing conditions the higher surtax rates are undoubtedly operating to reduce rather than increase the revenues. This presents a problem which calls for solution, and I believe it can be solved only by relieving on the one hand the pressure for

reducing taxable income, by making further readjustments of the surtax rates, and on the other hand by closing, so far as possible, the existing avenues of escape. To attempt to close the gaps alone will not be enough, for the existing rates of surtax cause such heavy pressure for avoidance that new gaps would surely be found. The high rates sound productive, but the fact remains that they are becoming increasingly ineffective and are yielding less and less revenue every year. The time has come to face the facts squarely and to correct the artificial conditions which now prevail.

Revision of the surtaxes.

The higher rates of income surtaxes, as I have previously stated in the letter of April 30, 1921, to the chairman of the Committee on Ways and Means, "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." Developments since that time have more than confirmed these statements. Under the revenue act of 1921 the surtaxes rise to a maximum of 50 per cent, which applies to all net incomes over \$200,000, with rates on intermediate incomes graduated on this basis. According to the best estimates available, the total yield of all surtaxes in respect to the business of the taxable year 1922 will not exceed \$350,000,000, and the returns for several years have been steadily declining, from about \$800,000,000 for 1919, to about \$590,000,000 for 1920, and about \$450,000,000 for 1921 (estimated). The statistics of income for recent years likewise show that there has been a remarkable decline in the larger taxable incomes, at the very time that net incomes generally have been increasing. This appears most clearly from the following table:

Table showing decline of taxable incomes over \$300,000.

Year.	Number of returns.		Net income.		Dividends and interest on 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
1920.....	7,259,944	395	23,735,629,183	246,354,585	4,445,145,223	229,052,039

These figures show that while net incomes of all classes during the period from 1916 to 1920 increased from \$6,298,577,620 in 1916, to \$23,735,629,183 in 1920, and the number of returns from 437,036 in 1916 to 7,259,944 in 1920, the number of returns of incomes over \$300,000 decreased during the same period from 1,296 in 1916, to 395 in 1920, and the amount of incomes over \$300,000 from \$992,972,986 in 1916 to \$246,354,585 in 1920. During this same

period investment income of all classes increased, while in incomes over \$300,000 investment income shrank from \$706,945,738 in 1916 to \$229,052,039 in 1920. This indicates an astounding decline in taxable incomes over \$300,000 and clearly reflects the tendency of the high surtaxes to reduce taxable income. In this way the surtaxes are gradually defeating their own purpose and the high rates are becoming ineffective because of the steady disappearance of the taxable incomes to which they were intended to apply. The pressure operates in different ways, but among the means frequently used to reduce the amounts of income subject to taxation are the following:

1. Deductions of losses on sales of capital assets, with the failure to realize on capital gains;
2. Exchanges of property and securities so as to avoid taxable gains;
3. Tax-exempt securities; and
4. Other avenues of escape, such as the division of property, the creation of trusts, and the like.

Not all these things can be controlled by law or by regulation, and most of them lead to unnatural and frequently harmful economic results. To reach the evil the thing most necessary is the reduction of the surtax rates themselves, in order to reduce the pressure for avoidance and maintain the revenues derived from the surtax. I believe, therefore, that it would be sound policy, and at the same time most helpful to the general situation, to reduce the surtaxes to a maximum of not over 25 per cent, which would mean a combined maximum, including normal tax and surtax, of not over 33 per cent. Readjusted to this basis, the surtax rates would, in my judgment, accomplish their purpose and yield as large, or larger, revenues to the Government without the unwholesome consequences of the existing rates. The lower rates would at the same time broaden the market for Government securities, and otherwise encourage the development of productive enterprise.

Until some such readjustment is made the yield of the higher surtaxes will tend, in the ordinary course of events, to drop toward the vanishing point. The wise course is to reform the surtaxes now while the system still functions and at the same time to close, so far as possible, the gaps which now exist. On this basis the revision can be made without loss of revenue, and, in the long run, with material benefit to the revenues.

Capital gains and losses.

A most serious gap in the existing revenue laws arises from the treatment of capital transactions. The law taxes capital gains and recognizes capital losses, but the taxpayer retains the initiative and refrains from realizing taxable gains while taking deductible losses. The situation is particularly serious under the revenue act of 1921,

which limits the tax on capital gains to $12\frac{1}{2}$ per cent but puts no limit on the deduction of capital losses. This means that capital losses may entirely cancel real income, while capital gains will not be realized at all, or, if realized, are taxed at only $12\frac{1}{2}$ per cent. Under the present system the Government is being whipsawed, and the Treasury therefore strongly urges that the existing provision as to capital gains be made to apply conversely to capital losses and that the amount by which the tax may be reduced on account of losses from the sale of capital assets should not exceed $12\frac{1}{2}$ per cent of the amount of the loss. This would, to a large extent, check one of the methods widely used by taxpayers at the present time for decreasing their yearly income. The alternative is to refuse to recognize either capital gains or capital losses for income-tax purposes, and if the present situation were allowed to continue there is no doubt that it would save revenue to adopt this course. This is, in fact, the practice which has been followed in England for many years.

Exchanges of securities.

The revenue act of 1921 provides, in section 202, for the exchange of property held for investment for other property of a like kind without the realization of taxable income. Under this section a taxpayer who purchases a bond of \$1,000 which appreciates in value may exchange that bond for another bond of the value of \$1,000, together with \$100 in cash (the \$100 in cash representing the increase in the value of the bond while held by the taxpayer), without the realization of taxable income. This provision of the act is being widely abused. Many brokers, investment houses, and bond houses have established exchange departments and are advertising that they will exchange securities for their customers in such a manner as to result in no taxable gain. Under this section, therefore, taxpayers owning securities which have appreciated in value are exchanging them for other securities and at the same time receiving a cash consideration, without the realization of taxable income, but if the securities have fallen in value since acquisition will sell them and in computing net income deduct the amount of the loss on the sale. This result is manifestly unfair and destructive of the revenues. The Treasury accordingly urges that the law be amended so as to limit the cases in which securities may be exchanged for other securities, without the realization of taxable income, to those cases where the exchange is in connection with the reorganization, consolidation, or merger of one or more corporations.

Tax-exempt securities.

The most outstanding avenue of escape from the surtax exists in the form of tax-exempt securities, which under our constitutional system may be issued without restriction by the States and their

political subdivisions and agencies. The Federal Government may likewise issue securities wholly exempt from taxation, State and Federal, but since the first Liberty loan has followed the policy of issuing its bonds, notes, and certificates without exemptions from Federal surtaxes, except in minor amounts and for limited periods. Under the provisions of the Federal farm loan act, however, the Federal land banks and joint stock land banks are still authorized to issue, and are issuing in large blocks, bonds exempt from all Federal, State, and local taxation, and the State and municipal governments are constantly adding to the outstanding volume of their securities, all on a tax-exempt basis. The exemption which gives value to these securities is, of course, the exemption from the Federal income surtax, and as matters now stand, the Federal Government, while denying itself the advantage of the exemption from the surtaxes in selling its own securities, in effect provides a subsidy, at its own expense, to the State and municipal governments, the Federal and joint stock land banks and other agencies issuing tax-exempt securities, through the exemption from Federal income surtaxes which these tax-exempt securities enjoy. For this exemption the Federal Government gets no compensating advantage, and the effect of the exemption is to provide a perfect means of escape from Federal surtaxes which is naturally most valuable to the wealthiest investor, and especially to one who is not engaged in business and is, therefore, free to convert his investments into tax-exempt securities and thus avoid paying income tax.

The volume of fully tax-exempt securities, according to the best estimates available, is now approaching \$11,000,000,000 and has recently been increasing at the rate of about \$1,000,000,000 a year. With these securities available for investment, fully exempt as they are from Federal income surtaxes, investors who would normally put their surplus funds into productive enterprise, are automatically driven under the pressure of high surtax rates into investment in tax-exempt securities, with the result that the Federal Government loses the revenue, business and industry lose the capital, and funds badly needed for productive purposes are diverted into unproductive and frequently wasteful public expenditure. This is a situation which can not be permitted to continue without grave danger to our economic structure, as well as to our system of taxation, and the Treasury has accordingly been urging for some time the adoption of a constitutional amendment restricting further issues of tax-exempt securities as the only practicable means of correcting the evil. (See exhibit 87, page 8, for letter of January 16, 1922, from the Secretary of the Treasury to the Chairman of the Committee on Ways and Means, with accompanying papers.) Even a constitutional amendment would apply only to future issues of securities, but once

the amendment is adopted outstanding issues of tax-exempt securities will gradually eliminate themselves, and as they become scarcer should so increase in market value as to destroy or at least impair their value for tax-exempt purposes. An analysis of outstanding issues of State and municipal bonds indicates that 50 per cent, or thereabouts, will mature within the next 20 years, so that within a measurable period after the adoption of a constitutional amendment restricting further issues of tax-exempt securities the situation would, to a large extent, be under control.

A constitutional amendment, satisfactory to the Treasury and approved by the Attorney General, has already been proposed by joint resolution favorably reported to the last session of Congress by the Committee on Ways and Means. This amendment would apply equally, and without discrimination, to the Federal Government, on the one hand, and the State and municipal governments, on the other hand, and would in effect put an end to future issues of tax-exempt securities, making it possible for the Federal Government, to tax income from future issues by or under authority of the several States if, as, and to the extent that it taxes future issues of Federal securities, and for the State governments, to tax income from future issues of Federal securities if, as, and to the extent that they tax future issues of their own securities. The amendment, which appears in H. J. Res. 314, reads as follows:

ARTICLE —.

SECTION 1. The United States shall have power to lay and collect taxes on income derived from securities issued, after the ratification of this article, by or under the authority of any State, but without discrimination against income derived from such securities and in favor of income derived from securities issued, after the ratification of this article, by or under the authority of the United States or any other State.

SEC. 2. Each State shall have power to lay and collect taxes on income derived by its residents from securities issued, after the ratification of this article, by or under the authority of the United States; but without discrimination against income derived from such securities and in favor of income derived from securities issued, after the ratification of this article, by or under the authority of such State.

The Treasury most earnestly urges that this amendment be promptly adopted and submitted to the States for their approval.

Administrative changes.

Other administrative changes should be made in the law with a view to closing up miscellaneous avenues of escape and improving the collection of the revenues. There should also be an indefinite appropriation for refunds of taxes illegally or erroneously collected, in order to facilitate the adjustment and payment of claims. Appropriations of this character already exist for the payment of customs refunds and drawbacks, and similar provisions for internal revenue would avoid the necessity for frequent deficiency appropriations, and

incidentally save the interest which now accumulates from the allowance of the refunds in cases where no appropriation is available for payment.

No additional taxes.

The changes herein recommended will not decrease the revenues, and in the long run should bring larger returns to the Treasury. No additional taxes, therefore, are necessary on this account, and the Treasury is not recommending any new taxes at this time to meet indicated deficiencies in the revenue. It is still impossible to tell with certainty whether the present year will close without a deficit, but enough has already been accomplished to reduce materially the deficit appearing from the estimates presented at the beginning of the year. The latest figures show increased receipts from all sources, including particularly customs and internal taxes, aggregating about \$350,000,000, and, on the other hand, decreased expenditures of about \$200,000,000, making a net gain for Budget purposes of about \$550,000,000. The present year, moreover, presents extraordinary circumstances, including, as it does, many overhanging items, both of receipts and expenditure, which are not subject to administrative control and, since they depend upon extraneous conditions, are difficult, and sometimes almost impossible, to forecast. Under such conditions and with the progress that has already been made in bringing the Budget for the year into balance, the Treasury does not believe it necessary to impose at this time any additional taxes for the purpose of supplementing the revenues.

The probabilities are that reductions in expenditure will not overcome all of the deficit indicated by the estimates. The Treasury believes, however, that given relatively stable conditions in the markets and in the business world it will be possible to meet the rest of the deficit by increased receipts, arising, on the one hand, from further realization on securities and other surplus assets of the Government and, on the other, from increased collections of income and profits taxes in respect to prior years. To this end the Treasury is making exceptional efforts this year to dispose of the accumulation of income and profits tax returns covering 1917 and subsequent years, in the hope that by this means it will be able to make substantial further collections of back taxes. There are also indications, which have so far as possible been taken into account in the estimates already submitted, of increased collections of income taxes as a result of the improvement in business during the calendar year 1922. The extent of this improvement, and its effect on the revenues, will not, of course, be disclosed until March 15, 1923, when the first installment of income taxes for the taxable year 1922 becomes payable, but any additional receipts on that account will help to reduce any deficit that may still remain in the current revenues.

EXHIBIT 87.

LETTER OF THE SECRETARY OF THE TREASURY RELATIVE TO
TAX-EXEMPT SECURITIES, JANUARY 16, 1922.

JANUARY 16, 1922.

DEAR MR. CHAIRMAN: I am glad, in accordance with the request of the Committee, to present the Treasury's views as to the issuance of tax-exempt securities and the latest available information as to the amounts now outstanding and their effects upon the revenues and the investment markets. The problem presented by these issues of tax-free securities is of growing importance and I think that it deserves the most serious attention.

The views of the Treasury on the subject, and its suggestions as to possible remedies, have already been set forth in my letter to you of April 30, 1921,¹ and in my letter of September 23, 1921,¹ to the Chairman of the Committee on Banking and Currency of the House of Representatives, a copy of which I sent to you with my letter of September 23, 1921. Copies of these letters are attached for ready reference. The further views of the Treasury have been indicated to some extent in my letter of November 4, 1921, to you, and in the Under Secretary's letter of November 10th to the Chairman of the Committee on Banking and Currency, copies of which are enclosed.

Since these letters the President, in his address to Congress on December 6, 1921, has emphasized the importance of action in the matter in the following words:

There are a full score of topics concerning which it would be becoming to address you, and on which I hope to make report at a later time. I have alluded to the things requiring your earlier attention. However, I can not end this limited address without a suggested amendment to the organic law.

Many of us belong to that school of thought which is hesitant about altering the fundamental law. I think our tax problems, the tendency of wealth to seek nontaxable investment, and the menacing increase of public debt, Federal, State, and municipal—all justify a proposal to change the Constitution so as to end the issue of nontaxable bonds. No action can change the status of the many billions outstanding, but we can guard against future encouragement of capital's paralysis, while a halt in the growth of public indebtedness would be beneficial throughout our whole land.

Such a change in the Constitution must be thoroughly considered before submission. There ought to be known what influence it will have on the inevitable refunding of our vast national debt, how it will operate on the necessary refunding of State and municipal debt, how the advantages of Nation over State and municipality, or the contrary, may be avoided. Clearly the States would not ratify to their own apparent disadvantage. I suggest the consideration because the drift of wealth into nontaxable securities is hindering the flow of large capital to our industries, manufacturing, agricultural, and carrying, until we are discouraging the very activities which make our wealth.

I should also like to call to your attention the statement as to the decline in taxable income, particularly from investments, which appeared in my Annual Report for 1921, on pages 20-21, as follows:

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:

¹ See Annual Report of the Secretary of the Treasury, 1921, pp. 349 and 379.

Table showing decline of taxable incomes over \$300,000.

	Number of returns.		Net income.		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?

I attach for the further information of the Committee in this connection the following tables which have been prepared by the Government Actuary:

1. Estimate of the total amount of wholly tax-exempt securities outstanding January 1, 1922.
2. Table showing advantage of investing in tax-free securities as compared with a like investment in taxable securities.
3. Estimate of revenue loss to Federal Government through wholly tax-exempt securities outstanding January 1, 1922.

According to reports, there were issued during the calendar year 1921 fully tax-exempt securities of States and municipalities to the aggregate amount of about \$1,100,000,000, and the indications are that further issues will follow during the current year in substantial volume. Fully tax-exempt land bank bonds, Federal and Joint Stock, to an amount exceeding \$100,000,000, were also issued during 1921, and further issues are in prospect. The Federal Government, on the other hand, has adopted the policy of not issuing fully tax-exempt obligations of its own, and its current offerings must be sold in competition with the fully tax-exempt offerings of States and cities.

The most important consideration is that the existence of the growing mass of tax-exempt securities, coupled with the extremely high surtax rates still imposed by law, tends to drive persons of large income more and more to invest in wholly exempt securities issued and still being issued by States and municipalities and heretofore issued by the Federal Government. The result is to impair the revenues of the Federal Government and to pervert the surtaxes, so that instead of raising revenue they frequently operate rather to encourage investment in wholly tax-exempt securities, and even to encourage the issue of such securities by States and municipalities. This process tends to divert investment funds from the development of productive enterprises, transportation, housing, and the like, into non-productive or wasteful State or municipal expenditures, and forces both the Federal Government and those engaged in business and industry to compete with wholly tax-exempt issues and on that account to pay higher rates of interest.

The greatest value of the full exemption from taxation arises, of course, from the exemption it confers in respect to Federal income surtaxes, and the constantly increasing volume of tax-free securities therefore constitutes a real menace to the revenues of the Federal Government. At the same time it makes the high surtaxes operate as inducements to investment in non-productive public indebtedness and is gradually destroying them as revenue producers. As a consequence, the yield of the surtaxes is dwindling and there is a premium on the issue of bonds of States and cities. In the last analysis this is at the expense of the Federal Government, and it is having a most unfortunate and far-reaching effect upon the development of the whole country, because of the diversion of wealth from productive enterprise.

The problem is one of exceptional difficulty, and it is not easy to point to a practicable remedy. But the problem is none the less real, and it is important to do whatever can be done to meet it. One angle of approach is through the proposed Constitutional amendment; another is through the revision of the surtax rates to remove the heavy premium on tax-free securities. It will be helpful to the whole situation if the matter may have early consideration by the Committee, with a view to appropriate action.

Sincerely yours,

(Signed)

A. W. MELLON, *Secretary.*

Hon. JOSEPH W. FORDNEY,

Chairman, Committee on Ways and Means,

House of Representatives, Washington, D. C.

EXTRACT FROM REPORT OF SECRETARY OF THE TREASURY. 11

JANUARY 12, 1922.

Memorandum for Secretary:

(In re tax-exempt securities.)

The Bureau of the Census reports that for the years 1913 and 1919, the total indebtedness of the States was as follows:

1913.....	\$422, 796, 525
1919.....	744, 582, 933

This would indicate a total indebtedness of the States, as of January 1, 1920, of about \$775,000,000.

The Bureau of the Census reported the total indebtedness of County and minor civil divisions of the States, which includes all cities, towns, etc., as of 1913, at \$4,075,152,904. This included \$3,475,954,353 exclusive of Sinking Fund assets. This indebtedness probably increased by January 1, 1920, to about \$5,595,000,000. That is, the total indebtedness of the States and their minor civil divisions as of January 1, 1920, was about \$6,370,000,000.

According to the financial press, about \$672,000,000 of new indebtedness was added during the year 1920, and about \$1,100,000,000 for the year 1921. This would make the total indebtedness of the States and minor political subdivisions thereof as of January 1, 1922, \$8,142,000,000.

From this the estimated total tax-free securities outstanding, as of January 1, 1922, may be tabulated as follows:

State, County, and minor political subdivisions of the States.....	\$8, 142, 000, 000
U. S. tax-free bonds (net outstanding).....	2, 184, 000, 000
Federal Farm Loan Bonds (net outstanding).....	284, 000, 000
Bonds of Insular possessions (net outstanding) ¹	50, 000, 000
Total.....	10, 660, 000, 000

This estimate may be fairly taken as a maximum, as no allowance is made in the computation for any debt maturing since July 1st, 1919.

(Sgd.) Jos. S. McCoy
Government Actuary.

JANUARY 14, 1922.

Memorandum for Secretary:

Loss to Government through tax-free securities.

Estimated total of all tax-free securities issued in the United States, outstanding January 1, 1922..... \$10, 660, 000, 000

Of this amount it is probable that say \$5,660,000,000 is held by Corporations, such as Insurance, Surety and Bonding companies, Banks and Trust companies, etc., which are required to retain certain reserves. Many States require these reserves held by concerns doing business therein to be in the form of local state and municipal securities. A taxable security to yield the same revenue, after paying a tax of 12½%, as does a 5% tax-exempt security, must yield 5.714%. That is, on an investment of \$100,000 by a corporation, the advantage of a tax-free investment would be \$714.00 per year, as compared with a taxable investment. As a large percentage of insurance, banking and surety companies are required to invest in these tax-free securities, they would still be obliged to invest in them if they were taxable, so it would seem safe to say that, if they were all made taxable, the gain to the Federal Government in tax from corporation-held tax-exempt securities would be not in excess of \$35,000,000 per annum. We must also remember that all commercial stocks are now tax-exempt in the hands of corporations, without materially reducing their taxes. Of the remaining \$5,000,000,000 in tax-exempt securities, held by individuals, partnerships and abroad, it is safe to say that upon about \$2,500,000,000 the gain in tax would be nil, and that upon the remaining \$2,500,000,000, about \$85,000,000. That is, if all tax-exempt securities outstanding January 1, 1922, were made taxable, the gross increase in revenue to the Government would be approximately \$120,000,000.

There is little doubt that under these conditions the future investor in what are now tax-exempt securities, would demand that they bear a higher rate of interest or be sold at a discount, sufficient at least to meet this tax.

(Sgd.) Jos. S. McCoy
Government Actuary.

¹ Philippine Islands, Hawaii and Porto Rico.

JANUARY 14, 1922.

ADVANTAGE OF INVESTING IN TAX-FREE SECURITIES AS COMPARED WITH A LIKE INVESTMENT IN TAXABLE SECURITIES.

I. In each case \$40,000 is assumed to be invested in a tax-free 5% security and by comparison in a taxable stock bearing the necessary rate of interest so as to yield the same income, after paying the income tax of the existing law.

Net income of investor exclusive of that from the above investment.	Net income of investor from the above investment, after paying income tax on same.		Tax—Surtax on dividends.	Income from taxable stock before paying tax.	Necessary rate of interest of taxable security.
	With tax-free security.	With taxable stock.			
\$4,000	\$2,000	\$2,000	\$0.00	\$2,000.00	5.00%
16,000	2,000	2,000	105.26	2,105.26	5.28%
28,000	2,000	2,000	272.73	2,272.73	5.68%
40,000	2,000	2,000	439.02	2,439.02	6.10%
60,000	2,000	2,000	777.78	2,777.78	6.94%
80,000	2,000	2,000	1,225.81	3,225.81	8.06%
100,000	2,000	2,000	1,846.15	3,846.15	9.62%
200,000	2,000	2,000	2,000.00	4,000.00	10.00%
500,000	2,000	2,000	2,000.00	4,000.00	10.00%
1,000,000	2,000	2,000	2,000.00	4,000.00	10.00%

II. Advantage of investing in a tax-free security, as compared with any other form of investment when the income is subject to both normal and surtax, such as a mortgage, commercial bond, etc.:

In each case \$40,000 is assumed to be invested in a tax-free security, and by comparison, the same amount in the other form of investment, yielding the necessary rate of profit, so as to give the same income after paying the income tax of the existing law. The investor is assumed to be married, without dependents.

Net income of investor exclusive of that from the above investment.	Net income of investor from the above investment, after paying income tax on same.		Total tax on receipts from above investment.	Income from taxable security before paying tax.	Necessary rate of interest of taxable security.
	With tax-free security.	With taxable security.			
\$500	\$2,000	\$2,000	\$0.00	\$2,000.00	5.00%
4,000	2,000	2,000	80.00	2,080.00	5.20%
16,000	2,000	2,000	265.26	2,265.26	5.66%
28,000	2,000	2,000	432.73	2,432.73	6.08%
40,000	2,000	2,000	599.02	2,599.02	6.50%
60,000	2,000	2,000	937.78	2,937.78	7.34%
80,000	2,000	2,000	1,385.81	3,385.81	8.46%
100,000	2,000	2,000	2,006.15	4,006.15	10.02%
200,000	2,000	2,000	2,160.00	4,160.00	10.40%
500,000	2,000	2,000	2,160.00	4,160.00	10.40%
1,000,000	2,000	2,000	2,160.00	4,160.00	10.40%

From these tables it is observed that there is an advantage to the investor in tax-exempt securities yielding a 5% income, as compared with an investment of the same sum in the stock of a corporation where the return from that stock is less than from 5% to 10%, depending upon the taxable net income of the investor. In case of an investment of the same sum in a mortgage, corporate bond, or other completely taxable form of investment the advantage exists, unless this latter investment yields from 5% to 10.40%, depending upon the net income.

Where the amount invested is greater than \$40,000, the upper limit will be the same, but the advantage will be somewhat extended where the net income from other sources is small or comparatively small, as is shown in the table following.

EXTRACT FROM REPORT OF SECRETARY OF THE TREASURY. 13

Investment of \$1,000,000 in a 5 per cent tax-exempt security as compared with the investment of the same sum in commercial stocks.

Net income of investor exclusive of that from the above investment.	Net income of investor from the above investment, after paying income tax on same.		Tax—Sur-tax on dividends.	Income from taxable stock before paying tax.	Necessary rate of interest of taxable security.
	With tax-free security.	With taxable stock.			
\$4,000	\$50,000	\$50,000	\$7,611.11	\$57,611.11	5.76%
16,000	50,000	50,000	13,111.11	63,111.11	6.31%
28,000	50,000	50,000	20,037.74	70,037.74	7.00%
40,000	50,000	50,000	28,923.08	78,923.08	7.89%
60,000	50,000	50,000	38,076.92	88,076.92	8.81%
80,000	50,000	50,000	44,509.80	94,509.80	9.45%
100,000	50,000	50,000	47,058.82	97,058.82	9.71%
200,000	50,000	50,000	50,000	100,000.00	10.00%
500,000	50,000	50,000	50,000	100,000.00	10.00%
1,000,000	50,000	50,000	50,000	100,000.00	10.00%

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OBLIGATIONS
OF
FOREIGN GOVERNMENTS

BEING AN EXTRACT FROM THE REPORT
OF THE SECRETARY OF THE TREASURY
ON THE STATE OF THE FINANCES FOR
THE FISCAL YEAR 1922



WASHINGTON
GOVERNMENT PRINTING OFFICE
1922

OBSTRUCTIONS

FOREIGN CONTRACTS

THE UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
BUREAU OF CUSTOMS AND EXCISE
WASHINGTON, D. C.



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OBLIGATIONS OF FOREIGN GOVERNMENTS.

The obligations of various foreign governments held by the Treasury on November 15, 1922, aggregated \$10,045,282,026.60, principal amount, and may be classified as follows:

(1) \$9,386,311,178.10 representing loans made by the Secretary of the Treasury, with the approval of the President, under the Liberty bonds acts.

(2) \$574,876,884.95 received from the Secretary of War and the Secretary of the Navy on account of sales of surplus war material under the act of July 9, 1918.

(3) \$84,093,963.55 received from the American Relief Administration on account of relief supplies furnished under the act of February 25, 1919.

In addition to the above, the United States Grain Corporation, the entire stock of which is owned by this Government, holds obligations of various foreign governments amounting to \$56,858,802.49. It is expected that these obligations, which were acquired by the Grain Corporation on account of sales of flour for relief purposes under the act of March 30, 1920, will also be turned over to the Treasury Department for custody upon the completion of the pending liquidation of that corporation. Notes of the Polish Government amounting to about \$24,000,000 are also held by the War Department and the United States Shipping Board. It is understood that these obligations were received on account of sales of surplus war material by the former and transportation services by the latter, and that the amounts may be subject to further adjustment.

A detailed statement of the foreign obligations now held by the Treasury and by the United States Grain Corporation, showing also the interest accrued and remaining unpaid as of the last interest payment dates, is given as Exhibit 77, page 281.

The following statement shows the credits established under the Liberty bond acts (after deducting credits withdrawn), as at the close of business on November 15, 1922:

Country.	Credits established.	Cash advanced.	Other charges against credits.	Balance under established credits.
Belgium.....	\$349,214,467.89	\$349,214,467.89		
Cuba.....	10,000,000.00	10,000,000.00		
Czechoslovakia.....	67,329,041.10	61,974,041.10		\$5,355,000.00
France.....	2,997,477,800.00	2,997,477,800.00		
Great Britain.....	4,277,000,000.00	4,277,000,000.00		
Greece.....	48,236,629.05	15,000,000.00	\$33,236,629.05	
Italy.....	1,648,034,050.90	1,648,034,050.90		
Liberia.....	26,000.00	26,000.00		
Rumania.....	25,000,000.00	25,000,000.00		
Russia.....	187,729,750.00	187,729,750.00		
Serbia.....	26,780,465.56	26,780,465.56		
Total.....	9,636,828,204.50	9,598,236,575.45	33,236,629.05	5,355,000.00

The balance of the credit which was granted to the Czecho-Slovak Republic to assist that Government in the repatriation of its troops from Siberia was \$6,072,834.36 at the beginning of the fiscal year 1922. The movement of these troops was carried out by the War Department and the Shipping Board, and on May 29, 1922, the Czecho-Slovak Republic used \$717,834.36 out of this credit to reimburse the Shipping Board for its services. The balance to the credit of that Republic is now \$5,355,000, and whatever may remain after all payments to the War Department have been completed will be withdrawn.

It is not contemplated that any further advances will be made by the Treasury against the credits in favor of Greece. The nature of these credits was described in last year's annual report.

The following statement shows the amount of advances which have been repaid up to November 15, 1922:

Country.	To Nov. 16, 1921.	Nov. 16, 1921, to Nov. 15, 1922.	Total.
Belgium.....	\$1,522,901.66	\$440,552.83	\$1,963,454.49
Cuba.....	1,425,000.00	834,500.00	2,259,500.00
France.....	46,714,861.81	17,357,868.04	64,072,729.85
Great Britain.....	110,681,641.56	30,500,000.00	141,181,641.56
Rumania.....	1,794,180.48		1,794,180.48
Serbia.....	605,326.34	48,564.63	653,890.97
Total.....	162,743,911.85	49,181,485.50	211,925,397.35

The \$30,500,000 repaid by the British Government during the past year was on account of the obligations of that Government given for purchases of silver under the Pittman Act, according to the special arrangement made regarding these obligations.

The repayments made by the Governments of Belgium and Serbia and substantially all of those made by France during the past year represent the unused balances of advances made by the Treasury to those Governments and turned over by them to the Commission for Relief in Belgium and to the American Relief Commission to be expended for relief purposes. These unused balances were returned to

the Treasury to be applied as payments on account of the principal of the obligations of the respective Governments.

No repayments of principal have been made on any of the obligations acquired under the acts of July 9, 1918, February 25, 1919, or March 30, 1920.

The following table shows the amount of interest paid on foreign obligations acquired by the Treasury under the Liberty bond acts:

Country.	To Nov. 15, 1921.	Nov. 16, 1921, to Nov. 15, 1922.	Total.
Belgium.....	\$10,907,281.55		\$10,907,281.55
Cuba.....	1,442,922.91	\$416,810.23	1,859,733.14
Czechoslovakia.....	304,178.09		304,178.09
France.....	129,570,376.13		129,570,376.13
Great Britain.....	247,844,685.50	103,812,500.00	351,657,185.50
Greece.....	1,159,153.34		1,159,153.34
Italy.....	57,598,852.62		57,598,852.62
Liberia.....	861.10		861.10
Rumania.....	263,313.74		263,313.74
Russia.....	4,872,811.50	2,612,744.46	7,485,555.96
Serbia.....	636,059.14		636,059.14
Total.....	454,600,495.62	106,842,054.69	561,442,550.31

Great Britain's interest payments during the past year were made as follows:

Date of payment.	Interest on obligations given for Pittman silver advances.	Interest on other obligations.	Total.
Apr. 15, 1922.....	\$1,372,500.00		\$1,372,500.00
May 15, 1922.....	915,000.00		915,000.00
Oct. 16, 1922.....	915,000.00	\$50,000,000.00	50,915,000.00
Nov. 15, 1922.....	610,000.00	50,000,000.00	50,610,000.00
Total.....	3,812,500.00	100,000,000.00	103,812,500.00

On page 58 of the Annual Report of the Secretary of the Treasury for the fiscal year 1920, reference was made to two special funds arising out of the liquidation of certain property of the Russian Government and held for Russia by the Secretary of the Treasury, aggregating \$2,143,601.07. On August 3, 1922, these funds were applied (1) to cancel the unpaid balance of the interest, amounting to \$1,808,506, which became due on Russian obligations, May 15, 1918; and (2) as part payment of the unpaid balance of the interest due November 15, 1918. Most of the funds which the Treasury has received in payment of interest on Russian obligations represent the proceeds of liquidation of the financial affairs of the Russian Government in this country. Copies of a letter dated May 23, 1922, from the Secretary of State and the reply of the Secretary of the Treasury, dated June 2, 1922, in regard to the loans of this Government to Russia and the liquidation of the affairs of the Russian Government in this country, are attached as Exhibit 79, page 283.

The following statement shows the amount of interest paid by each foreign government on obligations acquired under the act of July 9, 1918, on account of sales of surplus war material:

Country.	To Nov. 15, 1921.	Nov. 16, 1921, to Nov. 15, 1922.	Total.
Belgium.....	\$2,797,351.40	\$1,379,429.06	\$4,176,780.46
France.....	20,038,719.13	20,859,564.43	40,898,283.56
Latvia.....	126,266.19	.....	126,266.19
Poland.....	1,290,620.78	.....	1,290,620.78
Russia.....	10,179.87	40,580.43	50,760.30
Total.....	24,263,137.37	22,279,573.92	46,542,711.29

The only interest payment received to date on foreign obligations acquired under the act of February 25, 1919, was one of \$181,017.17 on Russian obligations, which was paid on August 5, 1922.

The Treasury understands that no interest has been paid on the obligations held by the United States Grain Corporation, acquired under the act of March 30, 1920.

The following statement by the Secretary of the Treasury, regarding the status of the obligations of foreign governments held by the United States, and particularly the origin of the indebtedness of the British Government to the United States, was made public on August 24, 1922:

A number of inquiries have been received, as a result of statements recently published, with respect to the exact status of the obligations of foreign governments held by the United States. Especial attention has been directed to the origin of the indebtedness of the British Government amounting to about \$4,135,000,000. It has been said that this liability was not incurred for the British Government, but for the other allies, and that the United States, in making the original arrangements, had insisted in substance that though the other allies were to use the money borrowed, it was only on British security that the United States was prepared to lend it. It is apparent from the inquiries which have reached the Treasury Department that it is supposed that this, in substance, is the explanation of the existing indebtedness of Great Britain.

In answer to these inquiries, it should be said that the obligations of foreign governments, in question, had their origin almost entirely in purchases made in the United States, and the advances by the United States Government were for the purpose of covering payments for these purchases by the Allies.

The statement that the United States Government virtually insisted upon a guaranty by the British Government of amounts advanced to the other allies is evidently based upon a misapprehension. Instead of insisting upon a guaranty, or any transaction of that nature, the United States Government took the position that it would make advances to each Government to cover the purchases made by that Government and would not require any Government to give obligations for advances made to cover the purchases of any other Government. Thus, the advances to the British Government, evidenced by its obligations, were made to cover its own purchases, and advances were made to the other allies to cover their purchases.

The nature of the arrangements is shown by a memorandum which the Secretary of the Treasury, in June, 1918, handed to the British ambassador, as follows:

So far as the purchases of the allied Governments for war purposes within the United States and its Territories and insular possessions are concerned it is the expectation of the Secretary of the Treasury to continue as heretofore the advances necessary to enable the financing of such approved purchases. The Secretary of the Treasury quite agrees with what he understands to be the views of the Chancellor of the Exchequer that advances shall be made to each allied Government for the commodities purchased in the United States by or for it and that no allied Government should be required to give its obligations for such purposes when merely serving as a conduit for the supply of the materials so purchased to another allied Government. Any other course would indeed be incompatible with what the Secretary of the Treasury deems a cardinal principle which should be followed in respect to such advances, namely, that the allied Government for the use of which the commodity is purchased must give its own obligation therefor and the obligation of any other allied Government can not be accepted by the United States as an equivalent.

It is well to further quote from a memorandum handed to the British ambassador in June, 1920, by the Secretary of the Treasury, in regard to these loans as follows:

It has been at all times the view of the United States Treasury that questions regarding the indebtedness of the Government of the United Kingdom of Great Britain and Ireland to the United States Government and the funding of such indebtedness had no relation either to questions arising concerning the war loans of the United States and of the United Kingdom to other Governments or to questions regarding the reparation payments of the central Empires of Europe. These views were expressed to the representatives of the British Treasury constantly during the period when the United States Government was making loans to the Government of the United Kingdom and since that time in Washington, in Paris, and in London.

From these two statements it appears to be quite clear that the respective borrowing nations each gave their own obligations for the money advanced by the United States and that no guaranty of the obligations of one borrowing nation was asked from any other nation. This is the understanding of the Treasury as to the status of the foreign obligations growing out of the war now held by the United States.

Austrian relief.—The United States Government holds one of a series of Austrian Government bonds designated as "Relief Series B of 1920," which was issued by that Government in connection with food purchased on credit from the United States Grain Corporation for relief purposes. The face value of this obligation is \$24,055,708.92. A copy is attached as Exhibit 78, page 282. The other bonds of "Relief Series B of 1920" outstanding are held by various European nations. This series of bonds, according to the express terms thereof, is a first lien upon all the assets and revenues of Austria. Her assets and revenues are also subject to claims of certain foreign governments on account of reparations and costs of armies of occupation. Measures for the financial and economic reconstruction of Austria have for some time been the subject of considerable discussion between the principal governments interested in the Austrian situation. The proposed plan of Austrian rehabilitation contemplates that all Governments having claims against Austria on account of relief, reparation, or costs of armies of occupation shall extend the time of payment thereof and suspend their liens on Austrian assets for a period of 20 years, so that such assets may be available as security for new external credits. In order that this Government might cooperate in this respect with

the other governments having claims against Austria, the following joint resolution was passed by the Congress and approved by the President on April 6, 1922:

Whereas the economic structure of Austria is approaching collapse and great numbers of the people of Austria are, in consequence, in imminent danger of starvation and threatened by diseases growing out of extreme privation and starvation; and

Whereas this Government wishes to cooperate in relieving Austria from the immediate burden created by her outstanding debts: Therefore be it

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary of the Treasury is hereby authorized to extend, for a period not to exceed twenty-five years, the time of payment of the principal and interest of the debt incurred by Austria for the purchase of flour from the United States Grain Corporation, and to release Austrian assets pledged for the payment of such loan, in whole or in part, as may in the judgment of the Secretary of the Treasury be necessary for the accomplishment of the purposes of this resolution: *Provided, however,* That substantially all the other creditor nations, to wit, Czechoslovakia, Denmark, France, Great Britain, Greece, Holland, Italy, Norway, Rumania, Sweden, Switzerland, and Yugoslavia shall take action with regard to their respective claims against Austria similar to that herein set forth. The Secretary of the Treasury shall be authorized to decide when this proviso has been substantially complied with.

The Secretary of the Treasury has not yet been requested to take formal action under the above resolution, but stands ready to act when occasion arises and its conditions are met. On August 7, 1922, the Reparation Commission released from reparation claims for a period of 20 years certain revenues of the Austrian Government in order that they might be used as security for a new Austrian bank of issue. In this connection the United States Government informed the Austrian Government that it was prepared, within the limits of the resolution of April 6, 1922, to suspend its priority in respect to Austrian assets and revenues to the extent necessary for this purpose.

WORLD WAR FOREIGN DEBT COMMISSION.

The World War Foreign Debt Commission was created by the act of February 9, 1922, entitled "An act to create a commission authorized under certain conditions to refund or convert obligations of foreign Governments held by the United States of America, and for other purposes," the text of which is as follows:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That a World War Foreign Debt Commission is hereby created consisting of five members, one of whom shall be the Secretary of the Treasury, who shall serve as chairman, and four of whom shall be appointed by the President, by and with the advice and consent of the Senate.

SEC. 2. That, subject to the approval of the President, the commission created by section 1 is hereby authorized to refund or convert, and to extend the time of payment of the principal or the interest, or both, of any obligation of any foreign Government now held by the United States of America, or any obligation of any foreign Government hereafter received by the United States of America (including obligations held by the United States Grain Corporation, the War Department, the Navy Depart-

ment, or the American Relief Administration), arising out of the World War, into bonds or other obligations of such foreign Government in substitution for the bonds or other obligations of such Government now or hereafter held by the United States of America, in such form and of such terms, conditions, date or dates of maturity, and rate or rates of interest, and with such security, if any, as shall be deemed for the best interests of the United States of America: *Provided*, That nothing contained in this act shall be construed to authorize or empower the commission to extend the time of maturity of any such bonds or other obligations due the United States of America by any foreign Government beyond June 15, 1947, or to fix the rate of interest at less than 4½ per centum per annum: *Provided further*, That when the bond or other obligation of any such Government has been refunded or converted as herein provided the authority of the commission over such refunded or converted bond or other obligation shall cease.

SEC. 3. That this act shall not be construed to authorize the exchange of bonds or other obligations of any foreign Government for those of any other foreign Government, or cancellation of any part of such indebtedness except through payment thereof.

SEC. 4. That the authority granted by this act shall cease and determine at the end of three years from the date of the passage of this act.

SEC. 5. That the annual report of this commission shall be included in the annual report of the Secretary of the Treasury on the state of the finances, but said commission shall immediately transmit to the Congress copies of any refunding agreements entered into, with the approval of the President, by each foreign Government upon the completion of the authority granted under this act.

Approved, February 9, 1922.

The act provides that the Secretary of the Treasury shall be one of the members of the commission and serve as its chairman. As the other four members of the commission, the President appointed on February 21, 1922, Charles E. Hughes, Secretary of State; Herbert C. Hoover, Secretary of Commerce; Reed Smoot, United States Senator; and Theodore E. Burton, Member of the House of Representatives. On February 28, 1922, the Senate confirmed the appointments of Secretary Hughes and Secretary Hoover, and on April 11, 1922, confirmed the appointments of Senator Smoot and Congressman Burton.

The organization and first meeting of the commission was held on April 18, 1922. Eliot Wadsworth, Assistant Secretary of the Treasury, was appointed secretary of the commission, and the following resolution was adopted:

Resolved, That the Secretary of State be requested to inform each of the Governments whose obligations, arising out of the World War, are held by the United States, including obligations held by the United States Grain Corporation, the War Department, the Navy Department, or the American Relief Administration, of the organization of the World War Foreign Debt Commission pursuant to the act of Congress approved February 9, 1922, and that the commission desires to receive any proposals or representations which the said Government may wish to make for the settlement or refunding of its obligations under the provisions of the act.

In accordance with this resolution the Secretary of State instructed the diplomatic representatives of this Government at the capitals of

each of the foreign Governments indebted to the United States, with the exception of Armenia, Austria, Cuba, Greece, Liberia, Nicaragua, and Russia, to communicate to the respective Governments to which they were accredited the text of the resolution and of the act. This action was not taken in respect to the Governments above named for the following reasons:

Armenia, Greece, and Russia: In none of these countries is there a Government recognized by the United States.

Austria: Congress passed on April 6, 1922, a joint resolution giving the Secretary of the Treasury special authority to deal with the Austrian debt.

Cuba: Interest and installments of principal are being regularly paid and no refunding is required.

Liberia: An act authorizing a new loan, from the proceeds of which the existing loan will be repaid in full, has already been passed by the House of Representatives pursuant to request of the Department of State, and is now pending before the Senate.

Nicaragua: This debt is regarded as already in funded form.

In response to the invitation of this Government the following countries have designated representatives to negotiate with the commission: Belgium, Czechoslovakia, Finland, France, Great Britain, Hungary, Poland, Rumania, and Serbia.

The commission held further meetings on June 1 and 30, July 27, August 10, and September 29, 1922.

In July, 1922, the French Government sent a special mission, headed by Mr. Jean V. Parmentier, director of the movement of funds of the French treasury, to the United States to discuss with the commission the French debt to this Government. Mr. Parmentier, upon his arrival, placed in the hands of the commission certain data relating to the financial and economic situation of France. He explained to the commission the position of his Government in respect to the funding of its debt to the United States, stating that he had been designated by the French Government to afford the commission complete information as to the financial condition of his Government, but that the latter did not consider it possible at the present time to enter into any definite engagements for a funding or settlement of its debt. He further stated that it was his Government's desire to postpone for an indefinite period consideration of this matter, until the financial situation of France should become more clear, particularly as to reparation receipts from Germany. The commission's position on the subject was explained to Mr. Parmentier, and especially its desire that a funding of the French debt should take place in the near future. On August 17, 1922, Mr. Parmentier informed the chairman of the commission that he had been keeping

his Government informed of the progress made in the negotiations and that he had received a cable instructing him to return for a full discussion with his Government of the situation as it had developed. The chairman replied that in his view it could only be beneficial if Mr. Parmentier should in person discuss with his Government the negotiations which had taken place between him and the commission. Mr. Parmentier returned to France shortly after this conference.

Announcement was made by the Government of Great Britain on July 17, 1922, that a special delegation would proceed to the United States early in September to negotiate terms for the funding of the British debt to the United States. The British Embassy in Washington subsequently reported that the delegation would sail on October 18 for New York, headed by Sir Robert Horne, Chancellor of the Exchequer, who would be accompanied by Mr. Montagu Collet Norman, Governor of the Bank of England, as second delegate. With the recent change of government in England, however, the departure of a delegation has been postponed pending the holding of the elections in that country.

Great Britain has paid \$100,000,000 as interest on her obligations to the United States during the current fiscal year, \$50,000,000 on October 16, 1922, and \$50,000,000 on November 15, 1922, in addition to the payments under the special agreement as to silver advances.

The Italian Government has stated that it is prepared to send a special commission to this country to negotiate with the commission.

The Rumanian Government has sent a special delegation to the United States to negotiate with the commission.

The commission has had discussions of a preliminary nature with a few of the other debtor governments, but no definite funding agreements have yet been entered into.

Statistical information has been and is being compiled and analyzed with a view to ascertaining the financial and economic conditions of the various debtor nations. The commission is hopeful that after the British debt to the United States has been refunded, which is expected to take place shortly, substantial progress will be made in concluding refunding arrangements with the other debtor nations.

EXHIBIT 77.

OBLIGATIONS OF FOREIGN GOVERNMENTS HELD BY THE UNITED STATES, TOGETHER WITH INTEREST ACCRUED AND REMAINING UNPAID THEREON AS OF THE LAST INTEREST PERIOD PRIOR TO OR ENDING WITH NOVEMBER 15, 1922.

Country.	Obligations acquired under Liberty bond acts.		Obligations acquired from sales of surplus war material (act of July 9, 1918).		Obligations acquired by American relief administration on account of relief (act of Feb. 25, 1919).		Obligations held by United States Grain Corporation on account of sales of flour (act of Mar. 30, 1920).		Total.		Total indebtedness.
	Principal.	Interest (including interest due Nov. 15, 1922).	Principal.	Interest.	Principal.	Interest.	Principal.	Interest.	Principal.	Interest.	
Armenia.....					\$8,028,412.15	\$1,204,261.83	\$3,931,505.34	\$472,995.05	\$11,959,917.49	\$1,677,256.88	\$13,637,174.37
Austria.....									24,055,708.92	2,886,685.08	26,942,394.00
Belgium.....	\$347,251,012.40	\$60,073,383.65	\$29,872,732.54	(1) (2)					377,123,745.94	160,073,383.65	437,197,129.59
Cuba.....	7,740,500.00	(3)							7,740,500.00	(3)	7,740,500.00
Czechoslovakia.....	61,974,041.10	10,136,141.81	20,612,300.11	\$2,959,392.88	6,428,089.19	964,213.38	2,873,238.25	344,788.60	91,887,668.65	14,404,536.67	106,292,205.32
Estonia.....			12,213,377.88	1,832,006.70	1,785,767.72	257,618.96			13,999,145.60	2,089,625.66	16,088,771.26
Finland.....					8,281,926.17	1,012,436.10			8,281,926.17	1,012,436.10	9,294,362.27
France.....	2,933,405,070.15	503,386,035.61	407,341,145.01	(2)					3,340,746,215.16	503,386,035.61	3,844,132,250.77
Great Britain.....	4,135,818,358.44	611,044,201.85							4,135,818,358.44	611,044,201.85	4,746,862,560.29
Greece.....	15,000,000.00	750,000.00							15,000,000.00	750,000.00	15,750,000.00
Hungary.....							1,685,835.61	202,300.28	1,685,835.61	202,300.28	1,888,135.89
Italy.....	1,648,034,050.90	284,681,434.61							1,648,034,050.90	284,681,434.61	1,932,715,485.51
Latvia.....			2,521,869.32	252,014.20	2,610,417.82	391,562.67			5,132,287.14	643,576.87	5,775,864.01
Liberia.....	26,000.00	3,518.85							26,000.00	3,518.85	29,518.85
Lithuania.....			4,159,491.96	623,923.80	822,136.07	123,320.40			4,981,628.03	747,244.20	5,728,872.23
Nicaragua.....			170,585.35	(1)					170,585.35	(1)	170,585.35
Poland.....			59,678,604.07	7,042,817.10	51,671,749.36	7,750,762.41	24,312,514.37	2,825,229.50	135,662,867.80	17,618,809.01	153,281,676.81
Rumania.....	23,205,819.52	3,925,703.00	12,922,675.42	1,938,401.34					36,128,494.94	5,864,104.34	41,992,599.28
Russia.....	187,729,750.00	39,214,326.16	406,082.30	10,152.06	4,465,465.07	488,192.56			192,601,297.37	39,712,670.78	232,313,968.15
Serbia.....	26,126,574.59	4,611,738.14	24,978,020.99	3,352,349.78					51,104,595.58	7,994,087.92	59,098,683.50
Total....	9,386,311,178.10	1,517,826,483.68	574,876,884.95	18,041,057.86	84,093,963.55	12,192,368.31	56,858,802.49	6,731,998.51	10,102,140,829.09	1,554,791,908.36	11,656,932,737.45

¹ No interest due on Nicaraguan notes until maturity, as is also the case of certain Belgian obligations aggregating \$2,284,151.40.

² Interest has been paid as it became due.

³ Includes \$61,000,000 of British obligations which were given for Pittman silver advances and for which an agreement for payment has been made.

⁴ Great Britain paid \$50,000,000 on October 16, 1922, and \$50,000,000 on November 15, 1922, on account of interest on other than Pittman silver obligations.

EXHIBIT 78.

SPECIMEN OF OBLIGATION OF AUSTRIA.

OBLIGATION OF THE GOVERNMENT OF AUSTRIA—TWENTY FOUR MILLION SIXTY SIX THOUSAND SEVEN HUNDRED NINETY EIGHT DOLLARS AND FIFTY SIX CENTS (\$24,066,798.56).—RELIEF SERIES B OF NINETEEN HUNDRED AND TWENTY.—No. I.

The Government of Austria for value received, promises to pay to the Government of the United States of America, or assigns, on the First Day of January, Nineteen Hundred and Twenty-Five, the principal sum of Twenty Four Million Sixty-Six Thousand Seven Hundred Ninety Eight Dollars and Fifty-Six Cents (\$24,066,798.56), on which interest will be paid half yearly at the rate of six per cent (6%) per annum from date of this obligation to the date of payment. Both the principal and the interest of this obligation will be paid in gold coin of the United States of America, of the standard weight and fineness existing at the date of this obligation at the Treasury of the United States of America in the city of Washington, District of Columbia, or at the option of the holder, at the Sub-Treasury of the United States of America in the City of New York.

The principal and interest of this obligation will be paid without deduction for and will be exempt from any and all tax and/or charge, present and future, imposed by authority of the Government of Austria or its possessions, or by any political or taxing authority within Austria.

This obligation is one of a series of obligations of similar tenor but in different amounts and payable in different currencies, all maturing on the first day of January Nineteen Hundred and Twenty-Five, designated as "Relief Series B of 1920".

The Government of Austria agrees that no payment will be made upon or in respect of any of the obligations of said Series issued by the Government of Austria before, at or after, maturity, whether for principal or for interest, unless a similar payment shall simultaneously be made upon all obligations of the said Series issued by the Government of Austria in proportion to the respective obligations of said Series.

Pursuant to the powers conferred upon it, the Reparation Commission has authorized the Austrian Government, under the control of the Austrian Section of the Reparation Commission, to issue the present series of bonds, which shall be a first charge upon all the assets and revenues of Austria, and shall have a priority over costs of reparation under the Treaty of Saint-Germain, or under any treaty or agreement supplementary thereto, or under arrangements concluded between Austria and the Allied and Associated Powers during the Armistice signed on November 3rd, 1918, without prejudice to the obligations of Austria to pay the expenses of the Armies of Occupation, of the Reparation Commission and of restitution, and to make deliveries and payments in kind under the Treaty of Saint-Germain (except under Article 181, and Paragraph 19 of Annex II of Part VIII) and under any protocols or agreements in force to the extent to which such deliveries may be required by the Reparation Commission or, in accordance with the provision of the said Treaty, protocols or agreements, by an interested Power.

IN WITNESS WHEREOF the Government of Austria has caused this obligation to be executed and its official seal attached by Dr. Richard Reisch, Secretary of State for Finances duly authorized and empowered for that purpose.

Dated September 4, 1920.

Signed for the Government of Austria

WITNESS:

(Sgd)	Dr. SIMON	(Sgd)	REISCH
			<i>Secretary of State for Finances.</i>
(Sgd)	Dr. SCHULLER	(Sgd)	Dr. WLADIMER BECK
(SEAL)			<i>President of the Audit Office.</i>

Countersigned for the Austrian Section of the Reparation Commission.

(Sgd)	H. KLOBUKOWSKI	(Sgd)	SCARAMANGA
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(Notation on back of obligation:)

The foregoing obligation has been taken from the Government of Austria in payment of food commodities sold by the United States Grain Corporation to the Government of Austria.

The United States Grain Corporation finds that the Government of Austria is entitled to an allowance amounting to Eleven Thousand and Eighty-nine Dollars Sixty-Four Cents (\$11,089.64) for damaged flour on the steamship "Gudvun", and that the foregoing obligation should be credited in the said amount.

	UNITED STATES GRAIN CORPORATION
(Signed)	EDW. M. FLESH
	<i>Vice-President and Treasurer.</i>

Dated at New York, N. Y., November 4th, 1920.

EXHIBIT 79.

LETTER FROM THE SECRETARY OF STATE CONCERNING THE LIQUIDATION OF RUSSIAN OBLIGATIONS IN THE UNITED STATES, AND THE REPLY OF THE SECRETARY OF THE TREASURY.

DEPARTMENT OF STATE,
Washington, May 23, 1922.

MY DEAR MR. SECRETARY: I desire to refer to the arrangements made toward the close of 1917 for the liquidation of the financial business of Russia in this country, following the fall of the last recognized Russian Government.

It appears from the files of the State Department, and from published records, that the extraordinarily difficult task of dealing with the Russian financial situation in this country under the circumstances indicated was undertaken jointly by the State and Treasury Departments in cooperation with Mr. Boris Bakhmeteff, representing the last recognized Russian Government, and that contracts then outstanding with American manufacturers to the value of more than \$102,000,000 were successfully liquidated with funds of the Russian Government amounting to much less than that sum. It is the understanding of the State Department that this process of liquidation has now been brought to a practical conclusion, and that such business as remains is in process of orderly settlement.

Having regard to recent public discussion of the subject, may I ask that you confirm these facts and furnish any additional information from the records of the Treasury Department which you may consider helpful to a public understanding of the matter?

I am, my dear Mr. Mellon,

Very sincerely yours,

(Sgd)

CHARLES E. HUGHES.

TREASURY DEPARTMENT,
Washington, June 2, 1922.

MY DEAR MR. SECRETARY: I received your letter of May 23, 1922, regarding the liquidation of the Russian Government's financial obligations in this country after the fall of the last recognized Russian Government.

The facts set forth in your letter are in accord with the information possessed by the Treasury on the subject, and I am glad to avail myself of your suggestion to furnish any additional information from the Treasury's records that may be considered helpful to a public understanding of the matter.

It appears that under the authority of the Liberty Bond Acts the Secretary of the Treasury, with the approval of the President, made certain loans to the Provisional Government of Russia for the purpose of more effectually providing for the national security and defense and prosecuting the war. The net amount of the loans so made is \$187,729,750. Although a credit of \$100,000,000 was established by the Treasury in favor of the Russian Government on May 16, 1917, the first loan to that Government was not actually made until July 6, 1917, and was in the amount of \$35,000,000. No loans were made by the Treasury to the Russian Government after the fall of the Provisional Government early in November, 1917, with the exception of an advance of \$1,329,750 on November 15, 1917, the proceeds of which were simultaneously applied by the Russians to the payment of interest to the Government of the United States.

The funds advanced by the Treasury in making the above loans were used solely for the purchase of obligations of the Russian Government in accordance with the Liberty Bond Acts, in the same manner as with other foreign governments, and the funds so paid for these obligations became the funds of the Russian Government. All of the obligations thus purchased are signed in the name of the Provisional Government of Russia by Mr. Boris Bakhmeteff who was the representative of that Government designated to the Treasury by the Department of State as being authorized to sign them in the name and on behalf of that Government.

In connection with the loans so made to the Russian Government, the latter rendered reports to the Treasury of its expenditures. These reports cover the period from April 6, 1917, the date of the United States Government's entry into the war, to March 4, 1921, and show total expenditures for that period of about \$231,000,000. The principal items of such expenditures appear to have been munitions, including remounts; exchange and cotton purchases, and other supplies. It would seem clear that only a comparatively small portion of the total expenditures of the Russian Government in this country during

the period referred to was made from funds advanced by the United States Treasury, in view of the fact that it appears from the reports filed by the Russian representatives with this Department that of the \$187,729,750 so loaned about \$125,000,000 was transferred by the Russian Ambassador to the account of the Russian Ministry of Finance at Petrograd and only the balance of about \$62,000,000 was retained by the Russian Ambassador for expenditure in this country.

According to information shown by the Treasury records, the Russian Government's financial situation in this country at the time of the fall of the Provisional Government in November, 1917, was, in a general way, as follows:

Its bank balances then on hand amounted to about \$56,000,000. The Russian Ambassador has estimated that about \$10,000,000 thereof represented the balance remaining from this Government's loans to Russia, and that the rest of such funds consisted of moneys derived from other sources, such as British credits and loans made by private bankers in this country. At this time the Russian Government also had a large amount of property in the United States, consisting mainly of war supplies. Apart from its indebtedness to the United States Government on account of the loans above mentioned, the Russian Government's financial obligations in the United States arose principally out of contracts for supplies and certain private loans issued in this country. The contractual liabilities amounted to about \$102,000,000, and the total principal amount of such private loans was \$86,000,000. In these circumstances, the Department of State and the Treasury considered it advisable to enter into arrangements with the Russian Ambassador with a view to effecting such an application of the Russian Government's available assets in this country that the interests of the American manufacturers and contractors and of the United States Government would be protected. In accordance with these arrangements, the Russian Ambassador deposited about \$47,000,000 of the \$56,000,000 cash above referred to with the National City Bank of New York in a so-called liquidation account, subject to his disposition. This money was to be devoted to the general liquidation of Russian obligations in this country. The balance of approximately \$9,000,000 was placed in special accounts with that bank to be used for certain specific purposes. These funds also were subject to the Ambassador's disposition. Pursuant to an understanding had with the National City Bank, however, no withdrawals were to be made from the liquidation account without the bank's first notifying the Treasury and ascertaining whether it objected to the particular disbursement proposed.

It further appears that from December 1, 1917, when the liquidation account was opened, to March 4, 1921, when the account was closed, additional deposits were made therein, aggregating a total amount of about \$29,000,000. The funds so deposited resulted chiefly from the sale of Russian property in this country and the charter hire from certain Russian ships. This made the total deposits in the liquidation account aggregate about \$76,000,000, and the total disbursements from this account for the period in question also amounted to about \$76,000,000. From the reports of the Russian representatives, it appears that these disbursements were made for supplies, transportation, storage, inspection, interest on loans made by the United States Government and on private loans floated in this country, salaries and

upkeep of the Russian Embassy and consulates and other Russian institutions in the United States, and various miscellaneous purposes. It is further shown by such reports that payments on contracts for supplies amounted to approximately \$36,000,000, and that about \$10,000,000 was expended for interest on said loans. It will be noted that these two items alone are greatly in excess of the portion of the liquidation funds estimated by the Russian Ambassador to have been derived from American Government loans.

From the pertinent records, it appears that the settlement of the contracts outstanding in this country at the time of the fall of the Provisional Government was effected by the Russian Ambassador in cooperation with representatives of the Department of State, of the Treasury, and of the War Industries Board, with the result that the outstanding contracts were settled by payment, cancellation, and other means, without loss to American contractors. This settlement, I should say, may well be regarded as a noteworthy achievement in view of the extent of the liabilities involved in such contracts and the comparatively limited amount of cash available here to the Russian Government for use in respect thereto.

On February 14, 1921, the Treasury was informed by the Russian representatives that the liquidation of the outstanding liabilities of the Provisional Government of Russia in regard to contracts placed in the United States had been for the most part completed, and an arrangement was thereupon entered into whereby the liquidation account as such was closed out March 4, 1921, and the balance therein, amounting to \$70,426.34, paid to the Treasurer of the United States and applied on account of interest due and payable on Russian obligations held by the United States. It was agreed by the Russian representatives, however, that sums which might still accrue to them from the remaining business of liquidation which would, prior to the closing out of the liquidation account, have been payable into that account, should likewise be applied on interest due on said obligations. Such sums to the aggregate amount of \$337,766.73 have actually been paid since March 4, 1921, by the Russian representatives to the Treasurer of the United States and applied on interest due on the Russian obligations. It is the understanding of the Treasury that the funds so paid were realized chiefly from further sales of the Russian Government's property.

As you are aware, all of the information above given with respect to loans made by this Government to Russia, and the greater part of the data set forth in regard to the liquidation of the Russian Government's financial obligations in this country after the fall of the Provisional Government, have heretofore been made public in various reports and other documents. Attention is particularly called to the Annual Report of the Secretary of the Treasury for the fiscal year 1920; the testimony of Mr. Polk, then the Under Secretary of State, and of Mr. Leffingwell, a former Assistant Secretary of the Treasury, before the House Committee on Expenditures in the State Department on June 26 to September 8, 1919, in connection with House Resolution 132; the correspondence between the Russian Ambassador and the Department of State read before the subcommittee of the Senate Committee on Foreign Relations during the second session of the 66th Congress at the hearing on Senate Resolution 263 and printed

on pages 501-504 of Senate Report 526, dated April 14, 1920; the hearings on House Resolution 635 before the Committee on Foreign Affairs of the House, 66th Congress, third session; Senate Document No. 86, 67th Congress, second session, entitled "Loans to Foreign Governments"; the testimony of former Secretary of the Treasury Houston and former Assistant Secretary of the Treasury Kelley before the Senate Committee on the Judiciary on February 2 to February 7, 1921; and the letter dated February 25, 1921, from Secretary Houston in response to Senate Resolution 417, printed in the Congressional Record for February 26, 1921.

In addition to reports showing the Russian Government's expenditures since the entry of the United States Government into the war, the Russian Embassy has filed with the Treasury Department detailed reports and statements, with explanatory memoranda, in respect to the liquidation by such Embassy, after the fall of the Provisional Government, of the Russian Government's obligations in the United States out of that Government's assets in this country, and I understand that the Russian representatives have shown every disposition to make all possible information available to the Treasury.

Sincerely yours,

(Signed)

A. W. MELLON, *Secretary.*

Honorable CHARLES E. HUGHES,
Secretary of State.

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World War Foreign Debt Commission.

Immediate release
January 8, 1923.

The first meeting of the Debt Funding Commissions of the United States and Great Britain took place at the office of the Secretary of the Treasury at 10 o'clock today.

The representatives of the United States in attendance comprised Secretary of the Treasury Andrew W. Mellon, chairman, Secretary of State Charles E. Hughes, Secretary of Commerce Herbert C. Hoover, Senator Reed Smoot and Representative Theodore E. Burton.

Great Britain was represented by the Hon. Stanley Baldwin, M.P., Chancellor of the Exchequer, and Mr. Montagu C. Norman, Governor of the Bank of England.

Secretary Mellon extended official greeting in most cordial terms and expressed particular appreciation of the courtesy of the British Government in having designated as its delegates gentlemen so notably distinguished. It was the first time, he believed, that a Chancellor of the Exchequer had left his country to participate in a mission of this nature.

It indicated clearly to his mind a realization of the magnitude of a negotiation or transaction, not merely of the utmost importance in itself but bearing with it possible consequences so far-reaching that they could hardly be computed.

He begged to assure the distinguished visitors that the United States Commission, of which he had the honor of being the chairman, was no less sensible than themselves of the extreme desirability, amounting to a virtual necessity, of effecting a definite settlement of the financial relationship of the two countries upon a basis entirely just to both.

The purposes of the conferences and the conditions bearing upon them were so well understood that he saw no necessity of stating them in detail. He wished at the moment only to say that the prompt payment by Great Britain of \$100,000,000 of interest during the past three months, pending a definite arrangement, was to his mind conclusive proof of the right spirit of financial integrity which he was proud and glad to say had always animated both of the two great English speaking nations.

The Chairman also called attention to the fact that the Commission had a limited authority under the applicable statute.

The Chancellor's reply is attached.

After an informal discussion the British Mission retired and the American Commission continued its consideration of the general situation.

It was stated after the meeting that the British Mission has in course of preparation further data with reference to the general statement submitted.

FOR RELEASE ON DELIVERY

EXPECTED TO BE RELEASED ON MONDAY 8th JANUARY

SPEECH DELIVERED BY THE RIGHT HON. THE CHANCELLOR OF THE EXCHEQUER AT THE
OPENING MEETING OF THE ANGLO-AMERICAN DEBT COMMISSION ON
MONDAY 8th JANUARY 1923.

On behalf of the British Delegation, I take this opportunity of expressing to the American Government and people our heartfelt appreciation of the warmth and courtesy of our reception - a reception so characteristic of the generous hospitality of this great nation.

We have come with the express intention of repaying our debt, and it is owing to the practical difficulties of making international payments that we are about to consult with you in order to accomplish the end which we both have in view.

We meet today under extraordinary circumstances. We meet to settle the largest single financial transaction, I believe, between two friendly nations, in the history of the world. We are here to arrange the terms of the payment of the British debt to the United States. That debt was contracted in a common cause. It was the first contribution made by the United States to save civilization from being engulfed and free peoples being brought under the destructive rule of a military autocracy; it was followed by the contribution of the man-power of the United States, whose soldiers fought so gallantly with ours and those of our Allies for the same purpose.

Then we were enlisted in a common cause; we still have common economic interests. The payment of our debt to you involves much more than the transfer of huge sums from London to Washington. It must affect the future well being of both countries and on their prosperity depends to a large extent that of the entire world. The settlement we make here will determine the condition and material welfare of the great mass of wage earners in Great Britain and the United States, their wives and children. I do not, I believe, exaggerate. I state this as my deliberate opinion after having given the subject matured consideration.

The payment of our debt to you will impose upon us the necessity of levying heavy taxes to meet these payments. From the beginning of the war we were the heaviest taxed nation in the world. We financed our military operations to a greater degree than any other nation by making the present generation pay. It is our way to pay as we go so far as we can. From that fixed principle we have no intention now to depart. The total annual per capita taxation in Great Britain is today still greater than that of any other people. It amounts to more than \$100 per head of the population.

I invite you to consider my views as to what this means and how I fear it will affect your own wage earners no less than ours. Further taxation would decrease the purchasing power of the British workman and reduce our consumption of American products. There would be a diminished export demand for American cereals, cotton, meats and other products of the soil, the mine, and the factory. Desirous as we are to maintain the social scale of our own worker, the effect of additional taxation would be inevitably to depress it. From the consequences of that I do not see how American can escape. The social condition of the American workman, raised to its present

level in some measure as a result of the war, is now the highest in the world, but if we are unable to purchase from you, if we are forced by stern necessity to economise still further, to buy from you only those things we must have, but even these in greatly reduced quantities, the American farmer, as well as the American workingman, will feel the pinch. He likewise will be compelled to economise; he will have to do with less; he will be brought down to a lower standard of living. Our modern civilization does not permit of economic isolation. Economic relations are too closely interwoven for one nation to be prosperous when other nations are suffering. Speaking broadly, if I may use the phrase, "spotted prosperity" is impossible. If on the economic map of the world there is a spot of prosperity surrounded by distress, that spot will not spread to bring health but it will be wiped out by the poverty and misery that surround it.

In this spirit I address myself to the task before us. I shall now consider the subject more in detail.

Had it been possible to find in the world a nugget of gold worth 4 billions of dollars, we would have spared no sacrifice to secure it and we would have brought it with us, but unfortunately the limitations of nature put such a simple method of payment out of the question and we have to explore other means.

Let us examine how the debt came into being and see if that will help us to a solution.

This debt is not a debt for dollars sent to Europe, the money was all expended here, most of it for cotton, wheat, food products and munitions of war. Every cent used for the purchase of these goods was spent in America; American labour received the wages: American capitalists the profits: the

United States Treasury the taxation imposed on those profits.

At the time these goods were bought, we were associates in a great war. Out of 7 billion dollars worth of goods bought after the United States came into the war, we paid for 3 billion dollars worth, leaving 4 billions which were supplied on credit. Now seeing that the debt is a debt for goods supplied, it would be natural to ask, why not repay with goods?

A moment's consideration is sufficient to answer that question.

These goods were supplied in war time at war prices. Prices have fallen so far that thus to repay 4 billions of dollars, Great Britain would have to send to America a far greater bulk of goods than she originally purchased with the money loaned, and laying aside all consideration of the tariff barrier, would it be possible for America to accept repayment in coal, steel, iron, manufactured cotton goods and so forth, a method of repayment which would affect the employment of her people for years to come?

We have now seen that immediate repayment by gold is impossible and that an equivalent transaction in direct repayment by goods is full of difficulties so we shall have to explore what remaining methods of international payment are presented by the markets of the world.

Here attention will have to be paid to several considerations.

We lent large sums to and established large credits for our European Allies, so that while we are dealing with our liabilities we find a large proportion of our assets temporarily frozen.

To balance our annual accounts in times of unexampled difficulty, we have made great sacrifices. We are affected by the terrible economic situation in Europe and are passing through the worst period of unemployment in our history. I have already referred to the weight of our taxation which

with the prolonged unemployment is already bearing cruelly on our women and children.

So far from the war having left us richer by the acquisition of new territory, the acceptance of Mandates in some of the most disturbed parts of the world has involved us in vast unproductive expenditure in policing and patrolling territories in which we have no economic rights which are not open equally to other nations.

Having regard to all these circumstances, the British Government has to consider very carefully the terms of the liquidation of the debt, lest an annual obligation be assumed which it might be impossible to meet in years of bad trade and falling revenue.

In common with the rest of the world, we have watched with admiration the open-handed charity of America to the stricken countries of Europe, to the peoples of Belgium, of France, of Russia. The generosity of America is proverbial, but we are not here to ask for favours or to impose on generosity.

We want, on such terms as will produce the least possible disturbance in the trade relations of the two countries a fair business settlement, a square deal, a settlement that will secure for America the repayment to the last cent of those credits which the United States Government established in America for us their associates in the war.

Our wish is to approach the discussion as business men seeking a business solution of what is fundamentally a business problem.

May I put it in this way? We intend to pay but how best can international credits be made liquid when the creditor nation is unwilling to permit liquidation through the direct delivery of goods and is also unwilling to see the current sale of her products to the debtor nation interrupted,

and when the debtor nation is unwilling to be put in the position of being unable to buy the products of the creditor nation?

The cordial and prompt agreement of the two greatest democracies of the world on a question of this intricacy and magnitude will be an example to the nations and a long step forward in effecting a solution of the economic troubles of Europe. Let us never forget that until these troubles are solved, there can be no general revival of international trade.

For myself I look forward to the meetings of the Commission with hope and confidence. I believe that I shall not be disappointed.

SUMMARY OF CERTAIN FISCAL DATA PRESENTED BY
BRITISH DEBT MISSION TO WORLD WAR FOREIGN DEBT COMMISSION,
GIVEN OUT ON JANUARY 11, 1923.

BUDGET OF 1922/23 (FISCAL YEAR ENDS MARCH 31st)
PERCENTAGE OF REVENUE RECEIVED FROM VARIOUS SOURCES
ESTIMATED

Income Tax and Super-Tax	36.1
Duties on Consumption of Beverages and Liquors	17.5
Tobacco	5.2
Food	5.5
Death Duties	5.2
Excess Profits and Corporation Profits Duties	5.2
Special non-recurring Receipts due to the war (Sales of War Supplies etc.)	9.9
Posts and Telegraphs and Miscellaneous	15.4

TAX BURDEN

In discussing the burden of taxation which has been imposed upon the British people, amounting annually to approximately \$100 per capita, certain items were particularly emphasized as showing the drastic steps which had been taken to make the British Budget balance.

Pleasure motor vehicles pay an annual tax of £ 1 (Approximately \$5) per horse power. The tax on trade vehicles is not so heavy.

The buyer of a pint of beer pays 7 cents as a tax and 7 cents for the beer, a total cost of 14 cents as against 6 cents before the war. On a glass of spirits, the tax represents 2/3 of the cost to the consumer. Sugar in England costs at retail about 11 cents a pound, of which approximately 50% is in the tax taken by the Government. Both the beer tax and the sugar tax are thirteen or fourteen times what they were before the war.

Tobacco, practically all of which is imported, carries an import duty of \$2 per pound.

Inheritance taxes for direct inheritance from parent to child run from 1% to over 40% depending upon the size of the estate. Heavy additional duties are payable for indirect inheritance.

The income tax bears especially hardly upon moderate incomes. A single person the whole of whose income is earned pays in income tax (including super-tax where applicable) as follows:

Total income .	Tax
\$1,250	\$56
2,500	253
5,000	815
10,000	1,940
20,000	5,500

Where the income is derived from investments the tax is at a higher rate. The maximum rate of tax on the highest incomes is about 54%.

Taking a comparison of the last pre-war financial year and the last completed year the National taxation per head of population is as follows:

1913-14	£ 3.11.2
1921-22	£17.17.5
1922-23 Estimated	£17.1.2

To get the total burden there must be added local taxation. This will increase the above figures for 1913-1914 and 1921-22, respectively, to approximately £ 5.10.0 and £ 22.10.0. The post-war burden is thus over four times the pre-war.

REVENUE FROM NATIONAL TAXATION BY YEARS.

<u>Year ending 21st March</u>	<u>In Millions of Pounds</u>
1913	155
1914	163
1915	189
1916	290
1917	514
1918	613
1919	784
1920	999
1921	1025
1922	846
1923 Estimated	719

BUDGET OF 1922/23 (FISCAL YEAR ENDS MARCH 31st)
PERCENTAGE OF TOTAL EXPENDITURE APPLIED TO CERTAIN PURPOSES
ESTIMATED.

Interest on Debt	57.8
Fighting Forces (Army, Navy and Air Forces)	16.7
War Pensions	10.2
Social Services (including education, Public health, old age pensions and unemployment)	13.4
Foreign and Colonial Services other than Defense	0.6
Administration including cost of collecting Revenue	11.5
All other	9.8
Total	100.0

PERCENTAGE OF TOTAL ANNUAL EXPENDITURE MET FROM REVENUE.

Showing effect of war on British Budget and return to Balanced Budget in 1921.

Year ending 31 March

1913	100
1914	100
1915	38.6
1916	21.6
1917	26.0
1918	26.2
1919	34.4
1920	80.4
1921	100.
1922	100.
x 1923 (Estimated)	100.

x Provision for the redemption of debt (Sinking Fund) was omitted from the Budget for 1922/23, a step without precedent except in time of war.

SUMMARY OF INFORMATION
AS TO BRITISH DEBTS, LOANS, AND UNEMPLOYMENT RELIEF EXPENDITURES
PRESENTED BY THE
BRITISH DEBT MISSION TO THE WORLD WAR FOREIGN DEBT COMMISSION
Given out January 12th, 1923

NATIONAL DEBT AND INTEREST CHARGES BY YEARS IN POUND STERLING

Financial Year.	Total amount of the Dead Weight Debt on the 1st April of each year.	Payment in the year to meet interest on debt.
	£	£
1913-14	661,473,765	16,894,120
1914-15	651,270,091	19,512,539
1915-16	1,108,817,076	58,080,105
1916-17	2,140,748,644	125,068,977
1917-18	4,011,445,908	187,665,554
1918-19	5,871,850,637	267,969,204
1919-20	7,434,949,429	326,603,498
1920-21	7,831,744,300	328,331,757
1921-22	7,585,409,690	307,283,737
1922-23	7,676,295,109	335,000,000 Estimate

BRITISH DEBT

Approximate Classification according to Period of Maturities.

(Figures are in millions of pounds)

	at 31 March 1919	at 31 March 1920	at 31 March 1921	at 31 March 1922
Floating Debt, including: War Savings Certificates: (Payable on demand or within six months)	1,674	1,535	1,532	1,364
Bonded Debt, maturing within five years	1,020	1,123	1,027	712
Bonded Debt, maturing after five years	3,923	4,272	4,188	4,762
Debt to United States Government at par of ex- change	817	841	838	838
Total	7,434	7,831	7,585	7,676

DEBTS DUE BY ALLIES TO GREAT BRITAIN (EXCLUDING RELIEF LOANS)

<u>Country</u>	<u>Cash Advances - excluding all interest</u>	
	<u>On 31 March 1917</u>	<u>On 30 Sept. 1922</u>
	<u>£</u>	<u>£</u>
France	178,635,795	453,000,255
Russia	364,654,015	494,594,647
Italy	146,872,125	380,708,116
Belgium	49,925,045	97,308,698
Belgian Congo	900,000	3,499,581
Serbia	12,129,122	22,453,020
Roumania	11,574,093	16,585,364
Portugal	1,832,973	15,012,377
Greece	1,448,421	20,479,958
	767,971,589	1,503,642,016 x
		<u>767,971,589</u>
	Increase	735,670,427

x Interest accrued and unpaid approximately - £ 500,000,000.

Expenditure incurred in respect of the Relief of
Unemployment and in Re-settling Demobilized Soldiers in Civil Life
(in pounds sterling)

	<u>From the Armistice to 31 March, 1922.</u>	<u>Estimate for year ending 31 March, 1923</u>
I. <u>From the National Exchequer</u>		
Out of work donation i.e., the so-called dole	63,000,000	
State Contributions to the Unemployment Insurance Fund	28,000,000	24,500,000
Grants to Local Authorities for unclassified relief works	1,500,000	2,000,000
Grants for Roads, Land, Drain- age, &c.	2,500,000	4,000,000
Total	95,000,000	30,500,000

From the Armistice
to 31 March, 1922

Estimate for year
ending 31 March, 1923

II. By Local Authorities

Expenditure by Board of Guardians	104,500,000	40,000,000
Relief works including Roads	<u>6,500,000</u>	<u>5,000,000</u>
Total	111,000,000	45,000,000

III. Contributions from Employers
and Employed to the unemploy-
ment Insurance Fund

<u>Employers</u>	19,500,000	18,500,000
<u>Employed</u>	<u>18,000,000</u>	<u>16,500,000</u>
	37,500,000	35,000,000

In addition expenditure has been incurred upon such objects as the training of demobilized soldiers and sailors and in re-settling them in civil life as follows:

Training and Education of ex-service men and women	26,500,000	7,500,000
Re-settlement on the land & in civil occupations	23,000,000	1,750,000
Assistance to emigrants	2,000,000	750,000



THE SECRETARY OF THE TREASURY

WASHINGTON

January 9, 1923.

Dear Sir:

I am sending you herewith a copy of the official Treasury Department Circular announcing an offering of $4\frac{1}{2}$ per cent Treasury notes, of Series A-1927, dated January 15, 1923, and maturing in a little less than 5 years, on December 15, 1927. Subscription books open to-day, and $4\frac{3}{4}$ per cent Victory notes, whether or not called for redemption, and unregistered 1918 War-Savings certificates, which matured on January 1, 1923, will be accepted in payment, on the terms stated in the circular. The new notes will be issued in coupon form, in denominations of \$100 and upwards, and the Treasury is prepared to make deliveries promptly upon allotment and payment.

This offering of Treasury notes affords a good opportunity to holders of $4\frac{3}{4}$ per cent Victory notes and 1918 War-Savings certificates to renew their investment in a Government security running for about 5 years and yielding an attractive interest return. As already announced, all $4\frac{3}{4}$ per cent Victory notes bearing the distinguishing letters A, B, C, D, E, or F, prefixed to their serial numbers, were called for redemption on December 15, 1922, and interest on such notes stopped absolutely on that date, while the remaining $4\frac{3}{4}$ per cent Victory notes, bearing the distinguishing letters G, H, I, J, K, or L, prefixed to their serial numbers, will mature on May 20, 1923, according to their terms, and will cease to bear interest on that date. Victory notes tendered in payment, if in registered form, must be duly assigned to "The Secretary of the Treasury for redemption," before some officer authorized to witness assignments of United States registered bonds, in accordance with the general regulations of the Treasury Department governing assignments.

War-Savings Certificates, Series of 1918, if unregistered, will also be accepted in payment for the new notes, and must be duly receipted in the name inscribed thereon. These certificates matured on January 1, 1923, and do not carry interest after that date.

Holders of Victory notes or of unregistered War-Savings Certificates, Series of 1918, who wish to invest in the new notes should make prompt application through their own banks, or, if desired, direct to the Federal Reserve Bank of the district.

Very truly yours,

A. W. Mellon

Secretary of the Treasury.

To the Holder of
Victory notes addressed.

Inclosure: Treasury Department Circular No. 318, dated January 9, 1923.

January 20, 1923.

The President

of the Senate.

My dear Mr. President:

I have received the resolution of the Senate, No. 409, passed January 17, 1923, which the Secretary of the Senate transmitted to me with his letter dated January 16, 1923. This resolution, after referring to a report from the Federal Trade Commission that "three hundred and twenty-eight corporations have released surpluses by the stock dividend plan during the calendar year 1922, reaching more than \$2,149,151,425," quotes in part the provisions of section 220 of the Revenue Act of 1921, and requests the Secretary of the Treasury to furnish the Senate "the names of companies, amounts, and dates of penalties, if any, imposed by the Commissioner of Internal Revenue during said year of 1922, pursuant to the provisions of section 220, Internal Revenue Laws of 1921."

Section 220 of the Revenue Act of 1921, approved November 23, 1921, provides that if any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, there shall be levied upon the net income of the corporation a tax of 25 per cent, in addition to the other taxes imposed upon corporations, but that the fact that the gains

and profits are permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the surtax unless the Commissioner of Internal Revenue certifies that in his opinion such accumulation is unreasonable for the purposes of the business.

The Revenue Act of 1921, of which section 220 is a part, became effective for the taxable year 1921, and for subsequent years. The first returns filed under the Revenue Act of 1921 were not received by the Bureau of Internal Revenue until March, 1922, and the returns have not yet been examined because of the heavy pressure to dispose of the extraordinary accumulation of returns for the years 1917, 1918 and 1919. It is likely to be several months before the audit and examination of these 1921 returns can be put under way. The returns for the year 1922, the year to which S. Res. 409 seems to have particular reference, have not as yet been received by the Bureau of Internal Revenue, and are not due until March 15, 1923. Since the penalty imposed by section 220 may be assessed only after the Commissioner of Internal Revenue certifies, in the light of data obtained from the income tax return, that in his opinion the accumulation of gains and profits by the corporation is unreasonable for the purposes of the business, it will be readily understood that no occasion has yet arisen to invoke against any corporation the penalty imposed by section 220 of the Revenue Act of 1921.

In this connection it is proper to point out that there seems to be much misapprehension as to the effect of section 220 of the Revenue Act of 1921. It applies to corporations formed or availed of for the purpose of preventing the imposition of the

surtax upon the stockholders through the medium of permitting gains or profits to accumulate instead of being distributed. It expressly provides, however, that the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be considered as evidence of a purpose to escape the tax unless the Commissioner of Internal Revenue certifies that in his opinion such accumulation is unreasonable for the purposes of the business. The section does not impose a tax on undistributed profits or on accumulated surplus, but puts a penalty on the accumulation of gains and profits beyond the reasonable needs of the business when made for the purpose of escaping the surtax.

There is at the same time much confusion as to the relation of the declaration of a stock dividend to the application of section 220. S. Res. 409 refers in the preamble to the report of the Federal Trade Commission that three hundred and twenty-eight corporations have declared stock dividends during the calendar year 1922. The declaration of a stock dividend has no significance under section 220, and in any case where the section applies the Department can proceed with its enforcement quite as well after as before the declaration of a stock dividend. The declaration of a stock dividend does not relieve corporations from Section 220, nor, on the other hand does it indicate that a corporation has accumulated gains or profits beyond the reasonable needs of the business, for the entire amount of the surplus capitalized by the declaration of the stock dividend may be invested in plant, equipment and inventory, or be needed as working capital, or it may have been accumulated before the high surtaxes became effective and quite without regard to their possible application.

Furthermore, the receipt of a stock dividend by itself has no effect upon the tax liability of the recipient, since the holder of stock in a corporation after the receipt of a stock dividend has altogether no more than he had before. This was aptly expressed by the Supreme Court in Eisner v. Macomber, 252 U. S. 189, as follows:

"This, however, (declaration of a stock dividend) is merely bookkeeping that does not affect the aggregate assets of the corporation or its outstanding liabilities; * * * it does not alter the preexisting proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before. The new certificates simply increase the number of the shares, with consequent dilution of the value of each share."

As I have already stated, there have necessarily been no cases as yet in which the penalty imposed by section 220 of the Revenue Act of 1921 has been invoked, and there is, therefore, nothing to report at this time.

Very truly yours,

(Signed) A. W. MELLON

Secretary of the Treasury.

C O P Y

February 3, 1923.

The President:

The World War Foreign Debt Commission created under the Act of Congress approved February 9, 1922, having received the Mission appointed by the British Government to consider the funding of the demand obligations of that Government held by the United States, reports as follows:

The British Government designated as its representatives The Right Honorable Stanley Baldwin, Chancellor of the Exchequer, and Mr. Montagu Norman, the Governor of the Bank of England, who have conferred with the Commission in Washington and presented facts relating to the position of the British Government. The Commission has also met frequently in separate sessions and has given the fullest consideration to the problems involved in the funding of the British debt to the United States. It became manifest at the outset that it would not be possible to effect an agreement for funding within the limits of the Act approved February 9, 1922, and the Commission has, therefore, considered the practicability of a settlement on some other basis, and though it has not been able, in the absence of authority under the law, to conclude negotiations, it unanimously recommends for submission to Congress a settlement with the British Government, as follows:

Principal of notes to be refunded- - - - -	\$4,074,818,358.44
Interest accrued and unpaid up to December 15, 1922,	
at the rate of $4\frac{1}{4}\%$ - - - - -	629,836,106.99
	<u>\$4,704,654,465.43</u>
Deduct payments made October 16, 1922, and November 15,	
1922, with interest at $4\frac{1}{4}\%$ thereon to December	
15, 1922- - - - -	100,526,379.69
	<u>\$4,604,128,085.74</u>
To be paid in cash - - - - -	4,128,085.74
Total principal of indebtedness as of December 15, 1922,	
for which <u>British Government Bonds</u> are to be issued	
to the United States Government at par - - - - -	\$4,600,000,000.00

The principal of the bonds shall be paid in annual instalments on a fixed schedule, subject to the right of the British Government to make these payments in three-year periods. The amount of the first year's instalment will be \$23,000,000 and these annual instalments will increase with due regularity during the life of the bonds until, in the 62nd year, the amount of the instalment will be \$175,000,000, the aggregate instalments being equal to the total principal of the debt.

The British Government shall have the right to pay off additional amounts of the principal of the bonds on any interest date upon 90 days previous notice.

Interest is to be payable upon the unpaid balances at the following rates, on December 15 and June 15 of each year:

3% semi-annually, June 15, 1923 - to December 15, 1932, inclusive,
3½% " " " " 1933 - until final payment.

For the first five years one-half the interest may be deferred and added to the principal, bonds to be issued therefor similar to those of the original issue.

Any payment of interest or of principal may be made in any United States Government bonds issued since April 6, 1917, such bonds to be taken at par and accrued interest.

The Commission believes that a settlement of the British debt to the United States on this basis is fair and just to both governments and that its prompt adoption will make a most important contribution to international stability. The extension of payment both of the principal and interest over a long period will make for stability in exchange and promotion of commerce between the two countries. The payment of principal has been established on a basis of positive instalments of increasing volume, firmly establishing the principle of repayment of the entire capital sum. The

payment of interest has been established at the approximately normal rates payable by strong governments over long terms of years. It has not been the thought of the Commission that it would be just to demand over a long period the high rate of interest naturally maintained during the war and reconstruction, and that such an attempt would defeat our efforts at settlement. Beyond this, the Commission has felt that the present difficulties of unemployment and high taxation in the United Kingdom should be met with suitable consideration during the early years, and, therefore, the Commission considers it equitable and desirable that payments during the next few years should be made on such basis and with such flexibility as will encourage economic recuperation not only in the countries immediately concerned but throughout the world.

This settlement between the British Government and the United States has the utmost significance. It is a business settlement, fully preserving the integrity of the obligations, and it represents the first great step in the readjustment of the intergovernmental obligations growing out of the war.

Respectfully submitted:

S/ A. W. MELLON
Chairman

S/ CHARLES E. HUGHES

S/ HERBERT HOOVER

S/ REED SMOOT

S/ THEODORE E. BURTON.

February 16, 1923.

Dear Mr. Chairman:

I received your letter of February 13th, requesting certain information for the use of the subcommittee of the Committee on the Judiciary in connection with its consideration of House Joint Resolution No. 314, proposing a Constitutional amendment restricting further issues of tax-exempt securities. I have noted the brief and tables presented by the Governor of the State of Virginia, through Mr. E. Warren Hall, Second Assistant of the State Tax Board, and have examined the statements and figures embodied in the argument presented in behalf of the State. Many of the arguments and figures are either irrelevant or misconceived, and in large measure they are already answered by my letter of December 21, 1922, to the Acting Chairman of the Committee on Ways and Means, and of January 31, 1923, to Mr. Clarence H. Kelsey, Chairman of the Committee on Taxation of the Chamber of Commerce of the State of New York, copies of which are herewith enclosed. The argument presented for the State of Virginia may be answered more specifically in taking up the several questions raised by your letter, but I may say at the outset that no amount of arbitrarily assumed figures or loosely drawn conclusions such as appear in its brief and accompanying tables can serve to obscure the main facts in the situation upon which the Treasury relies in urging support for the proposed Constitutional amendment, namely, that the continued issuance of tax-exempt securities is building up a constantly growing mass of privately held property exempt from all taxation; that tax-exemption in a democracy such as ours is repugnant to

every Constitutional principle, since it tends to create a class in the community which cannot be reached for tax purposes and necessarily increases the burden of taxation on property and incomes that remain taxable; and that it is absolutely inconsistent with any system of graduated income surtaxes to provide at the same time securities which are fully exempt from all taxation, since the exemptions will sooner or later defeat at least all the higher graduations and will always be worth far more to the wealthier taxpayers than to the small ones. Tax-exemption, of course, gets quite a disproportionate value when taxes are not at a level rate but are levied at graduated rates, and the Federal surtaxes are almost wholly responsible for the extraordinary value which tax-exempt securities enjoy to-day. It is nonsense to refer to this value as something which the States have the right to enjoy in selling their securities, for the value depends in large measure on the relative scarcity of tax-exempt securities and the Federal Government could seriously impair, and nearly destroy, it by issuing all its own securities exempt from surtaxes. Contrariwise, since the value of the exemption turns largely on the existence of graduated surtaxes, the Federal Government could certainly reduce and probably destroy the present premium on tax-exempt securities by changing its own tax system and substituting for the income surtaxes some other form of tax which would not be affected by the presence of tax-exempt securities, as, for example, a tax on sales or expenditures. It may, in fact, be driven to some such change by force of necessity if the present situation continues and enough of the States cling to the privilege for which the Governor of Virginia contends, of issuing securities that give rich investors the power, at the expense of the rest of the community, to escape from the common burdens of taxation.

In proposing the Constitutional amendment now before your Committee the Federal Government is not asking from the States any more than it is willing to yield for itself, and I am sure that in considering the pending resolution your Committee will examine the question on its merits, free from the prejudices with which it is so frequently involved.

To take up specifically the questions raised by your letter:

1. It is impossible to give a definite statement as to the difference there would be in interest charges paid by the United States if all its obligations were wholly exempt from taxes, for it would depend on a number of factors and is largely a matter of judgment. I have already indicated, in my letter of January 31st to Mr. Kelsey, that in my judgment the difference would not be substantial, since if the United States were to issue about \$22,000,000,000 of fully tax-exempt securities instead of about \$1,500,000,000 of its tax-exempt securities now outstanding (leaving out of account the circulation bonds held by National banks), the market would be so flooded with tax-exempt securities that tax-exemption would lose its market value and it would be impossible to make any material saving of interest by granting full exemption from taxation. This conclusion is borne out by the actual experience of the United States with the tax-exempt series of Victory notes, as set forth in the letter to Mr. Kelsey, and it is further supported by the general experience of the United States in dealing with its war obligations, the Federal Government having financed all its war borrowings except for the First Liberty Loan $3\frac{1}{2}$ per cent bonds, and the $3\frac{1}{2}$ per cent Victory notes (all of which have now been retired), without recourse to full exemption from taxation. I am satisfied that if instead of following this policy the United States had issued all

of its war obligations on a fully tax-exempt basis the rates of interest on the tax-exempt obligations would have become practically as high as the rates actually paid on the obligations which have been issued. While it is not possible, since the contrary policy was pursued, to demonstrate this conclusion mathematically it must be obvious that if there were now \$32,000,000,000 face amount instead of about \$11,000,000,000 face amount of fully tax-exempt securities outstanding, the value of the tax-exemption would be so much diluted that it would have but little effect on interest rates. From the point of view of the revenue, however, the situation would be vastly more serious than at present, for there would be nearly three times as large a volume of tax-exempt securities available, and available at higher yields, for purchase by wealthy investors, with the probability that in these circumstances the graduated rates of surtaxes would have become almost completely ineffective. It is also necessary to remember that if there is now any material saving of interest to States and municipalities in issuing tax-exempt instead of taxable securities, that saving does not at all accrue to the benefit of the Federal Government, whereas the loss of revenue through the purchase of the tax-exempt securities in order to reduce taxable income for surtax purposes, falls entirely on the Federal Government.

2. It is not possible to give any complete statement showing the surtaxes collected by the United States upon income received as interest on its obligations not wholly exempt from tax. The latest figures are those for the taxable year 1920, and show total interest on such obligations returned as income for that year as \$61,549,572, according to table 2 on pages 46-47 of The Statistics of Income for 1920, a copy of which is

enclosed. There is also enclosed a table, made up from these Statistics of Income, which shows, by income classes, surtaxable interest on United States obligations aggregating \$60,431,903 for the year 1920, from which it is estimated that the surtaxes collected thereon amounted to about \$9,693,112 for that year. This does not, however, give a correct picture of the general situation, for a substantial part of the outstanding Federal obligations is in the hands of small holders or corporations not subject to surtax, and as to the balance it must be remembered that during this period there were certain limited exemptions from surtaxes, which have been largely availed of to reduce taxable income. In greater part these limited exemptions will expire by limitation on July 2, 1923, and practically all the rest by July 2, 1926. In the meantime, however, the figures as to surtaxable interest on United States obligations are necessarily reduced by these temporary exemptions, and do not show enough about collections on taxable obligations to make it possible to draw any general conclusions as to what might be the effect of the proposed Constitutional amendment in increasing the revenues from taxation.

3. The answer to the third point has already been given in part under (2), but to supplement that information there is enclosed herewith a copy of a statement prepared by the Statistical Division of the Income Tax Unit showing wholly tax-exempt income reported by individuals having incomes of \$5,000 and over for the calendar year 1920, separating interest on United States obligations from interest on State and municipal obligations, and showing the tax-exempt income of both kinds by income classes. This table compiles the reports of tax-exempt income made on the returns for 1920 pursuant to the provisions of the returns, and while it is accurate so far as it goes it is undoubtedly not complete since these reports

were required to be made only as a matter of information and the Bureau of Internal Revenue has not had occasion to check them up for tax purposes.

4. The Treasury has strongly recommended that the surtaxes be reduced to a maximum of 25 per cent, that is to say, a maximum combined normal and surtax of 33 per cent. It believes that a revision of the surtaxes on substantially this basis is fundamentally necessary if our present internal revenue system is to be successfully administered. There seems to be no prospect, however, of action by this Congress upon these recommendations and for the time being, therefore, it is necessary to face the fact of surtaxes running to a maximum of 50 per cent, or a combined maximum of 58 per cent. A revision to substantially the basis recommended by the Treasury would, no doubt, correct to some extent the evil of tax-exempt securities, since it would reduce the pressure to escape taxable income, but the evil would none the less remain and would still be serious, at least so long as there were any material graduation of surtax rates. For example, even with a maximum surtax of 25 per cent there would still be a material inducement for large investors to reduce taxable income, and to an investor paying surtaxes at the rate of 25 per cent a fully tax-exempt security would offer substantial advantages as compared with a surtaxable security, while the tax-exempt security would, of course, be far more valuable to such an investor than to a small investor. Lower surtaxes, in other words, would mitigate the evil but would not go the heart of the situation, for tax-exemptions would still persist and tend to defeat any taxes levied at the revised rates.

5. The Treasury regards the estimate of approximately \$185,000,000, submitted by the Governor of Virginia as the additional annual interest charge upon the Government of the United States on account of issuing obligations not wholly exempt from taxes, as wholly unfounded and grossly inaccurate. The reasons for this view have already been given in large measure in the discussion under (1) above, and the inaccuracy of the figure proceeds largely from the fact that it results from calculations which assume that all of the war borrowing of the Federal Government could have been carried on through the issue of tax-exempt obligations at a rate of interest approximately 1 per cent less than the rate paid upon surtaxable obligations. It is the opinion of the Treasury that if it had placed the whole war debt on a tax-exempt basis there would have been practically no differential between tax-exempt and surtaxable obligations. On this basis the United States would be paying to-day approximately the same annual interest on tax-exempt obligations that it is now paying on its outstanding debt not wholly exempt from taxes, and losing more in revenue.

6. The estimates submitted by the Governor of Virginia as to the maximum amount of surtaxes collected under the 1920 rates, and under the 1922 rates, on the interest on Government obligations returned as subject to surtaxes are substantially correct, but, as pointed out above in the discussion under points 2 and 3, the figures for these years are vitiated by temporary factors and have no bearing at all upon the merits of the pending Constitutional amendment.

The brief submitted by the Governor of Virginia contains a number of inaccuracies related to this discussion which impair its whole position. On page 14, for example, the brief states that the proposed amend-

ment would be unfair to the States since "The Federal Government has issued about twenty-three billions of bonds. It does not contemplate any further large issues. These bonds cannot be taxed by the States.

It is thus probable that during the next fifty years, at least, there will be no Federal securities liable to State taxation, but on the other hand, the States and municipalities are issuing about a billion dollars in securities each year. All of these will be liable to the Federal taxation. Since there will be no Federal securities liable to the tax, the value of the provision against discrimination will be nil." These statements are manifestly false and misleading. The Federal Government is issuing each year substantial amounts of new securities and for many years to come will be issuing new securities every year, probably in amounts larger than the aggregate of State and municipal issues during the year, in order to refund its obligations previously issued. Between now and the end of 1928, for example, about \$9,000,000,000 of bonds, notes and certificates issued by the Federal Government will mature and in large measure these maturing obligations will have to be refunded. Any of these refunding obligations issued after the ratification of the Constitutional amendment would be subject to its provisions in the same manner as State or municipal obligations issued after its ratification. The same would be true of other refunding obligations issued by the Federal Government in succeeding years. To show how completely false is the argument made by the Governor of Virginia it is enough to call attention to the fact that the whole war debt of the Federal Government actually matures within the next thirty years, with substantial maturities falling at frequent intervals. These maturing obligations will either be redeemed, in which event the tax exemptions they now carry will

cease to be of any importance, or will be refunded into other obligations; and these refunding obligations, if issued after the ratification of the Constitutional amendment, will be subject to its provisions.

The brief submitted by the Governor of Virginia is filled with inaccuracies and loose statements of this nature, and contains also numerous misquotations of my testimony before the Ways and Means Committee and unwarranted and irrelevant conclusions from statements made in letters and testimony before the Committee. It is hardly worth while to take these inaccuracies up in detail in a letter of this character but if the subcommittee would like to have me appear personally before it, either in reply to the arguments made by the Governor of Virginia or in support of the position which the Treasury has taken with respect to the Constitutional amendment, I shall be glad to appear at such time as the subcommittee may desire.

I feel that I should not close without again expressing the hope that the Committee will take action on this measure at a date early enough to assure favorable action by the Senate at this session of Congress. It is a matter of the utmost importance to our economic and financial development, and I view with real concern the possibility that action on this amendment, which was first suggested by the Treasury in April, 1921, may again be deferred to some later date. The resolution has already passed the House of Representatives by a decisive vote, and within the next year or two there are sessions of most of the State legislatures, so that the time to propose the amendment is now, when there is a favorable opportunity for action upon it, before the volume of tax-exempt

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securities grows to uncontrollable proportions.

Cordially yours,

(Signed) A. W. Mellon

Secretary of the Treasury.

Hon. Knute Nelson,
Chairman, Committee on the Judiciary,
United States Senate,
Washington, D. C.

enclosures.

TREASURY DEPARTMENT

FOR RELEASE, Morning Papers,
Thursday, February 1, 1923.

Inclosure to Memo
dated 2/16/23

The following is a copy of a letter from Secretary Mellon to Mr. Clarence H. Kelsey, Chairman of the Committee on Taxation of the Chamber of Commerce of the State of New York, with respect to the question of tax-exempt securities:

January 31, 1923.

My dear Mr. Kelsey:

I received your letter of January 22, 1923, with further reference to the question of tax-exempt securities, and have since had opportunity to examine the report of your Committee on this subject to the Chamber of Commerce of the State of New York, which I notice was published yesterday morning and is expected to come up for action at the meeting of the Chamber on Thursday. I cannot escape the feeling after reading this report that the position which it takes is founded upon several serious misconceptions, and I am satisfied that on many points the report is directly at variance with the facts. Reduced to its lowest terms, the main contention of the report seems to be that so long as there are high surtaxes there ought to be tax-exempt securities to provide relief from those surtaxes. This view is not unnatural, having regard to the excessive rates of surtax which now prevail, but it is the Treasury's view that to sanction the continued issuance of securities carrying full exemptions from taxation and at the same time attempt to levy Federal income surtaxes running as high as 58 per cent, when combined with the normal tax, creates an impossible situation, since the tax-exemptions of the securities will tend to defeat the collection of the taxes. I have accordingly urged that action be taken, first, to restrict further issues of tax-exempt securities, in order to block this avenue of escape from the

surtaxes, and, second, to reduce the surtax rates to a reasonable level, with a maximum of 25 per cent, amounting to 33 per cent when combined with the normal tax. This would, in my judgment, provide a workable system and in the long run produce more revenue than the present rates.

The report of your Committee, it seems to me, overlooks the most important factor in the tax-exempt security problem, namely, that the root of the trouble lies in the Federal income surtaxes. The high surtaxes date from the Revenue Act of 1917, and until that time tax-exempt securities presented a problem of but small magnitude since most taxes were levied at level rates and it could generally be said, as stated in your report, that the loss of taxes was roughly made up by the saving in interest costs. With taxes at flat rates the exemption is worth about as much to one taxpayer as another, and barring any questions as to conflicting State and Federal jurisdiction it could be said with some force that if the State or Federal Governments were to tax the securities which they themselves issued purchasers of the securities would insist on an interest yield high enough to compensate for the taxes levied. The Federal surtaxes have changed all this and created an entirely different problem. The exemption to which the greatest importance now attaches is the exemption from Federal surtaxes and the value of this exemption depends entirely upon the income of the individual taxpayer. Generally speaking, it will be greatest in the case of the wealthiest taxpayer, while to the person paying only a normal tax or a low surtax the exemption will be relatively

of little value. This makes it quite impossible, as a practical matter, for the borrowing State or Federal Government to obtain full value for the exemption carried by the securities, for in the nature of things the securities will be sold in the open market at quoted prices adjusted to market conditions, though to one purchaser the exemption may be worth little or nothing and to another purchaser, who pays the same price, the exemption may be worth the equivalent of 10 or 11 per cent on a taxable security. Another fundamental difference, which your report completely overlooks, is that the surtaxes are levied by the Federal Government while the tax-exempt securities are, for the most part, issued by the State and municipal governments. In other words the Federal Government gets no compensating advantages whatever from any reduction in interest rates that may accrue to the State or municipal government through the tax-exempt privilege, so that the tax-exemption from Federal surtaxes is in fact an involuntary subsidy conferred upon State and municipal governments by the Federal Government at the expense of its own revenues. Your report, I notice, attempts to meet this on the ground that whether the State or Federal Governments are involved it is all one body of taxpayers, but while this is undoubtedly a valid argument in support of uniformity of treatment as between the State and Federal Governments it cannot be advanced in support of a system which permits taxpayers to avoid their taxes to the Federal Government by purchasing securities issued by or under authority of the States.

The argument in your report assumes as a basis for all its calculations that fully taxable securities would have to bear interest at a rate about 1 per cent higher than fully tax-exempt securities, and at the outset purports to quote my testimony in January, 1922, before the Committee on Ways and Means in support of this assumption. That testimony did not involve any such statement, but simply admitted that the Federal Government, under the conditions then prevailing, would have to pay more than $3\frac{1}{2}$ per cent, and probably more than 4 per cent, in order to sell Government securities without full exemptions from taxation. I do not believe that on any substantial volume of securities there is 1 per cent difference, or anything like that between tax-exempt and taxable securities. The value of tax exemption in the sale of securities depends in large measure on the volume of securities available, and once this scarcity value is destroyed there would in my judgment be but little difference, with borrowers of equal credit, between the yields of tax-exempt and taxable securities. I have already stated in my letter of February 9, 1922, to the Chairman of the Committee on Ways and Means my general views on this subject, as follows:

"But the case in favor of the proposed amendment from a revenue standpoint is even stronger, because it would be quite impossible for the Government to float \$20,000,000,000 of tax-exempt bonds at a rate of interest three-fourths per cent less than that of taxable bonds. There is only a limited class of people in the United States to whom the exemption from surtax is worth as much as three-fourths of 1 per cent. On November 30, 1921, the amount of Liberty $3\frac{1}{2}$'s outstanding was \$1,410,074,450, and of Victory $3\frac{3}{4}$'s, \$497,915,100. These two issues include the great bulk of wholly tax-exempt United States obligations which are held by investors (as distinguished from circulation bonds held by national banks). If instead of less than \$2,000,000,000 there were \$20,000,000,000 of these bonds, the value of the exemption would probably be almost imperceptible in the market quotations. The result of such an extension would be that the Government would have to pay almost the same amount in interest charges as before and would be wholly deprived of the surtaxes which it might otherwise collect".

The experience of the Federal Government in these matters furnishes perhaps the best practical answer to the conclusions embodied in your report. Since the First Liberty Loan it has been the consistent policy of the Federal Government (except for the issue of $3\frac{3}{4}$ per cent Victory notes, all of which have now been retired), to finance itself without relying upon the issue of fully tax-exempt securities, and generally speaking all of the Liberty bonds (except the First $3\frac{1}{2}$'s), all outstanding Victory notes and Treasury notes, Treasury bonds and Treasury certificates of indebtedness, have been denied exemption from Federal income surtaxes. The total amount of the First $3\frac{1}{2}$'s outstanding is only about \$1,500,000,000, while the pre-war debt of the Federal Government is almost entirely in the form of bonds held by national banks to secure circulation, so that practically all the remainder of the Federal debt has been floated without recourse

to the exemption from Federal surtaxes which has created the tax-exempt security problem. The experience of the Federal Government has further shown that tax-exempt securities at a rate of interest 1 per cent less than that paid on taxable securities are not particularly attractive to investors, and that your assumption that any substantial amounts of fully tax-exempt securities could be sold at 1 per cent less than taxable securities is fallacious. The Victory Liberty Loan was offered in two series, one fully tax-exempt and the other entirely without exemption from Federal surtaxes, both series being interconvertible during their lives. The total amount of the loan was about $4\frac{1}{2}$ billion dollars, and yet the tax-exempt series never passed beyond 1 billion dollars, and had actually dwindled to about \$375,000,000 when it was called for redemption last year. The comparative yields of high-grade State and municipal securities, carrying full tax exemptions, and Federal securities without the exemptions from surtaxes, also indicate the underlying fallacy in your figures. The Treasury bonds of 1947-52 offered by the Federal Government last October are, generally speaking, subject to Federal surtaxes, and are quoted in the market to yield about $4\frac{1}{4}$ per cent, while State and municipal securities of the highest grades having full exemptions from surtaxes are quoted to yield about 4 per cent to 4.15 per cent, and other State and municipal obligations of not such good credit are quoted to yield $4\frac{1}{2}$ per cent, and even higher. This all indicates as conclusively as can be that owing to the gradual dilution of the security market with tax-exempt securities the value of the tax exemption to the

borrowing State or Federal Government is gradually dwindling, while the tax-exemption still retains its value to the wealthy taxpayer.

I can perhaps best summarize the Treasury's position by enclosing for your information a copy of a letter of December 21, 1932, which I sent to the Acting Chairman of the Committee on Ways and Means. The facts are that the Federal Government, under the power granted by the 16th amendment to the Constitution of the United States, now levies income taxes on individual incomes, and is imposing graduated additional income taxes, commonly known as surtaxes, on the higher incomes. At the same time the States and municipalities are issuing a growing volume of tax-exempt securities, the income from which is wholly exempt from these very surtaxes, while the Federal Government, though under our present Constitutional system it could itself issue fully tax-exempt securities, has for some years past consistently refrained from issuing such securities in order to protect the public revenues. The Federal Government might change this policy, and by issuing its own securities with full tax exemptions cancel much of the artificial value of State and municipal securities, but this would merely swell the volume of tax-exempt issues and still further endanger the revenues.

It must be clear that graduated additional income taxes cannot be effective when there exist side by side with them practically unlimited quantities of fully tax-exempt securities available to defeat them, and that either some way must be found to stop the continued issuance of tax-exempt securities or the Federal Government must find some substitute for the surtaxes. The issue is immediate and serious, for the yield of the surtaxes has already been reduced to a relatively small sum as compared with the early years, and the persistence of the present system is distorting our

whole economic structure and hampering the development of business and industry throughout the country.

A Constitutional amendment along the lines proposed in the pending resolution would correct the situation and would put State and Federal Governments on an exact equality. I believe that such a Constitutional amendment is safe and practicable and I hope that the Chamber of Commerce of the State of New York will not take a position adverse to its adoption.

Very truly yours,

A. W. MELLON,

Secretary of the Treasury.

Clarence H. Kelsey, Esq.,
President, Title Guarantee and Trust Co.,
176 Broadway,
New York, N.Y.

Inclosure to Memo
dated 3/16/23

December 21, 1922.

Dear Mr. Green:

I received your letter of December 20, 1922, with respect to H. J. Res. 314, proposing an amendment to the Constitution of the United States to restrict further issues of tax-exempt securities, and note your statement that an amendment has been proposed by Mr. Garner, of Texas, which would strike out in Section 1, after the word "income", the following words: "derived from securities issued, after the ratification of this article, by or under the authority of the United States or any other State", and in Section 2, after the word "income", the words "derived from securities issued, after the ratification of this article, by or under the authority of such State". For the words thus stricken out the Garner amendment would, I understand, substitute the words "from any source" in both Sections. I note further that in support of his proposed amendment Mr. Garner has stated that under the resolution as reported by the Committee on Ways and Means the United States might discriminate against the bonds of a State and in favor of the bonds of a railroad or industrial corporation, and that his amendment is proposed in order to prevent such a result. I am glad to be able to write you, first, that in the judgment of the Treasury the resolution in the form reported by the Committee would not of itself prevent discrimination of this character, so that the amendment proposed by Mr. Garner is unnecessary, and, second, that to adopt the amendment proposed by Mr. Garner would probably nullify both Sections and make the whole Constitutional amendment ineffective.

Whatever opposition there is to the proposed amendment to restrict further issues of tax-exempt securities rests, I think, upon a misunderstanding of the object and effect of the amendment, and this, in turn, harks back to the old controversies about States' rights and the powers of the Federal Government. I can say without hesitation that, separated from these old prejudices and taken from the point of view of the facts as we have to face them to-day, the proposed Constitutional amendment involves no question whatever of States' rights and makes no attack whatever on the credit or borrowing power of the States or their political subdivisions. The amendment would apply with absolute equality to the Federal Government, on the one hand, and the States and their political subdivisions on the other, and in the interests of the general welfare would put exactly the same restrictions upon future borrowings by the Federal Government as upon future borrowings by the States and their political subdivisions. The constantly growing mass of tax-exempt securities threatens the public revenues, not only of the Federal Government, but of the States as well, and it is reaching such proportions as to undermine the development of business and industry.

The Federal Government, for the most part, has refused to have recourse to tax-exempt issues in financing its own operations, but the volume of tax-exempt securities of the States and their political subdivisions, and of other agencies, already outstanding and currently issued, is so large that the value of the exemption to the borrower issuing the securities has become relatively insignificant. Even now the States and their political subdivisions, notwithstanding the full tax exemptions

on their securities, are obliged to pay substantially the same rates on their tax-exempt borrowings as the Federal Government pays on securities without exemption from Federal income surtaxes. The facts are that under our system of graduated Federal income surtaxes the issue of tax-exempt securities, while of constantly diminishing advantage to the borrowing State or city, provides a perfect refuge for wealthy investors, being most valuable to the wealthiest taxpayer. The actuarial figures show that to taxpayers paying surtaxes in the highest brackets securities subject to Federal income surtaxes would have to yield about 10.4 per cent in order to be as attractive as a 5 per cent tax-exempt security. For this great advantage the State which issues the securities gets but very little compensating return, and certainly no greater return from the wealthiest investor than from the smallest investor (to whom the exemption is relatively worthless), while the United States, which imposes the surtaxes, loses its revenue without any compensating advantage whatever. It is the graduated surtax, or course, that gives the greatest value to the tax exemption, and viewed from this aspect the tax exemption, in substance, constitutes a subsidy from the Federal Government, the cost of which in the long run must fall on those taxpayers who do not or cannot take refuge in tax-exempt securities. Even from the point of view of the States themselves, I believe it is clear that the continued issuance of tax-exempt securities saves nothing to the tax-payers in the States and that in the long run it brings heavier taxes. The tax-exempt privilege, with the facility that it gives to borrowing, leads in many cases to unnecessary or wasteful public expenditure, and this in turn is bringing

about a menacing increase in the debts of States and cities. These debts constitute a constantly growing charge upon the taxpayers in the several States, and will ultimately have to be paid, principal and interest, through tax levies upon these very taxpayers. It is easy to overlook this when the debts are incurred, but it is none the less impossible to escape the facts when the time comes for payment. It is also necessary to bear in mind that in the long run all of these public debts, whether the debts of States and their political subdivisions or of the Federal Government itself, as well as the taxes which must be imposed to meet them, fall upon but one body of taxpayers, and that the apparent advantage of borrowing by States and cities at the expense of the Federal revenues is illusory, since any temporary advantages thus obtained will have to be paid for by the Federal Government at the expense ultimately of the great body of taxpayers. This ^{is} particularly true of tax-exempt securities, for their effect is to provide a refuge from taxation for certain classes of taxpayers, with correspondingly higher taxes on all the rest in order to make up the resulting deficiency in the revenue.

Once it is understood I think no one can raise any valid objection to the proposed Constitutional amendment restricting further issues of tax-exempt securities. As a matter of fact, it is almost grotesque to permit the present anomalous situation to continue, for as things now stand we have on the one hand a system of highly graduated Federal income surtaxes and on the other a constantly growing volume of securities issued by States and cities which are fully exempt from these surtaxes, so that taxpayers have only to buy tax-exempt securities to make the

surtaxes ineffective. The only way to correct this condition is by Constitutional amendment, accompanied, if possible, by a reduction in the rates.

To take up the Garner amendment more specifically, I believe that the changes it would make are very clearly unnecessary. The resolution reported by the Committee on Ways and Means expressly provides in Section 1 that Federal taxes on income derived from securities, issued after the ratification of the article, by or under the authority of any State, must be without discrimination against income derived from such securities and in favor of income derived from securities issued after the ratification of the article by or under the authority of the United States or any other State. The same protection for the Federal Government is accorded by the second Section, conferring power on the States to lay and collect taxes on income derived from securities issued after the ratification of the article by or under the authority of the United States. Under Section 1 as it stands it would be impossible for the Federal Government to impose an income tax on income from future issues of State or municipal bonds without imposing the same tax on income derived from future issues of its own bonds, and as a practical matter it is almost inconceivable that Congress would be willing to impose such a tax upon the income from both State and Federal securities and at the same time exempt from the tax income derived from securities issued by private corporations. Such a course would be repugnant to every Constitutional principle. Entirely apart from the practical impossibility of such a situation, however, I think it clear that the amendment in its present form would prohibit discrimination

against the bonds of a State and in favor of a railroad or industrial corporation. All corporations in this country are organized under either State or Federal law and derive their powers, including the power to borrow money, from charters issued by the State or Federal Governments, as the case may be. Securities issued by private corporations, therefore, may be said to be issued "under the authority of" the United States, in the case of a Federal corporation, or the State of incorporation, in the case of a State corporation. Section 1 of the Constitutional amendment as reported by the Committee expressly prohibits discrimination in favor of securities issued after ratification of the article under the authority of the United States or any other State. This in terms would prevent discrimination in favor of any bonds issued by a railroad or industrial corporation incorporated under the laws of the United States or of any other State, and likewise, it seems to me, by a corporation organized under the laws of the State concerned, for it would be Constitutionally impossible for the Federal Government to single out corporations of one State in the granting of tax exemptions. If there were any danger here, however, it could readily be corrected by striking out in the last line of Section 1 the word "other", and I suggest that this be done to remove any question in the matter.

The Garner amendment is not only unnecessary, -- it would defeat the entire Constitutional amendment and make it practically impossible for either the States or the Federal Government to proceed effectively under it. The Garner amendment by its terms forbids discrimination by either the Federal Government or the States, in favor of

"income derived from any source". This apparently covers all sources of income, including, for example, income from securities already issued and outstanding, and income from salaries of State and Federal officers. Even after the adoption of the proposed Constitutional amendment, neither the United States nor any State would have power to tax securities of the other already issued and outstanding, and under generally accepted Constitutional principles, which have been affirmed by the Supreme Court, the Federal Government cannot levy income taxes upon the salaries of State or municipal officers, nor can the States levy income taxes upon the salaries of Federal officers. To forbid discrimination in favor of these non-taxable sources of income would, in effect, make the Constitutional amendment inoperative. There are also other generally recognized distinctions, as, for example, between earned and unearned income, and miscellaneous special exemptions which it might be impossible to make under the form of wording proposed. These difficulties would embarrass the State Governments, in proceeding under the Constitutional amendment, quite as much as they would the Federal Government, and would make it impossible for the States to levy any income tax upon future issues of Federal securities without at the same time imposing an income tax on all outstanding issues of their own securities, and, in fact, a general income tax upon all sources of income subject to State taxation. Even if it could be Constitutionally done, to levy income taxes upon securities already issued as tax-exempt would constitute a gross breach of faith, while to require a general and uniform income tax, with exactly the same taxation of income from securities as of all

other sources of income, would involve almost insuperable practical difficulties and probably prove impossible.

I believe, therefore, that the Garner amendment would accomplish nothing but to defeat what is probably the most necessary reform in our system of taxation, and I hope that in the light of these comments as to the effect of the Constitutional amendment as reported by the Committee and the changes proposed, the Garner amendment will either be withdrawn or rejected. The Constitutional amendment as reported puts the Federal Government and the States on absolutely the same basis, and the very fact that the Federal Government is ready and willing, for the sake of the general welfare, to place itself under these restrictions as to future issues of tax-exempt securities, notwithstanding its own heavy debt and the practical certainty that it will always have obligations outstanding and to be financed, gives the best possible assurance that the States and their political subdivisions can place themselves under like restrictions without endangering their credit or embarrassing their necessary borrowings.

Very truly yours,

(Signed) A. W. MELLON

Secretary of the Treasury.

Hon. William R. Green,
Acting Chairman, Committee on Ways and Means,
House of Representatives,
Washington, D. C.

TABLE 2. -- PERSONAL RETURNS -- DISTRIBUTION, BY INCOME CLASSES, FOR THE UNITED STATES; showing for each class of income the number of returns, net income, personal exemption, dividends, tax paid, and percentages.
(Income returned for the calendar year ended Dec. 31, 1920.)

Income class.	Number of returns.	Net income	Exemptions from normal tax			Normal	Surtax	Total Tax	Average amount of tax per individual	Average rate of tax per cent.
			Personal exemptions	Dividends	Interest on Government obligations. 1					
\$1,000 to \$2,000 2	761,995	\$1,201,296,261	\$1,561,058,719	\$38,889,381						
\$1,000 to \$2,000	1,909,955	2,848,770,357	1,920,895,163	15,318,566	\$118,145	\$36,859,732		\$36,859,732	\$19.30	1.29
\$2,000 to \$3,000 2	930,659	2,129,193,720	2,346,669,224	58,757,898						
\$2,000 to \$3,000	1,638,657	4,055,349,648	2,890,213,944	38,802,446	153,115	45,507,821		45,507,821	27.77	1.12
\$3,000 to \$4,000 2	37,564	125,598,720	93,504,684	50,217,981						
\$3,000 to \$4,000	856,995	2,941,487,294	1,758,241,908	57,889,135	280,956	45,166,537		45,166,537	52.70	1.54
\$4,000 to \$5,000 2	11,416	50,581,107	20,703,781	39,154,600						
\$4,000 to \$5,000	431,141	1,921,940,118	889,737,327	72,935,508	565,453	38,329,579		38,329,579	88.90	1.99
\$5,000 to \$6,000	177,147	969,504,603	361,206,842	85,642,089	4,780,958	22,031,171	\$692,383	22,723,554	128.28	2.34
\$6,000 to \$7,000	112,444	726,361,550	228,585,811	85,334,736	3,542,047	18,534,425	2,023,158	20,557,583	182.83	2.83
\$7,000 to \$8,000	74,511	557,103,872	149,965,534	76,168,995	3,168,739	16,617,190	2,886,839	19,504,029	261.76	3.50
\$8,000 to \$9,000	51,211	434,462,407	101,737,772	71,694,936	2,052,173	14,347,134	3,274,111	17,621,245	344.09	4.06
\$9,000 to \$10,000	40,129	380,898,531	79,624,590	66,061,095	2,646,518	13,695,156	3,784,466	17,479,622	435.59	4.59
\$10,000 to \$11,000	29,984	314,400,337	58,790,816	61,234,473	1,761,879	11,874,098	3,872,596	15,746,694	525.17	5.01
\$11,000 to \$12,000	24,370	280,196,629	47,971,393	57,665,639	2,721,163	11,087,241	4,119,372	15,206,613	623.99	5.43
\$12,000 to \$13,000	19,388	242,527,549	37,797,463	54,459,354	2,036,482	9,847,146	4,168,823	14,015,969	722.92	5.78
\$13,000 to \$14,000	16,089	217,085,265	31,379,422	51,288,059	2,079,973	9,011,825	4,244,561	13,256,386	823.94	6.11
\$14,000 to \$15,000	13,739	199,128,079	26,489,941	47,995,870	1,307,255	8,447,705	4,376,737	12,824,442	933.43	6.44
\$15,000 to \$20,000	44,531	765,354,264	85,699,368	204,945,101	6,566,926	33,495,378	22,013,101	55,508,479	1,246.51	7.25
\$20,000 to \$25,000	23,729	529,212,663	45,050,205	169,984,024	3,780,318	23,828,602	21,872,136	45,700,738	1,925.95	8.64
\$25,000 to \$30,000	14,471	395,807,952	27,164,221	133,778,337	2,942,660	17,894,313	21,310,372	39,204,685	2,709.19	9.90
\$30,000 to \$40,000	15,808	543,792,249	29,308,578	201,886,226	4,201,978	24,282,793	38,911,865	63,194,658	3,997.64	11.62
\$40,000 to \$50,000	8,269	368,184,912	15,117,152	152,860,997	3,075,861	16,224,352	35,641,581	51,865,933	6,272.33	14.09
\$50,000 to \$60,000	4,785	261,433,828	8,613,544	116,740,720	2,057,036	11,315,900	31,875,512	43,191,412	9,026.42	16.52
\$60,000 to \$70,000	3,006	194,506,539	5,410,897	90,936,869	1,705,928	8,277,842	28,589,460	36,867,302	12,264.57	18.95
\$70,000 to \$80,000	1,969	147,024,770	3,536,853	70,146,319	1,067,066	6,340,791	25,269,888	31,610,679	16,054.18	21.50
\$80,000 to \$90,000	1,356	114,818,467	2,385,288	55,581,429	1,020,858	4,843,015	22,607,109	27,450,124	20,243.45	23.91
\$90,000 to \$100,000	977	92,602,729	1,755,689	44,380,282	569,887	4,017,531	20,580,671	24,598,202	25,177.28	26.56

1. Interest on Government obligations not wholly exempt from tax.

2. Nontaxable. Personal exemptions and dividends exceed net income.

TABLE 2. - PERSONAL RETURNS - DISTRIBUTION, BY INCOME CLASSES, FOR THE UNITED STATES; (cont'd)

\$100,000 to \$150,000.....	2,191.	265,511,505.	3,724,543.	143,158,774.	2,821,861.	10,950,766.	75,636,928.	86,587,694.	39,519.71.	32.61
\$150,000 to \$200,000.....	590	100,966,280	966,808	55,619,123	892,315	3,923,046	36,137,724	40,060,770	67,899.61	39.68
\$200,000 to \$250,000.....	307	68,307,141	514,874	46,828,195	687,785	2,449,725	27,930,180	30,379,905	98,957.35	44.47
\$250,000 to \$300,000.....	166	45,865,252	279,200	27,282,351	375,407	1,888,716	20,275,032	22,163,748	133,516.55	48.32
\$300,000 to \$400,000.....	169	58,252,657	265,100	39,150,948	496,264	2,147,724	27,875,298	30,023,022	177,651.02	51.54
\$400,000 to \$500,000.....	70	31,060,895	107,975	22,099,996	334,297	1,311,303	15,709,136	17,020,439	243,149.13	54.80
\$500,000 to \$750,000.....	98	58,890,818	136,400	44,347,149	987,385	1,497,074	31,267,938	32,765,012	334,336.86	55.64
\$750,000 to \$1,000,000.....	25	21,072,076	38,600	11,954,254	72,969	802,115	12,075,878	12,875,993	515,039.72	61.10
\$1,000,000 to \$1,500,000.....	19	21,988,642	16,900	14,797,956	144,853	723,294	13,030,056	13,753,350	723,860.53	62.55
\$1,500,000 to \$2,000,000.....	3	5,087,594	3,200	7,989,220	58,688	9,226	3,046,350	3,055,576	1,018,525.33	60.06
\$2,000,000 to \$3,000,000.....	4	10,863,868	5,000	6,508,744	94,123	420,213	6,732,213	7,152,426	1,788,106.50	65.84
\$3,000,000 to \$4,000,000.....	3	9,218,058	3,200	8,336,392	172,071	245,081	5,792,268	6,037,349	2,012,449.67	65.49
\$4,000,000 to \$5,000,000.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
\$5,000,000 and over.....	4	29,919,977	6,600	37,021,628	208,180	4,359	19,182,025	19,186,384	4,796,596.00	64.13
Total.....	7,259,944	23,735,629,183	12,834,684,529	2,735,845,795	61,549,572	478,249,919	596,803,767	1,075,053,686	148.08	4.53

ESTIMATED SURTAX DUE ON INCOMES FROM GOVERNMENT
OBLIGATIONS NOT WHOLLY EXEMPT FROM TAX - 1920 RETURNS.

Income Class		Interest on Government obligations not wholly exempt from tax	Rate of surtax	Amount of Surtax
\$5,000 to	\$5,000	\$4,780,958	1 per cent	\$ 47,809.58
6,000 "	8,000	6,710,786	2	134,215.72
8,000 "	10,000	4,698,691	3	140,960.73
10,000 "	12,000	4,433,042	4	179,321.68
12,000 "	14,000	4,116,455	5	205,822.75
14,000 "	20,000	7,874,181	7	551,192.67
20,000 "	30,000	6,722,978	11	739,527.58
30,000 "	40,000	4,201,978	16	672,316.48
40,000 "	50,000	3,075,861	21	645,930.81
50,000 "	60,000	2,057,036	26	534,829.36
60,000 "	70,000	1,705,928	31	528,837.68
70,000 "	80,000	1,067,066	36	384,143.76
80,000 "	90,000	1,020,858	41	418,551.78
90,000 "	100,000	569,887	46	262,148.02
100,000 "	150,000	2,821,861	52	1,467,367.72
150,000 "	200,000	892,315	56	499,696.40
200,000 "	300,000	1,063,192	60	637,915.20
300,000 "	500,000	830,561	63	523,253.43
500,000 "	1,000,000	1,060,354	64	678,626.56
Over	1,000,000	677,915	65	440,644.75
TOTAL		\$ 60,431,903		\$9,693,112.66

STATISTICAL DIVISION -- INCOME TAX UNIT.

Wholly Tax-Exempt Income reported by Individuals having Net Income of \$5,000 and over, for the calendar year 1920.

Income Classes.			United States obligations. Interest.		States and Territories. Interest and Salaries.		Total.
5,000 to 6,000	6,000 to 7,000	\$	808,597	:	\$ 3,260,072	:	\$ 4,068,669
6,000 "	7,000 "	:	881,401	:	3,579,012	:	4,460,416
7,000 "	8,000 "	:	695,657	:	2,751,914	:	3,447,571
8,000 "	9,000 "	:	539,042	:	2,368,929	:	2,907,971
9,000 "	10,000 "	:	569,990	:	2,025,246	:	2,595,236
10,000 "	11,000 "	:	493,771	:	1,701,853	:	2,195,629
11,000 "	12,000 "	:	411,007	:	1,558,101	:	1,969,108
12,000 "	13,000 "	:	393,263	:	1,456,608	:	1,849,871
13,000 "	14,000 "	:	357,317	:	1,114,690	:	1,472,007
14,000 "	15,000 "	:	317,164	:	1,086,762	:	1,403,926
15,000 "	20,000 "	:	1,628,697	:	4,808,573	:	6,437,270
20,000 "	25,000 "	:	1,200,925	:	3,284,812	:	4,485,737
25,000 "	30,000 "	:	1,001,604	:	3,008,805	:	4,010,409
30,000 "	40,000 "	:	1,707,681	:	4,556,759	:	6,264,440
40,000 "	50,000 "	:	1,658,792	:	3,273,211	:	4,937,003
50,000 "	60,000 "	:	1,305,306	:	2,454,805	:	3,760,111
60,000 "	70,000 "	:	1,133,106	:	2,174,197	:	3,307,303
70,000 "	80,000 "	:	1,024,237	:	1,946,835	:	2,971,072
80,000 "	90,000 "	:	797,526	:	1,424,900	:	2,222,426
90,000 "	100,000 "	:	1,016,534	:	1,500,841	:	2,517,375
100,000 "	150,000 "	:	3,643,759	:	4,639,323	:	8,283,082
150,000 "	200,000 "	:	2,671,969	:	2,545,723	:	5,217,692
200,000 "	250,000 "	:	1,703,250	:	1,540,636	:	3,243,886
250,000 "	300,000 "	:	1,032,467	:	1,077,012	:	2,109,479
300,000 "	400,000 "	:	1,214,526	:	1,341,141	:	2,555,667
400,000 "	500,000 "	:	1,006,114	:	1,271,414	:	2,277,528
500,000 "	750,000 "	:	1,705,518	:	1,698,087	:	3,403,605
750,000 "	1,000,000 "	:	1,246,016	:	1,537,758	:	2,783,774
1,000,000 "	1,500,000 "	:	363,360	:	627,095	:	1,490,455
1,500,000 "	2,000,000 "	:	358,536	:	195,830	:	554,366
2,000,000 "	3,000,000 "	:	282,497	:	38,216	:	320,713
3,000,000 "	4,000,000 "	:	1,160,392	:	432,018	:	1,592,410
4,000,000 "	5,000,000 "	:	.....	:	.....	:	.....
5,000,000 and over		:	2,731,636	:	1,639,529	:	4,371,165
Total.....			37,559,460	:	67,925,712	:	105,485,172

February 19, 1923.

My dear Congressman McFadden:

I received your letter of February 17, 1923, requesting my opinion on the bill (S. 4287), "to provide credit facilities for the agricultural and livestock industries of the United States; to amend the Federal Farm Loan Act; to amend the Federal Reserve Act; and for other purposes", which was recently approved by the Senate and is now under consideration by your Committee. I have been particularly concerned to see whether the bill conforms to sound banking principles and whether its administrative features are workable.

I have had prepared and send you herewith a detailed memorandum analyzing the bill from these points of view, and commenting also upon some other features which seem to be important. This memorandum points out grave defects in the bill, not only in matters of draftsmanship, but in its larger outlines and policies as well. It seems to me that a careful study of the measure in the light of this memorandum leads necessarily to the conclusion that its financial provisions, as now drawn, are unsound and dangerous, and that its administrative features are unworkable.

I realize that some support has been given to the bill in the belief that it will assist the farmers of the country in obtaining credit accommodation, adapted to the needs of agriculture, and in sufficient amounts to avoid the disastrous effect of a credit stringency similar to the one through which this country has recently passed. With this object I am in the heartiest accord. I feel that the students of our banking structure have given too much attention in the past to

the commercial and industrial needs of the country, and not enough attention to the vital problem of fitting our banking structure to the needs of agriculture. I am convinced, however, that no benefits will enure to the farmer from a system which is financially unsound. The farmer has suffered enough in the past from unsafe banking systems. Let us not now add to this source of danger to the farmer by giving the sanction of the United States Government to a system which violates every canon of sound banking to which this Government has been committed since the establishment of the national banking system.

Some support has also been given upon the assumption that this bill was indorsed by the Joint Commission of Agricultural Inquiry, which conducted an elaborate investigation and has published a valuable report upon agricultural conditions. This, however, is a misapprehension, for the bill in its present form differs radically from the bill which the Joint Commission indorsed. Many of the features especially criticized in the accompanying memorandum were not contained in the bill indorsed by the Joint Commission, but were added in subsequent revisions. The indorsements given to the bill in its original form, therefore, are not applicable to the bill as it passed the Senate.

In my opinion the greatest service could be rendered to agriculture by enacting into law at the present session the Capper bill (S. 4280), and withholding action upon the Lenroot bill until the situation can be more thoroughly investigated. The Capper bill has the endorsement of the livestock industry, and of the great cooperative

marketing movement. It will go far, in my opinion, in satisfying the needs of those sections of the country which have suffered in the past from inadequate credit facilities. At the same time it is financially sound, and in its administrative features avoids the excessive centralization which, in my opinion, constitutes a serious defect in the Lenroot bill. The Capper bill carries with it important amendments to the Federal Reserve Act. It also includes a provision extending for nine months the time during which the War Finance Corporation can make loans for agricultural purposes, thus bringing assurance that any unforeseen credit needs will be amply taken care of during the coming crop season. Until the results of further investigation and experience are available, it seems to me that this is a complete and adequate program of agricultural credits legislation.

There are certain features of the Lenroot bill which have great merit and should, in my opinion, be incorporated in the Capper bill by your Committee. The farm credits departments contemplated in the Lenroot bill are, for instance, authorized to make loans direct to cooperative marketing associations upon warehouse receipt security. It seems to me that similar powers could well be given to the rediscount corporations contemplated in the Capper bill. The Lenroot bill also renders eligible for rediscount with Federal Reserve Banks the paper of factors based upon agricultural products in their raw state. It seems to me that this provision is sound, and I recommend its insertion in the Capper bill. I should also suggest including in the Capper bill the section of the Lenroot bill which repeals the amendment to the Federal Reserve Act authorizing progressive rediscount rates.

If I may sum up briefly the reason why, in my opinion, the

Capper bill is preferable to the Lenroot bill, it is this: The Lenroot bill attempts to create a separate and independent rediscount system for agriculture. Necessarily this will be a secondary and, in all probability, an inadequate rediscount system. It seems to me, on the other hand, that the agricultural interests can properly demand that they be given the benefit, upon sound lines, of the best and most adequate rediscount system which the country can furnish, and that, in my opinion, is the Federal Reserve System, liberalized and extended as proposed in the Capper bill. The Capper bill aims at strengthening and developing the existing banking structure and the Federal Reserve System, and rendering them more useful and more suited to the needs of agriculture.

Very truly yours,

(Signed) A. W. MELLON

Secretary of the Treasury.

Hon. L. T. McFadden,
Chairman, Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

1 enclosure.

February 19, 1923.

MEMORANDUM ON S. 4287.

Sections 1 to 6 of the Lenroot-Anderson bill (S. 4287) provide for the organization and operation of farm credits departments in the Federal Land Banks throughout the United States. Sections 7 to 13, inclusive, contain amendments to the Federal Reserve Act similar to those embodied in Part 2 of the Capper-McFadden bill. It is the purpose of this memorandum to discuss those sections of the Lenroot-Anderson bill which relate to the organization of farm credits departments.

The purpose of these sections appears to be to establish a separate rediscount facility for certain types of agricultural and live stock paper.

The bill provides in effect for twelve agricultural rediscount banking departments, one in each of the existing Federal Land Banks. Each such department would have a capital of \$5,000,000 (to which an additional \$10,000,000 might be added with the approval of the President) to be subscribed and paid in by the United States Government. The aggregate capital of all the Farm Credits Departments might therefore reach \$120,000,000.

To a considerable extent, the proposed new rediscount system would perform functions which are already being performed by the Federal Reserve Banks. Federal Reserve Banks are now authorized to rediscount for member banks agricultural paper with a maturity up to six months. Under other pending legislation this maximum maturity will be extended to nine months. Under the Lenroot-Anderson Bill, however, the farm credits departments of Federal Land Banks could discount,

for national banks, state banks, trust companies, and certain other enumerated kinds of credit institutions, agricultural paper with a maturity of not less than six months nor more than three years. As far as concerns agricultural paper having a maturity from six to nine months, inclusive, offered by national banks or state banks which are members of the Federal Reserve System, the two systems would, therefore, be overlapping.

The main purpose of the bill, however, appears to be to establish a rediscount system for agricultural paper which is not eligible for rediscount in the Federal Reserve System, either because of its maturity, or because it does not carry the endorsement of a member bank. It is contemplated that such longer term paper shall be made the basis for the issuance of collateral trust debentures, which would be sold in the investment market in the same manner that Farm Loan Bonds are now sold. These debentures would be exempt from all taxation, State or Federal, including surtaxes, and would be secured by the agricultural paper discounted or purchased by the farm credits department.

The capital of the farm credits departments would be completely supplied by the United States Government, and these departments would be operated by directors appointed by the Government. In effect, therefore, the system contemplates a policy of Government ownership and operation of

an agricultural banking system, through the medium of subsidiary corporations owned and operated by the United States. It does not appear to be contemplated that the United States shall be legally liable upon the debentures or other obligations of farm credits departments. Yet the moral obligation would be a strong one, for it is hardly conceivable that the United States Government could permit a corporate subsidiary owned and operated by it to default upon its just debts. In estimating the liability which the Government would assume in enacting the bill, we must therefore consider not only the technical liability which under the bill might reach \$120,000,000, but also the potential moral liability, which might be in any amount up to \$1,200,000,000.

Before launching the United States Government in a business venture which involves an investment of \$120,000,000 in cash and a possible moral obligation of \$1,200,000,000, the proposed plan should be studied not only with a view to ascertaining whether it is drawn upon sound lines, and with proper safeguards sufficient to insure its financial integrity, but also to see whether it is effective in accomplishing the purposes which its authors have in mind.

1. The System is Financially Unsound.

The farm credits departments organized under the Act are expected to operate principally upon borrowed capital. It is provided that they may issue collateral trust debentures up to ten times the amount of their paid in capital and surplus. These debentures would be secured by at least a like face amount of agricultural paper bearing the endorsement of the discounting bank or other institution. The financial integrity of the system would depend, therefore, upon three factors: (1) the financial strength of the farm credits departments primarily and secondarily liable upon the debentures; (2) the financial strength of the bank or other rediscounting institution; (3) the

nature and value of the primary paper pledged as collateral.

(1) The farm credits departments. The capital supplied by the United States Government is expected to stand as a guaranty fund to protect holders of debentures. In estimating the value of this guaranty certain elements of weakness must be considered. There is no requirement that any part of this capital be maintained in liquid form, or that a cash reserve be maintained. All the capital might be invested in non-liquid agricultural paper. There is no limit to the amount of paper which may be taken from any one discounting agency in relation to the capital of the farm credits department; so far as legal limitations are concerned, the whole capital or even more than the whole capital could be invested in paper bearing the endorsement of one bank or other discounting agency. Considering that the liabilities of the farm credits departments may be as high as ten times the capital and surplus, it is apparent that the value of the guaranty of the farm credits department would depend to a very large extent upon the value of the agricultural paper in which its assets are invested.

It is true that the debentures of each farm credits department would be protected by a pro rata guaranty of all other farm credits departments. The value of this guaranty, however, appears to be overestimated. It is not a joint guaranty. If the assets of a farm credits department should prove insufficient to pay all its outstanding debentures, the deficiency may be assessed against other "solvent farm credits departments," but only in proportion to the amount of debentures which each such department has outstanding at the time of the assessment. A farm credits department which has issued no debentures, but has operated solely upon its capital, although

to a high degree solvent, would assume no liability for the debentures of any other department. On the other hand, the larger the liability of any department upon its own debentures, the larger would be its liability as guarantor of other debentures. Moreover it is obvious that the guaranty could be enforced only against the unpledged assets of a farm credits department. Its pledged assets would go primarily to satisfy the debentures which they secure. If, therefore, a farm credits department had issued its full limit of ten dollars of debentures for each dollar of capital and surplus, and had pledged, (as would no doubt generally be required on account of this very liability) agricultural paper of a face value ten per cent in excess of the face amount of its debentures, it would have no unpledged assets against which its guaranty could be enforced. In general, as a farm credits department becomes more extended, and as its unpledged assets diminish, it would automatically assume a larger share of liability as guarantor. It does not seem that much reliance can be placed upon such a guaranty.

2. The discounting institution. It is apparent, therefore, that unless the paper in which the assets of the farm credits departments are invested is financially sound, little reliance can be placed upon the liability or guaranty of these departments. The paper will bear the indorsement of the discounting institutions, and the next step in our analysis is to determine the value of this indorsement.

In the original Lenroot-Anderson bill, which had the approval of the Joint Commission of Agricultural Inquiry, the discounting institution could be a national or state bank or a trust company, savings institution or incorporated livestock loan company. In the bill as it passed the Senate there are added rural credit corporations, incorporated farm credit companies, cooperative banks, and cooperative credit or marketing associations. The additions are important.

National banks, and to a large degree, state banks, savings institutions and trust companies, are subject to limitations under state or national law, and to periodic inspections by state or national examiners. They are required to keep a minimum cash reserve; their investments are frequently limited; there is usually double liability on the part of stockholders; and any tendency toward unsound practices can be quickly checked by state or national banking authorities. Incorporated livestock loan companies are generally formed on a substantial scale, and take only secured paper. In the original bill, therefore, some reliance could have been placed on the indorsement of the discounting institution.

No such safeguards surround the operations of the institutions added by the revised Lenroot-Anderson bill. Rural credit corporations, incorporated farm credit companies, cooperative banks or cooperative credit or marketing associations are enumerated, but not defined, in the new bill, hence it is impossible to ascertain under what limitations they will operate. There is no requirement that they be subject to periodic inspection, state or national. There is no requirement that they maintain a cash reserve, or maintain their capital in liquid form. There is no limitation on the amount which such an institution may lend to one borrower—a limitation essential to sound banking. There is no requirement that capital be paid in in cash. In the case of cooperative credit associations (a vague and undefined term) there is no requirement that there be any capital at all.

As amended in the Senate, the bill contains certain limitations on the amount of paper which may be discounted for any one institution, but upon examination it appears that these limitations could hardly be effective. No paper may be discounted for any agricultural credit corporation, incorporated livestock loan company, or farm credit company, "which has rediscounted paper equal to or exceeding ten times the paid-up capital and surplus of such company." It will be observed, however, that the limitation refers only to rediscounted paper. A company may be indebted upon its own promissory notes or bonds or other primary obligations in any conceivable amount, and yet it would not be debarred from discounting paper with the farm credits department. Moreover, there is nothing in the bill to prevent a company from incurring liabilities in any amount which unsound finance might dictate after it has discounted its limit with the farm credits department. A company with \$10,000 capital could discount \$100,000 of paper with a farm credits department, and the next day borrow \$100,000 more from some other source.

As far as "cooperative credit associations" are concerned, there is no limit whatever upon the amount which they may discount.

Even if the limits which the bill attempts to place were effective, they would be far too high to afford adequate protection. A company taking the best quality of real estate mortgages, or paper secured by livestock or commodities with a safe margin, can properly borrow a maximum of ten times its capital. The discounting agencies may, however, do a miscellaneous agricultural business, and may make loans without security, or upon questionable security such as crop mortgages or second or third mortgages on land. For such companies the limit of ten to one is much too high. For banks the limit (unless further restricted by state or

federal law) is five to one. A bank already has demand or short time deposit liabilities which often exceed ten times its capital and surplus. A law which encourages such banks, in addition, to incur rediscount liabilities equal to five times their capital and surplus, is an invitation to unsound banking and a menace to the public welfare.

It follows, therefore, that no great reliance can be placed upon the endorsement of the discounting institutions contemplated by the bill, since they are not surrounded by the restrictions and safeguards which experience has shown to be essential to sound banking.

5. The agricultural paper. We are thrown back, then, upon the primary agricultural paper upon which the whole system is built. Not only the proceeds of debentures, but the whole capital reserve of the discounting institutions, as well as of the farm credits departments, may be invested in this paper. If the paper is unsound, the system is unsound. One might expect to find, therefore, safeguards and limitations thrown about such paper comparable to the safeguards thrown around the farm mortgage paper upon which the existing Federal Farm Loan System is based.

No such limitations or safeguards are provided. Only in the case of direct loans to cooperative producing or marketing associations is there any requirement as to security. Such direct loans must be upon livestock or commodities, and must not exceed 75 per centum of their value. These limitations are not applicable to paper rediscounted for banks, rural credit corporations, livestock loan or farm credit companies, or cooperative credit associations. A farm credit corporation could invest ten times its capital in crop mortgage paper, with all its hazards and uncertainties. A cooperative credit association, without a

dollar of capital, could make unlimited loans to its members without any security whatever. And such paper, discounted with a farm credit department, could form the security for debentures issued under Government auspices and sold to investors.

It is apparent, therefore, that the most elementary principles of sound finance have been overlooked in drafting the bill. In its national banking laws the United States Government has set up a standard of sound banking which is regarded as a model among the states. Through the Federal Reserve Board, it endeavors to promote sound banking practices on the part of state banks which are members of the system. In its Federal Farm Loan System it has set a standard of conservatism and soundness which has won the confidence of investors. It is difficult to conceive that Congress should now stand sponsor for a system which violates every sound banking principle and contains not even the rudiments of safety.

II.

The Administrative Features of the Bill Unworkable.

The discussion heretofore has been of the financial features of the bill. Even the soundest financial plan, however, must depend upon good administration for its success. It is important to examine, therefore, the administrative structure which the bill contemplates, both with respect to the management of the farm credits departments, and with respect to their supervision by the Federal Farm Loan Board.

Nominally, the new powers conferred by the bill are vested in the Federal Land Banks. These are corporations organized under the Farm Loan

Act, for the exclusive purpose of making mortgage loans upon farm lands. The last annual report of the Secretary of the Treasury showed that the Government on October 31, 1922, owned somewhat over \$4,000,000 out of a total of approximately \$35,000,000 of the capital stock of these banks, the remainder being owned by local farm loan associations and to a small extent by individual borrowers. Under the Farm Loan Act, the temporary management of these banks is placed in the hands of five directors appointed by the Federal Farm Loan Board. The permanent management was to be in a board of nine directors, of which six, known as "local directors", were to be selected by the stockholding farm loan associations, and three, known as "district directors", were to be appointed by the Farm Loan Board. In fact, however, the permanent organization has never been effected, a Joint Resolution approved January 18, 1918, authorizing the Secretary of the Treasury to purchase Farm Loan Bonds from the Federal Land Banks, and continuing the temporary organization as long as any such bonds are held. The Strong bill, recently reported by the House Banking and Currency Committee, provides for termination of the temporary management, and substitution of a permanent board composed of three local directors chosen by the farm loan associations, three district directors appointed by the Farm Loan Board, and a seventh director appointed by the Farm Loan Board out of three nominees selected by the farm loan associations.

These boards of directors (whether permanent or temporary) are authorized to elect the president, vice-president, secretary and treasurer and other officers and employees of the Federal Land Banks, to define their duties, and to dismiss them at pleasure.

Upon this existing structure, the Lenroot Anderson bill superimposes an auxiliary organization designed to exercise the powers conferred in the bill. It is provided that each Federal Land Bank shall establish "under the supervision of its temporary directors and, after the establishment of the permanent organizations, under the supervision of its district directors", a farm credits department. During the temporary organization, therefore, the five directors appointed by the Government to carry on the farm loan business will also operate the farm credits department. Under the permanent organization, the three directors appointed by the Government will act, apparently, as a separate board of directors in charge of farm credits. There will, therefore, be one corporation with two boards of directors. Such a situation can hardly promote efficient administration, since the same set of officials and employees will be subject to the orders of two boards of directors.

The most serious objection to the plan, however, is that in either event the operation of the farm credit rediscount system will be placed in the hands of men who have no special qualifications for the positions. The temporary directors of the Federal Land Banks have already been selected and are now in office. They were selected, it may be assumed, because of their experience in passing upon real estate mortgage loans, and not because of their familiarity with loans upon livestock, agricultural products, or growing crops. These directors are to be required to undertake the administration of an entirely new business, enormous in scope, technical and difficult in its details, and very much more hazardous than the mortgage loan business which they are now carrying on.

If the Strong bill is adopted at this session, (it has not yet passed the House, and has not even been considered by the Senate Banking and Currency Committee) it will be possible to organize the system under the direction of the three "district directors" to be appointed by the Farm Loan Board. These same district directors, however, will constitute the Government representatives upon the board of directors in connection with farm mortgage loans. Unless an entirely

new set of district directors should be appointed, it would be necessary to find among the existing directors of the Federal land banks men who combine the qualifications necessary for both positions. It is by no means certain that such men can be found.

The same difficulty of adapting an existing institution to new and unfamiliar uses will be encountered when we consider the provision made for supervision of the farm credits departments. The supervision is placed in the hands of the Federal Farm Loan Board. It has power to make rules and regulations governing the execution of the Act, and has virtual control over the operations of the farm credits departments, and their debenture issues. The executive officer of the Board has stated at a public hearing that the Board does not want to administer the Act. None of its members were appointed with a view to their qualifications in administering a rediscount banking system. Nor is it contemplated, in the present draft of the bill, that any new members be appointed for the purpose.

Apart from the difficulty of personnel, the bill contains administrative features which even with the best possible personnel would appear to be unworkable. The provisions of Title I of the Farm Loan Act, relating to the preparation and issue of farm loan bonds, are made to govern, "so far as applicable", the preparation and issue of debentures issued by farm credits departments. Under Title I the following procedure is prescribed in connection with issuance of farm loan bonds: Land Banks must first, through the "registrar" of the district, (an official appointed by the Board) make written application for approval of an issue, tendering with the application the collateral security to be offered. With the

security there must be a schedule and description thereof. It must be checked by the "registrar", and forwarded to the Federal Farm Loan Board. The Board is required to "cause to be made such investigation and appraisal of the securities tendered as it shall deem wise", and to grant or reject the application in whole or in part. The Registrar then attends to the issuance and execution of the bonds, and assumes custody of the collateral. The bonds are engraved by the Treasury Department, according to prescribed forms.

It is apparent that this machinery, while perhaps appropriate in the case of farm loan bonds, is not adapted to the needs of short term or "intermediate" farm credits. It contemplates that the Farm Loan Board shall itself, through agents and inspectors, satisfy itself as to the safety and adequacy of all collateral. A bank in Idaho, or a loan company in Oregon, may desire to discount a block of paper with the local Land Bank. The Land Bank, for fear of tying up its capital in unacceptable loans, will generally be unwilling to discount the paper until it receives the approval of the Farm Loan Board. The paper, comprising perhaps the notes of a hundred or more farmers, is put into shape, financial statements are executed, chattel mortgages and crop mortgages are analyzed and described, and the material delivered to the Land Bank. It is checked by the registrar, and shipped, with his report, to Washington. The Board sends out its appraisers, analyzes the hundred or more statements, inspects the chattels and crops, has the debentures prepared, and ships the material back with its approval. By the time the loan is approved and the debentures issued, several months may have expired. Such an amount of centralization is not in the long run workable in a business in which promptness, flexibility and adaptation to local needs are as essential as they are in the business of rediscount banking. It is

doubtful whether the sponsors of the bill realize, moreover, that it will necessitate a permanent credit and clerical staff, in Washington, of several hundred men. The War Finance Corporation, doing a similar business on a smaller scale than is contemplated and with an effective field organization, required a staff of over 300 employees in Washington. The twelve Land Banks may do a business of more than a billion dollars. It is impracticable to operate such a centralized system upon sound lines and yet give satisfaction to the agricultural communities.

III.

The System Will Be Inelastic.

A fundamental defect in the Lenroot-Anderson bill, from the point of view of the farmers whom it is intended to benefit, will be its inelasticity. The Federal Reserve System is based upon the theory of an elastic currency. As long as reserve requirements are met, the Federal Reserve Banks can issue all the currency that is required for legitimate commercial or agricultural needs. The farm credits system created by the Lenroot-Anderson bill, however, depends upon the sale of debentures in the investment market. In a time of difficulty debentures may be unsaleable. Yet it is in periods of stress that the farmer is generally most in need of credit. During the collapse in agricultural prices in 1921, the situation was greatly aggravated by a general calling of loans on the part of the banks due to reduced deposits. A bank has a strong incentive to accommodate its customers in a time of stringency. The investors holding farm credit debentures will have no such incentive. They will expect that the debentures be paid when due, regardless of the needs of the farmer. To protect their debentures, the Land Banks will be compelled to liquidate their paper, to press it for collection, regardless of the hardships to the farmer. Far from supplying a reserve facility in times of deflation and stringency, the Lenroot-Anderson bill will, therefore, tend to accentuate the stringency and accelerate the contraction of credit.

IV.

The System rests upon Tax Exemption.

In its promise of cheap money to the farmer, the bill relies mainly upon exemption of debentures from federal and state taxes. Yet the House has recently passed a resolution for a Constitutional amendment prohibiting the issuance of tax exempt obligations. A proviso exempting farm loan bonds from the prohibition was rejected. It is difficult to see how the House could consistently, within a few weeks, authorize the issuance of a large amount of new tax exempt securities, nor is a possible additional billion of tax exempt securities to be contemplated without grave concern.

V.

Other defects.

There are other defects in the Lenroot-Anderson bill, largely due to faulty draftsmanship, which will be alluded to only briefly.

(a) By providing that debentures shall be payable only out of the assets of farm credits departments, the bill might render them non-negotiable, in view of the provisions of the Negotiable Instruments Law.

(b) The bill provides that discount rates shall not exceed by more than 1 per cent the rate borne by the last preceding issue of debentures (Sec.202). It also contemplates that collateral may be segregated, so that high grade paper, e. g. warehouse receipt paper, may be made the basis of a separate issue, and thus obtain the benefit of the lower interest rate to which its credit standing entitles it. (Sec.201 (b)). If the last previous issue was based on such high grade paper, this would set a standard for discount rates for all paper, whether high grade or otherwise. In a period of rising rates, the banks might find their operations paralyzed by this limitation.

(c). Moreover, the makers of the high grade paper would not get the benefit of the lower rate to which their paper is entitled, since discount rates must apparently be uniform to all.

(d). The provision which purports to limit to $1\frac{1}{2}$ per cent the amount which a discounting institution may charge for its indorsement is ineptly drawn. Any paper upon which the borrower "has been charged" more than $1\frac{1}{2}$ per cent in excess of the discount rate is ineligible. There is no criminal penalty for any evasion of the Act. Moreover, a bank which has paper upon which a greater rate has been charged cannot make such paper eligible by rebating the excess to the borrower. Unless the discount rate is high, there will, therefore, probably be but little eligible paper in the Western and Southern agricultural States, where interest rates are often as high as 10 and 12 per cent.

(e) The provision relating to distribution of earnings are incomplete. No disposition is made of earnings above dividends and above the 25 per cent to be used to retire stock.

(f) There is no provision for liquidation of farm credits departments, or administration in the event of insolvency.

(g). No provision is made for suits by or against farm credits departments.

(h). Agricultural paper is not correctly defined. Only paper the proceeds of which have been used for an agricultural purpose is eligible. Paper "issued" for an agricultural purpose, such as fertilizer notes, or notes evidencing purchase of livestock or farm supplies, is apparently not eligible, since "proceeds" of such notes are not generally used for an agricultural purpose. The corresponding definition in the Federal Reserve Act covers both types of paper.

FEDERAL RESERVE BOARD

X-3674

STATEMENT FOR THE PRESS.

For immediate release.

The Federal Reserve Board today has received numerous telegrams referring to rumors as to its contemplated actions.

In reply, the Board has said, "Should be greatly obliged if you and others who have telegraphed would supply the Board with the source of your information. The Federal Reserve Board wishes to say with all possible emphasis that so far as it is concerned there is no basis for any rumors with respect to its intentions or actions. When the Board has anything to say with respect to the credit conditions or policies of the Federal Reserve System it will itself make the announcement, and no one else is authorized to speak for it. Board cannot undertake to deny all idle rumors nor should it be charged with them."

March 27, 1923.

TO COLLECTORS OF INTERNAL REVENUE:

Please send the following story to each daily paper in your district for release March 26. Time transmission so that story will reach papers a day or so in advance of the release date.

The following statement is issued by Collector of Internal Revenue

_____ of the _____ district of _____.

- - - - -

Administrative measures have been taken by the Bureau of Internal Revenue to carry into effect two important amendments to the Revenue Act of 1921, adopted during the closing days of the session, in respect to exchanges of property and income tax of non-resident aliens. Section 202 of the act is amended by eliminating the provision allowing the exchange free from tax of stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, and limits the cases where securities may be exchanged for other securities without the realization of taxable income to those cases where the exchange is in connection with the reorganization of one or more corporations. As a consequence of this amendment, any exchange of securities effected subsequent to January 1, 1923, may result in taxable income or deductible loss,

the amount of which should be computed as if the securities had been sold for an amount of cash equivalent to the fair market value of the property received in exchange. Section 202, prior to its amendment, provided for the exchange of property held for investment for other property of a like kind without the realization of taxable income.

Section 202 is amended also to provide that in the case of tax free exchanges; for example, exchanges of securities, in connection with the reorganization of a corporation, where money is received "to boot", the amount of gain realized from the exchange is the excess of the sum of the money and the

fair market value of the property received in exchange over the cost (where applicable the fair market value as of March 1, 1913) of the property exchanged, provided, however, that the amount of taxable gain resulting from the exchange shall not exceed the amount of money received. For example, if, prior to the enactment of this amendment, a taxpayer exchanged, in connection with the reorganization of a corporation, stock which cost him \$1,000 for other stock of a fair market value of \$1,100, together with \$400 in cash, no taxable income resulted therefrom. Under this amendment, the amount of gain resulting from this exchange would be \$500, but the taxable gain would be only \$400, the amount of money received in exchange.

The effect of the amendment in respect to income tax of non-resident aliens is to give non-resident aliens who are residents of a contiguous country (for example, Canada) the benefit of the 4 per cent rate of normal tax on the first \$4,000 of net income in excess of a personal exemption of \$1,000 received as compensation for labor or services performed in the United States. Prior to the enactment of this amendment the entire net income of every non-resident alien from sources received within the United States, in excess of a personal exemption of \$1,000, was subject to a normal tax rate of 8 per cent. The amendment extends also to non-resident aliens, who are residents of a contiguous country, the benefit of the \$400 credit for each dependent. The amendment is retroactive to take effect January 1, 1922.

May 9, 1923.

My dear Senator:

I received your letter of April 23, 1923, with respect to the cancellation under the Pittman Act of allocations of silver for subsidiary coinage, in which you suggest that, without regard to the question of the legal authority of the Treasury Department to cancel these allocations, it is morally obligated to treat such allocations as sales under the Act and to add the amount of such allocations to the purchases to be made under the Act. I note that you refer particularly to the statement issued by the Director of the Mint on March 30, 1923, stating that there were then only about 20,000,000 ounces of silver remaining to be purchased under the Pittman Act, and imply that the difference between this figure and previously published figures was due to cancellation of the allocations for subsidiary coinage. This, I should say at the outset, is in error, for the Secretary of the Treasury had already announced on December 31, 1922, that the amount of silver bullion remaining to be purchased under the Pittman Act was then about 49,667,478 fine ounces. A copy of this statement is enclosed for your information. This figure took into account the cancellation of the allocations of silver for subsidiary coinage, and received wide public notice at the time. The reduction in the amount remaining to be purchased which occurred between December 31, 1922, and March 30, 1923, was due to wholly different causes, entirely beyond the control of the Treasury, namely, first, the greatly increased production of silver, particularly as a by-product of other metals, and, second, unusually heavy tenders of silver by large vendors,

representing silver actually received at reduction works for smelting or refining, for which settlement had already been made with American miners on the basis of \$1 per ounce, 1000 fine, pursuant to the Act.

As to the allocations of silver for subsidiary coinage, it is necessary to distinguish between the allocations of silver resulting from the melting down of silver dollars, and the allocations of silver bullion purchased under the provisions of the Pittman Act. By letter dated February 11, 1922, a copy of which is enclosed, the Director of the Mint was authorized and directed to restore to the Pittman silver bullion account 4,341,753.61 ounces of silver, this amount representing a part of an allocation of 6,000,000 ounces of silver for subsidiary coinage which had been previously authorized out of silver bullion purchased under the Act, but which had not in fact ever been used for subsidiary coinage and much of which had never even been transferred on the books from the Pittman silver bullion account to the subsidiary silver bullion account. As to this 4,341,753.61 fine ounces, there can be no doubt about the authority of the Secretary of the Treasury to revoke the allocation, for under the express terms of Section 2 of the so-called Pittman Act it is provided, as to silver purchased under the Act, that "any excess of such silver so purchased over and above the requirements" for the purposes specified in Section 3 of the Act, "shall be coined into standard silver dollars or held for the purpose of such coinage". Notwithstanding the authority previously given to the Director of the Mint to use up to 6,000,000 of the silver purchased under the Act for subsidiary coinage, it had become evident that the amount in question was not needed for the purpose, and the 4,341,753.61 ounces being "excess of such silver so purchased over and above the requirements for such purposes", it was clearly within the

authority of the Treasury to declare this silver excess silver and put it back into the Pittman silver bullion account, thus making it available for the recoinage of standard silver dollars under the Act. The provision of Section 3 of the Act, to which you refer, stating that "The allocation of any silver to the Director of the Mint for subsidiary coinage shall, for the purposes of this Act, be regarded as a sale or resale", manifestly does not have any bearing on the question, for the reason that, until carried out by the Director of the Mint, the authorization to use the silver for subsidiary coinage would be merely an authorization, and, it appearing that there was no necessity for it, could be revoked by the same authority which gave the original authorization. Certainly the Mint would not be expected, on account of what would be at the most a bookkeeping transaction, to go out and buy more silver to replace silver which had never left the Mint and at the most had only been transferred from one account to another on the books of the Mint.

The remainder of the silver as to which the allocation for subsidiary coinage was revoked involved silver resulting from the melting of standard silver dollars, and the question of the authority to revoke this allocation, since it raised questions both of law and accounting, was presented to the Comptroller General of the United States for consideration. The Comptroller General gave his decision in the matter under date of November 29, 1922, a copy of which is herewith enclosed for your ready reference. This decision held that the Secretary of the Treasury was authorized, as a matter of law, to revoke allocations of silver amounting to 10,247,976.52 fine ounces and to restore this amount of silver to the standard silver dollar account, thus making it available for recoinage. This decision speaks for itself and shows,

among other things, that in making it the Comptroller General had before him the provisions of the last sentence of Section 3 of the Act, as to allocations of silver for subsidiary coinage, which you particularly emphasize in your letter. Under the laws governing the Executive Departments the Comptroller General's decision is conclusive and binding on the Secretary of the Treasury, and the questions of law and accounting having thus been disposed of, the Treasury proceeded forthwith to revoke the allocations of silver for subsidiary coinage covered by the decision, amounting in the aggregate to 10,247,976.52 fine ounces, and instructions accordingly were given to the Director of the Mint.

On the question of moral obligation as distinguished from legal authority, I think you will agree upon further consideration that there is no basis for questioning these revocations of allocations of silver for subsidiary coinage. The purpose of the repurchase provisions of the Pittman Act, as generally understood, was to assure to American producers the fixed price of \$1 per ounce, 1000 fine, for silver produced by mines situated within the United States and reduction works so located, up to such amounts as might be necessary to coin "an aggregate number of standard silver dollars equal to the aggregate number of standard silver dollars theretofore melted or broken up and sold as bullion" under the provisions of the Act. The whole object, in other words, was to replace silver which had been sold as bullion out of the Treasury's holdings, and there would certainly be no equity whatever in expecting the Mint to purchase at the artificial price of \$1 per ounce, 1000 fine, a further amount of silver representing an amount allocated for subsidiary coinage but which had never in fact left the Treasury and was still being held as bullion in the vaults of the Mint. The silver thus held in the

vaults, never having left the Mint, manifestly would not have to be replaced, and ordinary common sense would require the Treasury, in the proper administration of the Department, to restore the bullion back to the standard silver dollar bullion account as soon as it became evident that it would not be needed for subsidiary silver coinage, thus making it immediately available for recoinage into standard silver dollars and reducing the amount of silver to be purchased in the market at the artificial price of \$1 per ounce. The fact of the matter is, therefore, that American producers have not in any way been prejudiced by the revocation of these allocations and have no standing in equity to ask that the Treasury buy these additional amounts of silver, beyond what is needed to cover the recoinage of standard silver dollars under the provisions of the Act.

Entirely apart from the fact that producers of silver have no special equity in the matter, you will appreciate that in administering the provisions of the Act the Treasury of the United States must keep in mind the best interests of the country as a whole, and not merely the special interests of the silver producers. The revocation of these allocations of silver for subsidiary coinage means a saving to the people of the United States, or, in other words, to the whole body of taxpayers, of over \$5,000,000, representing in part the saving realized through not having to purchase over 14,500,000 ounces of silver at a price averaging about 30 cents an ounce over the regular market price, and in part a saving of interest resulting from making available for immediate coinage into standard silver dollars bullion which would otherwise be kept as a dead asset in the subsidiary silver bullion account until such later time as further silver might be needed for subsidiary coinage. The Comptroller General of the United States, the highest

authority in these matters, having decided that the course was authorized, the Treasury's duty was clear and the allocations in question were accordingly revoked. This action has saved the people of the United States about \$5,000,000, without depriving the silver producers of anything to which they were properly entitled under the law. To reverse this action now and make the additional purchases, would mean a gift of about \$5,000,000 of the public funds to the producers of silver, and throw upon the Treasury of the United States the burden of carrying, at an artificial price, over 14,500,000 ounces of silver not needed for any purpose.

Very truly yours,

S. P. GILBERT, Jr.,

Under Secretary.

Hon. Key Pittman,
Vice-Chairman, Senate Commission of
Gold and Silver Inquiry,
United States Senate,
Washington, D. C.

3 enclosures.

May 31, 1923.

My dear Senator:

I received your letter of May 14, 1923, with further reference to the allocation of silver for subsidiary coinage under the Act approved April 23, 1918. I have already stated the Treasury's position with respect to the cancellation of these allocations in my letter of May 9, 1923, and have called your particular attention to the decision of the Comptroller-General of the United States in the matter, given under date of November 29, 1922.

The Comptroller-General's decision is conclusive and binding upon the Secretary of the Treasury, and the Treasury Department accordingly proceeded forthwith to revoke the allocations covered by the decision, amounting in the aggregate to 10,247,976.52 fine ounces. Your letter, I notice, seems to involve some misunderstanding of the decision, for it states toward the end that "the opinion of the Comptroller-General upon which the Treasury Department depends expressly states that the matter of revocation or non-revocation is entirely within the discretion of the Treasury Department." What the Comptroller-General said was that:

"the matter of coinage into standard silver dollars of bullion * * which was allocated and charged to the subsidiary silver account and which allocations are authorized to be revoked and recharged to the standard silver dollar bullion account, is for administrative consideration."

This clearly means that the revocation of the allocations is authorized, and that the question of recoinage into dollars would be one for administrative determination by the Secretary. That determination has been reached, and the recoinage of the silver into standard silver dollars is proceeding in accordance with the decision.

What you say about profit to the Government through revoking the allocations of silver for subsidiary coin shows a further misunderstanding of the situation. Take, for example, the 10,247,976.52 ounces of bullion once allocated and since revoked. This bullion, or its equivalent, has been in the vaults all along and is not needed for subsidiary coinage. Restoring it to the standard silver dollar bullion account does not make a cent of profit to the Government. It simply puts the silver back where it was before, and when it has been recoinced into standard silver dollars the Government will be restored to its former position, the recoinced standard silver dollars filling the place of the standard silver dollars originally broken up and melted. To do as you recommend, on the other hand, would involve a serious loss. In the first place it would mean buying silver at the artificial price of \$1 per ounce 1,000 fine to take the place of silver which never left the Government's own vaults and does not in any proper sense need to be replaced. This of itself would be a futile thing, and it would be a most unusual construction of the law to require it. If it were done, moreover, the result would be that the Government would have 10,247,976.52 ounces of silver bullion on hand that it would not be able to use, and this bullion would have been purchased at a price exceeding by more than 30 cents an ounce the regular market price for silver. It would not be needed for any purpose for a long time to come, and it would, therefore, have to lie idle in the vaults of the Treasury at a constant expense to the Government.

A similar misunderstanding apparently underlies your comments about the purchase of silver for subsidiary coinage. There is nothing in the Pittman Act that requires the Treasury at any time to buy silver for

subsidiary coinage at the artificial price of \$1 per ounce. The Act simply requires the purchase of silver at the fixed price to replace the standard silver dollars broken up and actually used, and this will be done in accordance with the terms of the law and the regulations of the Director of the Mint prescribed thereunder. The purchase of silver for subsidiary coinage, on the other hand, depends entirely upon the demands of business, and it is perfectly well settled that in making purchases of silver for subsidiary coinage the Government pays only the market price. The difference between the price paid and the face value of the subsidiary silver coined therefrom constitutes seigniorage, and this, as you know, accrues to the Government by virtue of its sovereign power to coin money and maintain its circulation. It does not result from any intrinsic merit of silver, and there is no reason why the Government, in buying silver for purposes of coinage, should pay any more for the silver than anyone else would have to pay in the markets of the world. Silver, as you know, is not the standard of value. It is a commodity, and like other commodities must respond to market conditions. Silver producers stand in this respect on the same basis as producers of other commodities and have no just cause for complaint against the Government if their product falls in the market to a price lower than the cost of production.

The fact is, of course, that the Pittman Act has had the effect for about three years of giving American producers of silver a bonus equivalent to the difference between the world market price and the fixed price of \$1.00 per ounce, 1,000 fine. This has amounted, on an average, to over 30 cents an ounce, and the effect has been to give an artificial stimulus to the production of silver. The termination of purchases under

the Act will doubtless cause some disturbance to the silver industry, but that is always the result of maintaining an artificial condition and the hardships incident to returning to normal are inherent in the situation and cannot be overcome by any action of the Government. The Treasury, on its part, has been doing everything possible to assure equitable treatment to American producers in making final purchases under the Act, and has promulgated appropriate regulations to that end, but beyond that it cannot go. The Treasury, of course, has to consider the interests of the people as a whole, and not merely the special interests of the silver producers, and it would be manifestly improper for it to throw an additional burden of \$5,000,000 or more on the taxpayers of the country in order to help producers of silver by making purchases of silver at the artificial price of \$1.00 per ounce, 1,000 fine, beyond what is needed under the Act.

Very truly yours,

S. P. GILBERT, Jr.

Under Secretary.

Hon. Key Pittman,
Vice-Chairman, Senate Commission
of Gold and Silver Inquiry,
United States Senate,
Washington, D. C.

June 2, 1928

(T. D. 3484)

Prohibition - Liquors on United States and Foreign Vessels.

TREASURY DEPARTMENT,
Office of Commissioner of Internal Revenue
Washington, D.C.

TO FEDERAL PROHIBITION DIRECTORS AND OTHERS CONCERNED:

1. The Supreme Court of the United States having decided that the National Prohibition Act extends to all merchant vessels, both domestic and foreign, when within the territorial waters of the United States and all its possessions to which such Act applies (see the case of Cunard Steamship Company, Ltd., v Mellon, decided April 30, 1923, and reported in T.D. 3474), the following regulations are promulgated, relative to liquor on vessels, effective at 12-01 A.M., Sunday, June 10, 1923:

DEFINITIONS.

Sec. 1. The territorial waters of the United States comprise all waters over which the United States claims and exercises dominion and control as a sovereign power, including ports, harbors, bays and other enclosed arms of the sea along the coast of the United States and of the island and other possessions thereof, together with a marginal belt of the sea extending from low water mark outward a marine league, or three geographical miles, the seaward boundary thereof following a coast of land belonging to the United States; bays, such as the Chesapeake Bay and the Delaware Bay, which, except at their entrance, are so surrounded by the lands of the United States as to be reasonably regarded as geographically a part thereof, regardless of the distance between the opening headlands; and as to the Great Lakes, Puget Sound, and the St. Lawrence River, the waters on the United States side of the boundary fixed pursuant to the Convention relating to the Canadian International Boundary, concluded between the United States and Great Britain on April 11, 1908. The words "territorial waters of the United States", as used in these regulations, shall be taken to be the above described waters with the exception that these words shall not include the territorial waters of the Philippine Islands and of the Panama Canal Zone.

The words "medical officer of the Public Health Service" include any medical officer of the United States Public Health Service of the Treasury Department permanently or temporarily in charge of either a hospital or relief station of the said Public Health Service, or any subordinate medical officer of said Public Health Service designated by such medical officer in charge.

The word "vessel" shall be taken to include every description of water craft or other contrivance used, or capable of being used, as a means of transportation on or in water, or through the air.

By "war vessels" is meant all vessels over which the government of the vessel's flag exercises control and for the conduct of which it assumes full responsibility. The term "merchant vessels" includes all vessels other than war vessels.

As used in these regulations, the word "master" of a vessel shall be taken to mean the person having the command of the vessel, and, in addition, such other appropriate officer or officers of the vessel whose duties include acts authorized or required by these regulations.

By "cargo liquor" is meant liquor, either beverage or nonbeverage in character, on board a vessel, not for use on the vessel, but to be carried to a destination certain, and there landed.

"Sea stores" of liquor include all liquors carried by a vessel for use on board such vessel; but as used in these regulations such term means all such liquors except those held for use for nonbeverage (including medicinal) purposes and wines held for sacramental purposes or like religious rites.

APPLICABILITY OF NATIONAL PROHIBITION ACT
AND OF THESE REGULATIONS.

Sec. 2. The provisions of the National Prohibition Act, as amended and supplemented, apply to the regional areas of land and territorial waters of the United States and of all the island and other possessions thereof except the Philippine Islands; they therefore apply and extend to United States and foreign merchant vessels while such vessels are within the territorial waters of the United States, except in the territorial waters of the Philippine Islands. The National Prohibition Act provides that the prohibitions of the Act which relate to the Canal Zone, being section 20 of Title III, shall be enforced under regulations to be made by the President, and such prohibitions shall not apply to liquor in transit through the Panama Canal or on the Panama Railroad. These regulations do not, therefore, apply either to the Philippine Islands and the territorial waters thereof, or to the Panama Canal, the Panama Canal Zone, and the territorial waters thereof.

WAR VESSELS.

Sec. 3. The National Prohibition Act applies to persons on board war vessels of the United States, and the Navy Department has authority to take appropriate measures for its enforcement thereon, this being in addition to the measures taken by customs officers under the customs laws and regulations in connection with such vessels.

Sec. 4. In accordance with the law of nations, the war vessels of foreign nations, even when within the territorial waters of the United States, are to be regarded as exempt from the operation of the local laws of the United States. The provisions of the National Prohibition Act do not, therefore, apply to foreign vessels of war.

INVOLUNTARY ENTRANCE OF MERCHANT VESSELS
INTO TERRITORIAL WATERS OF THE UNITED STATES.

Sec. 5. The National Prohibition Act does not apply to merchant vessels which are forced into port by stress of weather, or by inevitable necessity. The involuntary entrance furnishes a ground of exemption, and, under international law, it is improper to impose fines upon vessels compelled to put into port for such reason. This rule also applies to goods on board vessels so circumstanced. These exemptions depend, however, upon proof of the fact of the urgency of the distress. The necessity must be grave and the proof convincing. Before clearance papers are granted, such vessels must, in all cases comply with the provisions of customs T.D. 39,442, requiring a bond for landing of liquors on board at a foreign destination and furnishing proof thereof, as provided in Section 442 of the Tariff Act approved September 21, 1922.

DIPLOMATIC EXEMPTIONS.

Sec. 6. No seizure shall be made of liquor in the possession of any person in the following classes (see letter of February 10, 1923, from the Secretary of State to the Chairman of the Committee on the Judiciary of the House of Representatives, as published in the Congressional Record of February 16, 1923):

(a) Diplomatic officers duly accredited by a foreign Government to the Government of the United States.

(b) Diplomatic officers of a foreign Government duly accredited to another foreign Government and temporarily within the United States or its possessions.

(c) Persons attached to or employed by any diplomatic mission, whose names have been registered with the Department of State in accordance with the provisions of section 4065 of the Revised Statutes of the United States.

Sec. 7. The Division of Customs and the Bureau of Internal Revenue will, from time to time, report to the Department of State such information and records regarding importations into the United States, withdrawals from bonded warehouses, and shipments, of liquor belonging to persons in the classes mentioned in the last section as come to the knowledge of such Division or Bureau.

CARGO LIQUOR.

Sec. 8. No merchant vessel, domestic or foreign, may lawfully carry as cargo within the territorial waters of the United States any liquor for use for beverage purposes.

Sec. 9. Liquor for nonbeverage purposes may be transported on vessels within the territorial waters of the United States under permit in accordance with the provisions of Section 93 of Regulations 60, as amended by T.D. 3350.

SEA STORES.

Sec. 10. It is unlawful for any United States or foreign merchant vessel within the territorial waters of the United States to carry or possess as sea stores any liquor whatever for beverage use.

LIQUOR FOR NONBEVERAGE PURPOSES.

Sec. 11. Any merchant vessel arriving in port with liquor not classed, in these regulations, either as cargo or sea stores, but claimed by the master to be held for nonbeverage purposes, or with wine claimed to be held for sacramental purposes, but without a permit or certificate authorizing its possession under the National Prohibition Act, may be allowed to retain a reasonable quantity for such purposes until the master has had fair opportunity to obtain either a permit or a certificate of medicinal need, or otherwise satisfy the requirements of the prohibition law and regulations. Liquor removed as being in excess of such reasonable quantity may be returned to such vessel if a permit or certificate of medicinal need which would authorize its possession be subsequently obtained. Otherwise such liquor will be dealt with in accordance with sections 19, 20 and 21 hereof.

Sec. 12. Liquor for nonbeverage purposes and wine for sacramental purposes or like religious rites may be obtained, possessed, transported, prescribed, sold and used on any United States or foreign vessel within the territorial waters of the United States, in the same way, to the same extent, and with the same limitations as on land. The provisions of Regulations 60 of the Bureau of Internal Revenue (being regulations relating to the traffic in liquor under Title II of the National Prohibition Act), and of all other regulations made under the National Prohibition Act, as amended and supplemented, shall extend to all such vessels so far as applicable. United States and foreign vessels may obtain such liquor and wine under Regulations 60 or other regulations applicable to their needs in so far as their requirements may thereby be met. In addition thereto, or in lieu thereof, vessels may obtain, possess and transport liquor for medicinal purposes in the manner set forth in the following sections.

Sec. 13. When the master of any vessel desires to possess or procure liquor for medicinal purposes for use on such vessel, he may apply in person to a medical officer of the Public Health Service, located at the port where the vessel lies, or, if there is no such medical officer at such port, then to any medical officer of the Public Health Service, and file with such officer, in five identical copies, application for medicinal liquor for vessel, Form 1539, giving the information called for on such form and such additional information as such officer may request. If the master shall knowingly make statements on such form which are untrue in any material averment, the certificate of medicinal need, on such form, signed by the medical officer of the

Public Health Service, shall be and constitute no protection for the possession of liquor on such vessel.

Sec. 14. The medical officer of the Public Health Service to whom, under these regulations, an application for medicinal liquor for vessel, on Form 1539, is presented will decide what supply of liquor (if any) is needed for medicinal purposes by such vessel and will date and fill out said form according to such decision: Provided, that if it be shown that such vessel is, or during its next voyage will be, required by the laws of a foreign country to carry medicinal liquor in any specified kind and amount, the certificate of medicinal need, on Form 1539, will be made to cover such kind and not less than such amount of liquor. Such officer will also decide what purchase of liquor should be authorized, if any. If no purchase is to be made under the certificate, the word "None" should be filled in after the word "Total" in the authority to purchase. If five gallons or more are required, the authority to purchase should be crossed out and the master be instructed to apply to the Federal Prohibition Director of the state for permit to purchase, Form 1410A. If the purchase of less than five wine gallons is to be authorized, the amount, kind and total, with the name of the druggist, will be filled in as provided in section 16. Such medical officer will thereupon sign in ink the master's and the vendor's copies of the certificate of medicinal need, on Form 1539, as thus made out, except that when no purchase may be made, the vendor's copy should be destroyed. The other three copies will also be signed, but this signing may be by facsimile rubber stamp or by an agent whose authority to sign such medical officer's name for this purpose has been duly filed with the Federal Prohibition Director of the state and with the Prohibition Commissioner at Washington. Such certificate of medicinal need, with or without the authority to purchase, shall constitute a permit under the National Prohibition Act for exercising the privileges attaching to such certificate under these regulations; unless sooner surrendered or otherwise made void, such privileges will expire on the 31st day of December following the issuance of such certificate, unless issued after August 31st of any year, in which case such privileges will expire on the 31st day of December of the following year. The medical officer of the Public Health Service will cancel any former certificate of medicinal need that may have been issued to the vessel and surrendered by the master and will send same to the Prohibition Commissioner as provided below. He will distribute the five copies of such form by retaining one copy, handing one to the master as the vessel's authority to purchase, transport and possess liquor, handing the vendor's copy to the master to be given to the vendor or attached to application for permit to purchase, Form 1410, in case a purchase of five gallons or more is authorized (or such copy will be destroyed if no purchase is to be made), sending a fourth to the Federal Prohibition Director of the state in which the retail druggist named in the certificate has his place of business, or, if no sale in quantity of less than five wine gallons is authorized, to the Federal Prohibition Director of the State in the waters of which the vessel lies, and sending the fifth, with the canceled certificate of medicinal need, if any, to the Federal Prohibition Commissioner, Washington, D.C. The copies for the Director and Commissioner will be mailed to them on the day of issue or within not to exceed 24 hours after the master receives his copy. The copy retained by the medical officer of the Public Health Service will be kept by him until the tenth, and not later than the fifteenth, day of the next calendar month, when all copies of such applications and certificates issued during the preceding month will be forwarded to the Prohibition Commissioner, Washington, D.C.

Sec. 15. If, in the opinion of the medical officer of the Public Health Service, the vessel should obtain a permit under Regulations 60 for all or part of its supply of medicinal liquor, such officer should so state in the certificate of medicinal need, with his reason for such statement. If, pending the granting of such a permit, such vessel should be allowed to possess liquor for medicinal purposes, or if the permit granted will not meet the medicinal requirements of such vessel, the medical officer should so state in the certificate. If the vessel has no need for medicinal liquor, in the opinion of the medical officer, such statement should be made in the certificate of medicinal need. In no case should a certificate of medicinal need, on Form 1539, be refused by the medical officer, but should be given when applied for and limited as herein provided.

Sec. 16. At the time a medical officer of the Public Health Service gives the master of a vessel a certificate of medicinal need, on Form 1539, he will, if proper under the circumstances, include in such certificate authority to purchase in a quantity less than five wine gallons, and will name therein a retail druggist who holds a permit to sell under the National Prohibition Act, from whom such purchase may be made. Such authority to purchase will authorize such master to purchase from the retail druggist therein named, and will authorize such druggist to sell, the kind and amount of liquor therein named. The master will deliver the vendor's copy of such certificate of medicinal need, Form 1539, to the retail druggist named, at the same time exhibiting to such druggist the master's copy of such certificate.

Sec. 17. When the retail druggist named therein receives any certificate of medicinal need, on Form 1539, authorizing a purchase, and has been shown the master's copy thereof, such retail druggist shall satisfy himself fully of the authenticity thereof, either by recognizing the handwriting and signature of the medical officer of the Public Health Service or by calling upon such medical officer, personally, by telephone, or otherwise, to state whether such certificate of medicinal need with authority to purchase was duly issued; and such druggist shall also make certain of the identity of the master of the vessel. If such certificate of medicinal need and authority to purchase is authentic, the master named therein may purchase and the retail druggist named therein may sell, and either the master or the retail druggist may transport to the vessel, the liquor authorized to be purchased. Upon delivery, the master shall sign a receipt endorsed on the vendor's copy of Form 1539 in order that the druggist may prove delivery and obtain credit on his records under his basic permit.

Sec. 18. In case the master, under a certificate of medicinal need, desires to purchase liquor in an amount of five wine gallons or more, such master will apply on Form 1410 to the Federal Prohibition Director to whom, under these regulations, the director's copy of Form 1539 is sent, for a permit to purchase, Form 1410A, in accordance with the provisions of Regulations 60. The certificate of medicinal need, Form 1539, shall be the basic permit for such purpose and the vendor's copy of Form 1539 shall be attached to such application and be retained in the Director's files. The provisions of Regulations 60 shall be followed in the purchase and delivery of such liquor. In every such case the director, before issuing such permit to purchase, shall make certain of the genuineness of certificate of medicinal need, Form 1539, and of the identity of the master. The director will also make such investigation of the vessel as, in his opinion, may be necessary.

LIQUOR SURRENDERED BY OR SEIZED FROM VESSELS.

Sec. 19. All liquors found by customs officers on board any vessel, either foreign or American, in ports or territorial waters of the United States, and which shall be transported, sold or possessed in violation of the National Prohibition Act, as amended and supplemented, and the regulations thereunder, as distinguished from the customs laws, shall be seized by the said customs officers under the prohibition laws and a receipt given the master or other person in charge of the vessel, showing the name of the vessel and master, the date, the number of cases, bottles or other containers, with their unit capacity, and whether the liquors were carried as cargo or sea stores. This receipt shall be made in duplicate and a copy retained by the collector of customs.

Sec. 20. All liquors coming into the possession of customs officers as provided in the preceding section shall, as soon as practicable, be turned over to the Federal Prohibition Director of the state or his authorized representative at the port, to be listed, segregated and labeled for identification, and safely stored for disposal according to law. The actual expenses incurred by customs officers in unloading such liquors from vessels and conveying the same to a warehouse or other storage place will be paid from the appropriation for enforcement of national prohibition. The Prohibition Director, or his representative receiving such liquors, shall make acknowledgment thereof by signing the collector's copy of receipt therefor given by him to the master of the vessel. The Prohibition Director shall also cause to be made a careful list by classes of each lot received, showing the name of the shipping concern, the name of the vessel and master, the quantities of the respective kinds of liquors taken and the date thereof. These lists shall be in quadruplicate; one to be held in the office of the prohibition officer receiving the liquor, one to be forwarded to the Federal Prohibition Director of the state, one to be forwarded to the Federal Prohibition Commissioner at Washington, D.C., and one to the collector of internal revenue of the district.

Sec. 21. All liquors found by customs officers on board any vessel, either foreign or American, in violation of the customs laws and regulations, as distinguished from the prohibition laws, shall be seized by customs officers, receipts given therefor as required in section 19 hereof, and shall be dealt with under the customs laws. When both the prohibition laws and the customs laws appear to have been broken, the officers of the customs service shall first proceed under the customs laws unless, in the particular case, they elect to turn the case over to the prohibition officers for prior proceedings under the prohibition laws.

2. Subsection (q) of Section 93 of Regulations 60, as amended by T.D. 3350, is hereby repealed.

3. Although this Treasury Decision will not be in mandatory force until June 10, 1923, as set forth in the first paragraph above, yet any domestic or foreign vessel may, at any time after the approval of this Treasury Decision, voluntarily take advantage of any of the benefits thereof; Provided, that if Form 1539 is required for such purpose, this paragraph shall not apply until a supply of such form is available.

4. If any foreign vessel leaves a foreign port before June 10, 1923, for an American port, having liquor on board for beverage purposes, such liquor shall not be seized under the above regulations while kept under customs seal in American territorial waters on such voyage.

D. H. BLAIR,

Commissioner of Internal Revenue.

Approved: June 2, 1923.

A. W. MELLON,

Secretary of the Treasury.

TREASURY DEPARTMENT

FOR RELEASE, AFTERNOON PAPERS,
Monday, July 9, 1923.

Attached hereto are copies of the formal Proposal of the British Government for the funding of the British debt to the United States, as executed on the 18th of June, 1923, by the British Ambassador, and the Acceptance thereof dated June 19, 1923, executed in behalf of the United States by the Secretary of the Treasury, as Chairman of the World War Foreign Debt Commission, with the approval of the President, together with the form of bond actually executed and delivered on July 5, 1923, by the Counsellor of the British Embassy at Washington.

Proposal,

Dated the eighteenth day of June, 1923, by His Britannic Majesty's Government (hereinafter called GREAT BRITAIN) to the Government of the United States of America (hereinafter called the UNITED STATES) regarding the funding of the debt of Great Britain to the United States.

Whereas Great Britain is indebted to the United States as of 15th December, 1922, upon demand obligations in the principal amount of \$4,074,818,358.44, not including obligations in the principal amount of \$61,000,000, representing advances deemed to have been made to cover purchases of silver under the Act of Congress approved 23rd April, 1918, of which \$30,500,000 has been repaid in April and May, 1923, and the balance is to be repaid in 1924, pursuant to an agreement already made between the parties, and Great Britain is further indebted to the United States, as of 15th December, 1922, on account of interest accrued from 15th April and 15th May, 1919, on said \$4,074,818,358.44, principal amount of demand obligations:

And whereas Great Britain has power under the War Loan Act, 1919 (9 and 10 Geo. 5, cap 37) to issue securities in exchange for maturing securities issued under the War Loan Acts, 1914 to 1918:

And whereas the demand obligations now held by the United States Treasury were so issued, and will become payable upon the request of the United States Treasury for their payment:

Now therefore Great Britain proposes, in the exercise of the powers above recited and in consideration and in faith

of the statements, conditions, premises and mutual covenants herein contained, to issue to the United States, in exchange for the demand obligations now held by the United States Treasury, securities which shall be in their terms and conditions in accordance with the following provisions:

1. *Amount of Indebtedness.*

The total amount of indebtedness to be funded is \$4,600,000,000, which has been computed as follows:

Principal amount of demand obligations to be funded.....	\$4,074,818,358.44	
Interest accrued thereon from 15th April and 15th May, 1919, respectively, to 15th December, 1922, at the rate of 4½ per cent per annum.....	\$629,836,106.99	
Less—Payments made by Great Britain on 16th October and 15th November, 1922, on account of inter- est, with interest thereon at 4½ per cent per annum from said dates, re- spectively, to 15th December, 1922.	100,526,379.69	529,309,727.30
Total principal and interest, accrued and unpaid, as of 15th December, 1922.....	4,604,128,085.74	
Paid in cash by Great Britain, 15th March, 1923..	4,128,085.74	
Total indebtedness to be funded into bonds of Great Britain.	4,600,000,000.00	

2. *Issue of Long-Time Obligations.*

The securities, which it is proposed to issue at par as promptly as possible, shall be obligations in the principal amount of \$4,600,000,000, in the form of bonds to be dated 15th December, 1922, maturing 15th December, 1984, with interest payable semi-annually on 15th June and 15th December in each year at the rate of 3 per cent per annum from 15th December, 1922, to 15th December, 1932, and thereafter at the rate of 3½ per cent per annum until the principal thereof shall have been repaid.

3. *Method of Payment.*

The bonds shall be payable as to both principal and interest in United States gold coin of the present standard of weight and fineness, or its equivalent in gold bullion, or,

at the option of Great Britain, upon not less than thirty days' advance notice indicating the minimum amount which it is contemplated to pay at next due date in gold, cash or available funds, in any bonds of the United States issued or to be issued after 6th April, 1917, to be taken at par and accrued interest to the date of payment hereunder: *provided, however*, that Great Britain may at its option, upon not less than ninety days' advance notice, pay up to one-half of any interest accruing between 15th December, 1922, and 15th December, 1927, on any British bonds proposed to be issued hereunder, in bonds of Great Britain, maturing 15th December, 1984, dated and bearing interest from the respective dates when the interest to be paid thereby becomes due and substantially similar in other respects to the original bonds proposed to be issued hereunder.

All payments to be made by Great Britain on account of the principal or interest of any bonds proposed to be issued hereunder shall be made at the Treasury of the United States in Washington or, at the option of the Secretary of the Treasury of the United States, at the Federal Reserve Bank of New York and, if in cash, shall be made at the option of Great Britain in gold coin of the United States or in gold bullion or in immediately available funds (or, if in bonds of the United States, shall be in form acceptable to the Secretary of the Treasury of the United States). Appropriate notation of all payments on account of principal shall be made on the bonds proposed to be issued hereunder which may be held by the United States: *provided, however*, that all payments in respect of any marketable obligations issued under paragraph 9 of this proposal shall be made at the office of the fiscal agents of the British Government in the City of New York.

4. *Exemption from Taxation.*

The principal and interest of all bonds issued or to be issued hereunder shall be exempt from all British taxation, present or future, so long as they are in the beneficial ownership of the United States or of a person, firm, association, or corporation neither domiciled nor ordinarily resident in the United Kingdom.

5. *Form of Bonds.*

All bonds proposed to be issued hereunder to the United States shall be payable to the United States of America, or order, shall be issued, so far as possible, in denominations of \$4,600,000 each, and shall be substantially in the form set forth in the exhibit annexed hereto, and marked "Exhibit A." The bonds shall be signed for Great Britain by the Counsellor of His Britannic Majesty's Embassy at Washington.

6. *Repayment of Principal.*

To provide for the repayment of the total principal of the debt before maturity of the \$4,600,000,000 principal amount of bonds to be issued, it is proposed that the bonds shall contain provisions the effect of which shall be that Great Britain shall make to the United States payments, on account of the original principal amount of the bonds to be issued, in the amounts and on the dates named in the following table:

Date.	Annual instalments to be paid on account of principal.	Date.	Annual instalments to be paid on account of principal.
15th December:		15th December—Contd.	
1923.....	\$23, 000, 000	1936.....	\$32, 000, 000
1924.....	23, 000, 000	1937.....	37, 000, 000
1925.....	24, 000, 000	1938.....	37, 000, 000
1926.....	25, 000, 000	1939.....	37, 000, 000
1927.....	25, 000, 000	1940.....	42, 000, 000
1928.....	27, 000, 000	1941.....	42, 000, 000
1929.....	27, 000, 000	1942.....	42, 000, 000
1930.....	28, 000, 000	1943.....	42, 000, 000
1931.....	28, 000, 000	1944.....	46, 000, 000
1932.....	30, 000, 000	1945.....	46, 000, 000
1933.....	32, 000, 000	1946.....	46, 000, 000
1934.....	32, 000, 000	1947.....	51, 000, 000
1935.....	32, 000, 000	1948.....	51, 000, 000

Date.	Annual instalments to be paid on account of principal.	Date.	Annual instalments to be paid on account of principal.
15th December—Contd.		15th December—Contd.	
1949.....	\$51,000,000	1968.....	\$100,000,000
1950.....	53,000,000	1969.....	105,000,000
1951.....	55,000,000	1970.....	110,000,000
1952.....	57,000,000	1971.....	114,000,000
1953.....	60,000,000	1972.....	119,000,000
1954.....	64,000,000	1973.....	123,000,000
1955.....	64,000,000	1974.....	127,000,000
1956.....	64,000,000	1975.....	132,000,000
1957.....	67,000,000	1976.....	136,000,000
1958.....	70,000,000	1977.....	141,000,000
1959.....	72,000,000	1978.....	146,000,000
1960.....	74,000,000	1979.....	151,000,000
1961.....	78,000,000	1980.....	156,000,000
1962.....	78,000,000	1981.....	162,000,000
1963.....	83,000,000	1982.....	167,000,000
1964.....	85,000,000	1983.....	175,000,000
1965.....	89,000,000	1984.....	175,000,000
1966.....	94,000,000		
1967.....	96,000,000	Total.....	4,600,000,000

Provided, however, that Great Britain may at its option, upon not less than ninety days' advance notice, postpone any payment of principal falling due as hereinabove provided to any subsequent 15th June or 15th December, not more than two years distant from its due date, but only on condition that, if Great Britain shall at any time exercise this option as to any payment of principal, the payment falling due in the next succeeding year cannot be postponed to any date more than one year distant from the date when it becomes due, unless and until the payment previously postponed shall actually have been made, and the payment falling due in the second succeeding year cannot be postponed at all unless and until the payment of principal due two years previous thereto shall actually have been made.

In the event of Great Britain issuing bonds to the United States in payment of interest accruing between 15th December, 1922, and 15th December, 1927, as proposed in paragraph 3 above, the bonds so issued shall contain provision for the payment of their principal before maturity through annual instalments on account of principal corre-

sponding substantially to the schedule of payments on account of principal appearing in the table hereinabove set forth.

7. *Payments before Maturity.*

Great Britain may at its option, on any interest date or dates upon not less than ninety days' advance notice, make advance payments of principal, in addition to the payments required to be made by the provisions of the bonds in accordance with paragraph 6 of this proposal. Any such additional payments shall first be applied to the principal of any bonds which shall have been issued hereunder on account of interest accruing between 15th December, 1922, and 15th December, 1927, and then to the principal of any other bonds which shall have been issued hereunder. Any payments made to the United States under this provision shall be in amounts of \$1,000,000 or multiples thereof.

8. *Calculation of Interest.*

Notwithstanding anything herein contained, the interest payable from time to time on the bonds proposed to be issued shall be computed on the amount of the principal outstanding on the previous interest date, with adjustments in respect of any payment on account of principal which may have been made since the previous interest date.

9. *Exchange for Marketable Obligations.*

Great Britain will issue to the United States at any time or from time to time, at the request of the Secretary of the Treasury of the United States, in exchange for any or all of the bonds proposed to be issued hereunder and held by the United States, definitive engraved bonds in form suitable for sale to the public, in such amounts and denominations as the Secretary of the Treasury of the United States may request, in bearer form, with provision for

registration as to principal, and/or in fully registered form, and otherwise on the same terms and conditions, as to dates of issue and maturity, rate or rates of interest, exemption from taxation, payment in bonds of the United States issued or to be issued after 6th April, 1917, payment before maturity, and the like, as the bonds surrendered on such exchange, except that the bonds shall carry such provision for repayment of principal as shall be agreed upon; provided that, if no agreement to the contrary is arrived at, any such bonds shall contain separate provision for payments before maturity, conforming substantially to the table of repayments of principal prescribed by paragraph 6 of this proposal and in form satisfactory to the Secretary of the Treasury of the United States, such payments to be computed on a basis to accomplish the retirement of any such bonds by 15th December, 1984, and to be made through annual drawings for redemption at par and accrued interest. Any payments of principal thus made before maturity on any such bonds shall be deducted from the payments required to be made by Great Britain to the United States in the corresponding years under the terms of the table of repayments of principal prescribed in paragraph 6 of this proposal.

Great Britain will deliver definitive engraved bonds to the United States in accordance herewith within six months of receiving notice of any such request from the Secretary of the Treasury of the United States, and pending the delivery of the definitive engraved bonds will, at the request of the Secretary of the Treasury of the United States, deliver temporary bonds or interim receipts in a form to be agreed upon within three months of the receipt of such request. The United States, before offering any such bonds or interim receipts for sale in Great Britain, will first offer them to Great Britain for purchase at par and accrued interest and Great

Britain shall likewise have the option, in lieu of issuing to the United States any such bonds or interim receipts, to make advance redemption, at par and accrued interest, of a corresponding amount of bonds issued hereunder and held by the United States.

10. *Cancellation and Surrender of Demand Obligations.*

Upon the delivery to the United States of the \$4,600,000,000 principal amount of bonds proposed to be issued hereunder, the United States will cancel and surrender to Great Britain, through the British Ambassador at Washington, or his representative, at the Treasury of the United States in Washington, the demand obligations of Great Britain in the principal amount of \$4,074,818,358.44 described in the preamble to this proposal.

11. *Notices.*

Any notice, request or consent under the hand of the Secretary of the Treasury of the United States shall be deemed and taken as the notice, request, or consent of the United States, and shall be sufficient if delivered at the British Embassy at Washington or at the office of the Permanent Secretary of the British Treasury in London; and any notice, request, or election from or by Great Britain shall be sufficient if delivered to the American Embassy in London or to the Secretary of the Treasury of the United States at the Treasury of the United States in Washington. The United States in its discretion may waive any notice required hereunder, but any such waiver shall be in writing and shall not extend to or affect any subsequent notice or impair any right of the United States to require notice hereunder.

Signed on behalf of the Lords Commissioners of His Majesty's Treasury, this eighteenth day of June, 1923.

Washington.

A. GEDDES,

His Britannic Majesty's Ambassador

Extraordinary and Plenipotentiary.

EXHIBIT "A."

(Form of Bond.)

THE GOVERNMENT OF THE UNITED KINGDOM.

Sixty-two year 3-3½ per cent Gold Bond

Dated 15th December, 1922. Maturing 15th December, 1984.

\$

No.

The Government of the United Kingdom, hereinafter called Great Britain, for value received, promises to pay to the United States of America, hereinafter called the United States, or order, on the 15th day of December, 1984, the sum of Four Million Six Hundred Thousand Dollars (\$4,600,000), less any amount which may have been paid upon the principal hereof as endorsed upon the back hereof, and to pay interest upon said principal sum semiannually on the fifteenth day of June and December in each year at the rate of three per cent per annum from 15th December, 1922, to 15th December, 1932, and at the rate of three and one-half per cent per annum thereafter until the principal hereof shall have been paid. All payments on account of principal and/or interest shall be made at the Treasury of the United States in Washington, or, at the option of the Secretary of the Treasury of the United States, at the Federal Reserve Bank of New York. This bond is payable as to both principal and interest in gold coin of the United States of America of the present standard of weight and fineness or in its equivalent in gold bullion, or, at the option of Great Britain, upon not less than thirty days' notice indicating the minimum amount which it is contemplated to pay at next due date in gold, cash or available funds, in any bonds of the United States issued or to be issued after 6th April, 1917, to be taken at par and accrued interest to the date of payment hereunder; *provided, however, that*

Great Britain may at its option, upon not less than ninety days' advance notice, pay up to one-half of any interest accruing hereon between 15th December, 1922, and 15th December, 1927, in bonds of Great Britain dated and bearing interest from the respective dates when the interest to be paid thereby becomes due, and substantially similar in maturity and other respects to this bond.

The principal and interest of this bond shall be exempt from all British taxation, present or future, so long as it is in the beneficial ownership of the United States, or of a person, firm, association or corporation neither domiciled nor ordinarily resident in the United Kingdom.

In order to provide for the repayment of the principal of this bond before maturity, Great Britain will make to the United States payments of principal in the amounts, and on the dates shown in the following table:

Date.	Annual instalments to be paid on account of principal.	Date.	Annual instalments to be paid on account of principal.
15th December:		15th December—Contd.	
1923.....	\$23,000	1946.....	\$46,000
1924.....	23,000	1947.....	51,000
1925.....	24,000	1948.....	51,000
1926.....	25,000	1949.....	51,000
1927.....	25,000	1950.....	53,000
1928.....	27,000	1951.....	55,000
1929.....	27,000	1952.....	57,000
1930.....	28,000	1953.....	60,000
1931.....	28,000	1954.....	64,000
1932.....	30,000	1955.....	64,000
1933.....	32,000	1956.....	64,000
1934.....	32,000	1957.....	67,000
1935.....	32,000	1958.....	70,000
1936.....	32,000	1959.....	72,000
1937.....	37,000	1960.....	74,000
1938.....	37,000	1961.....	78,000
1939.....	37,000	1962.....	78,000
1940.....	42,000	1963.....	83,000
1941.....	42,000	1964.....	85,000
1942.....	42,000	1965.....	89,000
1943.....	42,000	1966.....	94,000
1944.....	46,000	1967.....	96,000
1945.....	46,000	1968.....	100,000

Date.	Annual instalments to be paid on account of principal.	Date.	Annual instalments to be paid on account of principal.
15th December—Contd.		15th December—Contd.	
1969.....	\$105,000	1978.....	\$146,000
1970.....	110,000	1979.....	151,000
1971.....	114,000	1980.....	156,000
1972.....	119,000	1981.....	162,000
1973.....	123,000	1982.....	167,000
1974.....	127,000	1983.....	175,000
1975.....	132,000	1984.....	175,000
1976.....	136,000		
1977.....	141,000	Total.....	4,600,000

Provided, however, that Great Britain may, at its option, upon not less than ninety days' advance notice, postpone any payment of principal falling due, as hereinabove provided, to any subsequent 15th June or 15th December, not more than two years distant from its due date, but only on condition that if Great Britain shall at any time exercise this option as to any payment of principal, the payment falling due in the next succeeding year cannot be postponed to any date more than one year distant from the date when it becomes due unless and until the payment previously postponed shall actually have been made, and the payment falling due in the second succeeding year cannot be postponed at all unless and until the payment of principal due two years previous thereto shall actually have been made.

This bond may be paid on any interest date before maturity in whole or in part, in amounts of \$1,000,000, or multiples thereof, at the option of Great Britain, on not less than ninety days' advance notice.

This bond is issued by Great Britain pursuant to the proposal, dated the 18th day of June, 1923, and to the Acceptance of proposal, dated the 19th day of June, 1923.

In Witness Whereof, Great Britain has caused this bond to be executed in its behalf by the Counsellor of His Britannic Majesty's Embassy at Washington, thereunto duly authorized.

For the United Kingdom:

Dated 15th December, 1922.

(Back.)

The following amounts have been paid upon the principal amount of this bond:

Date.

Amount paid.

Acceptance.

JUNE 19, 1923.

The Right Honorable,

Sir AUCKLAND GEDDES, G. C. M. G., K. C. B.,

Ambassador Extraordinary and Plenipotentiary,

The British Embassy,

Washington, D. C.

MY DEAR MR. AMBASSADOR: I have the honor to acknowledge the receipt of your note of June 18, 1923, transmitting the proposal dated the 18th day of June, 1923, by His Britannic Majesty's Government to the Government of the United States of America regarding the funding of the debt of Great Britain to the United States. This proposal is agreeable to the World War Foreign Debt Commission, and I am writing for the Commission and by its authority to advise you that the proposal is hereby accepted on behalf of the United States of America, pursuant to the authority conferred by the Act of Congress approved February 9, 1922, as amended by the Act of Congress approved February 28, 1923. In accordance therewith I am writing to ask that the bonds as contemplated thereby may be delivered as soon as possible to the Secretary of the Treasury of the United States in exchange for the demand obligations amounting to \$4,074,818,358.44 now held by him which are otherwise now payable.

Very truly yours,

A. W. MELLON,

*Secretary of the Treasury, and Chairman of
the World War Foreign Debt Commission.*

Approved:

WARREN G. HARDING,

President.

JUNE 19, 1923.

(13)

TREASURY DEPARTMENT

Washington.

July 13, 1923.

My dear Senator:

I received on July 11 your letter of July 9, 1923, requesting the Treasury to petition the Comptroller General of the United States for a re-hearing upon the question of authority to revoke allocations of silver for subsidiary coinage under the terms of the act approved April 23, 1918, sometimes known as the Pittman Act. I have read your letter and its enclosures, and find therein no new facts that would justify the Treasury in asking the Comptroller General for a re-hearing. I am, however, sending a copy of your letter and of this reply to the Comptroller General for his information.

The statement of facts contained in my letter of November 2, 1922, first submitting the case to the Comptroller General, was prepared by the Bureau of the Mint on the basis of its records and accounts, and is correct. The Comptroller General, furthermore, as the chief accounting officer of the Government, had full access at all times to the records and accounts of the Bureau of the Mint, and of the several coinage mints, and at the Treasury's request made independent investigation into the facts before rendering his decision on November 29, 1922. There is no question but that the standard silver dollars involved in the allocations were actually broken up and melted, and this is expressly stated as one of the facts in the Comptroller General's decision. It was also expressly stated in my letter of November 2, 1922, to the Comptroller General that the "allocations of

silver for subsidiary coinage under the act were made in part to make up shortages at the individual coinage mints, rather than for the Mint Service as a whole, and in part to supply refined silver immediately available for coinage, where the silver already on hand was unrefined." As to the coinage into subsidiary silver, it must be clear that once melted into bullion the silver could not be earmarked and treated separately from other silver in the mints. The silver bullion carried by the mints is held for practical purposes in one mass, separate accounts being kept on the books of the Bureau of the Mint showing the bullion carried in the subsidiary silver bullion account and the standard silver dollar bullion account. Adjustments between these accounts are made from time to time, without physically affecting the silver bullion, in order to reflect the operations of the mints, but it is always impossible to earmark the silver bullion in the several accounts or to identify any coins as having been made from a particular lot of silver.

In general, I notice that your letter deals solely with the technical points relating to the melting of standard silver dollars and the coinage of bullion into subsidiary silver. These points are covered by the Comptroller General's decision, and it is unnecessary further to discuss them. I do not find it anywhere disputed that the action which the Treasury has taken in respect to the reversal of the allocations for subsidiary coinage, and the subsequent recoinage of this silver into standard silver dollars, have merely restored the situation to what it would have been had the allocations never been made. This fulfills the primary purpose of the act, which was to relieve an emergency and restore

the silver currency to what it was when the act was passed, ^{and} it has been done without purchasing silver under the act at the price of \$1 per ounce by transferring back to the standard silver dollar account an amount of silver carried in the subsidiary silver bullion account which had been lying in the mints at all times since the original allocations were made. To do otherwise, and follow the course which you recommend, would mean purchasing over 10,000,000 ounces of unnecessary silver at the artificial price of \$1 per ounce, at a loss of over 35 cents an ounce as compared with the ordinary market price, and carrying an equivalent amount of silver as a dead asset in the Treasury at a heavy loss for interest and other carrying charges. The Treasury's action in adjusting the accounts of the mints has thus saved the people of the United States at least \$5,000,000, that would otherwise have gone to subsidize the silver industry. The action taken was clearly in the public interest, and though apparently not acceptable to the silver interests of Nevada should commend itself, I believe, to the Commission of Gold and Silver Inquiry, a committee of the Senate of the United States which was appointed to serve the interests of the people as a whole rather than the special interests of a single class.

Very truly yours,

(Signed) S. P. Gilbert, Jr.

Acting Secretary of the Treasury.

Hon. Key Pittman,
Vice-Chairman, Commission
of Gold and Silver Inquiry,
United States Senate,
Washington, D. C.

July 16, 1928

(T.D. 3497)
Income Tax.

Ownership Certificates: Articles 365, 367, 369, 370, 1074, 1076, 1077, 1078 and 1079, of Regulations 62, amended.

TREASURY DEPARTMENT
Office of Commissioner of Internal Revenue
Washington, D. C.

TO COLLECTORS OF INTERNAL REVENUE AND OTHERS CONCERNED:

Articles 365, 367, 369, 370, 1074, 1076, 1077, 1078 and 1079, of Regulations 62, are hereby amended to read as follows:

ART. 365. Ownership certificates for interest coupons. - The owners, except domestic and resident corporations, of bonds or other obligations containing a tax-free covenant clause, issued by a domestic or resident foreign corporation, when presenting interest coupons for payment, shall file a certificate of ownership for each issue of bonds, showing the name and address of the debtor corporation, the name and address of the owner of the bonds, the nature of the obligations, the amount of interest and its due date, and the amount of any tax withheld. In case of bonds not containing a tax-free covenant clause, no ownership certificates are required unless the owner of such bonds is a nonresident alien individual, fiduciary, partnership or corporation. No ownership certificates need be filed in the case of interest payments on bonds, the income from which is not required to be included in gross income, nor in the case of any obligations of the United States. See section 213(b) of the statute and articles 74-84. Where in connection with the sale of its property payment of the bonds or other obligations of a corporation is assumed by the assignee, such assignee, whether an individual, partnership, corporation, or a State or political subdivision thereof, must deduct and withhold such taxes as would have been required to be withheld by the assignor had no such sale and transfer been made. As to ownership certificates in the case of bonds of foreign countries, or bonds of nonresident foreign corporations, see article 1077.

ART. 367. Form of certificate where no withholding required. - For the purposes of article 365, Form 1001 shall be used by citizens or residents of the United States when personal exemption is claimed against interest on bonds containing a tax-free covenant clause. In case a citizen or resident alien individual receives interest on bonds containing a tax-free covenant clause in excess of the amount of personal exemption which the individual may claim, any such excess must be reported on Form 1000.

ART. 369. Interest coupons without ownership certificates. - When interest coupons are received unaccompanied by certificates of ownership, unless the first bank be satisfied that the owner is a citizen of the United States or a resident individual, fiduciary, partnership or corporation, the first bank shall require of the payee a statement showing the name and address of the payee, the name and address of the debtor corporation, the date of the maturity of the interest, the name and address of the person from whom the coupons were received, the amount of the interest, and a statement that the owner of the bonds is unknown to the payee. Such statement shall be forwarded to the Commissioner with the monthly return on Form 1012. The first bank receiving such coupons shall also prepare a certificate on Form 1000, crossing out "owner" and inserting "payee" and entering the amount of interest on line 6, and shall stamp or write across the face of the certificate "Statement furnished," adding the name of the bank.

ART. 370. Interest on registered bonds. - Ownership certificates are required in connection with interest upon registered bonds, as in the case of coupon bonds, if such bonds contain a tax-free covenant clause or if such bonds are owned by a nonresident alien individual, fiduciary, partnership or corporation. If ownership certificates are not furnished by the owner of the bonds, such certificates must be prepared by the debtor corporation or its withholding agent. (a) If the bonds contain a tax-free covenant clause, ownership certificates must be prepared on Form 1000 for the following classes of bondholders: Citizens or residents of the United States, nonresident alien individuals, partnerships, whether foreign or domestic, foreign corporations having no office or place of business within the United States. (b) If the bonds do not contain a tax-free covenant clause, Form 1000 shall be prepared in the case of nonresident alien individuals, partnerships composed in whole or in part of nonresident aliens and not having an office or place of business within the United States, or in case the owner is a foreign corporation not engaged in trade or business within the United States and not having an office or place of business therein.

Regardless of whether the registered bonds do or do not contain a tax-free covenant clause, no ownership certificate is required in connection with such bonds owned by a domestic or resident corporations.

ART. 1074. Return of information as to interest on corporate bonds. - In the case of payments of interest, regardless of amount, upon bonds and similar obligations of domestic or resident foreign corporations, the original ownership certificates, when duly filed, shall constitute and be treated as returns of information. If a bondholder files no ownership certificate in the case of payments of interest on registered bonds, if such bonds contain a tax-free covenant clause, or if such bonds are owned by a nonresident alien individual, fiduciary, partnership or corporation, the withholding agent shall make out such a certificate in each instance and file it with the monthly return. See sections 221 and 237 of the statute and articles 361-375 and 601.

ART. 1076. Foreign items. - The term "foreign item," as here used, means any dividend upon the stock of a nonresident foreign corporation or any item of interest upon the bonds of foreign countries or nonresident foreign corporations, whether or not such dividend or interest is paid in the United States or by check drawn on a domestic bank. (a) Wherever a foreign country or nonresident foreign corporation issuing bonds has appointed a paying agent in this country, charged with the duty of paying the interest upon such bonds, such paying agent shall be the source of information. If such foreign country or foreign corporation has no such agent, then the last bank or collecting agent in this country shall be the source of information. (b) In the case of dividends on the stock of a nonresident foreign corporation, however, the first bank or collecting agent accepting such item for collection shall be the source of information. No return of information is required with respect to foreign items unless the amount thereof is \$1,000 or more in any taxable year, nor is any return of information required with respect to such items owned by a nonresident alien individual, a foreign partnership or a foreign corporation, provided the first bank or collecting agent is satisfied as to such ownership. In the latter case the foreign item may be stamped "foreign owner".

ART. 1077. Ownership certificates for foreign items. - When bonds of foreign countries or of nonresident foreign corporations contain a tax-free covenant clause and are owned by citizens or residents of the United States, the foreign country or nonresident foreign corporation having a fiscal or paying agent in the United States, such agent is required to withhold a tax of 2 percent from the interest on such bonds. Ownership certificate Form 1000, modified to show the name and address of the fiscal agent or the paying agent, should be used unless the owner (if so entitled) desires to claim exemption, in which case Form 1001 should be filed. See article 361.

ART. 1078. Foreign items presented for collection unaccompanied by ownership certificates. - If the foreign item is an interest coupon detached from bonds containing a tax-free covenant clause, issued by a foreign country or corporation having a paying agent in the United States, a statement and ownership certificate, Form 1000, shall be furnished as provided in article 369.

ART. 1079. Return of information as to foreign items. - In the case of collections of foreign items, the original ownership certificates when required and duly filed shall constitute and be treated as returns of information. (a) In the case of dividends on the stock of a nonresident foreign corporation paid to citizens or residents of the United States a return of information on Forms 1096 and 1099 shall be required if the amount thereof is \$1,000 or more in any taxable year. (b) In the case of interest items on bonds containing a tax-free covenant clause as to which the paying agent in this country is the source of information, the ownership certificate shall accompany the coupon to such agent or source of information, who shall forward the ownership certificate to the Commissioner accompanied by a monthly return on Form 1096 A. An annual return on Form 1096 B shall be forwarded to the Commissioner not later than March 15th of each year, on which shall be given a summary of the monthly returns. Where ownership certificate Form 1000 is used, a monthly return shall be made on Form 1012 and an annual return on Form 1013, as provided in articles 361-375. Forms 1012 and 1013, when so used, should be modified to show the name and address of the paying agent. The use of substitute certificates is not permitted in the collection of foreign items.

D. H. BLAIR,
Commissioner of Internal Revenue.

APPROVED: July 16, 1923.

McKENZIE MOSS,
Acting Secretary of the Treasury.

TREASURY DEPARTMENT
WASHINGTON

July 17, 1923.

My dear Senator:

I received your letter of July 14, 1923, with further reference to the question of authority to revoke allocations of silver for subsidiary coinage under the Act approved April 23, 1918, sometimes known as the Pittman Act. Your letter is limited to the technical question of authority, which is fully covered by the Comptroller General's decision of November 29, 1922. This decision was made upon a full statement of the case, and was rendered by the chief accounting officer of the Government, who has access to all the accounts and records in question. You have presented no new evidence, and I quite agree with you that it would be a waste of time to discuss the matter further. I take it that the Treasury's position in the matter is clear and beyond question. The action it has taken satisfies all the equities in the case, and the highest constituted authority has held that it was fully authorized as a matter of law. In these circumstances I should not feel warranted, as a public officer, in taking any different action, particularly when that would mean a loss of at least \$5,000,000 to the people of the United States.

I had already seen the resolution of the Board of Governors of the Western Division of the American Mining Congress to which you refer, and enclose for your information a copy of my letter of June 30, 1923, in reply to that resolution.

Very truly yours,

(Signed) S. P. GILBERT, Jr.

Acting Secretary of the Treasury.

Hon. Key Pittman,
Vice Chairman of the Senate Commission
of Gold and Silver Inquiry,
United States Senate,
Washington, D. C.

1 enclosure.

TREASURY DEPARTMENT
WASHINGTON

Inclosure to Memo
dated 7/17/23

June 30, 1923.

Dear Sir:

I have received your letter of June 26, 1923, enclosing a copy of a resolution adopted by the Board of Governors of the Western Division of the American Mining Congress at their annual meeting held at San Francisco, California, June 12, 13 and 14, 1923, with respect to the administration of the Act of Congress approved April 23, 1918, sometimes known as the Pittman Act. I note that the resolution urges the executive officers of the American Mining Congress, in conjunction with silver producers of the Western States, to take immediate steps to bring before the proper courts the "legality and propriety" of the cancellation by the Treasury Department of allocations of silver for subsidiary coinage under the Act, to the end that the question may be settled "regardless of the action of a department that is wrongfully endeavoring through widespread propaganda to deceive the people into believing that producers seek an unfair interpretation of the act." This resolution is quite obviously part of the campaign of misrepresentation that various interested parties have been carrying on for the past two or three months in an effort to make silver producers believe that they have been unfairly treated, and I am surprised that it would be adopted by the Board of Governors of the American Mining Congress without the slightest effort to ascertain the facts. The Treasury's action in respect to the allocations of silver for subsidiary coinage is clear and beyond dispute. It rests upon the

decision rendered November 29, 1922, by the Comptroller-General of the United States, which is conclusive and binding upon the Department, and is supported by every consideration of equity and common sense. The Treasury's position in the matter is set forth in my letters of May 9 and May 31, 1923, to Senator Pittman of Nevada, copies of which, with a copy of the Comptroller-General's decision, are enclosed herewith.

The Treasury Department is not engaging in any propaganda in this matter, and has no occasion to do so. It has taken action under the law, upon the advice of the highest constituted authority, and has stated its position in the clearest possible terms. Its action fully satisfies the purchase provisions of the Pittman Act and saves to the people of the United States at least \$5,000,000. It would be more becoming, it seems to me, if those who are trying to have this sum diverted out of the public Treasury to promote the special interests of the silver industry, would tell the truth in the propaganda which they are carrying on and present the case on its merits, without persistently misrepresenting the Treasury's attitude.

Very truly yours,

(Signed) S. P. GILBERT, Jr.

Acting Secretary of the Treasury.

J. F. Callbreath, Esq.,
Secretary, American Mining Congress,
Washington, D. C.

July 20, 1923.

(T. D. 3499)

Distribution out of earnings or profits accumulated prior to March 1, 1913.

Article 1543 of Regulations 62 amended; T.D. 3478 revoked and T.D. 3475 affirmed.

TREASURY DEPARTMENT
Office of Commissioner of Internal Revenue
Washington, D. C.

TO COLLECTORS OF INTERNAL REVENUE AND OTHERS CONCERNED:

Article 1543 of Regulations 62 is hereby amended to read as follows (the underlining is not a part of the amended Article, but is used to indicate the additions and changes made by the amendment):

ART. 1543. Distribution out of earnings or profits accumulated prior to March 1, 1913. - Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of increase in value of property accrued prior to March 1, 1913 (whether or not realized by sale or other disposition prior to March 1, 1913), is not a dividend within the meaning of the Act. The provisions of the preceding sentence shall be applied uniformly to cases arising under the Revenue Act of 1916, the Revenue Act of 1917, and the Revenue Act of 1918, as well as the Revenue Act of 1921. A corporation can not distribute earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, unless and until all earnings or profits accumulated since February 28, 1913, have been distributed. Whenever one corporation receives from another corporation distributions out of earnings or profits accumulated by such other corporation prior to March 1, 1913, or out of increase in value of its property accrued prior to March 1, 1913, and the "receiving" corporation, after having first distributed all of its earnings and profits accumulated since February 28, 1913, distributes to its stockholders the amount so received by it from such other corporations, the distribution by the "receiving" corporation to its stockholders is not a dividend within the meaning of the Act and is exempt from tax.

In determining whether a dividend is out of earnings or profits accumulated since February 28, 1913, or prior to March 1, 1913, due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive.

A distribution made by a corporation out of earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, is exempt from tax, even if in excess of the cost or other basis provided in articles 1561-1563 and 1568, of the stock on which declared. However, where any tax-free distribution out of earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, has been made, the distributee can not deduct any loss from the sale or other disposition of the stock unless, and then only to the extent that, the cost, or other basis, exceeds the sum of (1) the amount realized from the sale or other disposition of the stock, and (2) the aggregate amount of such distributions received by him thereon. The provisions of this paragraph are also applicable to a distribution by a "receiving" corporation made under the conditions set forth in the first paragraph of this article, and to the distributees in deducting any loss from the sale or other disposition of stock in the "receiving" corporation.

Example. - A purchased certain stock subsequent to March 1, 1913, for \$10,000 and received in 1921 a distribution thereon of \$2,000, paid out of the earnings or profits of the corporation accumulated prior to March 1, 1913. This distribution does not constitute taxable income to A. If A subsequently sells the stock for \$6,000 a deductible loss of \$2,000 is sustained. If he sells the stock for \$12,000, a taxable gain of \$2,000 is realized. No gain or loss is recognized if he sells the stock for an amount ranging between \$8,000 and \$10,000.

Under date of May 9, 1923, T.D. 3475 was approved, amending Article 1543 of Regulations 62 to provide substantially as above set forth. On May 14, 1923, no cases having been closed on the basis of T.D. 3475, T.D. 3478 was issued revoking T.D. 3475, and the question involved in the amendment was referred to the Attorney General for opinion. His opinion, dated June 21, 1923, has now been received, and is in entire accord with the amendment originally effected by T.D. 3475. Accordingly T.D. 3478 is revoked; T.D. 3475 is approved; and Article 1543 of Regulations 62 is amended to read as hereinabove provided.

D. H. BLAIR,
Commissioner of Internal Revenue.

APPROVED: July 20, 1923.

S. P. GILBERT, JR.,
Acting Secretary of the Treasury.

THE SECRETARY OF THE TREASURY
WASHINGTON

August 11, 1923.

SUPPLEMENTAL INSTRUCTIONS WITH RESPECT TO EXCHANGES,
REPLACEMENT, AND REDEMPTION OF UNITED STATES PAPER CURRENCY.

To the Treasurer of the United States,
Federal Reserve Banks and Others Concerned:

Section 17 of the Secretary's confidential instructions of August 30, 1920, with respect to exchanges, replacement, and redemption of United States paper currency, as amended February 7, 1921, is hereby further amended so as to read as follows:

PAYMENTS OF CURRENCY AND COIN UPON EXCHANGE, REPLACEMENT OR REDEMPTION. United States notes are redeemable in gold coin; Treasury notes of 1890 are redeemable in gold coin or standard silver dollars; gold certificates are redeemable in gold coin; and silver certificates are redeemable in standard silver dollars. Under the provisions of the act approved March 14, 1900, as amended, sometimes known as the Gold Parity Act, it is, however, the duty of the Secretary of the Treasury to maintain all forms of money issued or coined by the United States at a parity of value with the gold standard defined by the act, and the Treasury's general policy is to make payments of gold not only in cases where it is demanded against United States paper currency or other obligations redeemable in gold, but also when demanded against other forms of currency as well as in the ordinary course of Government payments. The Treasurer of the United States is acting under general instructions to pay out gold certificates with other forms of money in the ordinary course of business, without demand, particularly in denominations ranging from \$10 to \$1000, and it is desired that so far as possible the Federal Reserve Banks shall follow a similar policy, particularly in making payments on Government account or on exchange, replacement or redemption of United States paper currency. It is not the policy to encourage the circulation of gold coin, for this involves a considerable loss due to abrasion and it is not generally needed to meet the demands of business. Specific demands for the redemption of United States paper currency in coin must, however, be honored, and no obstacle should be interposed to the circulation of gold coin if demanded. Whenever gold coin is demanded Federal Reserve Banks should pay out therefor available (but, so far as possible, NOT new) gold coin in the denomination of \$20, avoiding the use of gold coin in the

denominations of \$2.50, \$5, and \$10 unless specifically demanded. Payments of standard silver dollars should be freely made whenever desired, whether or not silver certificates or Treasury notes of 1890 are presented for redemption, for the circulation of standard silver dollars in many sections of the country is desirable in order to meet the needs of business and reduce the demands upon the Treasury for paper currency in the \$1 denomination. In general, it is the policy of the Treasury to provide for payments of currency and coin at the Federal Reserve Banks on the same basis as at Treasury offices, and where the Federal Reserve Banks make payments in coin the Treasurer of the United States will make redemption in appropriate coin on request therefor by Federal Reserve Banks, upon surrender by them of United States notes, Treasury notes of 1890, gold certificates, or silver certificates. The expense of transportation of such coin will be paid from the appropriation "Contingent Expenses, Public Moneys", or such other appropriation as may be available, without application on the part of the Federal Reserve Banks. Where gold certificates are surrendered to the Treasurer of the United States the Treasurer will give appropriate credit therefor, upon request, in the Gold Settlement Fund. In cases where coin shipments are made, or where credit is given in the Gold Settlement Fund for gold certificates, Federal Reserve Banks will give corresponding credits for such amounts in the Treasurer's account as a transfer of funds.

S. P. GILBERT, Jr.,

Acting Secretary of the Treasury.

August 25, 1923.

My dear Senator:

I have recently received from the Secretary to the Commission the printed copies of the proceedings before your Subcommittee with respect to silver purchases under the Act approved April 23, 1918, sometimes known as the Pittman Act. In so far as these proceedings cover the question of allocations for subsidiary coinage, the Treasury's attitude has already been stated in my several letters to you. There are other questions, however, which you have raised in course of the proceedings and in your correspondence which should also be finally disposed of, and I am accordingly writing at this time to state the position which the Department takes with respect to these matters.

I take it from your letters and the hearings that you contend, in substance, that in making purchases of silver under the Pittman Act the Director of the Mint has not insisted upon sufficient deductions for metallurgical losses, and has thus, in effect, purchased a certain percentage of foreign silver. This is not true, as is clear both from the hearings and from the records and accounts of the Bureau of the Mint.

To consider this matter intelligently it is necessary to begin with the discussions which took place in May and June, 1920, when the market price of silver fell below \$1 an ounce and purchases of silver first had to be made under the Act. Under the first announcement of the Director of the Mint, dated May 17, 1920, and the affidavits prescribed thereunder, only unmixed silver could be purchased,

and silver into which any admixture of foreign silver entered would have to be rejected. This immediately led to protests, in which, as I recall you joined, on the ground that for metallurgical reasons most of the domestic production of silver had to be smelted and refined in conjunction with foreign silver and would come from the refineries as part of a mixed product of domestic and foreign silver, so that it would be barred from purchase under the Act if the Mint would only purchase unmixed silver. The inherent difficulty with accepting mixed silver in any form was, as you know, that it is always perfectly impossible to prove that any given piece of mixed silver is either domestic or foreign in origin, and the legal question, therefore, was whether a proportionate part of the mixed product could be regarded as silver which was the product of mines located in the United States and of reduction works so located, within the terms of the Act. This question was accordingly presented to the Comptroller of the Treasury for decision, by letter dated June 10, 1920, from the Secretary of the Treasury, of which a copy is enclosed for your ready reference. The Comptroller rendered his decision under date of June 12, 1920, holding that mixed silver could be purchased up to the proportionate part of the mixed product representing domestic silver and prescribing in general the nature of the proof that should be required and the method of accounting to be followed. On June 18th the Director of the Mint accordingly issued a further statement to the effect that he was 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 were provided, and subsequently more detailed regulations were issued, under date of August 30, 1920, carrying out the decision of the Comptroller of the Treasury and the method of accounting prescribed thereunder. Copies of the Comptroller's decision of June 12th and of the regulations of August 30, 1920, with exhibits, including forms of affidavits and the public statements of May 17 and June 18, 1920, are enclosed herewith for your ready reference. Supplemental regulations governing purchases of silver on this basis have been promulgated from time to time, and are already included in the record of proceedings before your Subcommittee.

In other words, the acceptance of mixed silver, up to the proportionate part of the mixed product representing domestic silver, was necessary to meet the practical situation in the silver industry if the purchase provisions of the Act were to be made effective, and it was authorized by the decision of the highest constituted authority. The decision having been made, regulations had to be promulgated to carry it out, and this meant establishing a practical plan for determining what proportionate part of the mixed product should be regarded as representing domestic production. Obviously, no given piece of mixed silver could, strictly speaking, be proven to be of either domestic or foreign origin, and it was therefore necessary to provide by regulation for apportioning the mixed product as between domestic and foreign content, first determining the proportion in which domestic silver entered into the mixture and then applying that proportion to the mixed product. This was done by regulations of the Director of the Mint, issued pursuant

to the express authority of the law, which provides that all purchases shall be made in accordance with the regulations of the Director of the Mint. These regulations have the force and effect of law, and are binding upon all concerned.

The regulations thus prescribed provided in detail for accepting the amounts of foreign and domestic silver entering into the mixed product, in accordance with the accounting methods prescribed by the Comptroller of the Treasury, and on the question of metallurgical losses provided expressly that "all silver lost in process must be apportioned between domestic and foreign silver for the purposes of settlement on account of silver purchased hereunder according to the amounts of domestic and foreign silver received for reduction as shown by the records" required to be filed by the vendors. In other words, exactly the same proportion has been applied in determining the deductions for metallurgical losses as in determining the part of the mixed product representing domestic silver. Metallurgical losses accordingly are required to be shown in the periodical reports rendered to the Director of the Mint, and are required to be deducted in the established proportion in determining the amount of silver purchaseable as domestic silver under the Act. This followed necessarily from the principles involved in the acceptance of mixed silver, and, as the testimony before your own Subcommittee shows, is regarded by the silver industry as fair and reasonable.

The contention which you advance, that the Director of the Mint, instead of following the plan actually adopted, should have made an arbitrary deduction of 5 per cent in all cases in order to cover metallurgical losses, and that not having made such an arbitrary deduction the Mint has, in effect, purchased 5 per cent in foreign rather than domestic silver, is entirely without merit. As already stated, the silver in

question is a mixture, so that it is quite as impossible to prove that any given piece is foreign silver as it is impossible to prove that any given piece is domestic silver. There had to be an apportionment of the mixed product, and the same method of apportionment has been consistently applied throughout, in determining what metallurgical losses are allocable to domestic silver as well as in determining what portion of the mixed product represents domestic silver. The proportionate part of the mixture ascertained to represent domestic silver, on this basis, is all domestic silver, under the regulations, for the purposes of purchases under the Act. These regulations of the Director of the Mint, moreover, have stood for over three years, during substantially the whole period of purchases under the Act, and have the force and effect of law. It is not material that another, and admittedly arbitrary, method of enforcing deductions for metallurgical losses might have been applied. The regulations of the Mint have all along prescribed a fair and consistent method of apportionment, and certainly no one has any standing to attack the regulations on that ground nearly three years after their issuance, when the silver industry generally had adjusted itself to the requirements of the Mint and nearly all purchases under the Act had been completed on that basis. For the same reason, it is entirely out of the question to adopt the proposal of the Anaconda Copper Mining Company, which was transmitted in your letter of June 18, 1923, that purchases now be reopened and an arbitrary deduction of 5 per cent made in all cases. The regulations of the Director of the Mint do not provide for any such 5 per cent deduction, and there is no basis, therefore, for making it. Such a deduction, moreover, at this time might operate most unfairly against some companies,

making little difference to companies like the Anaconda Copper Mining Company which deal almost exclusively in the product of their own mines, and operating very much to the prejudice of companies which do business as customs smelters and deal chiefly with the product of mines owned by others.

Apart from this, there is no reason in equity for making the 5 per cent deduction which you suggest. It is admitted on all sides that it has been the usual course of business for years before purchases under the Pittman Act began for smelters to make a 5 per cent treatment charge. The Treasury is not concerned with the equity of this charge, but only with the fact. The result to the miner is exactly the same whether this treatment charge is assessed as a separate charge and settlement made on the basis of 100 per cent of the silver content of his ore, or whether the charge is deducted and settlement made on the basis of 95 per cent of the ore. Apparently, the practice before purchases began under the Act was to make settlements on the basis of 95 per cent, and since that time to make settlements on the basis of 100 per cent, subject to a 5 per cent treatment charge. The miner gets the same result in either case, and the smelter, whatever the method of settlement, has admittedly bought 100 per cent of the ore, and not merely 95 per cent. The smelter is clearly the owner of all the ore thus purchased, and of all its silver content, and it is equally clear that with domestic ore all of the silver content is domestic silver, no matter what the basis on which settlement was made with the miner. Furthermore, under the method adopted after purchases began under the Act, the smelter has just as surely paid the miner on the basis of \$1 per ounce for the silver taken in payment of treatment charge as if it had paid 100 per cent for the silver and exacted a cash payment for the

treatment charge. In other words, the 5 per cent of silver is accepted in payment of the charge, and that silver is just as truly paid for as any of the rest. Under either system the silver content of the ore purchased is clearly domestic silver, and manifestly it must be taken into account, subject to such metallurgical losses as may develop, in determining the amount of domestic silver entering into the mixed product. Since both domestic and foreign silver enter into the mixture, it is impossible, of course, to make an exact separation between metallurgical losses on domestic silver and metallurgical losses on foreign silver, and these losses are, accordingly, apportioned between domestic and foreign silver according to the relative amounts of each entering into the mixture. The testimony before your own Subcommittee shows that metallurgical losses with some companies are extremely low, averaging less than 1 per cent, while with other companies metallurgical losses frequently average as high as two or three per cent or even more. Whatever the losses may prove to be, deduction is required to be made for them, in the proper proportion, in the settlements with the Mint for purchases under the Act.

It is not for the Mint to say, of course, whether a low rate of losses indicates that the treatment charge collected by the smelter is too high. That is a matter between the smelter and the miner, and the Mint cannot properly interfere with the course of business between them. In this connection it is worth while to point out further that there is no requirement whatever in the Act to the effect that settlement has to be made with the miner on the basis of \$1 per ounce. The Act is perfectly silent on the subject. This requirement was made by the Treasury, and has throughout been enforced in an effort to see that the benefits of the Act go to the

American miner, for whom they were supposedly intended. The regulations which the Director of the Mint adopted are reasonably calculated to accomplish this purpose, and all purchases of silver under the Act are supported by at least 100 per cent of affidavits from American miners certifying that settlement has been made with them for their silver at the rate of \$1 per ounce, 1000 fine. Miners' affidavits to this effect are also on hand, or before purchases are completed will have to be filed with the Mint, in an amount sufficient to cover all metallurgical losses which have to be deducted. Where metallurgical losses are relatively small, as with the American Smelting & Refining Company, this means only a small amount of affidavits over and above the actual sales of silver to the Director of the Mint, while with other companies which have relatively large metallurgical losses there will have to be a correspondingly larger amount of miners' affidavits for this purpose. This explains the variations in the amounts of affidavits to which you refer.

So much for the question of metallurgical losses. As to ore bearing what is called a "trace of silver", I do not understand that any serious question arises. The amount involved is relatively insignificant in any event, and in all cases where it does not satisfactorily appear to the Mint that this silver results from domestic ore, with settlement therefor on the usual basis, the silver is treated as foreign silver, and therefore operates to the prejudice of the vendor in settlements with the Mint. This I understand from the records is what actually happens with the Anaconda Copper Mining Company, the United States Smelting, Refining and Mining Company, and other companies selling silver to the Mint, silver recovered from ore bearing a trace of silver being treated as foreign silver for purposes of accounts with the Mint. Apart from this, assuming the ore to be domestic ore even the trace of silver would be domestic silver and properly tenderable under the Act.

The other question which you have raised from time to time, namely, as to the policy of accepting tenders of silver for future delivery, I have already covered in my letter of May 9, 1923, a copy of which is enclosed herewith for your ready reference. I have not understood from any of your statements that you ~~ever~~ had any other policy to suggest in this regard in any event. It would not have been possible to do business under the Act on any other basis, and if the Mint had not at all times been prepared to accept tenders for future delivery, miners generally would have had to wait for months before getting settlements for their silver on the basis of the fixed price of \$1 per ounce. This would have operated most unfairly to the prejudice of small miners, except possibly those in Nevada whose ore could readily be reduced to dore bullion, and it would certainly have been an arbitrary policy to pursue, since the Mint has always been able to protect itself on acceptance for future delivery by not making payment without actual delivery of the bullion, supported by the necessary affidavits as to domestic origin from both vendors and miners.

As to the winding up of purchases, the Director of the Mint, by public statement dated May 29, 1923, of which a copy is enclosed for your ready reference, announced that in order to avoid any possibility of accepting excessive tenders and at the same time to assure the most equitable treatment to the American producers of silver, the Mint would not accept any further tenders of silver under the Act until a sufficient examination had been made of the tenders already received to indicate the precise amount of silver remaining to be purchased. At the same time the Director of the Mint announced that the Mint would continue to receive tenders under the Act until the close of business June 15, 1923, filing such tenders in the order of their receipt, and that as soon as the amount remaining to be purchased

had been definitely determined the Mint would accept all tenders up to such amount in the order of their receipt, in accordance with the general regulations governing purchases, all tenders in excess of that amount to be rejected. This procedure made it possible for the Bureau of the Mint to check up all tenders received and accept them in proper order, thus avoiding any difficulties in winding up purchases under the Act. Pursuant to this announcement the Mint stopped receiving tenders under the Act at the close of business June 15, 1923. It has since accepted tenders which were received before that date and temporarily held in suspense up to the amount necessary to meet the requirements of the Act. Unaccepted tenders to the amount of 3,072,267 ounces are still held in suspense by the Mint, thus giving an adequate margin to take care of such further adjustments as may prove to be necessary as deliveries are received and final check is made of the proofs tendered in support of the purchases. Actual deliveries of silver up to July 31, 1923, have been made in the amount of 190,314,579 ounces, leaving approximately 10,257,000 ounces of additional deliveries to be made before purchases are completed.

Purchases of silver by the Mint under the Act receive an independent audit by the accounting officers of the Government, and as soon as deliveries are complete this audit can be concluded and operations under the Act finally determined. All purchases have to be supported by the proof required by the regulations and all affidavits and other supporting papers presented in connection with sales of silver to the Mint are first given an administrative examination by the Bureau of the Mint and then transmitted in the regular course to the General Accounting Office, where they receive a final audit to make sure that the purchases conform to the law and the regulations. Any tenders which are found not to be supported

by the necessary proof are rejected in the first instance, and if a subsequent audit shows that any of the proof is defective the Mint is, of course, in a position to require the transaction to be reversed and if there is any evidence of fraudulent dealing to take steps looking toward the prosecution of the fraudulent parties.

As I understand the results of the audit which has been had up to date there has not yet been discovered any evidence of fraud, but there has been every indication that vendors of silver to the Mint have been careful to support all their transactions with the required proof. If your Subcommittee have any evidence of improper dealings in connection with sales of silver to the Mint under the Act, the Treasury would be glad if you would present it, in order that any tenders which may be insufficiently supported may be rejected and the proper United States Attorney advised of any fraudulent misrepresentations that may have been made. If, on the other hand, you have no evidence of fraud to present but are suspicious of the companies, I suggest that the way is open to the Commission to bring the representatives of the various companies before it under regular subpoenas and get their direct testimony as to their transactions under the Act.

After reviewing all the testimony before your Subcommittee, and your letters in this matter, I cannot help but feel that much of the same misunderstanding runs through the whole discussion as underlies the original resolution designating the Subcommittee and describing you as "the author" of the Act. The facts are that the bill was originally prepared by the Treasury and the Federal Reserve Board, that it was drawn to meet an emergency situation which had arisen in

India, that it was not in any sense a bill to relieve the silver industry, and that it was passed through both Houses of Congress as a war measure, by the practically unanimous action of both parties and signed by the President all within about a week of its introduction. It was presented before the Banking and Currency Committees of both the Senate and the House of Representatives by the officers of the Treasury and the Federal Reserve Board who had drawn the bill, and throughout its course was handled as a non-partisan measure, designed to meet a war emergency. As it happened, the bill, as finally drawn, was handed to you by the former Director of the Mint to be introduced in the Senate, and in accordance with the usual custom in such matters is sometimes given your name. Even the provision requiring silver purchased under the Act to be the product of mines situated in the United States and of reduction works so located, was not inserted at your instance but was added to the bill on the floor of the Senate by amendment proposed by Senator Fall of New Mexico. Aside from this the bill was a Treasury bill, and the Treasury, which is also charged with its administration, through the Bureau of the Mint, may therefore speak with peculiar authority as to both its purpose and administration.

The Treasury has administered the Act throughout with the utmost fairness and impartiality, and with every regard for the proper interests of the silver industry as well as the interests of the United States. Operations under the Act have now ceased and except for the

final deliveries and the final check of the accounts this chapter in our war history is closed.

Very truly yours,

S. P. GILBERT, Jr.
Under Secretary.

Hon. Key Pittman,
Vice-Chairman of the Senate Commission
of Gold and Silver Inquiry,
United States Senate,
Washington, D. C.

Address of Wm. S. Moorhead, Chairman of
the Tax Simplification Board, before the American Bar
Association at Minneapolis, August 31, 1923.

"What is the matter with the Income Tax Unit?", is a question that is being asked from the Atlantic to the Pacific and from the Mexican Border to Canada. The answers vary from a disclaimer that anything is the matter, on the part of some of the insiders, to the assertion that the present organization can never carry on its work in a satisfactory manner or complete it within a reasonable time, on the part of an aggrieved taxpayer. "Speed up the audit of returns", says one; "Decentralize the Unit", suggests another; "Amend the Act", insists a third.

In attempting to say what is the matter with the Income Tax Unit, I would not have you consider me a representative of the Government, or attribute my remarks to the Treasury Department. The Tax Simplification Board is composed of three persons appointed by the President to represent the public, of whom I am one, and three persons appointed by the Secretary of the Treasury from the Bureau of Internal Revenue. Those of us representing the public conceive it to be our duty to maintain the view point of the taxpayers and since they constitute less than seven percent of the public, the attitude of the people at large. The primary trouble is with the Revenue Act, or rather, the Revenue Acts; for the Bureau is now administering the Acts of 1917, 1918, and 1921. The yoke imposed by previous revenue laws was easy and its burden comparatively light. Our Government entered the World War in the Spring of 1917 - "and it came to pass in those days, that there went out a decree from Caesar Augustus, that all the world should be taxed."

Congress was concerned in securing revenue, getting it quickly and taking it where it could be found. Being engaged in a colossal war, our representatives did not philosophize upon the theory of taxation, gave little consideration to administrative difficulties and considered not the vexation of the public. The public itself in those days paid their taxes cheerfully and without stint. Our present tax laws are the inheritance of those days. A few evenings ago, in considering - not without qualms - what I should say to this enlightened association, I went back to first principles and pulled down Adam Smith's "Wealth of Nations". That classic was completed about the year "the embattled farmers fired the shot heard 'round the world." For the last century and a half it has been the foundation on which economists have builded. He lays down four maxims applicable to tax legislation, which may be paraphrased as follows:

1. Taxpayers should contribute as nearly as possible in proportion to their respective abilities.

2. The tax ought to be certain and not arbitrary.

3. The tax ought to be levied at a time and in a manner most likely to be convenient for the contributor to pay it.

4. Every tax ought to be so contrived as to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury.

Let us see how the Revenue Act of 1921 squares with these maxims. As the result of exemptions and delinquencies, only about 6% of the population pay income taxes. Some citizens well able to contribute to the expense of the Government escape a large measure of taxation by investment in tax exempt

securities. This is, of course, largely attributable to our form of Government. It is possible, however, in my opinion, that the Act could have been so drawn as to eliminate a considerable measure of the preference incident to tax exempt securities. Deductions from income being allowed by Congress as a matter of grace, some of them, particularly losses and interest, could be limited to the amount whereby those items exceed the income received from tax exempt securities. The iniquity of these securities consists in their tendency to create a tax exempt class of persons who are able to buy and hold them and to withdraw their capital from business enterprises which would produce income liable to taxation.

Generally speaking, earned incomes pay a proportionately higher rate of tax than unearned incomes due largely to deductions that are available to persons whose income is derived from the ownership of property. This statement is subject to some qualification, but I believe it is generally true. It is a question, however, entirely too large even to touch upon here and now. The justice of a measure of relief in favor of earned incomes seems to be generally admitted. The difficulty would arise in the administration of the relief, involving as it would a determination of what is earned income. Salaries, wages, and fees manifestly constitute earned income. What is to be done in the case of the corner grocer, whose income is due partly to capital and partly to personal services? Many other instances of the difficulty in allocating income either to capital or labor will occur to you. Of course, the corner grocer may solve his difficulties by incorporation, but this is an unsatisfactory answer. Theoretically, the line should be drawn between

real earned and real unearned income, but practically it is impossible. It is my view that any relief in favor of earned income must be confined to earnings which are not derived in whole or in part from capital or in which the employment of capital is not necessary and is only incidental. Otherwise, such a provision would be impossible of satisfactory administration. The fact that absolute justice can not be obtained should not stand in the way of affording relief which will reach the great majority of cases and which may be availed of in others with little trouble.

I do not believe that their most ardent defender would assert that the income and profits tax laws are certain. So many matters are left within the discretion of the Commissioner of Internal Revenue, which must of necessity be exercised through his subordinates. It seems just to provide that a reasonable allowance shall be made for the exhaustion, wear, and tear of property; that a reasonable deduction shall be allowed for the amortization of war facilities; that a reasonable allowance shall be made for depletion, and that the tax imposed in Section 220 shall not be incident unless the Commissioner certifies that in his opinion the accumulation of gains and profits is unreasonable for the purposes of the business. It appears to be fair to assess a tax on the excess profits of a corporation based upon its invested capital; to allow a paid-in surplus when it is shown to the satisfaction of the Commissioner that tangible assets have been transferred to a corporation substantially in excess of the par value of the stock issued therefor, and to provide in exceptional cases that the tax paid by a corporation shall bear the same ratio to its net income that the average tax of representa-

tive corporations bears to their average net incomes. When we come to the administration of these apparently just provisions, what do we encounter?

What reasonable allowance shall be made for depreciation is a matter of judgment and is, therefore uncertain. Honest differences of opinion are bound to arise among the taxpayer and the Government officials, and, indeed, between those officials themselves. The reasonable deduction for the amortization of war facilities involves questions as to what are war facilities and as to what extent they are used in post-war activities. The reasonable allowance for depletion requires the valuation as of March 1, 1913, of all the coal, ore, oil, gas and other natural deposits in the United States acquired before that date and operated for profit. Most of these resources are under the ground. The valuation of the railroads by the Interstate Commerce Commission has been going on for years and yet that problem is easy compared with the valuation of property which can not be seen. The Excess Profits tax law was repealed by the Revenue Act of 1921. Its administration, however, is still going on with respect to unaudited returns for the years 1917 to 1921 inclusive. The determination of invested capital and paid-in surplus has not only proved to be complex, but has resulted in discriminations between taxpayers situated substantially alike. Old and conservatively managed companies have written off items against current earnings, which under management less conservative would have been added to the property account, thus increasing the invested capital. The discrimination which results from the imposition of the tax in such cases is manifest. Of the four divisions of the Income Tax Unit dealing with the audit of returns,

namely, the Personal Audit, the Corporation Audit, the Special Audit and the Natural Resources Divisions, the latter two are engaged primarily in the solution of the complex problems arising out of these reasonable, but uncertain, provisions of the Act. As may well be imagined, while the Personal Audit Division will probably become reasonably current with the work in the not too distant future, and while the Corporation Audit Division is fairly well in hand, the Special Audit and the Natural Resources Divisions are staggering under an apparently ever-increasing burden. There is a ray of hope for them, however, in the fact that when the problems of valuation and of invested capital are determined for the earlier years, the computations for the later years is greatly facilitated. The Commissioner has gathered together in these divisions groups of able men, but their task is an herculean one.

The inclusion in taxable income of profit realized from the sale of capital assets and the allowance as a deduction of the loss sustained on their sale requires the valuation as of March 1, 1913 of capital assets acquired before that date and upon which a profit has been realized or loss sustained. The administrative difficulties of such a computation are manifest. Capital gains are not taxed as income in England. The imagination is stretched in considering them a recurring flow of income upon which an income tax should be levied, just as it is in considering capital losses a recurring outgo, which should be allowed as deductions. The Supreme Court of the United States has held that Congress may tax such gains under the Sixteenth Amendment. Congress, however, is not obliged to tax this species of income and could, of course, eliminate capital losses as deductions. The Government actuary has expressed the opinion that if capi-

tal gains had been eliminated as income and capital losses as deductions, at the outset, the revenue of the Government would have been considerably increased. By this time the supply of old losses has been considerably diminished and there is a question as to whether or not both capital gains and capital losses could be eliminated without impairing the public revenues. Such a step would greatly simplify the administration of the law. A provision of this kind would not, and should not relieve the trader or dealer in capital assets from including in capital income the profits made by him or deprive him of the right to deduce his business losses.

The proximate cause of the difficulties with which the Bureau is now confronted is that in drafting and enacting tax legislation, too little attention has been given to tax administration.

The Income Tax is certainly not levied at a time when it is convenient to pay it. The tax according to the computation of the taxpayer on his return of income is payable, generally speaking, a year after he receives the income upon which the tax is levied. Would that I might stop here. Additional taxes are assessed upon the Government's investigation of the taxpayer's income and its computation of the tax, after applying the various rules of reason already mentioned, at any time or times from a year to five years after the income is earned. These additional assessments frequently come when the taxpayer has spent or lost the income upon which the tax is assessed. As I have said, the main trouble is with the provisions of a law which of necessity require time for the computation of the tax with a reasonable degree of accuracy. The Bureau, however, can not escape entire responsibility for the delay, heavy as its burden may be. Before I

was appointed a member of the Tax Simplification Board I had often expressed the opinion that the Government was endeavoring to attain too high a degree of accuracy in such cases, for instance, as involve fixing the value of property or determining the amount of depreciation. It requires no argument to demonstrate that 100% of accuracy is unattainable. Perhaps 90% of accuracy is obtainable by an audit within a given length of time and with a certain amount of work. The additional 10% of accuracy requires not only the same length of time and the same effort, but a far greater length of time and effort as the approach is made towards absolute accuracy. Eventually the law of diminishing return comes into play and the additional percentage of accuracy is not worth the time and effort to attain it. In addition to this, the Government loses the interest upon the revenue which it would receive in the event of prompt additional assessments which must further and considerably lessen the advantages of near absolute accuracy. The inconvenience to the taxpayer in paying the tax increases in something like geometrical progression to the delay in assessing it. Taxpayers are required to maintain unproductive reservations of capital until the end of the period of limitations and the loss of income resulting from this source alone must be enormous. To my mind a considerable percentage of accuracy can be sacrificed on the altar of promptitude.

Adam Smith says that a tax may take out or keep out of the pockets of people more than it brings into the public treasury in four ways: First, by the expenses incident to its collection. While the cost of collecting the internal revenue is large in amount, aggregating for the year 1922 about \$35,000,000, the cost was a little over one percent of the amount collected. It must be remembered, however, that much of this tax is assessed by the taxpayer upon himself in his return and paid by him at the time of the filing

thereof, or in quarterly installments thereafter. It would be interesting to know how much it costs to collect the additional taxes assessed less the credits and refunds allowed. I have never seen any statistics on this point.

The second way mentioned is by taking from productive industry the persons engaged in collecting the tax. The total personnel in the Income Tax Unit proper, not counting the employees in the Collectors' offices, amounts to 8,318. There are 6477 persons employed in the various Collectors' offices, making a total of 14,795 employed in the assessment and collection of the income and profits taxes.

The third way in which a tax may be unproductive is by the imposition of penalties ruinous to the taxpayer. Speaking of such penalties Adam Smith says:

. "The law, contrary to all the ordinary principles of justice, first creates the temptation, and then punishes those who yield to it; and it commonly enhances the punishment too in proportion to the very circumstance which ought certainly to alleviate it, the temptation to commit the crime."

I am firmly of the belief that penalties should be imposed in cases of intentional evasions and fraudulent returns, but only in clear cases. The presumption of innocence should obtain and there should be absence of reasonable doubt before the penalty is imposed. This, I believe, is the attitude of the Bureau. While ignorance of the law does not excuse, it should certainly palliate. Penalties for neglect should only be imposed where there is absence of ordinary care under the circumstances and it is my experience, generally, that ordinary care is rather a low degree of care.

Lastly, a tax may be objectionable by subjecting the people to frequent visits and odious examinations of tax-gatherers. A new provision in the Revenue Act of 1921 reads as follows:

"That no taxpayer shall be subjected to unnecessary examinations or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Commissioner, after investigation, notifies the taxpayer in writing that an additional inspection is necessary."

It is important both from the standpoint of the taxpayer and the Government that this provision should be carried out in spirit as well as in letter.

So much for the difficulties inherent in the administration of the Income Tax Laws.

The work of the Income Tax Unit is seriously impeded by totally inadequate housing conditions. It is quartered in five buildings. The Commissioner of Internal Revenue has his office in the Treasury Building. The Deputy Commissioner in charge of the Unit and various other administrative officers have their offices in Annex No. 1, at Pennsylvania Avenue and Madison Place; the Personal Audit, Corporation Unit and Special Audit Divisions are quartered in Annex No. 2, at Fourteenth and B Streets; The Sorting Section is located at Sixth and B Streets; the Rules and Regulations Sections at Twentieth and B Streets; the Natural Resources Division, the Solicitor of Internal Revenue and the Committee on Appeals and Review are housed in the Interior Department Building at Eighteenth and F Streets. The close personal contact so much to be desired in an organization of this kind is almost impossible when the various divisions and sections are so widely scattered.

Several floors of the Arlington Building at Vermont Avenue and H Street were originally intended for the Internal Revenue Bureau. This Building is sufficient in size to accomodate the entire Bureau. It is occupied at present by the Veterans' Bureau. It would be a measure of the first magnitude if Congress should provide an adequate building for the Income Tax Unit or make other provisions for the Veterans' Bureau and turn over the Arlington Building to the Bureau of Internal Revenue.

It requires no demonstration to show that the administration of the Income and Profits tax laws is a man-size job. In the fiscal year 1922, the receipts of revenue from those taxes amounted to over \$2,000,000,000. The complex character of the Act to be administered has already been discussed. The total personnel in the Income Tax Unit and the Collectors' offices is over 15,000. In view of this situation it is absurd to burden the Commissioner with the enforcement of the liquor and narcotic laws; yet so it is. If the Department of Justice is not the proper arm of the Government to enforce these laws, they should be put under a separate Bureau.

Figures show the size of the task that was suddenly dumped on the Commissioner of Internal Revenue in 1917. Prior to that year the burden had been light. In 1866 the receipts from the income tax law of 1861 amounted to \$72,982,159. This was the largest amount collected in any year under that law. In the fiscal year 1914, the receipts from the income tax law of 1913 amounted to \$71,381,275. In the year 1917, receipts from this tax amounted to \$359,681,228. In the year 1918, the receipts from the income and profits tax law of 1917 amounted to \$2,838,999,894. In the year 1920, the receipts under the income and profits tax law of 1918 amounted to \$3,956,936,004. In 1922, receipts from the revenue law of 1921 amounted to \$2,086,918,465. The amount of

internal revenue received from all other sources during the fiscal year 1922 amounted to \$1,121,239,843. Many provisions of the Revenue Law of 1917 were new and the force had to be educated in the law and trained in its administration. In order to secure uniformity of decisions under and application of the law, it was necessary to employ a considerable force at Washington. This was the original plan in this establishment, rather than the collection of the tax. It was contemplated at that time that as soon as the interpretation of the law should be settled, the work of administering it and collecting the tax would be carried out largely through the Collectors' offices.

Not only have the receipts grown, but the number of returns on which taxable income is reported has increased almost twenty fold from 1916 to 1920, due largely to the lowering of the personal exemptions. There were 437,036 income returns filed in the year 1916; in the year 1917 they increased to 3,473,890, and in 1920 they amounted to 7,259,944.

Exact figures are not available showing the increase in personnel in the income tax unit and their distribution in Washington or in the field during the period we are discussing. In 1913 the administrative force in the entire Internal Revenue Bureau at Washington consisted of 277 persons, while the field force numbered 3723. The total force in that year engaged in income tax administration, both in Washington and in the field, with the exception of employees in Collectors' offices, amounted to under 400 persons. In 1918, the entire personnel in the Bureau at Washington numbered 2245, and the field force 7257. In this year it is estimated that the total personnel at Washington and in the field employed in the income tax unit alone amounted to something over 2100 persons, of whom about 585 were at Washington and approximately 1540 in the field. The total number of persons employed in the income tax unit now amounts to about 8318 persons, of whom 3064 are in the field and 5254 are in

Washington. In addition to those employed in the income tax unit, probably about 6500 persons are employed in the various Collectors' offices.

These figures not only show the great increase in the number of persons employed in the administration of income and profits tax laws, but show, also, that the increase in the force at Washington has been, actually and comparatively, much greater than in the field. The process was one of centralization.

Personal income tax returns showing a net income of \$5,000 or less are left in the various Collectors' offices and are audited there. Work on this class of returns is practically current. Personal income tax returns disclosing net income of more than \$5,000, and all corporation returns, are sent to Washington. As a result of this procedure, approximately 1,200,000 income tax returns are forwarded to Washington each year. The completion of the audit of these returns is discouragingly in arrears. Only about 63,000 returns for the year 1921 have been audited, and those for 1922 are practically untouched. The audit of 674,642 returns for the years 1917 to 1920 inclusive, has not been completed. These returns are distributed over the four years as follows:

<u>Year</u>	<u>Returns</u>
1917	28,916
1918	84,324
1919	103,198
1920	458,205

These figures are taken from the Statement of Progress for the three months ending June 30, 1923. Although a considerable amount of work has been done in the audit of these returns, they involve very large amounts of tax and questions so difficult of solution that they have not been solved in all this time.

At the instance of our Board, an investigation is now being conducted by a man trained in business organization for the purpose of expediting the audit of returns, the disposition of claims, the elimination of unnecessary steps, and the fixing of responsibility. It is hoped that the result of his recommendations will materially increase the production of the Unit.

The very size of the task and the spread of the work over the entire country forces upon our consideration the advisability of decentralization. In the year 1863, when the Income Tax Law of 1861 was being administered, the Field Service personnel amounted to 3822, and the force at Washington to 60. A striking feature of this division compared with that at the present time is the smallness of the force at Washington. At the present time there are 34 Internal Revenue offices in various sections of the United States, each under a Revenue Agent in Charge, who reports directly to the Income Tax Unit at Washington. While this field force makes examinations when instructed so to do from Washington, they have no power to settle and determine cases and can only report their findings to the Income Tax Unit at Washington, where the tax is settled. There seems to be no reason to believe that the audit of returns by accountants could not be carried on in a number of different offices just as well as it is being done at Washington. Personal contact with the taxpayer would eliminate lengthy and unsatisfactory correspondence. Valuations could be arrived at with far greater expedition where the object of the valuation could be seen than by the application of formulae and rules of thumb at a great distance. While a collection of experts located at one place has some advantages and may in some instances insure a greater degree of accuracy, the examination in the field would prevent the Government from being imposed upon and in many instances would result in more reasonable valuations. As I have

already said, this attempt to arrive at absolute accuracy is one of the causes of the Bureau being so far behind in the audit of returns. The great majority of taxpayers are honest, but in doubtful cases, they naturally interpret the laws in their favor. The investigation by the Bureau should be designed to protect the Government, not to squeeze out the last dollar of tax. To accomplish the latter is impossible, and to attempt to do so is unprofitable.

If decentralization of the work of the Bureau were attempted it is presumed that District offices under the control of the Commissioner of Internal Revenue and under the supervision of his appointees would be established in various parts of the country. It would seem to be practicable that an Assistant Solicitor of Internal Revenue be connected with each District office to advise on points of law arising during the audit of returns. New questions of law could be referred to the Solicitor himself at Washington. Groups of the Committee on Appeals and Review could go on circuits of the District offices and hear appeals arising in those localities. Recommendations of the Committee should clear through the Chairman at Washington and be referred to the Commissioner for approval in the ordinary course. Such a practice would secure uniformity of decisions.

During the war, the War Department at first attempted to handle all of its activities in Washington. The result was such an accumulation of work and slowing up of progress that the Department was forced to decentralize its activities. This action was accompanied by marked expedition in the handling of work. In commenting upon the situation the Ordnance Department said, "All circumstances call for decentralization - the indicated solution for any problem, be it political, commercial, or industrial, in which size is the predominant factor".

The advantage to the taxpayer in decentralization is manifest. His taxes would be settled at or reasonably near to his place of business. Trips to Washington and the employment of counsel there would be unnecessary. Decentralization will require no amendment to the Act, should it be decided upon. Such a move, however, will meet with strenuous opposition in many quarters.

While complete and immediate decentralization is quite out of the question, the advantages which might accrue certainly warrant an experiment along that line. It could first be applied in respect of personal returns and if successful could be extended to corporation returns. It might be found advisable to continue the audit of consolidated returns of corporations at Washington.

Objection is often raised to decentralization on the ground that it would throw the administration of the Income Tax Laws into politics. This might be true if decentralization were carried out through the Collectors' offices. Such procedure, however, is entirely unnecessary and, in my opinion, inadvisable unless Collectors' offices are placed under the Civil Service laws. The various district offices could be placed directly under the Commissioner just as the Internal Revenue Agents in Charge are under him at this time.

The problem of decentralization is one that has been considered by our Board for some time. The first experiment therein was made by sending a group of the Committee on Appeals and Review to hear cases arising in this locality. That Committee is now in Los Angeles.

In pursuance of its statutory duties, the Tax Simplification Board has made a number of recommendations looking to the simplification of the pro-

cedure followed and forms used in the Bureau, most of which have been adopted and put in force. It would be tedious to describe them in detail. The following recommendations made this year may be noted briefly:

First: The clarification and simplification of the procedure on appeals to the Committee on Appeals and Review.

Second: The abolishing of ownership certificates in connection with bond interest, except in respect of bonds containing tax free covenant clauses. These certificates were found to be productive of little additional tax and to be a source of annoyance to the public. It is impossible under the law and in justice to the obligor to abolish them in connection with bonds containing tax free covenant clauses.

Third: The adoption of a simple form of return on one sheet for taxpayers whose net income is less than \$5,000 and is derived chiefly from one source. This return will be of benefit to the great majority of taxpayers next year.

Fourth: The strict requirement that cases once closed be not reopened except in cases of fraud or gross error.

Fifth: The examination by a man trained in business organization of the processes in the audit of returns and the adoption of his recommendations designed to speed up the work, eliminate unnecessary steps and fix responsibility.

Sixth: Experiments in decentralization.

The most effective way of simplifying the income tax law and procedure is by reducing the rates. Where the rate of taxation is high, every question becomes one of importance, is strenuously insisted upon by the taxpayer, and requires careful, and frequently minute, examination by the

Government.

Acting within the scope of my appointment, I have dealt with some of the problems arising out of the administration of the tax laws. These are the troubles of the income tax unit. The economic aspects of taxation I have discussed only incidentally. Presumably, Congress will have before it the question of taxation at its next session. This Association and its members will be influential in the course of future legislation. May I, therefore, again impress on you the importance of giving careful consideration to tax administration in any future tax legislation.

(COPY)

DEPARTMENT OF JUSTICE

Washington.

October 3, 1923.

Sir:-

I have your letter of August 30, 1923, requesting my opinion on the power of national banking associations to open and operate offices at places other than their banking houses for the performance of such routine services as the receipt of deposits and cashing of checks for their customers. You request to be advised whether:

(1) Assuming that a national banking association is without power to establish and maintain a branch bank for carrying on a general banking business, has it the corporate power to open and operate an office or offices at a place or places other than its banking house, for the performance of such routine services as the collection of deposits and cashing of checks for its customers?

(2) If a national banking association has the corporate power to open and operate such an office or offices, must they be located within the city limits of the place designated in the organization certificate of the association as the place where its operations of discount and deposit would be carried on?

The statutes relating to national banking associations, so far as they are material to our present inquiry, are Sections 5133, 5134 (Par. 2), 5136 (Par. 6 and 7), and 5190, R.S. The material parts of said statutes read as follows:

"Sec. 5133. Associations for carrying on the business of banking under this title may be formed by any number of natural persons, not less in any case than five. They shall enter into articles of association, which shall specify in general terms the object for which the association is formed,

and may contain any other provisions, not inconsistent with law, which the association may see fit to adopt for the regulation of its business and the conduct of its affairs."

"Sec. 5134. The persons uniting to form such an association shall, under their hands, make an organization certificate, which shall specifically state:

*** *** ***

Second. The place where its operation of discount and deposit are to be carried on, designating the State, Territory, or district, and the particular county and city, town, or village."

"Sec. 5136. Upon duly making and filing articles of association and an organization certificate, the association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power -

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Sixth. To prescribe, by its board of directors, by-laws not inconsistent with law, regulating the manner in which the stock shall be transferred, its directors elected or appointed, its officers appointed, its property transferred, its general business conducted, and the privileges granted to it by law exercised and enjoyed.

Seventh. To exercise by its board of directors, or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidence of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes, according to the provisions of this Title."

"Sec. 5190. The usual business of such national banking associations shall be transacted at an office or banking house located in the place specified in its organization certificate."

The provisions of Section 5190 R.S., as to the place at which the usual business of the bank shall be transacted refers to the city or town in which the bank is located and not the particular place within the city. *McCormick v. Market Nat'l Bank*, 165 U. S. 538, 549.

National banks have only those powers specified in the National Banking Acts, and such other powers as are necessarily incidental thereto. *McBoyle v. Union Nat'l Bank*, 122 Pa. 458; *First Nat'l Bank v. Nat'l Exchange Bank*, 92 U.S. 122,127; *Logan Co. Nat'l Bank v. Townsend*, 139 U.S. 67,73; *Bullard v. Bank*, 18 Wall, 589,593.

In *Bullard v. Bank*, supra, the Supreme Court said:

"The extent of the powers of national banking associations is to be measured by the Act of Congress under which such associations are organized."

In *Logan Co. Nat'l Bank v. Townsend*, supra, the court said:

"It is undoubtedly true, as contended by the defendant, that the National Banking Act is an enabling act for all associations organized under it, and that a national bank cannot rightfully exercise any powers except those expressly granted by that act, or such incidental powers as are necessary to carry on the business of banking for which it was established."

It is to be observed that section 5190 R.S., relates to the "usual business" which, in my opinion, is to be construed the general banking business usually conducted by national banks. There is no statutory requirement that all the business of a national bank shall be transacted at the general office or banking-house of the association.

In my opinion, a national banking association may establish in the city or place designated in its certificate of organization an office or offices for the transaction of business of a routine character, which does not require the exercise of discretion, and which may be legally transacted by the bank itself. It may not, however, establish a branch bank to do a general banking business such as is usually done by national banks. The establishment of such a branch would be illegal, and subject the offending bank to the forfeiture of its charter. 29 Op. 81.

It seems to be the intent of the national banking act that the business of banking ordinarily transacted by a national banking association shall be performed in the city or place designated in its organization certificate.

It has been held that a national bank cannot make a valid contract for the cashing of checks upon it, at a different place from that of its residence, through the agency of another bank. *Armstrong v. Second Nat'l Bank*, 38 Fed. 883,886.

While national banking associations may exercise all the powers expressly given them by the statute, and such additional powers as may be necessary to carry on the business of banking, the manner in which the powers may be exercised are subject to the supervision of the Comptroller of the Currency. Should the Comptroller, in the exercise of his supervisory powers over national banks, ascertain that the directors or officers have knowingly violated, or are violating the National Banking laws, he may proceed against such association, its officers and directors as provided by Section 5239, R.S., which reads as follows:

"If the directors of any national banking association shall knowingly violate, or knowingly permit any of the officers, agents, or servants of the association to violate any of the provisions of this Title, all the rights, privileges and franchises of the association shall be thereby forfeited. Such violation shall, however, be determined and adjudged by a proper circuit, district or territorial court of the United States, in a suit brought for that purpose by the Comptroller of the Currency, in his own name, before the association shall be declared dissolved. And in cases of such violation, every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person, shall have sustained in consequence of such violation."

Answering your specific questions I have the honor to advise you as follows:

First: National banking associations have the power to open and operate offices at places other than their banking-houses, within the place specified in their organization certificate, for the performance of such routine services as the receipt of deposits and the cashing of checks for their customers.

Second: National banking associations have no authority to open offices for the purpose of receiving deposits, paying checks, etc., outside of the limits of the city or place designated in the organization certificate as the place of its operations of discount and deposit.

Respectfully,

H. M. Daugherty

Attorney General.

The Honorable,

The Secretary of the Treasury.

Address before

Investment Bankers Association

by Garrard B. Winston

Assistant Secretary of the Treasury

Washington, October 30, 1923.

The story of Government finance, the science involved, the methods used, and the constantly recurring money questions, would be the history of the country. I can but give you a rough outline of what the United States owes, and how it expects to pay its debts and conduct its current business, with a few suggestions as to the direct effect of governmental policies on investment bankers.

Like most anything else in the present world, the war brought a complete new set of problems to Government finance. Without going into the history of war financing, it may be stated briefly that at the commencement of the war the public debt of the United States aggregated something over one billion dollars, consisting principally of the 2% Consols of 1930, 4% loan of 1925, and certain Panama Canal bonds. During the war and until expenditures could be cut in the period succeeding it, the debt of the United States was raised to $25\frac{1}{2}$ billion dollars as of June 30, 1919. The peak of the debt was somewhat in excess of $26\frac{1}{2}$ billion in August of that year, but for comparison I have used the end of a fiscal year since it gives a clearer view to use a date somewhere near a quarterly tax payment date, when the temporary borrowings of the Government are not excessive.

During the war, expenditures were so large that it was necessary that the Government have always available a working cash balance of substantially

$1\frac{1}{4}$ billion dollars. This balance was obviously much too large for peacetime operations, and one of the first and most natural things for the Government to do after the war was to use the balance in the reduction of debt. During the fiscal year 1920 the debt of the Government, as appears from the Treasury Daily Statement, was reduced by \$1,185,000,000, of which three-fourths came from reduction in the working cash balance. In 1921 there was a further reduction of debt of \$322,000,000, in 1922 of \$1,014,000,000, and last year of \$614,000,000 -- a total reduction up to July 1, 1923, of \$3,135,000,000, and a reduction from the peak of August 1919 of over 4 billion. Up to September 30, 1923, there has been a further reduction of the debt by \$225,000,000. Truly a remarkable record for four years, but realization of war assets and reduction of balances had a very material effect and hereafter these factors will be of little importance.

The present funded debt of the United States consists of approximately the original one billion dollars of pre-war debt, nearly \$15,000,000,000 of the four Liberty Loans, \$760,000,000 of the $4\frac{1}{4}\%$ Treasury bonds of 1947-52, \$4,000,000,000 of Treasury notes maturing in the next four years, about \$1,000,000,000 of Treasury certificates maturing in less than a year, and a third of a billion dollars of Treasury savings securities -- a total debt, as shown by the Daily Treasury Statement, of \$22,100,000,000. It is in the handling of this debt and in the current operations of the Treasury that the problems of Government finance are presented.

The influences which affect the amount of debt are of first importance.

Prior to 1920 there was no consistent policy in the reduction of public debt. It is true there was a sinking fund but it was only available if appropriations were specifically made therefor, and practically little was done prior to the war. Of course, during the war there could be no thought of debt payment.

In the Victory Loan Act, however, Congress established the present cumulative sinking fund. This fund was calculated to retire the war debt, less the amount of foreign government obligations held by the United States on July 1, 1920, in about 25 years. In other words, the sinking fund was so figured that it would retire about 10 billion dollars of debt within the period, and it was expected that foreign governments would repay our loans to them and thus extinguish the balance of the debt. The sinking fund consists of an initial credit of $2\frac{1}{2}\%$, or approximately \$250,000,000, and a secondary credit equal to the interest which would have been paid on bonds or notes which have been retired from the sinking fund if these bonds or notes had been outstanding during the year. The fund for the current fiscal year is \$300,000,000; for 1925 it will be \$311,000,000, and by 1937 it will exceed \$500,000,000 yearly. You can see that it mounts very rapidly. Of course, this means no increase in the total amount devoted to debt service, since the larger sinking fund represents interest saved.

The settlement of the foreign debt has progressed only to the point of an accomplished refunding agreement with the British Government.

Cuba has repaid her debt and Finland's agreement is before Congress. The British agreement fixed the debt and accumulated interest at \$4,600,000,000, and provided for payments of approximately \$160,000,000 per year for the first ten years and \$180,000,000 for the next 52 years, when the debt will be extinguished. These sums represent both principal and interest, principal payments increasing as the interest payments decrease. The British Government may make its payments in United States securities at par. So long, therefore, as any obligations of the United States can be acquired in the market below par, we may expect to receive our own securities and not cash. This is an advantage in expediting payment of the public debt, because under the law the United States securities received are cancelled.

Under the Act of March 3, 1881, any surplus revenues in the Treasury at the end of a fiscal year are applied to the reduction of the public debt. It is for this reason that, whereas you may hear of surpluses in Government operation, there is actually no increase in Government cash, but the money goes into the capital account and is not in the Government's pocket to use as income.

In addition, the right to pay estate taxes in Government securities under certain conditions has a small influence on debt reduction. During the year 1923 about \$6,000,000 worth were turned in and cancelled, and in the same year \$10,000,000 franchise taxes from Federal Reserve Banks, as required by law, were also used in making retirements. Of course, as other foreign nations make agreements requiring actual payment of what they owe us they will hasten the extinguishment of our debt.

Eliminating, however, the question of general foreign debt payment and not relying on surplus revenues, which are uncertain, but based solely on the sinking fund as at present constituted and the British refunding scheme as executed, it is believed that the public debt should be substantially retired by 1952, which year happens to be the maturity date of the last maturing funded obligation of the United States, the Treasury $4\frac{1}{2}$'s. There are many contingencies which affect this estimate, but it is safe to assume that a plan of refunding that part of the maturing debt, which cannot be presently met, to maturity dates within the next thirty years is a sound policy to be pursued.

By relying on the Treasury's ability to control securities purchased for the sinking fund, it is possible to reduce the earlier maturities and to make them more manageable. The Treasury, however, cannot affect the selection of securities by the British Government, and obviously during the present state of the market, the earlier maturities -- being higher priced -- will not be used by the British Government in making its payments.

To take the problem presented by the next five years, there mature in that period \$4,000,000,000 of notes and \$3,400,000,000 of Third Liberties -- a total of \$7,400,000,000. The sinking fund will take care of \$1,620,000,000. There is, therefore, nearly \$6,000,000,000 of

Government refunding to be done in the next five years, not in one lot, but during the period. What form these offerings will take cannot be determined now, but will depend on the condition of the money market at the time the offerings are made. It is to be remembered that these will be purely refunding operations, and do not mean that the Government will need new money from the investment market.

The other phase of Treasury financing is the current quarterly issuance of Treasury certificates. These normally aggregate about \$1,000,000,000, and at present there are outstanding \$370,000,000 maturing December 15, next, and \$570,000,000 maturing March 15, next. Treasury certificates are short-term securities having a year or less to run and becoming payable on the different quarterly income tax payment dates. These certificates are sold quite generally to the banks upon a basis of payment by credit. For example, if a bank should purchase for itself or for its customers \$1,000,000 in Treasury certificates, it would make no immediate payment of cash but would credit the Government on its books with \$1,000,000. From time to time, as the Government requires funds in its checking account with the Federal Reserve Banks, it draws on this credit. This means the acquisition of Government deposits by the banks at a cost of simply 2% interest and, depending upon the length of time within which the deposit remains with the bank, is sometimes a very valuable privilege.

Again the war can be given as the origin of this type of financing. During sales of Liberty bond issues, disbursements sometimes ran about \$2,000,000,000 a month. Temporary financing was continuous and issues came out as frequently as once every two weeks. Besides furnishing temporary relief to the Government, these certificates were designed to anticipate Liberty Loan issues and also to enable the taxpayer to have easy means of accumulating funds to meet the large tax payments, for which purpose they were generally used. Owing perhaps to the fact that taxes are not now so high, this tax use seems to be diminishing and gradually the certificates have taken on a somewhat different character.

With a more evenly balanced income and outgo, the Treasury might reduce the amount of Treasury certificates continually outstanding. While the cost of short-time financing varies, being sometimes above and sometimes below funded debt, I do not suppose, on the whole, the certificates will cost the Government more than an equivalent amount of bonds. However by having some certificates mature on every tax payment date, when large sums of money are pouring into the Treasury from the public, and by redemption for cash

and resale of certificates on credit, the Treasury has been able to make use of simple machinery to prevent any stringency in the money market. The tax payments might be handled without the certificates, but not easily.

Treasury certificates, and to them are added from time to time notes and bonds as they approach their maturity, play a most important part in the American financial structure. The certificates are in large amounts of short maturities and have a very wide market. No continuing decline in price need be anticipated, for the holder has but to wait a short period and he is paid at par. These certificates now constitute for the banks a secondary reserve, and they are, and properly so, treated as current assets practically on the same basis as cash. When a bank needs money, it sells certificates and reacquires them as its condition changes. They constitute collateral for borrowings from the Federal Reserve Banks. Corporations use them generally for their idle funds before dividend or tax payment dates. They are the best test of the price of money. So long as they serve this need of the banking world, the Treasury will be slow to eliminate them from its plans.

While effort has been made to place these certificates with small purchasers and preference is always given to subscribers in small amounts in allotments, I do not believe the certificates compete in any serious degree with bond offerings. Their term is too short and their value for other purposes than straight investment constitutes too great a part of their market price.

I have brought before you these elements of Treasury operation, refunding of debt, short-term financing, and payment of debt. With the first you are only concerned in that our offerings do not disturb the market. Refunding should take from you no customers. With the second, again, it is only collaterally you are affected, for the certificates are a banking and not an investment subject. But in the third -- debt payment -- you are vitally interested.

For its influence on the prosperity of your business, the question you ask, is: Will the Treasury in its operations contribute to or take from the supply of money which, like a great irrigation reservoir, exists here in America and from which you draw your customers? We cannot guarantee the future. If new extraordinary expenditures are authorized, new financing may be necessary or debt reduction slowed up or stopped, but under conditions as they now exist I see no future drain by the Treasury. We have drawn, and drawn deeply, from that reservoir in the past, but only during the war. To be able ourselves to draw, we have had to increase the drainage area of the reservoir by the education of the small investor.

During this fiscal year the United States will spend \$300,000,000 in purchasing for cash its own securities for retirement. This means that each month holders of \$25,000,000 of securities will have paid back to them their principal and will be looking to you for new investments. In like manner, \$160,000,000 a year of United States securities will be purchased by the British Government from holders here and turned in for retirement. The effect of pouring nearly half a billion dollars every year back into this reservoir for you to use must be encouraging to you. It is truly bread upon the water returned to you. During the

war you sacrificed your own profits to sell Government securities. Now with normal conditions permitting, you will receive the ultimate reward for your labors in the available investment funds you yourselves have helped to create.

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

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, November 10, 1923.

DEAR MR. GREEN:

In accordance with the request which you made shortly after the adjournment of Congress, the Treasury has been engaged for the past few months in considering the possibilities of tax revision and in developing recommendations for the simplification of the law. The situation has developed more favorably than was anticipated, and I am now presenting to you a comprehensive program to which I hope the Committee on Ways and Means will be able to give consideration at the outset of the legislative session.

The fiscal years 1922 and 1923 have each closed with a surplus of about \$310,000,000 over and above all expenditures chargeable against ordinary receipts, including the sinking fund and other similar retirements of the debt. This has been possible only through the utmost cooperation between the Executive and Congress, as well as among the executive departments and establishments, all of whom have united in a sincere effort to reduce the expenditures of the Government. At the same time there has been a substantial amount of realization upon securities and other assets remaining over from the war, and the Treasury has succeeded in collecting customs and internal revenue taxes in amounts somewhat exceeding original expectations. The result is that the Government of the United States is firmly established on the basis of having balanced its budget each year since the cessation of hostilities, with a reasonable surplus each year after providing for fixed debt charges like the sinking fund, and stands squarely committed to the policy of including these fixed charges on account of the public debt in its ordinary budget each year, thus assuring an orderly reduction of the war debt out of current revenues.

What has been done during the two years since the establishment of the budget system shows clearly what united effort can accomplish, and gives every reason for hope that the task to which the Administration has set itself for this fiscal year can be successfully performed, namely, the reduction of the ordinary expenditures of the Government to a total of not more than \$3,500,000,000, of which about \$500,000,000 will be fixed charges on account of the sinking fund and other retirements of the debt. To do this means reductions of about \$170,000,000 in the estimates of expenditures submitted by the spending departments and establishments and the exercise of continued pressure all along the line for the utmost economy and efficiency in the operations of the Government.

Having these things in mind, the Treasury has been canvassing the estimates for the present fiscal year and for the succeeding fiscal years with a view to determining on the one hand what further reductions in expenditure it would be safe to count on in developing a tax-revision program, and on the other hand what receipts might reasonably be expected on the basis of existing law, assuming that no changes were to be made in internal taxes. In doing this it has had to keep in mind that under present conditions receipts from customs are abnormally high and that surplus war supplies have now been for the most part liquidated, leaving relatively little to expect on this account in the years to come. It has also had to keep in mind that many of the internal revenue taxes, as, for example, the higher brackets of the surtax, are so rapidly becoming unproductive that it is unsafe to assume that even with no changes in the law the revenues from internal taxes would be maintained. After taking into account all these considerations, and making the most conservative estimates about the yield of existing taxes and the possibilities of further reductions in expenditure, it appears that for this year, and for the next four or five years, there should be a surplus of

something over \$300,000,000 a year over and above all expenditures chargeable to the ordinary budget, including the fixed debt charges payable out of current revenues. This gives a reasonable margin not merely for tax revision but also for tax reduction.

On this basis the Treasury has the following recommendations to make:

1. *Make a 25 per cent reduction in the tax on earned income.*—The fairness of taxing more lightly income from wages, salaries and professional services than the income from a business or from investment is beyond question. In the first case, the income is uncertain and limited in duration; sickness or death destroys it and old age diminishes it. In the other, the source of the income continues; it may be disposed of during a man's life and it descends to his heirs. It is estimated that this amendment will mean a loss in revenue of about \$97,500,000 a year, the greater part of which falls in the lower income brackets.

2. *Where the present normal tax is 4 per cent reduce it to 3 per cent, and where the present normal tax is 8 per cent reduce it to 6 per cent.*—This affects all personal incomes and the loss of revenue comes largely from the lower brackets. It is estimated that this will mean a loss in revenue of \$91,600,000 a year.

3. *Reduce the surtax rates by commencing their application at \$10,000 instead of \$6,000, and scaling them progressively upwards to 25 per cent at \$100,000.*—This will readjust the surtax rates all along the line, and the Treasury recommends the readjustment not in order to reduce the revenues but as a means of saving the productivity of the surtaxes. In the long run it will mean higher rather than lower revenues from the surtaxes. At the outset it may involve a temporary loss in revenue, but the Government Actuary estimates that even during the first year, if the revision is made early enough, the net loss in revenue from all the changes in the surtaxes would be only about \$100,000,000, and that in all probability the revenue from the reduced rates will soon equal or exceed what would accrue at the present rates, because of the encouragement which the changes will give to productive business.

The readjustment of the surtaxes, moreover, is not in any sense a partisan measure. It has been recommended, on substantially this basis, by every Secretary of the Treasury since the end of the war, irrespective of party. The present system is a failure. It was an emergency measure, adopted under the pressure of war necessity and not to be counted upon as a permanent part of our revenue structure. For a short period the surtaxes yielded much revenue, but their productivity has been constantly shrinking and the Treasury's experience shows that the high rates now in effect are progressively becoming less productive of revenue. See Table II, hereto attached. The high rates put pressure on taxpayers to reduce their taxable income, tend to destroy individual initiative and enterprise, and seriously impede the development of productive business. Taxpayers subject to the higher rates can not afford, for example, to invest in American railroads or industries or embark upon new enterprises in the face of taxes that will take 50 per cent or more of any return that may be realized. These taxpayers are withdrawing their capital from productive business and investing it instead in tax-exempt securities and adopting other lawful methods of avoiding the realization of taxable income. The result is to stop business transactions that would normally go through, and to discourage men of wealth from taking the risks which are incidental to the development of new business. Ways will always be found to avoid taxes so destructive in their nature, and the only way to save the situation is to put the taxes on a reasonable basis that will permit business to go on and industry to develop. This, I believe, the readjustment herein recommended will accomplish, and it will not only produce larger revenues but at the same time establish industry and trade on a healthier basis throughout the country. The alternative is a gradual breakdown in the system, and a perversion of industry that stifles our progress as a nation.

The growth of tax-exempt securities, which has resulted directly from the high rates of surtax, is at the same time encouraging extravagance and reckless expenditure on the part of local authorities. These State and local securities will ultimately have to be paid, principal and interest, out of taxes, thus contributing directly to the heavy local taxation which bears so hard on the farmers and small property owners. There is no immediate remedy for this within the power of Congress except the readjustment of the surtaxes on a

basis that will permit capital to seek productive employment and keep it from exhausting itself in tax-exempt securities. The productive use of capital in our railroads and industries will also tend to bring lower costs for transportation and manufactured products, thus helping to relieve the farmer from the maladjustment from which he now suffers.

4. *Limit the deduction of capital losses to 12½ per cent of the loss.*—The present revenue law limits the tax on capital gains to 12½ per cent but puts no limit on the capital losses. It is believed it would be sounder taxation policy generally not to recognize either capital gain or capital loss for purposes of income tax. This is the policy adopted in practically all other countries having income tax laws, but it has not been the policy in the United States. In all probability, more revenue has been lost to the Government by permitting the deduction of capital losses than has been realized by including capital gains as income. So long, however, as our law recognizes capital gains and capital losses for income tax purposes, gain and loss should be placed upon the same basis, and the provision of the 1921 Act taxing capital gains at 12½ per cent should be extended to capital losses, so that the amount by which the tax may be reduced by the capital loss will not exceed 12½ per cent of the loss. It is estimated that this will increase the revenues by about \$25,000,000.

5. *Limit the deductions from gross income for interest paid during the year and for losses not of a business character to the amount the sum of these items exceeds tax-exempt income of the taxpayer.*—The 1921 Act provides that interest on indebtedness to acquire or carry tax-exempt securities is not deductible. This provision is ineffective because a taxpayer may purchase tax-exempt securities for cash and borrow money for other purposes. It is felt also that so long as a taxpayer has income which is not reached for taxation, he should not be permitted to deduct his non-business losses from the income which is taxable, but should be restricted in the first instance to a deduction of these losses from his non-taxable income. The estimated increase of revenue from this source is \$35,000,000.

6. *Tax community property income to the spouse having control of the income.*—In some States the income of the husband is a joint income of the husband and wife, and each, therefore, is permitted to file a return for one-half of the income. This gives an unfair advantage to the citizens of those States over the citizens of the other States of this country, and this amendment seeks to restore the equality. It is estimated that it will increase revenues by \$8,000,000.

So much for the income tax recommendations, which should become effective January 1, 1924. In order that you may have before you a clear view of the effect of these recommendations as applied to incomes in the various brackets, I am attaching a table, prepared by the Government Actuary, showing the estimated results of the proposed changes in the calendar year 1925, on the basis of the taxable year 1924. The schedule shows a loss of revenue of about \$92,000,000 in the brackets under \$6,000, and a further loss of revenue of about \$52,000,000 in the next bracket of \$6,000 to \$10,000. In short, about 70 per cent of the reduction would be in the brackets of \$10,000 or less, and less than 5 per cent would fall in the brackets over \$100,000.

To show the effect of the proposed changes on the income of a typical salaried taxpayer, married and having two children, I call your attention to the following comparative figures:

Income	Present tax	Proposed tax	Saving to taxpayer
\$4,000	\$28.00	\$15.75	\$12.25
5,000	68.00	38.25	29.75
6,000	128.00	72.00	56.00
7,000	186.00	99.00	87.00
8,000	276.00	144.00	132.00
9,000	366.00	189.00	177.00
10,000	456.00	234.00	222.00

7. *Repeal the tax on telegrams, telephones, and leased wires.*—This is the last of the transportation taxes established during the war, is a source of inconvenience to every person using the telephone or telegraph, and should now be eliminated from the tax system. This would mean a loss in revenue of about \$80,000,000 a year.

8. *Repeal the tax on admissions.*—The greater part of this revenue is derived from the admissions charged by neighborhood moving picture theaters. The tax is, therefore, paid by the great bulk of the people whose main source of recreation is attending the movies in the neighborhood of their homes. This would mean a loss in revenue of about \$70,000,000.

9. *Miscellaneous nuisance taxes.*—Your Committee may wish to consider the elimination of various small miscellaneous taxes which have an inconsiderable bearing on the general revenue of the Government, but which are a source of inconvenience to taxpayers and difficult to collect; and possibly there are some articles of jewelry which according to our standard of living can not properly be denominated luxuries, such as, for instance, ordinary table silver or watches, which you may wish to exempt from the general tax on jewelry. There is not enough margin of revenue available to permit the repeal of the special taxes which are proving productive, but the law could be revised to good advantage and some of the nuisance taxes repealed without material loss of revenue.

10. In addition to the specific recommendations which directly affect Government revenues, there should be amendments to strengthen the Act and eliminate methods heretofore used by taxpayers to avoid imposition of the tax. The exact amount of additional revenue to the Government which will be brought in by these amendments can not be estimated, but certainly the amendments will reach much income that heretofore has escaped taxation.

11. *Establish a Board of Tax Appeals in the Treasury but independent of the Bureau of Internal Revenue, to hear and determine cases involving the assessment of internal revenue taxes.*—This will give an independent administrative tribunal equipped to hear both sides of the controversy, which will sit on appeal from the Bureau of Internal Revenue and whose decision will be conclusive on both the Bureau and the taxpayer on the question of assessment. The taxpayer, in the event that decision is against him, will have to pay the tax according to the assessment and have recourse to the courts, while the Government, in case decision should be against it, will likewise have to have recourse to the courts, in order to enforce collection of the tax.

12. Changes should be made in the present law to simplify administration, make the law more easily understood, and permit a prompt determination of liability in a manner more satisfactory to the taxpayer.

In order that you may see the effect on Government revenues of the above recommendations, I submit the following figures as to the estimated result of these changes:

	Decrease (in mil- lions of dollars)	Increase (in mil- lions of dollars)
Reduction of 25% in tax on earned income.....	97	
Reduction in normal tax.....	92	
Readjustment of surtax rates.....	102	
Capital loss limited to 12½%.....		25
Interest and capital loss deductions limited.....		35
Community property amendment.....		8
Repeal of telegraph and telephone tax.....	30	
Repeal of admissions tax.....	70	
TOTAL	391	68
	68	
NET LOSS	323	

The benefits of the reduction will be distributed among all classes of taxpayers, and the revision generally will help to free business and industry of vexatious interference and encourage in all lines a more healthy development of productive enterprise.

The present burden of taxation is heavy. The revenues of the Government are sufficient to justify substantial reductions and the people of the country should receive the benefits. No program, however, is feasible if the Government is to be committed to new and extraordinary expenditures. The recommendations for tax reduction set forth in this letter are only possible if the Government keeps within the program of expenditure which the Bureau of the Budget has laid down at the direction of the President. New or enlarged expenditures would quickly eat up the margin of revenue which now appears to be available for reducing the burden of taxation, and to embark on any soldiers' bonus such as was considered in the last Congress or any other program calling for similarly large expenditure would make it necessary to drop all consideration of tax reduction and consider instead ways and means for providing additional revenue. A soldiers' bonus would postpone tax reduction not for one but for many years to come. It would mean an increase rather than a decrease in taxes, for in the long run it could be paid only out of moneys collected by the Government from the people in the form of taxes. Throughout its consideration of the problem the Treasury has proceeded on the theory that the country would prefer a substantial reduction of taxation to the increased taxes that would necessarily follow from a soldiers' bonus, and I have faith to believe that it is justified in that understanding. Certainly there is nothing better calculated to promote the well-being and happiness of the whole country than a measure that will lift, in some degree, the burden of taxation that now weighs so heavily on all.

Very truly yours,

A. W. MELLON,
Secretary of the Treasury.

HON. WILLIAM R. GREEN,
*Acting Chairman, Committee on Ways and Means,
House of Representatives,
Washington, D. C.*

TABLE I.—Estimated effect upon the revenue of the proposed changes in the individual income tax law.

Income tax brackets.	Number paying tax in each bracket.	Loss in tax when all changes are in full effect. On income for calendar year 1924; tax collected 1925.						
		Normal tax.	Surtax.	Earned income at 75 per cent of rates.	Capital losses provision.	Certain deductions limited to nontaxable income.	Community property provision.	Net reduction in tax collected.
		(Loss.)	(Loss.)	(Loss.)	(Gain.)	(Gain.)	(Gain.)	
\$1,000-\$2,000	7,308,200	\$64,500,000		\$31,250,000	\$1,000,000	\$2,000,000		\$92,750,000
\$2,000-\$4,000	4,658,200							
\$4,000-\$6,000	1,158,200							
\$6,000-\$10,000	558,200	16,100,000	17,500,000	20,000,000	500,000	1,000,000		52,100,000
\$10,000-\$20,000	228,200	2,000,000	4,400,000	14,000,000	500,000	1,500,000	\$140,000	18,260,000
\$20,000-\$50,000	80,200	1,300,000	10,100,000	25,000,000	1,000,000	2,500,000	2,520,000	30,380,000
\$50,000-\$100,000	16,500	4,500,000	21,100,000	6,875,000	2,000,000	3,000,000	3,830,000	23,645,000
\$100,000-\$150,000	3,620	1,300,000	11,100,000	106,000	4,000,000	6,000,000	1,510,000	996,000
\$150,000-\$200,000	1,430	550,000	6,600,000	69,000	3,000,000	3,500,000		719,000
\$200,000-\$300,000	840	450,000	7,400,000	56,000	3,000,000	3,500,000		1,406,000
\$300,000-\$500,000	380	400,000	8,100,000	50,000	3,500,000	3,500,000		1,550,000
\$500,000-\$1,000,000	150	300,000	7,200,000	44,000	3,000,000	4,000,000		544,000
Over \$1,000,000	30	200,000	8,300,000	50,000	3,500,000	4,500,000		550,000
Gain					\$25,000,000	\$35,000,000	\$8,000,000	
Loss		\$91,600,000	\$101,800,000	\$97,500,000				\$222,900,000

This table shows the estimated gain or loss in revenue over that estimated under the present law, due to the proposed changes in the Revenue Act of 1921, and allows for the estimated increase in incomes by reason of the readjustment of taxes.

The figures opposite each income tax bracket cover the total estimated receipts within that bracket.

TABLE II.—Table showing decline of taxable incomes over \$300,000.

Year.	Number of returns.		Net income.		Dividends and interest on 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	5,832,760	679	19,859,491,448	440,011,589	3,954,553,925	314,984,884
1920	7,259,944	395	23,735,629,183	246,354,585	4,445,145,223	229,052,039
1921	6,662,176	246	19,577,212,528	153,534,305	4,167,291,294	155,370,228

Secretary Mellon's letter to Representative Andrew
on the cost of the Bonus Bill vetoed by President Harding.

December 18, 1923.

My dear Congressman:

I have your letter of December 10, 1923, in which you submit as the cost of a bonus three tables which appeared in the report of April 20, 1922, from Senator McCumber, of the Committee on Finance of the Senate. A fair representation should, of course, include the fourth year, when the Government is required to take over its burden which under the bill is placed for three years upon the banks of the country. These figures are not estimates of the Treasury Department. The Government Actuary, at the request of Senator McCumber, did the mechanical work of calculating the cost based upon the assumptions given him for that purpose by Senator McCumber. The bill in the form submitted never passed the Congress, and, therefore, no necessity for correction of or comment upon the tables arose. The figures you quote from the veto message of President Harding were made by the Government Actuary based upon the same assumptions as those given him by Senator McCumber applied to the bill in the form it was submitted to the President. In his message President Harding said:

"The Treasury estimates, based on what seems the most likely exercise of the options, figures the direct cost at approximately \$145,000,000 for 1923, \$225,000,000 for 1924, \$114,000,000 for 1925, \$312,000,000 for 1926, making a total of \$795,000,000 for the first four years of its operation and a total cost in excess of \$4,000,000,000. No estimate of the large indirect cost ever has been made. The certificate plan sets up no reserve against the ultimate liability. The plan avoids any considerable direct outlay by the Government during the earlier years of the bill's proposed operations, but the loans on the certificates would be floated on the credit of the Nation. This is borrowing on the Nation's credit just as truly as though the loans were made by direct Government borrowing, and involves a dangerous abuse of public credit. Moreover, the certificate plan of payment is little less than certified inability of the Government to pay, and invites a practice in sacrificial barter which I can not sanction.

"It is worth remembering that the public credit is founded on the popular belief in the defensibility of public expenditure as well as the Government's ability to pay. Loans come from every rank in life, and our heavy tax burdens reach, directly or indirectly, every element in our citizenship. To add one-sixth of the total sum of our public debt for a distribution among less than 5,000,000 out of 110,000,000, whether inspired by grateful sentiment or political expediency, would undermine the confidence on which our credit is builded and establish the precedent of distributing public funds whenever the proposal and the numbers affected make it seem politically appealing to do so."

In order that I may answer your question, the Treasury Department has considered the soldiers' bonus bill in the form in which it was vetoed by President Harding. Taking up each of the three options, the total direct cost if 100% of those entitled to the benefits of the bonus accept farm and home aid, would be \$2,068,662,305, and the average cost for the first four years would be \$475,000,000 a year. If 100% should take the vocational training aid, the total cost would be \$2,318,022,451, of which \$1,300,000,000 would be in the first year and \$1,000,000,000 in the second year. If 100% should choose the certificate plan, the total direct cost (including an estimate of \$23,000,000 a year for the first twenty years for administration), would be \$5,400,526,444, and the average for the first four years would be about \$225,000,000 a year. Senator McCumber assumed that 75% would take the certificate plan, 22½% the farm loan and home aid plan, and 2½% the vocational training plan. He also assumed that a certain amount would be borrowed on the certificates. With the passage of almost two years since the original assumptions were made, it is believed that a more probable estimate now is that there would be 90% who should choose the certificate plan, 9% the farm loan and home aid plan, and 1% vocational training. Since the obvious purpose of the bill is to permit borrowing, it is clear that greater recourse would be had by the certificate holders to this privilege. Account has also been taken of the savings to the Govern-

ment by probable failure on the part of at least 100,000 men to receive or redeem their certificates. Based on these estimates, the total direct cost of the bonus would be \$5,085,833,687, and an average for the first four years of over \$250,000,000 a year. A table is attached showing the amounts to be paid each year.

It has been the policy of the United States to make preparation to meet large principal payments coming due at a period in the future by use of a sinking fund, and no other policy is sound. The twentieth year of the bonus would see requirements of nearly \$3,000,000,000. If this sound policy be continued, it is estimated that with some borrowing by the Government during the fourth and fifth years, twenty-one payments of \$211,476,357 each from 1924 to 1944, both inclusive, if paid annually, would meet the cost of the bonus up to 1944, leaving a balance of about \$650,000,000 coming due in the later years to be met by new legislation.

Your letter of December 10, 1923, calls attention to a statement appearing in my letter of November 10th to Mr. Green, to the effect that "A soldiers' bonus would postpone tax reduction, not for one, but for many years to come. It would mean an increase rather than a decrease in taxes." This is well justified. You must add to the direct cost of \$250,000,000 a year for the first four years of the bonus and the average of \$211,000,000 per year for the first twenty years, the enormous indirect cost to the Government. The bill gives the right in the first three years to borrow from the banks of the country and that this right would be exercised by the great majority of the certificate holders none denies. The consequent demand for credit would raise the interest rates which the Government as well as the general public will have to pay on borrowed money. At the same time the mere passage of the bill would depress the price of Government bonds and increase

their basis of return. In such a money market the Government would have to take care of the \$8,000,000,000 of its securities which mature within the next five years, and to do so would, of course, have to meet the higher rate of interest. The continuing cost of an increase in interest rates on such a volume of refunding would be very large. The Government, like every other person in the United States, would also have to conduct its business at greatly increased expense due to the higher price level generally which would inevitably follow the credit expansion and decrease production brought on by the bonus law. Soon the disturbance to business by this and other factors would reduce the income of the people and thus the Government's revenue, so that any estimated surplus would no longer exist and recourse would have to be had to additional taxes.

It must be obvious to any impartial mind that a new obligation of the United States made in time of peace to pay over \$5,000,000,000, of which \$1,000,000,000 comes in the first four years, and an average drain on the Treasury for twenty years of \$211,000,000 a year, which is one-fifth of the total pre-war cost of Government, cannot be undertaken without serious economic consequences. If such a commitment is made, any reduction of Federal taxes upon a comprehensive plan will probably not be seen in this generation.

Very truly yours,

(Signed) A. W. MELLON

Secretary of the Treasury.

Hon. A. Piatt Andrew,

House of Representatives.

1 enclosure.

ESTIMATED ANNUAL DIRECT COST OF THE BONUS TO THE GOVERNMENT.
90% CHOOSING THE CERTIFICATE PLAN, 9% THE FARM AND HOME AID
PLAN, AND 1% VOCATIONAL TRAINING. UPON BASIS OF GOING INTO
FORCE JANUARY 1, 1924.

YEAR :	CERTIFICATE PLAN :	FARM AND HOME AID :	VOCATIONAL TRAINING :	TOTAL :
1924 :	\$65,229,002 :	\$67,500,000 :	\$13,000,000 :	\$161,729,002 (1)
1925 :	56,336,378 :	45,000,000 :	10,000,000 :	111,336,378
1926 :	56,495,781 :	36,000,000 :	180,224 :	92,676,005
1927 :	639,045,183 :	22,500,000 :	- - - - - :	661,545,183
1928 :	124,312,372 :	9,000,000 :	- - - - - :	133,312,372
1929 :	34,530,257 :	6,179,661 :	- - - - - :	40,759,918
1930 :	120,342,607 :	- - - - - :	- - - - - :	120,342,607
1931 :	84,714,548 :	- - - - - :	- - - - - :	84,714,548
1932 :	58,085,381 :	- - - - - :	- - - - - :	58,085,381
1933 :	58,563,589 :	- - - - - :	- - - - - :	58,563,589
1934 :	50,042,904 :	- - - - - :	- - - - - :	50,042,904
1935 :	50,621,846 :	- - - - - :	- - - - - :	50,621,846
1936 :	42,260,565 :	- - - - - :	- - - - - :	42,260,565
1937 :	43,056,472 :	- - - - - :	- - - - - :	43,056,472
1938 :	52,904,407 :	- - - - - :	- - - - - :	52,904,407
1939 :	26,965,985 :	- - - - - :	- - - - - :	26,965,985
1940 :	10,129,404 :	- - - - - :	- - - - - :	10,129,404
1941 :	(-) 24,491,319* :	- - - - - :	- - - - - :	(-) 24,491,319*
1942 :	(-) 67,846,370* :	- - - - - :	- - - - - :	(-) 67,846,370*
1943 :	(-) 151,492,206* :	- - - - - :	- - - - - :	(-) 151,492,206*
1944 :	2,885,786,816 :	- - - - - :	- - - - - :	2,885,786,816
Total :				
to 1945 :	4,215,643,602 :	186,179,661 :	23,180,224 :	4,441,003,487 (1)
1945 to :				
1966 :	644,830,200 :	- - - - - :	- - - - - :	644,830,200
Total :				
to 1966 :	4,860,473,802 :	186,179,661 :	23,180,224 :	5,085,833,687 (1)

(1) Includes \$16,000,000 paid in cash to veterans whose bonus is \$50 or less.

* Excess of receipts over payments.

No allowance is made for cost of administering Farm and Home or Vocational Training plans, which would be \$3,000,000 a year as a minimum, for some six years.

TREASURY DEPARTMENT.

December 22, 1923.
For immediate release.

The Secretary of the Treasury announces that W. G. Platt, Chief Clerk of the Treasury Department, has been transferred at the same salary to the position of Special Assistant in the Office of the Commissioner of Internal Revenue and assigned to act as Secretary of the Committee on Enrollment and Disbarment of the Treasury.

F. A. Birgfeld, Superintendent, Accounts Division, Office of the Supervising Architect, has been transferred and appointed Chief Clerk of the Treasury Department.

Both of these transfers take effect on January 1, 1924.

Letter from Secretary Mellon to The Outlook, dated December 22, 1923.

December 22, 1923.

My dear Sir:

At your request, I am glad to give The Outlook some observations related to my recommendations for a comprehensive plan of tax reduction, on a subject which seems not to be fully understood by the general public.

Adam Smith, in his great work "Wealth of Nations", laid down as the first maxim of taxation that "The subjects of every state ought to contribute toward the support of the government, as nearly as possible, in proportion to their respective abilities", and in his fourth and last maxim, that "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state", citing as one of the ways by which this last maxim is violated a tax which "may obstruct the industry of the people, and discourage them from applying to certain branches of business which might give maintenance and employment to great multitudes. * * * While it obliges the people to pay, it may thus diminish, or perhaps destroy some of the funds, which might enable them more easily to do so". The further experience of one hundred and fifty years since this was written has emphasized the truth of these maxims, but those who argue against a reduction of surtaxes to more nearly peace-time figures cite only the first maxim, and ignore the fourth. With the principle that a man should pay taxes in accordance with his ability, I thoroughly agree, but when, as a result of an unsound basis of taxation, it becomes evident that the source of taxation is drying up and wealth is being diverted into unproductive channels, yielding neither revenue to the Government nor

profit to the people, then it is time to readjust our basis of taxation upon sound principles.

It seems difficult for some to understand that high rates of tax do not necessarily mean large revenue to the Government, and that more revenue may often be obtained by lower rates. There was an old saying that a railroad freight rate should be "what the traffic will bear", that is, a combination of the highest rate at which the largest quantity of freight would move. The same rule applies to all private businesses. If a price is fixed too high, sales drop off and with them profits; if a price is fixed too low, sales may increase, but again profits decline. The most outstanding recent example of this principle is the sales policy of the Ford Motor Car Company. Does any one question that Mr. Ford has made more money by reducing the price of his car and increasing his sales than he would have made by maintaining a high price and a greater profit per car, but selling less cars? Your Government is just a business, and can and should be run on business principles. An income tax is the price the Government charges its people for the right to make a taxable profit. Experience has shown that the present high rates of surtax are bringing in each year progressively less revenue to the Government. This means that the price is too high to the large taxpayer and he is avoiding a taxable income by the many ways which are available to him. What rates will bring in the largest revenue to the Government experience has not yet developed, but it is estimated that by cutting the surtaxes in half, the Government, when the full effect of the reduction is felt, will receive more revenue from the owners of large incomes at the lower rates of tax than it would have received at the higher rates. This is simply an application of the same business principle, just

as Mr. Ford makes more money out of pricing his cars at \$300 than at \$3,000.

Looking at the subject, therefore, solely from the standpoint of Government revenues, lower surtax rates are essential. If we consider, however, the far more important subject of the effect of the present high surtax rates on the development and prosperity of our country, then the necessity for a change is more apparent. The most noteworthy characteristic of the American people is their initiative. It is this spirit which has developed America, and it was the same spirit in our soldiers which made our armies successful abroad. If the spirit of business adventure is killed, this country will cease to hold the foremost position in the world. And yet it is this very spirit which excessive surtaxes are now destroying. Any one at all in touch with affairs knows of his own knowledge of buildings which have not been built, of businesses which have not been started, and of new projects which have been abandoned, all for the one reason, high surtaxes. If failure attends, the loss is borne exclusively by the adventurer, but if success ensues, the Government takes more than half of the profits. People argue the risk is not worth the return.

With the open invitation to all men who have wealth to be relieved from taxation by the simple expedient of investing in the more than \$11,000,000,000 of tax-exempt securities now available, and which would be unaffected by any Constitutional amendment, the rich need not pay taxes. We violate Adam Smith's first maxim. Where those high surtaxes do bear, is not on the man who has acquired and holds available wealth,

but on the man who, through his own initiative, is making wealth. The idle man is relieved; the producer is penalized. We violate the fourth maxim. We do not reach the people in proportion to their ability to pay and we destroy the initiative which produces the wealth in which the whole country should share, and which is the source of revenue to the Government.

Yours sincerely,

(Signed) A. W. MELLON

Secretary of the Treasury.

Ernest Hamlin Abbott, Esq.,
Editor, The Outlook Company,
381 Fourth Avenue,
New York, N. Y.

INCOME TAX ON EARNED INCOMES FROM \$1200 TO \$6,000

Net income.	Single person.		Married person with two dependent children.	
	Present law.	Proposed	Present law.	Proposed
\$1,200	\$8	\$4.50	- - -	- - -
1,400	16	9.00	- - -	- - -
1,600	24	13.50	- - -	- - -
1,800	32	18.00	- - -	- - -
2,000	40	22.50	- - -	- - -
2,200	48	27.00	- - -	- - -
2,400	56	31.50	- - -	- - -
2,600	64	36.00	- - -	- - -
2,800	72	40.50	- - -	- - -
3,000	80	45.00	- - -	- - -
3,200	88	49.50	- - -	- - -
3,400	96	54.00	4	2.25
3,600	104	58.50	12	6.75
3,800	112	63.00	20	11.25
4,000	120	67.50	28	15.75
4,200	128	72.00	36	20.25
4,400	136	76.50	44	24.75
4,600	144	81.00	52	29.25
4,800	152	85.50	60	33.75
5,000	160	90.00	68	38.25
5,200	176	99.00	96	54.00
5,400	192	108.00	104	58.50
5,600	208	117.00	112	63.00
5,800	224	126.00	120	67.50
6,000	240	135.00	128	72.00

INCOME TAX ON EARNED INCOMES FROM \$1200 to \$6000.

Net income.	Single Person.		Married person with- out dependent children.	
	Present law.	Proposed.	Present law.	Proposed
\$1,200	\$8	\$4.50	- - -	- - -
1,400	16	9.00	- - -	- - -
1,600	24	13.50	- - -	- - -
1,800	32	18.00	- - -	- - -
2,000	40	22.50	- - -	- - -
2,200	48	27.00	- - -	- - -
2,400	56	31.50	- - -	- - -
2,600	64	36.00	\$4	\$2.25
2,800	72	40.50	12	6.75
3,000	80	45.00	20	11.25
3,200	88	49.50	28	15.75
3,400	96	54.00	36	20.25
3,600	104	58.50	44	24.75
3,800	112	63.00	52	29.25
4,000	120	67.50	60	33.75
4,200	128	72.00	68	38.25
4,400	136	76.50	76	42.75
4,600	144	81.00	84	47.25
4,800	152	85.50	92	51.75
5,000	160	90.00	100	56.25
5,200	176	99.00	128	72.00
5,400	192	108.00	136	76.50
5,600	208	117.00	144	81.00
5,800	224	126.00	152	85.50
6,000	240	135.00	160	90.00

INCOME TAX PAYABLE UPON CERTAIN EARNED NET INCOMES.

Net income.	Single person.		Head of family with two dependent children.	
	Present law	Proposed	Present law	Proposed
\$1,000	\$0.00	\$0.00	\$0.00	\$0.00
2,000	40.00	22.50	0.00	0.00
3,000	80.00	45.00	0.00	0.00
4,000	120.00	67.50	28.00	15.75
5,000	160.00	90.00	68.00	38.25
6,000	240.00	135.00	128.00	72.00
7,000	330.00	180.00	186.00	99.00
8,000	420.00	225.00	276.00	144.00
9,000	510.00	270.00	366.00	189.00
10,000	600.00	315.00	456.00	234.00
11,000	700.00	367.50	556.00	286.50
12,000	800.00	420.00	656.00	339.00
13,000	910.00	480.00	766.00	399.00
14,000	1,020.00	540.00	876.00	459.00
15,000	1,140.00	607.50	996.00	526.50
16,000	1,260.00	675.00	1,116.00	594.00
17,000	1,330.00	750.00	1,246.00	669.00
18,000	1,520.00	825.00	1,376.00	744.00
19,000	1,660.00	907.50	1,516.00	826.50
20,000	1,800.00	990.00	1,656.00	909.00
21,000	1,960.00	1,080.00	1,816.00	999.00
22,000	2,120.00	1,170.00	1,976.00	1,089.00
23,000	2,290.00	1,267.50	2,146.00	1,186.50
24,000	2,460.00	1,365.00	2,316.00	1,284.00
25,000	2,640.00	1,470.00	2,496.00	1,389.00

TABLE SHOWING THE TOTAL TAX PAYABLE UPON CERTAIN IN-
COMES UNDER THE RATES OF THE PRESENT LAW AND UNDER
THE SUGGESTED RATES.

Net income.	Single person. Unearned income.		Married man with two dependents. Unearned income.	
	Present law	Proposed law	Present law	Proposed law
\$30,000	\$3,600	\$2,720	\$3,456	\$2,612
40,000	5,920	4,600	5,776	4,492
50,000	8,720	6,740	8,576	6,632
100,000	30,220	19,900	30,076	19,792
150,000	58,220	35,400	58,076	35,292
200,000	86,720	50,900	86,576	50,792
250,000	115,720	66,400	115,576	66,292
300,000	144,720	81,900	144,576	81,792
400,000	202,720	112,900	202,576	112,792
500,000	260,720	143,900	260,576	143,792
1,000,000	550,720	298,900	550,576	298,792

TAXATION

AN EXTRACT FROM THE REPORT OF
THE SECRETARY OF THE TREASURY
ON THE STATE OF THE FINANCES FOR
THE FISCAL YEAR 1923



WASHINGTON

GOVERNMENT PRINTING OFFICE

1923

TAXATION.

The question of reduction of taxation is one which should have the serious consideration of Congress. Before the period of the war taxes as high as those now in effect would have been thought fantastic and impossible of payment. As a result of the patriotic desire of the people to contribute to the limit to the successful prosecution of the war, high taxes were assessed and ungrudgingly paid. Upon the conclusion of peace and the gradual removal of war-time conditions of business, the opportunity is presented to Congress to make the tax structure of the United States conform more closely to normal conditions and to remove the inequalities in that structure which directly injure our prosperity and cause strains upon our economic fabric.

In considering any reduction the Government must always be assured that taxes will not be so far reduced as to deprive the Treasury of sufficient revenue with which properly to run its business with the manifold activities now a part of the Federal Government and to take care of the public debt. Tax reduction must come out of surplus revenue. In determining the amount of surplus available these factors control: The revenue remaining the same, an increase in expenditures reduces the surplus, and expenditures remaining the same, anything which reduces the revenue reduces the surplus. The reaction, therefore, of the authorization of extraordinary or unsound expenditures is twofold—it serves, first, to raise the expenditures and so narrow the margin of available surplus; and, second, to decrease further or obliterate entirely this margin by a reduction of the Treasury's revenues through the disturbance of general business, which is promptly reflected in the country's income. On the other hand, a decrease of taxes causes an inspiration to trade and commerce which increases the prosperity of the country so that the revenues of the Government, even on a lower basis of tax, are increased. Taxation can be reduced to a point apparently in excess of the estimated surplus because by the cumulative effect of such reduction, expenses remaining the same, a greater revenue is obtained.

High taxation, even if levied upon an economic basis, affects the prosperity of the country because in its ultimate analysis the burden of all taxes rests only in part upon the individual or property taxed. It is borne by the ultimate consumer. High taxation means a high price level and high cost of living. A reduction in taxes, therefore,

results not only in an immediate saving to the individual or property directly affected, but an ultimate saving to all people in the country. It can safely be said, that a reduction in the income tax reduces expenses not only of the 7,000,000 income taxpayers but of the entire 110,000,000 people in the United States.

The results which flow from an economically unsound policy of taxation are not as easily visualized as the results of high taxation taken alone because the effects are indirect. These effects are a most insidious menace to a continued prosperity. In my previous reports I forecasted that high surtaxes were driving capital out of business productive of revenue to the Government. An examination of Table II, page 12, shows the progressive diminution in the number of taxpayers with incomes in excess of \$300,000, and confirms my forecast. The returns of 1921, which have recently been made available, give this figure as 246, as compared with 395 the year before.

While it is the policy of the Treasury not to make public information with respect to the incomes of particular individuals, still the publication in the newspapers of the probate of the estates of several wealthy men who have recently died permits comment on the type of investment into which the decedents appear to have been driven by the high surtaxes. These cases are remarkable for the way they show how men noted for their business ability and initiative have withdrawn their capital from productive business and placed it in municipal and other tax-free bonds. (For detailed statements of the Treasury's position with reference to tax-exempt securities see Exhibits 71-73, pages 376 to 392 of this report.) This is but one phase of the income-tax avoidance. Tax-exempt securities are not the only means by which the wealthy taxpayer, within his strictly legal rights, avoids a burden which appears to him to be confiscatory. It has been the history of taxation throughout the world that means have always been found by the ingenuity of the citizen to avoid taxes inherently excessive. If the present unsound basis of high surtaxes is maintained, they will continue to become progressively less productive.

On the other hand, a decrease in the surtaxes to a more reasonable amount would result not only in a more economically sound structure, but would ultimately yield more in revenue to the Government out of the lower taxes than the Government receives out of the higher taxes. The Government actuary has estimated that if the recommendations on tax reduction contained in my letter to Mr. Green are adopted, in the second year after operation, any loss in revenue on incomes in brackets in excess of \$100,000 will not only be overcome but additional revenue from these brackets will flow into the Government. His detailed estimate is as follows, and should be read in connection with the table appearing at the end of my letter to Mr. Green (p. 12):

EXTRACT FROM REPORT OF SECRETARY OF THE TREASURY.

3

Estimated effect upon the revenue of the proposed changes in the individual income tax law.

Income tax brackets.	Net reduction in tax when all changes have been in full effect.—On income for calendar year—		Net increase in tax collected, 1926 over 1925.
	1924, collected 1925.	1925, collected 1926.	
\$1,000-\$6,000.....	\$92,750,000	\$81,363,000	\$11,387,000
\$6,000-\$10,000.....	52,100,000	49,485,000	2,615,000
\$10,000-\$20,000.....	18,260,000	16,507,000	1,753,000
\$20,000-\$50,000.....	30,380,000	26,866,000	3,514,000
\$50,000-\$100,000.....	23,645,000	20,809,000	2,836,000
		<i>Net increase.</i>	
\$100,000-\$150,000.....	996,000	142,000	1,138,000
\$150,000-\$200,000.....	719,000	8,000	727,000
\$200,000-\$300,000.....	1,406,000	8,000	1,414,000
\$300,000-\$500,000.....	1,550,000	8,000	1,558,000
\$500,000-\$1,000,000.....	544,000	85,000	629,000
Over \$1,000,000.....	550,000	20,000	570,000
Total.....	1 222,900,000	1 194,759,000	28,141,000

¹ Loss.

I have considered this problem in the first instance solely from the standpoint of the Government's revenue and it is clear that from this standpoint alone a reduction in surtaxes is necessary. The other viewpoint, however, is much more important. High surtaxes drive capital from productive business to tax-exempt securities or other lawful methods of avoiding a taxable profit equally destructive of business advancement. The farmer is now complaining, and rightly, of the high freight rates and the high cost to him of that which he has to buy. The railroads of this country require a billion dollars a year of new capital in order that they may properly maintain their service and at the same time in keeping with the country's growth conduct the business of transportation upon such an economical basis as will permit the reduction of rates. The cost of capital is, therefore, one of the largest items of expense in the conduct of railroads. Nothing has so contributed to this additional cost of capital as the high surtaxes which have driven the large investors from railroad to tax-exempt securities. In like manner, the demands of capital for a higher return by reason of the high surtax rates have raised the cost of all manufactured products.

The constitutional amendment removing in the future the tax-exempt features of municipal bonds, which was introduced at the last session of Congress, would bring about a most desirable readjustment of the relation between the States and the Nation. Such an amendment, however, would not affect the already existing mass of tax-exempt securities aggregating about \$11,000,000,000, and these would continue during their life to be a means of escape from taxation. Such an amendment has yet to pass Congress and be ratified by the States. Its effect will not be immediate. A reduction of surtaxes destroys much of the desirability of the tax-exempt feature of these

securities, is within the sole power of Congress, and would promptly divert capital to productive investment, such as railroad securities, which tend to the reduction of costs, thus giving relief to the farmer and consumers generally.

On November 10, 1923, I addressed to the Hon. William R. Green, acting chairman of the Committee on Ways and Means of the House of Representatives, a communication which expressed the considered recommendations of the Treasury for a reduction of taxes and for a reestablishment of a more sound economic policy for the country. The letter is as follows:

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, November 10, 1923.

DEAR MR. GREEN: In accordance with the request which you made shortly after the adjournment of Congress, the Treasury has been engaged for the past few months in considering the possibilities of tax revision and in developing recommendations for the simplification of the law. The situation has developed more favorably than was anticipated, and I am now presenting to you a comprehensive program, to which I hope the Committee on Ways and Means will be able to give consideration at the outset of the legislative session.

The fiscal years 1922 and 1923 have each closed with a surplus of about \$310,000,000 over and above all expenditures chargeable against ordinary receipts, including the sinking fund and other similar retirements of the debt. This has been possible only through the utmost cooperation between the Executive and Congress, as well as among the executive departments and establishments, all of whom have united in a sincere effort to reduce the expenditures of the Government. At the same time there has been a substantial amount of realization upon securities and other assets remaining over from the war, and the Treasury has succeeded in collecting customs and internal-revenue taxes in amounts somewhat exceeding original expectations. The result is that the Government of the United States is firmly established on the basis of having balanced its budget each year since the cessation of hostilities with a reasonable surplus each year after providing for fixed-debt charges like the sinking fund, and stands squarely committed to the policy of including these fixed charges on account of the public debt in its ordinary budget each year, thus assuring an orderly reduction of the war debt out of current revenues.

What has been done during the two years since the establishment of the Budget system shows clearly what united effort can accomplish, and gives every reason for hope that the task to which the administration has set itself for this fiscal year can be successfully performed, namely, the reduction of the ordinary expenditures of the Government to a total of not more than \$3,500,000,000, of which about \$500,000,000 will be fixed charges on account of the sinking fund and other retirements of the debt. To do this means reductions of about \$170,000,000 in the estimates of expenditures submitted by the spending departments and establishments and the exercise of continued pressure all along the line for the utmost economy and efficiency in the operations of the Government.

Having these things in mind, the Treasury has been canvassing the estimates for the present fiscal year and for the succeeding fiscal years with a view to determining on the one hand what further reductions in expenditure it would be safe to count on in developing a tax-revision program, and on the other hand what receipts might reasonably be expected on the basis of existing law, assuming that no changes were to be made in internal taxes. In doing this it has had to keep in mind that under present conditions receipts from customs are abnormally high and that surplus war

supplies have now been for the most part liquidated, leaving relatively little to expect on this account in the years to come. It has also had to keep in mind that many of the internal-revenue taxes, as, for example, the higher brackets of the surtax are so rapidly becoming unproductive that it is unsafe to assume that even with no changes in the law the revenues from internal taxes would be maintained. After taking into account all these considerations, and making the most conservative estimates about the yield of existing taxes and the possibilities of further reductions in expenditure, it appears that for this year, and for the next four or five years, there should be a surplus of something over \$300,000,000 a year over and above all expenditures chargeable to the ordinary budget, including the fixed-debt charges payable out of current revenues. This gives a reasonable margin not merely for tax revision but also for tax reduction.

On this basis the Treasury has the following recommendations to make:

1. *Make a 25 per cent reduction in the tax on earned income.*—The fairness of taxing more lightly income from wages, salaries, and professional services than the income from a business or from investment is beyond question. In the first case, the income is uncertain and limited in duration; sickness or death destroys it and old age diminishes it. In the other the source of the income continues; it may be disposed of during a man's life and it descends to his heirs. It is estimated that this amendment will mean a loss in revenue of about \$97,500,000 a year, the greater part of which falls in the lower income brackets.

2. *Where the present normal tax is 4 per cent reduce it to 3 per cent, and where the present normal tax is 8 per cent reduce it to 6 per cent.*—This affects all personal incomes and the loss of revenue comes largely from the lower brackets. It is estimated that this will mean a loss in revenue of \$91,600,000 a year.

3. *Reduce the surtax rates by commencing their application at \$10,000 instead of \$6,000, and scaling them progressively upwards to 25 per cent at \$100,000.*—This will readjust the surtax rates all along the line, and the Treasury recommends the readjustment not in order to reduce the revenues but as a means of saving the productivity of the surtaxes. In the long run it will mean higher rather than lower revenues from the surtaxes. At the outset it may involve a temporary loss in revenue, but the Government Actuary estimates that even during the first year, if the revision is made early enough, the net loss in revenue from all the changes in the surtaxes would be only about \$100,000,000, and that in all probability the revenue from the reduced rates will soon equal or exceed what would accrue at the present rates, because of the encouragement which the changes will give to productive business.

The readjustment of the surtaxes, moreover, is not in any sense a partisan measure. It has been recommended, on substantially this basis, by every Secretary of the Treasury since the end of the war, irrespective of party. The present system is a failure. It was an emergency measure, adopted under the pressure of war necessity, and not to be counted upon as a permanent part of our revenue structure. For a short period the surtaxes yielded much revenue, but their productivity has been constantly shrinking and the Treasury's experience shows that the high rates now in effect are progressively becoming less productive of revenue. See Table II, hereto attached. The high rates put pressure on taxpayers to reduce their taxable income, tend to destroy individual initiative and enterprise, and seriously impede the development of productive business. Taxpayers subject to the higher rates can not afford, for example, to invest in American railroads or industries or embark upon new enterprises in the face of taxes that will take 50 per cent or more of any return that may be realized. These taxpayers are withdrawing their capital from productive business and investing it instead in tax-exempt securities and adopting other lawful methods of avoiding the realization of taxable income. The result is to stop business transactions that would normally go through, and to discourage men of wealth from taking the risks which are incidental to the development of new business. Ways will always

be found to avoid taxes so destructive in their nature, and the only way to save the situation is to put the taxes on a reasonable basis that will permit business to go on and industry to develop. This, I believe, the readjustment herein recommended will accomplish, and it will not only produce larger revenues but at the same time establish industry and trade on a healthier basis throughout the country. The alternative is a gradual breakdown in the system and a perversion of industry that stifles our progress as a nation.

The growth of tax-exempt securities, which has resulted directly from the high rates of surtax, is at the same time encouraging extravagance and reckless expenditure on the part of local authorities. These State and local securities will ultimately have to be paid, principal and interest, out of taxes, thus contributing directly to the heavy local taxation which bears so hard on the farmers and small property owners. There is no immediate remedy for this within the power of Congress except the readjustment of the surtaxes on a basis that will permit capital to seek productive employment and keep it from exhausting itself in tax-exempt securities. The productive use of capital in our railroads and industries will also tend to bring lower costs for transportation and manufactured products, thus helping to relieve the farmer from the maladjustment from which he now suffers.

4. *Limit the deduction of capital losses to 12½ per cent of the loss.*—The present revenue law limits the tax on capital gains to 12½ per cent but puts no limit on the capital losses. It is believed it would be sounder taxation policy generally not to recognize either capital gain or capital loss for purposes of income tax. This is the policy adopted in practically all other countries having income-tax laws, but it has not been the policy in the United States. In all probability, more revenue has been lost to the Government by permitting the deduction of capital losses than has been realized by including capital gains as income. So long, however, as our law recognizes capital gains and capital losses for income-tax purposes, gain and loss should be placed upon the same basis, and the provision of the 1921 act taxing capital gains at 12½ per cent should be extended to capital losses, so that the amount by which the tax may be reduced by the capital loss will not exceed 12½ per cent of the loss. It is estimated that this will increase the revenues by about \$25,000,000.

5. *Limit the deductions from gross income for interest paid during the year and for losses not of a business character to the amount the sum of these items exceeds tax-exempt income of the taxpayer.*—The 1921 act provides that interest on indebtedness to acquire or carry tax-exempt securities is not deductible. This provision is ineffective because a taxpayer may purchase tax-exempt securities for cash and borrow money for other purposes. It is felt also that so long as a taxpayer has income which is not reached for taxation, he should not be permitted to deduct his non-business losses from the income which is taxable, but should be restricted in the first instance to a deduction of these losses from his non-taxable income. The estimated increase of revenue from this source is \$35,000,000.

6. *Tax community property income to the spouse having control of the income.*—In some States the income of the husband is a joint income of the husband and wife, and each, therefore, is permitted to file a return for one-half of the income. This gives an unfair advantage to the citizens of those States over the citizens of the other States of this country, and this amendment seeks to restore the equality. It is estimated that it will increase revenues by \$8,000,000.

So much for the income-tax recommendations, which should become effective January 1, 1924. In order that you may have before you a clear view of the effect of these recommendations as applied to incomes in the various brackets, I am attaching a table, prepared by the Government Actuary, showing the estimated results of the proposed changes in the calendar year 1925, on the basis of the taxable year 1924. The schedule shows a loss of revenue of about \$92,000,000 in the brackets under \$6,000, and a further loss of revenue of about \$52,000,000 in the next bracket of \$6,000 to

\$10,000. In short, about 70 per cent of the reduction would be in the brackets of \$10,000 or less, and less than 5 per cent would fall in the brackets over \$100,000.

To show the effect of the proposed changes on the income of a typical salaried taxpayer, married and having two children, I call your attention to the following comparative figures:

Income.	Present tax.	Proposed tax.	Saving to taxpayer.
\$4,000	\$28.00	\$15.75	\$12.25
5,000	68.00	38.25	29.75
6,000	128.00	72.00	56.00
7,000	186.00	99.00	87.00
8,000	276.00	144.00	132.00
9,000	366.00	189.00	177.00
10,000	456.00	234.00	222.00

7. *Repeal the tax on telegrams, telephones, and leased wires.*—This is the last of the transportation taxes established during the war, is a source of inconvenience to every person using the telephone or telegraph, and should now be eliminated from the tax system. This would mean a loss in revenue of about \$30,000,000 a year.

8. *Repeal the tax on admissions.*—The greater part of this revenue is derived from the admissions charged by neighborhood moving picture theaters. The tax is, therefore, paid by the great bulk of the people whose main source of recreation is attending the movies in the neighborhood of their homes. This would mean a loss in revenue of about \$70,000,000.

9. *Miscellaneous nuisance taxes.*—Your committee may wish to consider the elimination of various small miscellaneous taxes which have an inconsiderable bearing on the general revenue of the Government, but which are a source of inconvenience to taxpayers and difficult to collect; and possibly there are some articles of jewelry which according to our standard of living can not properly be denominated luxuries, such as, for instance, ordinary table silver or watches, which you may wish to exempt from the general tax on jewelry. There is not enough margin of revenue available to permit the repeal of the special taxes which are proving productive, but the law could be revised to good advantage and some of the nuisance taxes repealed without material loss of revenue.

10. In addition to the specific recommendations which directly affect Government revenues, there should be amendments to strengthen the act and eliminate methods heretofore used by taxpayers to avoid imposition of the tax. The exact amount of additional revenue to the Government which will be brought in by these amendments can not be estimated, but certainly the amendments will reach much income that heretofore has escaped taxation.

11. *Establish a Board of Tax Appeals in the Treasury but independent of the Bureau of Internal Revenue, to hear and determine cases involving the assessment of internal-revenue taxes.*—This will give an independent administrative tribunal equipped to hear both sides of the controversy, which will sit on appeal from the Bureau of Internal Revenue and whose decision will be conclusive on both the bureau and the taxpayer on the question of assessment. The taxpayer, in the event that decision is against him, will have to pay the tax according to the assessment and have recourse to the courts, while the Government, in case decision should be against it, will likewise have to have recourse to the courts in order to enforce collection of the tax.

12. Changes should be made in the present law to simplify administration, make the law more easily understood, and permit a prompt determination of liability in a manner more satisfactory to the taxpayer.

In order that you may see the effect on Government revenues of the above recommendations, I submit the following figures as to the estimated result of these changes:

	Decrease (in mil- lions of dollars).	Increase (in mil- lions of dollars).
Reduction of 25 per cent in tax on earned income.....	97	.....
Reduction in normal tax.....	92	.....
Readjustment of surtax rates.....	102	.....
Capital loss limited to 12½ per cent.....	.....	25
Interest and capital loss deductions limited.....	.....	35
Community property amendment.....	30	8
Repeal of telegraph and telephone tax.....	70	.....
Repeal of admissions tax.....	.....	.....
Total.....	391	68
Net loss.....	323	.....

The benefits of the reduction will be distributed among all classes of taxpayers, and the revision generally will help to free business and industry of vexatious interference and encourage in all lines a more healthy development of productive enterprise.

The present burden of taxation is heavy. The revenues of the Government are sufficient to justify substantial reductions and the people of the country should receive the benefits. No program, however, is feasible if the Government is to be committed to new and extraordinary expenditures. The recommendations for tax reduction set forth in this letter are only possible if the Government keeps within the program of expenditure which the Bureau of the Budget has laid down at the direction of the President. New or enlarged expenditures would quickly eat up the margin of revenue which now appears to be available for reducing the burden of taxation, and to embark on any soldiers' bonus such as was considered in the last Congress or any other program calling for similarly large expenditure would make it necessary to drop all consideration of tax reduction and consider instead ways and means for providing additional revenue. A soldiers' bonus would postpone tax reduction not for one but for many years to come. It would mean an increase rather than a decrease in taxes, for in the long run it could be paid only out of moneys collected by the Government from the people in the form of taxes. Throughout its consideration of the problem the Treasury has proceeded on the theory that the country would prefer a substantial reduction of taxation to the increased taxes that would necessarily follow from a soldiers' bonus, and I have faith to believe that it is justified in that understanding. Certainly there is nothing better calculated to promote the well-being and happiness of the whole country than a measure that will lift, in some degree, the burden of taxation that now weighs so heavily on all.

Very truly yours,

A. W. MELLON,

Secretary of the Treasury.

Hon. WILLIAM R. GREEN,

Acting Chairman, Committee on Ways and Means,

House of Representatives, Washington, D. C.

EXTRACT FROM REPORT OF SECRETARY OF THE TREASURY. 9

TABLE I.—Estimated effect upon the revenue of the proposed changes in the individual income tax law.

Income tax brackets.	Number paying tax in each bracket.	Loss in tax when all changes are in full effect. On income for calendar year 1924; tax collected 1925.						
		Normal tax (loss).	Surtax (loss).	Earned income at 75 per cent of rates (loss).	Capital losses provision (gain).	Certain deductions limited to non-taxable income (gain).	Community property provision (gain).	Net reduction in tax collected.
\$1,000-\$2,000.....	7,308,200							
\$2,000-\$4,000.....	4,658,200	\$64,500,000		\$31,250,000	\$1,000,000	\$2,000,000		\$92,750,000
\$4,000-\$6,000.....	1,158,200							
\$6,000-\$10,000.....	558,200	16,100,000	\$17,500,000	20,000,000	500,000	1,000,000		52,100,000
\$10,000-\$20,000.....	228,200	2,000,000	4,400,000	14,000,000	500,000	1,500,000	\$140,000	18,260,000
\$20,000-\$50,000.....	80,200	1,300,000	10,100,000	25,000,000	1,000,000	2,500,000	2,520,000	30,380,000
\$50,000-\$100,000.....	16,500	4,500,000	21,100,000	6,875,000	2,000,000	3,000,000	3,830,000	23,645,000
\$100,000-\$150,000.....	3,620	1,300,000	11,100,000	106,000	4,000,000	6,000,000	1,510,000	998,000
\$150,000-\$200,000.....	1,430	550,000	6,600,000	69,000	3,000,000	3,500,000		719,000
\$200,000-\$300,000.....	840	450,000	7,400,000	56,000	3,000,000	3,500,000		1,406,000
\$300,000-\$500,000.....	380	400,000	8,100,000	50,000	3,500,000	3,500,000		1,550,000
\$500,000-\$1,000,000.....	150	300,000	7,200,000	44,000	3,000,000	4,000,000		544,000
Over \$1,000,000.....	30	200,000	8,300,000	50,000	3,500,000	4,500,000		550,000
Gain.....					25,000,000	35,000,000	8,000,000	
Loss.....		91,600,000	101,800,000	97,500,000				222,900,000

This table shows the estimated gain or loss in revenue over that estimated under the present law, due to the proposed changes in the revenue act of 1921, and allows for the estimated increase in incomes by reason of the readjustment of taxes.

The figures opposite each income tax bracket cover the total estimated receipts within that bracket.

TABLE II.—Table showing decline of taxable incomes over \$300,000.

Year.	Number of returns.		Net income.		Dividends and interest on 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
1920.....	7,259,944	395	23,735,629,183	246,354,585	4,445,145,223	229,052,039
1921.....	6,662,176	246	19,577,212,528	153,534,305	4,167,291,294	155,370,228

While the foregoing letter does not cover estate taxes, attention should ultimately be given to reductions in these taxes also. Every estate now pays tribute to at least two governmental authorities, the Federal Government and the State of the domicile of the decedent. It often happens that a particular asset is taxed also in one or more other States. The cumulative effect is confiscatory. Such taxes usually have to be paid in cash and a man's life work in the building up of a business is often lost to his heirs. It should be remembered also that estate taxes come not out of income but out of capital. In pending such taxes the Federal Government and the States are living on the country's capital, and by just so much are reducing the coun-

try's future earning power. While the States should do their share in the reduction of these taxes, the Federal tax is very heavy and could be lightened with benefit to our people.

There is one feature connected with such taxation which is not commonly understood. Values of property in our economic structure are intricately interwoven, and on these values is based credit. When one of these values is struck down it drags with it many other values. The facts that inheritance taxes are capital taxes and can not be paid in kind require a forced realization of a particular property, which greatly destroys its value and collaterally affects the value of all other properties. In time this feature may become a serious menace to our prosperity.

EXHIBIT 71.

LETTER FROM THE SECRETARY OF THE TREASURY TO THE ACTING CHAIRMAN OF THE COMMITTEE ON WAYS AND MEANS, DATED DECEMBER 21, 1922, WITH RESPECT TO HOUSE JOINT RESOLUTION 314, PROPOSING A CONSTITUTIONAL AMENDMENT RESTRICTING FURTHER ISSUES OF TAX-EXEMPT SECURITIES.

DECEMBER 21, 1922.

DEAR MR. GREEN: I received your letter of December 20, 1922, with respect to H. J. Res. 314, proposing an amendment to the Constitution of the United States to restrict further issues of tax-exempt securities, and note your statement that an amendment has been proposed by Mr. Garner, of Texas, which would strike out in Section 1, after the word "income", the following words: "derived from securities issued, after the ratification of this article, by or under the authority of the United States or any other State"; and in Section 2, after the word "income", the words "derived from securities issued, after the ratification of this article, by or under the authority of such State". For the words thus stricken out the Garner amendment would, I understand, substitute the words "from any source" in both Sections. I note further that in support of his proposed amendment Mr. Garner has stated that under the resolution as reported by the Committee on Ways and Means the United States might discriminate against the bonds of a State and in favor of the bonds of a railroad or industrial corporation, and that his amendment is proposed in order to prevent such a result. I am glad to be able to write you, first, that in the judgment of the Treasury the resolution in the form reported by the Committee would not of itself prevent discrimination of this character, so that the amendment proposed by Mr. Garner is unnecessary, and, second, that to adopt the amendment proposed by Mr. Garner would probably nullify both Sections and make the whole Constitutional amendment ineffective.

Whatever opposition there is to the proposed amendment to restrict further issues of tax-exempt securities rests, I think, upon a misunderstanding of the object and effect of the amendment, and this, in turn, harks back to the old controversies about States' rights and the powers of the Federal Government. I can say without hesitation that, separated from these old prejudices and taken from the point of view of the facts as we have to face them to-day, the proposed Constitutional amendment involves no question whatever of States' rights and makes no attack whatever on the credit or borrowing power of the States or their political subdivisions. The amendment would apply with absolute equality to the Federal Government, on the one hand, and the States and their political subdivisions on the other, and the interests of the general welfare would put exactly the same restrictions upon future borrowings by the Federal Government as upon future borrowings by the States and their political subdivisions. The constantly growing mass of tax-exempt securities threatens the public revenues, not only of the Federal Government, but of the States as well, and it is reaching such proportions as to undermine the development of business and industry.

The Federal Government, for the most part, has refused to have recourse to tax-exempt issues in financing its own operations, but the volume of tax-exempt securities of the States and their political subdivisions, and of other agencies, already outstanding and currently issued, is so large that the value of the exemption to the borrower issuing the securities has become relatively insignificant. Even now the States and their political subdivisions, notwithstanding the full tax exemptions on their securities, are obliged to pay substantially the same rates on their tax-exempt borrowings as the Federal Government pays on securities without exemption from Federal income surtaxes. The facts are that under our system of graduated Federal income surtaxes the issue of tax-exempt securities, while of constantly diminishing advantage to the borrowing State or city, provides a perfect refuge for wealthy investors, being most valuable to the wealthiest taxpayer. The actuarial figures show that to taxpayers paying surtaxes in the highest brackets securities subject to Federal income surtaxes would have to yield about 10.4 per cent in order to be as attractive as a 5 per cent tax-exempt security. For this great advantage the State which issues the securities gets but very little compensating return, and certainly no greater return from the wealthiest investor than from the smallest investor (to whom the exemption is relatively worthless), while the United States, which imposes the surtaxes, loses its revenue without any compensating advantage whatever. It is the graduated surtax, of course, that gives the greatest value to the tax exemption, and viewed from this aspect the tax exemption, in substance, constitutes a subsidy from the Federal Government, the cost of which in the long run must fall on those taxpayers who do not or can not take refuge in tax-exempt securities. Even from the point of view of the States themselves, I believe it is clear that the continued issuance of tax-exempt securities saves nothing to the tax-payers in the States and that in the long run it brings heavier taxes. The tax-exempt privilege, with the facility that it gives to borrowing, leads in many cases to unnecessary or wasteful public expenditure, and this in turn is bringing about a menacing increase in the debts of States and cities. These debts constitute a constantly growing charge upon the taxpayers in the several States, and will ultimately have to be paid, principal and interest, through tax levies upon these very taxpayers. It is easy to overlook this when the debts are incurred, but it is none the less impossible to escape the facts when the time comes for payment. It is also necessary to bear in mind that in the long run all of these public debts, whether the debts of States and their political subdivisions or of the Federal Government itself, as well as the taxes which must be imposed to meet them, fall upon but one body of taxpayers, and that the apparent advantage of borrowing by States and cities at the expense of the Federal revenues is illusory, since any temporary advantages thus obtained will have to be paid for by the Federal Government at the expense ultimately of the great body of taxpayers. This is particularly true of tax-exempt securities, for their effect is to provide a refuge from taxation for certain classes of taxpayers, with correspondingly higher taxes on all the rest in order to make up the resulting deficiency in the revenues.

Once it is understood I think no one can raise any valid objection to the proposed Constitutional amendment restricting further issues of tax-exempt securities. As a matter of fact, it is almost grotesque

to permit the present anomalous situation to continue, for as things now stand we have on the one hand a system of highly graduated Federal income surtaxes and on the other a constantly growing volume of securities issued by States and cities which are fully exempt from these surtaxes, so that taxpayers have only to buy tax-exempt securities to make the surtaxes ineffective. The only way to correct this condition is by Constitutional amendment, accompanied, if possible, by a reduction in the rates.

To take up the Garner amendment more specifically, I believe that the changes it would make are very clearly unnecessary. The resolution reported by the Committee on Ways and Means expressly provides in Section 1 that Federal taxes on income derived from securities, issued after the ratification of the article, by or under the authority of any State, must be without discrimination against income derived from such securities and in favor of income derived from securities issued after the ratification of the article by or under the authority of the United States or any other State. The same protection for the Federal Government is accorded by the second Section, conferring power on the States to lay and collect taxes on income derived from securities issued after the ratification of the article by or under the authority of the United States. Under Section 1 as it stands it would be impossible for the Federal Government to impose an income tax on income from future issues of State or municipal bonds without imposing the same tax on income derived from future issues of its own bonds, and as a practical matter it is almost inconceivable that Congress would be willing to impose such a tax upon the income from both State and Federal securities and at the same time exempt from the tax income derived from securities issued by private corporations. Such a course would be repugnant to every Constitutional principle. Entirely apart from the practical impossibility of such a situation, however, I think it clear that the amendment in its present form would prohibit discrimination against the bonds of a State and in favor of a railroad or industrial corporation. All corporations in this country are organized under either State or Federal law and derive their powers, including the power to borrow money, from charters issued by the State or Federal Governments as the case may be. Securities issued by private corporations, therefore, may be said to be issued "under the authority of" the United States, in the case of a Federal corporation, or the State of incorporation, in the case of a State corporation. Section 1 of the Constitutional amendment as reported by the Committee expressly prohibits discrimination in favor of securities issued after ratification of the article *under the authority* of the United States or any other State. This in terms would prevent discrimination in favor of any bonds issued by a railroad or industrial corporation incorporated under the laws of the United States or of any other State, and likewise, it seems to me, by a corporation organized under the laws of the State concerned, for it would be Constitutionally impossible for the Federal Government to single out corporations of one State in the granting of tax exemptions. If there were any danger here, however, it could readily be corrected by striking out in the last line of Section 1 the word "other," and I suggest that this be done to remove any question in the matter.

The Garner amendment is not only unnecessary,—it would defeat the entire Constitutional amendment and make it practically im-

possible for either the States or the Federal Government to proceed effectively under it. The Garner amendment by its terms forbids discrimination by either the Federal Government or the States, in favor of "income derived from any source". This apparently covers all sources of income, including, for example, income from securities already issued and outstanding, and income from salaries of State and Federal officers. Even after the adoption of the proposed Constitutional amendment, neither the United States nor any State would have power to tax securities of the other already issued and outstanding, and under generally accepted Constitutional principles, which have been affirmed by the Supreme Court, the Federal Government cannot levy income taxes upon the salaries of State or municipal officers, nor can the States levy income taxes upon the salaries of Federal officers. To forbid discrimination in favor of these non-taxable sources of income would, in effect, make the Constitutional amendment inoperative. There are also other generally recognized distinctions, as, for example, between earned and unearned income, and miscellaneous special exemptions which it might be impossible to make under the form of wording proposed. These difficulties would embarrass the State Governments, in proceeding under the Constitutional amendment, quite as much as they would the Federal Government, and would make it impossible for the States to levy any income tax upon future issues of Federal securities without at the same time imposing an income tax on all outstanding issues of their own securities, and, in fact, a general income tax upon all sources of income subject to State taxation. Even if it could be Constitutionally done, to levy income taxes upon securities already issued as tax-exempt would constitute a gross breach of faith, while to require a general and uniform income tax, with exactly the same taxation of income from securities as of all other sources of income, would involve almost insuperable practical difficulties and probably prove impossible.

I believe, therefore, that the Garner amendment would accomplish nothing but to defeat what is probably the most necessary reform in our system of taxation, and I hope that in the light of these comments as to the effect of the Constitutional amendment as reported by the Committee and the changes proposed, the Garner amendment will either be withdrawn or rejected. The Constitutional amendment as reported puts the Federal Government and the States on absolutely the same basis, and the very fact that the Federal Government is ready and willing, for the sake of the general welfare, to place itself under these restrictions as to future issues of tax-exempt securities, notwithstanding its own heavy debt and the practical certainty that it will always have obligations outstanding and to be financed, gives the best possible assurance that the States and their political subdivisions can place themselves under like restrictions without endangering their credit or embarrassing their necessary borrowings.

Very truly yours,

(Signed)

A. W. MELLON,

Secretary of the Treasury.

HON. WILLIAM R. GREEN,

Acting Chairman, Committee on Ways and Means,

House of Representatives,

Washington, D. C.

TABLE 2.—Personal returns—Distribution, by income classes, for the United States; showing for each class of income the number of returns, net income, personal exemption, dividends, tax paid, and percentages.

[Income returned for the calendar year ended December 31, 1920.]

Income class.	Number of returns.	Net income.	Exemptions from normal tax.			Normal.	Surtax.	Total tax.	Average amount of tax per individual.	Average rate of tax (per cent).
			Personal exemptions.	Dividends.	Interest on Government obligations. ¹					
			\$1,561,058,719	\$38,889,381	\$118,145	\$36,859,732		\$36,859,732	\$19.30	1.29
\$1,000 to \$2,000 ²	761,995	\$1,201,296,261	1,920,895,163	15,318,566						
\$1,000 to \$2,000 ²	1,909,955	2,848,770,357	2,346,669,224	58,757,898	153,115	45,507,821		45,507,821	27.77	1.12
\$2,000 to \$3,000 ²	930,659	2,129,193,720	2,890,213,944	38,802,446				45,166,537	52.70	1.54
\$2,000 to \$3,000 ²	1,638,657	4,055,349,648	93,504,684	50,217,981	280,956	45,166,537				
\$3,000 to \$4,000 ²	37,564	125,598,720	1,758,241,908	57,889,135						
\$3,000 to \$4,000 ²	856,995	2,941,487,294	20,703,781	39,154,600	565,453	38,329,579	\$692,383	38,329,579	88.90	1.99
\$4,000 to \$5,000 ²	11,416	50,581,107	889,737,327	72,935,508	4,780,958	22,031,171	2,023,158	22,723,554	128.28	2.34
\$4,000 to \$5,000 ²	431,141	1,921,940,118	361,206,842	85,642,089	3,542,047	18,534,425	2,886,839	20,557,583	182.83	2.83
\$5,000 to \$6,000 ²	177,147	969,504,603	228,585,811	85,334,736	3,168,739	16,617,190	3,274,111	19,504,029	261.76	3.50
\$5,000 to \$6,000 ²	112,444	726,361,550	149,965,534	76,168,995	2,052,173	14,347,134	3,784,466	17,621,245	344.09	4.06
\$6,000 to \$7,000 ²	74,511	557,103,872	101,737,772	71,694,936	2,646,518	13,695,156	3,872,596	15,746,694	435.59	4.50
\$7,000 to \$8,000 ²	51,211	434,462,407	79,624,590	66,061,095	1,761,879	11,874,098	4,119,372	15,206,613	525.17	5.01
\$8,000 to \$9,000 ²	40,129	380,898,531	58,790,816	61,234,473	2,721,163	11,087,241	4,168,823	14,015,969	623.99	5.43
\$9,000 to \$10,000 ²	29,984	314,400,337	47,971,393	57,665,639	2,036,482	9,847,146	4,244,561	13,256,386	722.92	5.78
\$10,000 to \$11,000 ²	24,370	280,196,629	31,379,422	54,459,354	2,079,973	9,011,825	4,376,737	12,824,442	823.94	6.11
\$11,000 to \$12,000 ²	19,388	242,527,549	26,489,941	51,288,059	1,307,255	8,447,705	22,013,101	55,508,479	933.43	6.44
\$12,000 to \$13,000 ²	16,089	217,085,265	28,699,368	47,995,870	6,506,926	33,495,378	21,872,136	55,508,479	1,246.51	7.25
\$13,000 to \$14,000 ²	13,739	199,128,079	45,050,205	204,945,101	3,780,318	23,823,602	21,310,372	45,700,738	1,925.95	8.64
\$14,000 to \$15,000 ²	44,581	765,354,264	169,984,024	169,984,024	2,942,660	17,894,313	38,911,865	39,204,685	2,709.19	9.90
\$15,000 to \$20,000 ²	23,729	523,212,663	27,164,221	133,778,337	4,201,978	24,282,793	35,641,581	63,194,658	3,997.64	11.62
\$20,000 to \$25,000 ²	14,471	395,807,952	29,308,578	152,860,997	3,075,861	16,224,352	31,875,512	51,865,933	6,272.33	14.09
\$25,000 to \$30,000 ²	15,808	543,792,249	15,117,152	116,740,720	2,057,036	11,315,900	28,589,460	43,191,412	9,026.42	16.52
\$30,000 to \$40,000 ²	8,269	368,184,912	8,613,544	90,936,869	1,705,928	8,277,842	25,269,888	36,867,302	12,264.57	18.95
\$40,000 to \$50,000 ²	4,785	261,433,828	5,410,897	70,145,319	1,067,066	6,340,791	22,607,109	27,450,124	16,054.18	21.50
\$50,000 to \$60,000 ²	3,006	194,506,539	3,536,853	55,581,429	1,020,858	4,843,015	20,580,671	26,587,694	20,243.45	23.91
\$60,000 to \$70,000 ²	1,969	147,024,770	2,355,288	44,380,282	569,887	10,950,766	75,636,928	24,598,202	25,177.28	26.56
\$70,000 to \$80,000 ²	1,356	114,818,467	1,755,689	143,158,774	2,821,861	3,923,046	27,930,180	30,379,905	39,519.71	32.61
\$80,000 to \$90,000 ²	977	92,602,729	3,724,543	55,619,123	892,315	2,449,725	20,275,032	22,163,748	67,899.61	44.47
\$90,000 to \$100,000 ²	2,191	265,511,505	960,808	46,828,195	375,407	1,888,716	27,875,298	30,023,022	98,957.35	48.32
\$100,000 to \$150,000 ²	590	100,966,280	514,874	27,282,351	496,264	2,147,724			133,516.55	51.54
\$150,000 to \$200,000 ²	307	68,307,141	279,200	39,150,948					177,651.02	
\$200,000 to \$250,000 ²	166	45,865,252	265,100							
\$250,000 to \$300,000 ²	169	58,252,657								
\$300,000 to \$400,000 ²										

Interest on Government obligations not wholly exempt from tax.

¹ Nontaxable. Personal exemptions and dividends exceed net income.

TABLE 2.—*Personal returns—Distribution, by income classes, for the United States; showing for each class of income the number of returns, net income, personal exemption, dividends, tax paid, and percentages—Continued.*

Income class.	Number of returns.	Net income	Exemptions from normal tax.			Normal.	Surtax.	Total tax.	Average amount of tax per individual.	Average rate of tax (per cent).
			Personal exemptions.	Dividends.	Interest on Government obligations. ¹					
\$400,000 to \$500,000.....	70	\$31,060,895	\$107,975	\$22,099,996	\$334,297	\$1,311,303	\$15,709,136	\$17,020,439	\$243,149.13	54.80
\$500,000 to \$750,000.....	98	58,890,818	136,400	44,347,149	987,385	1,497,074	31,267,938	32,765,012	334,336.86	55.64
\$750,000 to \$1,000,000.....	25	21,072,076	38,600	11,954,254	72,969	802,115	12,073,878	12,875,993	515,039.72	61.10
\$1,000,000 to \$1,500,000.....	19	21,988,642	16,900	14,797,956	144,853	723,294	13,030,056	13,753,350	723,860.53	62.55
\$1,500,000 to \$2,000,000.....	3	5,087,594	3,200	7,989,220	58,688	9,228	3,046,350	3,055,576	1,018,525.33	60.06
\$2,000,000 to \$3,000,000.....	4	10,863,868	5,000	6,508,744	94,123	420,213	6,732,213	7,152,426	1,788,106.50	65.84
\$3,000,000 to \$4,000,000.....	3	9,218,058	3,200	8,336,392	172,071	245,081	5,792,268	6,037,349	2,012,449.67	65.49
\$4,000,000 to \$5,000,000.....										
\$5,000,000 and over.....	4	29,919,977	6,600	37,021,628	208,180	4,359	19,182,025	19,186,384	4,796,596.00	64.13
Total.....	7,259,944	23,735,629,183	12,834,684,529	2,735,845,795	61,549,572	478,249,919	596,803,767	1,075,053,686	148.08	4.53

¹ Interest on Government obligations not wholly exempt from tax.

EXTRACT FROM REPORT OF SECRETARY OF THE TREASURY. 17

Estimated surtax due on incomes from Government obligations not wholly exempt from tax—1920 returns.

Income class.	Interest on Government obligations not wholly exempt from tax.	Rate of surtax.	Amount of surtax.
		<i>Per cent.</i>	
\$5,000 to \$6,000.....	\$4,780,958	1	\$47,809.58
\$6,000 to \$8,000.....	6,710,786	2	134,215.72
\$8,000 to \$10,000.....	4,698,691	3	140,960.73
\$10,000 to \$12,000.....	4,483,042	4	179,321.68
\$12,000 to \$14,000.....	4,116,455	5	205,822.75
\$14,000 to \$20,000.....	7,874,181	7	551,192.67
\$20,000 to \$30,000.....	6,722,978	11	739,527.58
\$30,000 to \$40,000.....	4,201,978	16	672,316.48
\$40,000 to \$50,000.....	3,075,861	21	645,930.81
\$50,000 to \$60,000.....	2,057,036	26	534,829.36
\$60,000 to \$70,000.....	1,705,928	31	528,837.68
\$70,000 to \$80,000.....	1,067,066	36	384,143.76
\$80,000 to \$90,000.....	1,020,858	41	418,551.78
\$90,000 to \$100,000.....	569,887	46	262,148.02
\$100,000 to \$150,000.....	2,821,861	52	1,467,367.72
\$150,000 to \$200,000.....	892,315	56	499,696.40
\$200,000 to \$300,000.....	1,063,192	60	637,915.20
\$300,000 to \$500,000.....	830,561	63	523,253.43
\$500,000 to \$1,000,000.....	1,060,354	64	678,626.56
Over \$1,000,000.....	677,915	65	440,644.75
Total.....	60,431,903		9,693,112.66

Statistical Division—Income Tax Unit.—Wholly tax-exempt income reported by individuals having net income of \$5,000 and over, for the calendar year 1920.

Income class.	United States obligations—Interest.	States and Territories—Interest and salaries.	Total.
\$5,000 to \$6,000.....	\$806,397	\$3,260,072	\$4,066,469
\$6,000 to \$7,000.....	881,404	3,579,012	4,460,416
\$7,000 to \$8,000.....	695,657	2,751,914	3,447,571
\$8,000 to \$9,000.....	539,042	2,368,929	2,907,971
\$9,000 to \$10,000.....	569,990	2,025,246	2,595,236
\$10,000 to \$11,000.....	493,771	1,701,858	2,195,629
\$11,000 to \$12,000.....	411,007	1,558,101	1,969,108
\$12,000 to \$13,000.....	393,263	1,450,608	1,843,871
\$13,000 to \$14,000.....	357,317	1,114,690	1,472,007
\$14,000 to \$15,000.....	317,164	1,080,762	1,403,926
\$15,000 to \$20,000.....	1,628,697	4,808,573	6,437,270
\$20,000 to \$25,000.....	1,200,925	3,284,812	4,485,737
\$25,000 to \$30,000.....	1,001,604	3,008,805	4,010,409
\$30,000 to \$40,000.....	1,707,681	4,556,759	6,264,440
\$40,000 to \$50,000.....	1,658,792	3,278,211	4,937,003
\$50,000 to \$60,000.....	1,305,306	2,454,805	3,760,111
\$60,000 to \$70,000.....	1,133,106	2,174,197	3,307,303
\$70,000 to \$80,000.....	1,024,237	1,946,835	2,971,072
\$80,000 to \$90,000.....	797,528	1,424,900	2,222,426
\$90,000 to \$100,000.....	1,016,534	1,500,841	2,517,375
\$100,000 to \$150,000.....	3,643,759	4,639,323	8,283,082
\$150,000 to \$200,000.....	2,671,969	2,545,723	5,217,692
\$200,000 to \$250,000.....	1,703,250	1,540,636	3,243,886
\$250,000 to \$300,000.....	1,032,407	1,077,012	2,109,419
\$300,000 to \$400,000.....	1,214,526	1,341,141	2,555,667
\$400,000 to \$500,000.....	1,006,114	1,271,414	2,277,528
\$500,000 to \$750,000.....	1,705,518	1,698,087	3,403,605
\$750,000 to \$1,000,000.....	1,246,016	1,537,758	2,783,774
\$1,000,000 to \$1,500,000.....	863,360	927,095	1,790,455
\$1,500,000 to \$2,000,000.....	358,536	195,830	554,366
\$2,000,000 to \$3,000,000.....	282,497	38,216	320,713
\$3,000,000 to \$4,000,000.....	1,160,392	432,018	1,592,410
\$4,000,000 to \$5,000,000.....			
\$5,000,000 and over.....	2,731,636	1,639,529	4,371,165
Total.....	37,559,460	67,925,712	105,485,172

EXHIBIT 72.

LETTER FROM THE SECRETARY OF THE TREASURY TO THE CHAIRMAN OF THE COMMITTEE ON TAXATION OF THE CHAMBER OF COMMERCE OF THE STATE OF NEW YORK, DATED JANUARY 31, 1923, WITH RESPECT TO THE QUESTION OF TAX-EXEMPT SECURITIES.

JANUARY 31, 1923.

MY DEAR MR. KELSEY: I received your letter of January 22, 1923, with further reference to the question of tax-exempt securities, and have since had opportunity to examine the report of your Committee on this subject to the Chamber of Commerce of the State of New York, which I notice was published yesterday morning and is expected to come up for action at the meeting of the Chamber on Thursday. I cannot escape the feeling after reading this report that the position which it takes is founded upon several serious misconceptions, and I am satisfied that on many points the report is directly at variance with the facts. Reduced to its lowest terms, the main contention of the report seems to be that so long as there are high surtaxes there ought to be tax-exempt securities to provide relief from those surtaxes. This view is not unnatural, having regard to the excessive rates of surtax which now prevail, but it is the Treasury's view that to sanction the continued issuance of securities carrying full exemptions from taxation and at the same time attempt to levy Federal income surtaxes running as high as 58 per cent, when combined with the normal tax, creates an impossible situation, since the tax-exemptions of the securities will tend to defeat the collection of the taxes. I have accordingly urged that action be taken, first, to restrict further issues of tax-exempt securities, in order to block this avenue of escape from the surtaxes, and, second, to reduce the surtax rates to a reasonable level, with a maximum of 25 per cent, amounting to 33 per cent when combined with the normal tax. This would, in my judgment, provide a workable system and in the long run produce more revenue than the present rates.

The report of your Committee, it seems to me, overlooks the most important factor in the tax-exempt security problem, namely, that the root of the trouble lies in the Federal income surtaxes. The high surtaxes date from the Revenue Act of 1917, and until that time tax-exempt securities presented a problem of but small magnitude since most taxes were levied at level rates and it could generally be said, as stated in your report, that the loss of taxes was roughly made up by the saving in interest costs. With taxes at flat rates the exemption is worth about as much to one taxpayer as another, and barring any questions as to conflicting State and Federal jurisdiction it could be said with some force that if the State or Federal Governments were to tax the securities which they themselves issued purchasers of the securities would insist on an interest yield high enough to compensate for the taxes levied. The Federal surtaxes have changed all this

and created an entirely different problem. The exemption to which the greatest importance now attaches is the exemption from Federal surtaxes and the value of this exemption depends entirely upon the income of the individual taxpayer. Generally speaking, it will be greatest in the case of the wealthiest taxpayer, while to the person paying only a normal tax or a low surtax the exemption will be relatively of little value. This makes it quite impossible, as a practical matter, for the borrowing State or Federal Government to obtain full value for the exemption carried by the securities, for in the nature of things the securities will be sold in the open market at quoted prices adjusted to market conditions, though to one purchaser the exemption may be worth little or nothing and to another purchaser, who pays the same price, the exemption may be worth the equivalent of 10 or 11 per cent on a taxable security. Another fundamental difference, which your report completely overlooks, is that the surtaxes are levied by the Federal Government while the tax-exempt securities are, for the most part, issued by the State and municipal governments. In other words the Federal Government gets no compensating advantages whatever from any reduction in interest rates that may accrue to the State or municipal government through the tax-exempt privilege, so that the tax-exemption from Federal surtaxes is in fact an involuntary subsidy conferred upon State and municipal governments by the Federal Government at the expense of its own revenues. Your report, I notice, attempts to meet this on the ground that whether the State or Federal Governments are involved it is all one body of taxpayers, but while this is undoubtedly a valid argument in support of uniformity of treatment as between the State and Federal Governments it cannot be advanced in support of a system which permits taxpayers to avoid their taxes to the Federal Government by purchasing securities issued by or under authority of the States.

The argument in your report assumes as a basis for all its calculations that fully taxable securities would have to bear interest at a rate about 1 per cent higher than fully tax-exempt securities, and at the outset purports to quote my testimony in January, 1922, before the Committee on Ways and Means in support of this assumption. That testimony did not involve any such statement, but simply admitted that the Federal Government, under the conditions then prevailing, would have to pay more than $3\frac{1}{2}$ per cent, and probably more than 4 per cent, in order to sell Government securities without full exemptions from taxation. I do not believe that on any substantial volume of securities there is 1 per cent difference, or anything like that between tax-exempt and taxable securities. The value of tax exemption in the sale of securities depends in large measure on the volume of securities available, and once this scarcity value is destroyed there would in my judgment be but little difference, with borrowers of equal credit, between the yields of tax-exempt and taxable securities. I have already stated in my letter of February 9, 1922, to the Chairman of the Committee on Ways and Means my general views on this subject, as follows:

"But the case in favor of the proposed amendment from a revenue standpoint is even stronger, because it would be quite impossible for the Government to float \$20,000,000,000 of tax-exempt bonds at a rate of interest three-fourths per cent less than that of taxable bonds. There is only a limited class of people in the United State

to whom the exemption from surtax is worth as much as three-fourths of 1 per cent. On November 30, 1921, the amount of Liberty 3½'s outstanding was \$1,410,074,450, and of Victory 3½'s, \$497,915,100. These two issues include the great bulk of wholly tax-exempt United States obligations which are held by investors (as distinguished from circulation bonds held by national banks). If instead of less than \$2,000,000,000 there were \$20,000,000,000 of these bonds, the value of the exemption would probably be almost imperceptible in the market quotations. The result of such an extension would be that the Government would have to pay almost the same amount in interest charges as before and would be wholly deprived of the surtaxes which it might otherwise collect."

The experience of the Federal Government in these matters furnishes perhaps the best practical answer to the conclusions embodied in your report. Since the First Liberty Loan it has been the consistent policy of the Federal Government (except for the issue of 3½ per cent Victory notes, all of which have now been retired), to finance itself without relying upon the issue of fully tax-exempt securities, and generally speaking all of the Liberty bonds (except the First 3½'s), all outstanding Victory notes and Treasury notes, Treasury bonds and Treasury certificates of indebtedness, have been denied exemption from Federal income surtaxes. The total amount of the First 3½'s outstanding is only about \$1,500,000,000, while the pre-war debt of the Federal Government is almost entirely in the form of bonds held by national banks to secure circulation, so that practically all the remainder of the Federal debt has been floated without recourse to the exemption from Federal surtaxes which has created the tax-exempt security problem. The experience of the Federal Government has further shown that tax-exempt securities at a rate of interest 1 per cent less than that paid on taxable securities are not particularly attractive to investors, and that your assumption that any substantial amounts of fully tax-exempt securities could be sold at 1 per cent less than taxable securities is fallacious. The Victory Liberty Loan was offered in two series, one fully tax-exempt and the other entirely without exemption from Federal surtaxes, both series being interconvertible during their lives. The total amount of the loan was about 4½ billion dollars, and yet the tax-exempt series never passed beyond 1 billion dollars, and had actually dwindled to about \$375,000,000 when it was called for redemption last year. The comparative yields of high-grade State and municipal securities, carrying full tax exemptions, and Federal securities without the exemptions from surtaxes, also indicate the underlying fallacy in your figures. The Treasury bonds of 1947-52 offered by the Federal Government last October are, generally speaking, subject to Federal surtaxes, and are quoted in the market to yield about 4½ per cent, while State and municipal securities of the highest grades having full exemptions from surtaxes are quoted to yield about 4 per cent to 4.15 per cent, and other State and municipal obligations of not such good credit are quoted to yield 4½ per cent, and even higher. This all indicates as conclusively as can be that owing to the gradual dilution of the security market with tax-exempt securities the value of the tax exemption to the borrowing State or Federal Government is gradually dwindling, while the tax-exemption still retains its value to the wealthy taxpayer.

I can perhaps best summarize the Treasury's position by enclosing for your information a copy of a letter¹ of December 21, 1922,

¹ See Exhibit 71, page 11.

which I sent to the Acting Chairman of the Committee on Ways and Means. The facts are that the Federal Government, under the power granted by the 16th amendment to the Constitution of the United States, now levies income taxes on individual incomes, and is imposing graduated additional income taxes, commonly known as surtaxes, on the higher incomes. At the same time the States and municipalities are issuing a growing volume of tax-exempt securities, the income from which is wholly exempt from these very surtaxes, while the Federal Government, though under our present Constitutional system it could itself issue fully tax-exempt securities, has for some years past consistently refrained from issuing such securities in order to protect the public revenues. The Federal Government might change this policy, and by issuing its own securities with full tax exemptions cancel much of the artificial value of State and municipal securities, but this would merely swell the volume of tax-exempt issues and still further endanger the revenues.

It must be clear that graduated additional income taxes cannot be effective when there exist side by side with them practically unlimited quantities of fully tax-exempt securities available to defeat them, and that either some way must be found to stop the continued issuance of tax-exempt securities or the Federal Government must find some substitute for the surtaxes. The issue is immediate and serious, for the yield of the surtaxes has already been reduced to a relatively small sum as compared with the early years, and the persistence of the present system is distorting our whole economic structure and hampering the development of business and industry throughout the country.

A Constitutional amendment along the lines proposed in the pending resolution would correct the situation and would put State and Federal Governments on an exact equality. I believe that such a Constitutional amendment is safe and practicable and I hope that the Chamber of Commerce of the State of New York will not take a position adverse to its adoption.

Very truly yours,

A. W. MELLON,
Secretary of the Treasury.

CLARENCE H. KELSEY, Esq.,
President, Title Guarantee and Trust Co.,
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EXHIBIT 73.

LETTER FROM THE SECRETARY OF THE TREASURY TO THE CHAIRMAN OF THE COMMITTEE ON THE JUDICIARY, UNITED STATES SENATE, DATED FEBRUARY 16, 1923, WITH RESPECT TO HOUSE JOINT RESOLUTION No. 314, PROPOSING A CONSTITUTIONAL AMENDMENT RESTRICTING FURTHER ISSUES OF TAX-EXEMPT SECURITIES.

FEBRUARY 16, 1923.

DEAR MR. CHAIRMAN: I received your letter of February 13th, requesting certain information for the use of the subcommittee of the Committee on the Judiciary in connection with its consideration of House Joint Resolution No. 314, proposing a Constitutional amendment restricting further issues of tax-exempt securities. I have noted the brief and tables presented by the Governor of the State of Virginia, through Mr. E. Warren Hall, Second Assistant of the State Tax Board, and have examined the statements and figures embodied in the argument presented in behalf of the State. Many of the arguments and figures are either irrelevant or misconceived, and in large measure they are already answered by my letter of December 21, 1922,¹ to the Acting Chairman of the Committee on Ways and Means, and of January 31, 1923,² to Mr. Clarence H. Kelsey, Chairman of the Committee on Taxation of the Chamber of Commerce of the State of New York, copies of which are herewith enclosed. The argument presented for the State of Virginia may be answered more specifically in taking up the several questions raised by your letter, but I may say at the outset that no amount of arbitrarily assumed figures or loosely drawn conclusions such as appear in its brief and accompanying tables can serve to obscure the main facts in the situation upon which the Treasury relies in urging support for the proposed Constitutional amendment, namely, that the continued issuance of tax-exempt securities is building up a constantly growing mass of privately held property exempt from all taxation; that tax-exemption in a democracy such as ours is repugnant to every Constitutional principle, since it tends to create a class in the community which cannot be reached for tax purposes and necessarily increases the burden of taxation on property and incomes that remain taxable; and that it is absolutely inconsistent with any system of graduated income surtaxes to provide at the same time securities which are fully exempt from all taxation, since the exemptions will sooner or later defeat at least all the higher graduations and will always be worth far more to the wealthier taxpayers than to the small ones. Tax-exemption, of course, gets quite a disproportionate value when taxes are not at a level rate but are levied at graduated rates, and the Federal surtaxes are almost wholly responsible for the extraordinary value which tax-exempt securities enjoy to-day. It is nonsense to refer to this value as something which the States have the right to

¹ See Exhibit 71, page 11.

² See Exhibit 72, page 18.

enjoy in selling their securities, for the value depends in large measure on the relative scarcity of tax-exempt securities and the Federal Government could seriously impair, and nearly destroy, it by issuing all its own securities exempt from surtaxes. Contrariwise, since the value of the exemption turns largely on the existence of graduated surtaxes, the Federal Government could certainly reduce and probably destroy the present premium on tax-exempt securities by changing its own tax system and substituting for the income surtaxes some other form of tax which would not be affected by the presence of tax-exempt securities, as, for example, a tax on sales or expenditures. It may, in fact, be driven to some such change by force of necessity if the present situation continues and enough of the States cling to the privilege for which the Governor of Virginia contends, of issuing securities that give rich investors the power, at the expense of the rest of the community, to escape from the common burdens of taxation.

In proposing the Constitutional amendment now before your Committee the Federal Government is not asking from the States any more than it is willing to yield for itself, and I am sure that in considering the pending resolution your Committee will examine the question on its merits, free from the prejudices with which it is so frequently involved.

To take up specifically the questions raised by your letter:

1. It is impossible to give a definite statement as to the difference there would be in interest charges paid by the United States if all its obligations were wholly exempt from taxes, for it would depend on a number of factors and is largely a matter of judgment. I have already indicated, in my letter of January 31st to Mr. Kelsey, that in my judgment the difference would not be substantial, since if the United States were to issue about \$22,000,000,000 of fully tax-exempt securities instead of about \$1,500,000,000 of its tax-exempt securities now outstanding (leaving out of account the circulation bonds held by National banks), the market would be so flooded with tax-exempt securities that tax-exemption would lose its market value and it would be impossible to make any material saving of interest by granting full exemption from taxation. This conclusion is borne out by the actual experience of the United States with the tax-exempt series of Victory notes, as set forth in the letter to Mr. Kelsey, and it is further supported by the general experience of the United States in dealing with its war obligations, the Federal Government having financed all its war borrowings except for the First Liberty Loan $3\frac{1}{2}$ per cent bonds, and the $3\frac{1}{4}$ per cent Victory notes (all of which have now been retired), without recourse to full exemption from taxation. I am satisfied that if instead of following this policy the United States had issued all of its war obligations on a fully tax-exempt basis the rates of interest on the tax-exempt obligations would have become practically as high as the rates actually paid on the obligations which have been issued. While it is not possible, since the contrary policy was pursued, to demonstrate this conclusion mathematically it must be obvious that if there were now \$32,000,000,000 face amount instead of about \$11,000,000,000 face amount of fully tax-exempt securities outstanding, the value of the tax-exemption would be so much diluted that it would have but little effect on interest rates. From the point of view of the revenue, however, the situation would be vastly more serious than at present, for there would be nearly three times as large a volume of tax-

exempt securities available, and available at higher yields, for purchase by wealthy investors, with the probability that in these circumstances the graduated rates of surtaxes would have become almost completely ineffective. It is also necessary to remember that if there is now any material saving of interest to States and municipalities in issuing tax-exempt instead of taxable securities, that saving does not at all accrue to the benefit of the Federal Government, whereas the loss of revenue through the purchase of the tax-exempt securities in order to reduce taxable income for surtax purposes, falls entirely on the Federal Government.

2. It is not possible to give any complete statement showing the surtaxes collected by the United States upon income received as interest on its obligations not wholly exempt from tax. The latest figures are those for the taxable year 1920, and show total interest on such obligations returned as income for that year as \$61,549,572, according to table 2 on pages 46-47 of The Statistics of Income for 1920, a copy of which is enclosed. There is also enclosed a table, made up from these Statistics of Income, which shows, by income classes, surtaxable interest on United States obligations aggregating \$60,431,903 for the year 1920, from which it is estimated that the surtaxes collected thereon amounted to about \$9,693,112 for that year. This does not, however, give a correct picture of the general situation, for a substantial part of the outstanding Federal obligations is in the hands of small holders or corporations not subject to surtax, and as to the balance it must be remembered that during this period there were certain limited exemptions from surtaxes, which have been largely availed of to reduce taxable income. In greater part these limited exemptions will expire by limitation on July 2, 1923, and practically all the rest by July 2, 1926. In the meantime, however, the figures as to surtaxable interest on United States obligations are necessarily reduced by these temporary exemptions, and do not show enough about collections on taxable obligations to make it possible to draw any general conclusions as to what might be the effect of the proposed Constitutional amendment in increasing the revenues from taxation.

3. The answer to the third point has already been given in part under (2), but to supplement that information there is enclosed herewith a copy of a statement prepared by the Statistical Division of the Income Tax Unit showing wholly tax-exempt income reported by individuals having incomes of \$5,000 and over for the calendar year 1920, separating interest on United States obligations from interest on State and municipal obligations, and showing the tax-exempt income of both kinds by income classes. This table compiles the reports of tax-exempt income made on the returns for 1920 pursuant to the provisions of the returns, and while it is accurate so far as it goes it is undoubtedly not complete since these reports were required to be made only as a matter of information and the Bureau of Internal Revenue has not had occasion to check them up for tax purposes.

4. The Treasury has strongly recommended that the surtaxes be reduced to a maximum of 25 per cent, that is to say, a maximum combined normal and surtax of 33 per cent. It believes that a revision of the surtaxes on substantially this basis is fundamentally necessary if our present internal revenue system is to be successfully administered. There seems to be no prospect, however, of action by this Congress upon these recommendations and for the time being,

therefore, it is necessary to face the fact of surtaxes running to a maximum of 50 per cent, or a combined maximum of 58 per cent. A revision to substantially the basis recommended by the Treasury would, no doubt, correct to some extent the evil of tax-exempt securities, since it would reduce the pressure to escape taxable income, but the evil would none the less remain and would still be serious, at least so long as there were any material graduation of surtax rates. For example, even with a maximum surtax of 25 per cent there would still be a material inducement for large investors to reduce taxable income, and to an investor paying surtaxes at the rate of 25 per cent a fully tax-exempt security would offer substantial advantages as compared with a surtaxable security, while the tax-exempt security would, of course, be far more valuable to such an investor than to a small investor. Lower surtaxes, in other words, would mitigate the evil but would not go to the heart of the situation, for tax-exemptions would still persist and tend to defeat any taxes levied at the revised rates.

5. The Treasury regards the estimate of approximately \$185,000,000, submitted by the Governor of Virginia as the additional annual interest charge upon the Government of the United States on account of issuing obligations not wholly exempt from taxes, as wholly unfounded and grossly inaccurate. The reasons for this view have already been given in large measure in the discussion under (1) above, and the inaccuracy of the figure proceeds largely from the fact that it results from calculations which assume that all of the war borrowing of the Federal Government could have been carried on through the issue of tax-exempt obligations at a rate of interest approximately 1 per cent less than the rate paid upon surtaxable obligations. It is the opinion of the Treasury that if it had placed the whole war debt on a tax-exempt basis there would have been practically no differential between tax-exempt and surtaxable obligations. On this basis the United States would be paying to-day approximately the same annual interest on tax-exempt obligations that it is now paying on its outstanding debt not wholly exempt from taxes, and losing more in revenue.

6. The estimates submitted by the Governor of Virginia as to the maximum amount of surtaxes collected under the 1920 rates, and under the 1922 rates, on the interest on Government obligations returned as subject to surtaxes are substantially correct, but, as pointed out above in the discussion under points 2 and 3, the figures for these years are vitiated by temporary factors and have no bearing at all upon the merits of the pending Constitutional amendment.

The brief submitted by the Governor of Virginia contains a number of inaccuracies related to this discussion which impair its whole position. On page 14, for example, the brief states that the proposed amendment would be unfair to the States since "The Federal Government has issued about twenty-three billions of bonds. It does not contemplate any further large issues. These bonds cannot be taxed by the States. It is thus probable that during the next fifty years, at least, there will be no Federal securities liable to State taxation, but on the other hand, the States and municipalities are issuing about a billion dollars in securities each year. All of these will be liable to the Federal taxation. Since there will be no Federal securities liable to the tax, the value of the provision against discrimination will be nil." These statements are manifestly false and misleading.

The Federal Government is issuing each year substantial amounts of new securities and for many years to come will be issuing new securities every year, probably in amounts larger than the aggregate of State and municipal issues during the year, in order to refund its obligations previously issued. Between now and the end of 1928, for example, about \$9,000,000,000 of bonds, notes and certificates issued by the Federal Government will mature and in large measure these maturing obligations will have to be refunded. Any of these refunding obligations issued after the ratification of the Constitutional amendment would be subject to its provisions in the same manner as State or municipal obligations issued after its ratification. The same would be true of other refunding obligations issued by the Federal Government in succeeding years. To show how completely false is the argument made by the Governor of Virginia it is enough to call attention to the fact that the whole war debt of the Federal Government actually matures within the next thirty years, with substantial maturities falling at frequent intervals. These maturing obligations will either be redeemed, in which event the tax-exemptions they now carry will cease to be of any importance, or will be refunded into other obligations; and these refunding obligations, if issued after the ratification of the Constitutional amendment, will be subject to its provisions.

The brief submitted by the Governor of Virginia is filled with inaccuracies and loose statements of this nature, and contains also numerous misquotations of my testimony before the Ways and Means Committee and unwarranted and irrelevant conclusions from statements made in letters and testimony before the Committee. It is hardly worth while to take these inaccuracies up in detail in a letter of this character but if the subcommittee would like to have me appear personally before it, either in reply to the arguments made by the Governor of Virginia or in support of the position which the Treasury has taken with respect to the Constitutional amendment, I shall be glad to appear at such time as the subcommittee may desire.

I feel that I should not close without again expressing the hope that the Committee will take action on this measure at a date early enough to assure favorable action by the Senate at this session of Congress. It is a matter of the utmost importance to our economic and financial development, and I view with real concern the possibility that action on this amendment, which was first suggested by the Treasury in April, 1921, may again be deferred to some later date. The resolution has already passed the House of Representatives by a decisive vote, and within the next year or two there are sessions of most of the State legislatures, so that the time to propose the amendment is now, when there is a favorable opportunity for action upon it, before the volume of tax-exempt securities grows to uncontrollable proportions.

Cordially yours,

(Signed)

A. W. MELLON,
Secretary of the Treasury.

Hon. KNUTE NELSON,
Chairman, Committee on the Judiciary,
United States Senate,
Washington, D. C.

Enclosures.