

FIFTH LIBERTY BOND BILL

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

SIXTY-FIFTH CONGRESS

THIRD SESSION

ON

H. R. 16136

A BILL TO AMEND THE LIBERTY BOND ACTS AND THE
WAR FINANCE CORPORATION ACT, AND
FOR OTHER PURPOSES

Printed for the use of the Committee on Finance



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FIFTH LIBERTY BOND BILL.

TUESDAY, FEBRUARY 25, 1919

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met at 10.30 o'clock a. m.

Present: Senator Simmons (chairman), Gore, Jones of New Mexico, Robinson, Nugent, Penrose, Lodge, McCumber, Smoot, La Follette, Townsend, and Dillingham; also Hon. R. C. Leffingwell, Assistant Secretary of the Treasury, Hon. Albert Rathbone, Assistant Secretary of the Treasury, and Hon. Eugene Meyer, jr., Managing Director of the War Finance corporation.

The CHAIRMAN. Mr. Leffingwell, the committee has sent for you because they wanted some statement from the Treasury Department with reference to the several provisions of the bill, and unless some Senator desires to ask you questions, I think it would be helpful if you would just take the bill up section by section and give the committee a brief statement of its purpose, and how you propose to administer it.

Mr. LEFFINGWELL. Mr. Chairman, if I may say just a word first about the condition of the Treasury, perhaps it will help in the explanation of the detail of the bill.

You will find in the hearings before the Committee on Ways and Means of the House of Representatives a very full and carefully prepared statement of Secretary Glass on the general plans and position of the Treasury, and I shall not burden you by going over in all its details the reasoning which led to the suggestion of legislation on somewhat the general lines of the present bill, which the Ways and Means Committee prepared and caused to be introduced in the House. On pages 31 to 35 of the testimony taken before the Ways and Means Committee of the House you will find some exhibits showing the condition of the Treasury on the 31st day of January of this year. Particularly interesting are the exhibits 1-A and 1-B, which show the total expenditures and the total revenue, excluding transactions in the principal of the public debt during the period of the war.

The total cash expenditure from April 6 to January 31 was approximately \$26,500,000,000, and the total tax receipts and other income of the Government during the same period were \$6,000,000,000. Although we had contemplated, in a general way, the financing of the Government one-third by taxes and two-thirds by loan, we were actually during the period of the war in receipt from taxes and in

interest from foreign loans made by us and from miscellaneous sources of an income a good deal less than a quarter of the amount of our expenditures during that period. That, of course, is partly due to the delay in the enactment of the revenue bill. On the other hand, we may now look forward to the fact that we have a very large revenue coming in in the 12 months beginning January 1, 1919.

During the war period we made large foreign loans and have carried into our revenue the receipts in the form of interest from those foreign loans, part of which are capitalized in the loans themselves. The position that the Treasury found itself in at the termination of hostilities was a very difficult one, and it seemed important at once to make some sort of a rough estimate of the problems before us. Secretary McAdoo immediately indicated to you his impression, in view of the armistice, that the expenditures for this fiscal year ending June 30, would be in the neighborhood of \$18,000,000,000. I remember that at the time Senator Smoot said that it would be nearer \$20,000,000,000, and it may be that he was right. The expenditures ran at nearly \$2,000,000,000 a month in November, December, and January last.

There has, however, been a very heavy reduction in expenditures in February to date, and it looks as though the total for the month (which is a short month) would be less than \$1,200,000,000. It is not possible to say even to-day positively what the cash expenditures this fiscal year will be. It depends, of course, partly upon the rapidity with which settlements are made of informal Army contracts, if and when the pending bill is enacted.

In May we estimated that we would expend \$24,000,000,000 during this fiscal year, assuming the continuance of the war. That was a real estimate, and we came very close to being right for the six months ending December 31. The actual expenditures in December were \$2,060,000,000, or within \$40,000,000 of the amount they would have reached that month on the basis of the general estimate which Secretary McAdoo presented to the Congress in May or June in connection with the revenue bill.

At the time of the armistice there was pending before this committee the revenue bill, and Secretary McAdoo thought it the duty of the Treasury (being quite unable to make a careful detailed estimate—to get from the departments of the Government, from the appropriation committees, from anyone, true estimates of the position of the Government in the light of the armistice, and are readjustments which would follow it) to give you immediately some indication of the situation as it appeared to the Treasury in the light of the change in the war position; and I believe still that that was the wise thing to do. I believe it made it easier for this committee to reach a determination and an agreement with the House of Representatives upon the revenue measure than it would have been if the Treasury had persisted in its estimate of \$24,000,000,000, which was made on a prewar basis, or had failed to express any opinion. We were simply trying in an emergency situation, two weeks after the armistice was signed, and obviously before it was possible to do more than hazard an enlightened guess concerning the situation, to give you the benefit of that guess in order that the country should not be burdened with taxation predicated upon the war program.

I said, Senator Smoot, before you came in, that you might prove to have been right when you said you thought we would spend \$20,000,000,000 in this fiscal year rather than \$18,000,000,000.

Senator SMOOT. Not only that, Mr. Leffingwell, but you ought to state, I think, referring to the estimates for December, that if the Government had paid its obligations, the expenditures for that month would have been over \$3,000,000,000 rather than \$2,000,000,000. That is, there are contracts that they can not pay that the Government was really under obligations to pay, and if paid, it would have amounted to over \$3,000,000,000.

Senator McCUMBER. That is the proportion of cost that would be due for that month?

Senator SMOOT. I think now from going in to the details, as I know they are existing to-day they will run a little over \$20,000,000,000. That is what it is going to run over, there is no doubt of it at all in my mind.

The CHAIRMAN. I think we all understood when Secretary McAdoo appeared before us and gave us the \$18,000,000,000 as the basis to proceed upon, that he impressed upon us that it was an estimate.

Senator PENROSE. A wild guess.

Senator LA FOLLETTE. It was made the basis of reducing the taxation \$2,000,000,000.

Senator PENROSE. I want to say that I am having the testimony taken before this committee analyzed since the war was declared, and the estimates from the Treasury Department has been from \$2,000,000,000 to \$4,000,000,000 less than what was required. In the early days of the war we had an estimate sent in here in which no provisions was made for heavy guns and ordnance, and in two weeks they came in here, like a flash out of the sky, with an estimate for \$7,000,000,000.

Mr. LEFFINGWELL. If you really want the Treasury Department to do more than give you the formal estimates which it receives from other departments and transmits to Congress, then it is clearly for your committee or some other committee to ask Congress to give the Treasury Department power to obtain such control over the expenditures of other departments as would enable them to make real estimates. You know that now the Treasury Department transmits to you estimates which it receives from the other departments. The Treasury Department is simply the messenger boy.

Senator PENROSE. Do you think it is unreasonable for this committee to be disappointed when several billion dollars are entirely overlooked and unmentioned, and two weeks afterwards an additional estimate is put in covering the same? It shows a lack of coordination.

Mr. LEFFINGWELL. It is not a lack of coordination. It is simply that we have transmitted to you the figures which we are obliged to accept from the other departments of the Government without any power of review on our part. There is no question in my mind that that is a situation that ought to be remedied. It is purely a personal opinion. There are two things when we are talking about estimates that we ought to have in mind.

Senator ROBINSON. Does it require legislation to remedy that?

Mr. LEFFINGWELL. It does. The President and the Treasury are utterly without power to do more than to transmit to Congress the estimates received from the other departments. At present the sole power of review is in Congress.

Senator SMOOT. In that connection, I want to say that the other day in the deficiency appropriation bill we repealed appropriations amounting to about \$15,000,000,000, and not 10 days passed after the passage of that bill through Congress before certain members of the Appropriation Committees of the House and Senate were called together and it was shown to us that in the War Department alone we had repealed \$750,000,000 too much. We said, "How can such a thing as this happen? What is the matter with the department that these mistakes occur and are found out a week or two afterwards?" There was no satisfactory explanation any further than in going over the figures again more carefully they learned that they had missed certain items, and cut others too much; and now we have got to pass in the regular deficiency bill that will come on in a day or two legislation giving \$750,000,000 more money to the War Department to meet the obligations that we thought were covered by the appropriation. I do not know really where we are going to land.

Senator PENROSE. It has shattered my confidence completely in estimates.

Mr. LEFFINGWELL. Senator Smoot, there is one thing you said that ought to be qualified. You said if the Government had met its obligations in December, we would have spent \$3,000,000,000. Of course, that is predicated upon the assumption that there would have been cancellation and liquidation of informal Army contracts, and that that would have thrown into the month of December \$1,000,000,000 more, which, had the war continued and the ordinary processes of production dragged out, would not have been spent in that month. I do not think if the authority had existed to make those settlements it would have been physically for the the organization of the War Department and the contractors to come to an understanding which would have resulted in the payment of any such sum of money in any one month. I do not think or believe that the Government was behind in its payments in December. It may be now as a result of the legal tangle.

Senator SMOOT. On the 1st day of February it was \$1,800,000,000; that is only for January. I think in January that \$800,000,000 occurred, and I figured in round numbers that it would be a billion dollars. I do not think I am very far off. I am very glad you made that qualification, because perhaps the way I stated it made it appear that it was really to be an amount that the Government actually owed on the delivery of the goods by that time. I had no intention of carrying that idea, but it is an obligation that the Government had to meet.

Mr. LEFFINGWELL. It is a liability, although it had not been liquidated at the moment. In that relation to that whole situation, it may be helpful for me to say one thing. The Treasury has constantly urged upon all departments of the Government the prompt payment of their bills. The Secretary of the Treasury has no power of review over the decisions of the Comptroller of the Treasury and the Secretary and the Treasury are utterly helpless in the

face of such a situation as developed from the opinion of the comptroller on those contracts. It is always harder for us to finance the Government when payments are being held back, when liquidations are slow. It is easier to borrow when the banks of the country are kept clean than when capital is tied up in unliquidated bills. That is one reason why the Secretary is before the Appropriation Committee urging the enactment of the bill of the Railway Administration.

Senator TOWNSEND. Mr. Secretary, I would like to ask one question.

Senator McCUMBER. I would like to have this bill explained.

Senator TOWNSEND. Before we get away from this point, you asked if further legislation was necessary, and the Secretary thought it was in order for them to get the necessary information. I would like to know why under the Overman bill the President has not full power to control that matter. We have given him full power. He can transfer the duties of the War Department to the Treasury if he wants to.

Mr. LEFFINGWELL. Fortunately, he did not think of doing that, Senator.

Senator TOWNSEND. No; but under that bill he had the power to remedy that evil.

Mr. LEFFINGWELL. You think under that bill he had the power to establish a budget system?

Senator TOWNSEND. He can compel the War Department to give you that information and give it to you promptly.

Mr. LEFFINGWELL. Of course, the War Department always gives us the best information it can, but there is a great deal of difference between accepting information from another department and exercising control over the expenditures of that department.

The CHAIRMAN. This bill we are about to pass here is to enable the Treasury Department to raise money to pay the appropriations of Congress, if I understand it?

Mr. LEFFINGWELL. That is correct.

The CHAIRMAN. And if Congress has appropriated more than it ought to appropriate, or less than it ought to appropriate, it is not a matter that the Treasury Department can control. What we have set here for, as I understand it, is to determine whether we want to pass this bill to enable you to raise the money to pay the appropriations that Congress has already made or is about to make.

Senator PENROSE. There is a widespread feeling all over the United States that no loan bill that we may pass, or no number of loan bills, or no tax bills, will be adequate to meet a situation of wasteful expenditure on one side and ever soaring estimates on the other. Unless we can find our moorings there is no use passing this bill.

The CHAIRMAN. That is a matter that this committee does not control.

Senator PENROSE. Well, it is pertinent to this inquiry.

The CHAIRMAN. The appropriation committees and the Congress make and control the appropriations. Our function here is to help the Government to raise the money to pay them. That is the purpose of this bill and that is what we are met here to discuss. We have not very much time to devote to these hearings, and if we take

it all up discussing questions about mistakes that have been made in estimates and in appropriations, we will not have any time to give to an investigation of the facts we want to elicit with reference to this bill.

Senator PENROSE. This bill provides for \$5,000,000,000 more in loans than was originally contemplated, does it not?

Mr. LEFFINGWELL. I do not think I could agree to that, Senator. I do not think we have ever made an estimate of the amount of loans that would be required. We have never known how long the war would continue, and we have only submitted to you from time to time requests for authorizations more than ample to meet the situation for a period of months ahead. There never was any given sum in contemplation as the amount of the war debt, for the reason that no human being had any notion what would be the length of the war, and we are only now getting in a position to estimate the probable amount of the debt of the Government.

Senator LODGE. In your calculations upon which this bill is based do you take into consideration \$400,000,000, which the revenue bill carries, the payment of \$60 to every soldier, \$200,000,000 that we put into the Post Office bill for roads, \$750,000,000 for the railroads, which must be passed, and \$1,000,000,000 to maintain the price of wheat, which must be passed?

Senator PENROSE. Let me add one other item. Do you take into consideration Mr. Lane's request for the reclamation of swamp lands and farms for the soldiers which he or someone in or about him says ought to be \$4,000,000,000 and that we ought to do as well as Canada proposes to do by these men. Do you take that into consideration also?

Mr. LEFFINGWELL. Senator, the Secretary of the Treasury submitted to the Ways and Means Committee (and sent a copy to your committee) a bill which would have authorized a total issue of bonds of \$10,000,000,000 in excess of the outstanding amount, a total issue of notes of \$10,000,000,000 and a total issue of Treasury certificates of \$10,000,000,000. It was his belief that \$10,000,000,000 represented the maximum increase in funded debt. The Ways and Means Committee has struck out any increase in the authorization of the issue of bonds and has authorized an issue of notes for \$7,000,000,000. That simply means that we have before us a bill to enable the Treasury to "carry on," but we have here no estimate to cover the particular items which Senator Lodge has mentioned and which you have mentioned.

Senator LODGE. I mean that those items amount in the rough to about \$3,000,000,000, and those are in addition to all the war expenses which we have to meet.

Mr. LEFFINGWELL. The point I am trying to make is that this bill as it now stands does not represent an estimate by the Treasury Department of the indebtedness of the Government, but represents the extent of the authority which the Ways and Means Committee thought it wise to confer upon the Treasury Department at this time.

Senator LODGE. It means there must be a further loan?

Mr. LEFFINGWELL. I should say that it is the belief of the Treasury that there will be one more Liberty loan, so called, and after that the requirements of the Government will be financed by the sale of securities by other methods.

Senator LODGE. This bill, as I understand it, is to take the place of the loan already authorized. You have not borrowed all the money authorized under the last bond bill?

Mr. LEFFINGWELL. No, sir.

Senator LODGE. This is to replace that with a larger amount, is it not?

Mr. LEFFINGWELL. This simply is a measure to deal with the situation which will arise in a couple of months, in a way which the Treasury believes meets the problems. About \$5,000,000,000 was the amount of bonds authorized and unissued under the bond act. The Ways and Means Committee felt it was unwise to authorize the issue of bonds at a higher rate or free from restrictions as to rate, but authorized the creation of an issue of notes. That may be taken as in lieu of the authorization of \$5,000,000,000 in bonds and the addition of \$2,000,000,000 more, although the actual authority continues.

Senator PENROSE. Then the bonds really authorized are not displaced by this new loan?

Mr. LEFFINGWELL. In a practical sense they would be, although the law contains the authorization for their issue.

Senator PENROSE. If the law still exists, then you would go on issuing this loan in addition? This bill should clearly define whether that authority still exists.

Mr. LEFFINGWELL. It is perfectly clear that the authority still exists.

Senator PENROSE. But as a practical effect you say that they will not be issued?

Mr. LEFFINGWELL. They could not be issued at this time within the limitation as to interest rate.

Senator PENROSE. Would there be any objection to repealing the law?

Mr. LEFFINGWELL. Except that I believe that those bonds will have to be issued at some time and, if the authorization were repealed, it would be necessary to come to Congress and ask for an increase in the authorization.

Senator PENROSE. With all due respect to the department, that does not seem to me to be exactly a candid answer.

Mr. LEFFINGWELL. It is perfectly candid. I may not have made myself perfectly clear to you.

Senator PENROSE. You say to all practical purposes these bonds will not be issued, and in the next breath you say later on they will be issued.

Mr. LEFFINGWELL. You have evidently misunderstood me. I said they could not be issued, at the interest rate fixed in the statute, this spring.

Senator PENROSE. Then, is there any objection to repealing that law?

Mr. LEFFINGWELL. As a practical matter they could not be sold now, but they must be sooner or later.

Senator SMOOT. They can not sell them at par at the rate money is to-day.

Senator PENROSE. But later on maybe they could. They may not be issued this month at that rate of interest, but per chance six months from now they can.

Senator SMOOT. I think Mr. Leffingwell's answer was perfectly straight, but I have not any doubt that they will have to be issued sooner or later to pay the obligations of the Government.

Senator PENROSE. Will this bill make the Government liable for the \$6,000,000,000 already authorized, and on top of that will they contemplate another loan?

Mr. LEFFINGWELL. You are giving, under this bill, authority to the Secretary of the Treasury to issue \$7,000,000,000 in notes and to increase the authorized amount of Treasury certificates \$10,000,000,000. That is the major feature of this bill.

Senator PENROSE. Then, in addition that that, there is this authority for an issue of bonds for how much?

Mr. LEFFINGWELL. \$5,022,000,000.

Senator SMOOT. I want to say now that before we get through with it we will have that amount. This is what it means: There are \$7,000,000,000 here of notes, \$2,000,000,000 additional certificates, as we have already authorized the \$8,000,000,000, and that is \$9,000,000,000 authorized. Now, Senator, that is not going to meet and pay the obligations of the Government when we clear up this whole question of the war. It will not do it. We could repeal that authorization for the issue of the bonds, but in order to do that we would either have to pass additional legislation in the future or else increase these amounts and agree that the obligations of the Government will be notes and short-time certificates, and no more note issues. That is what we will have to do if we are going to meet the situation.

Senator PENROSE. Roughly speaking, under this bill \$20,000,000,000 will be added to the national debt.

Senator McCUMBER. I agree with the Senator from Pennsylvania that it will run to \$50,000,000,000 before we get through, but we can not criticize the Treasury Department for that. Congress is voting these suns, billions upon billions, for roads and things that we do not need now.

Senator PENROSE. But we criticized the administration for permitting Mr. Lane and others to come down here and ask for these things.

Senator McCUMBER. But we are going right on piling them up, and as long as we pile them up we have to have some way to meet them, whether it is by bonds or taxation.

Senator PENROSE. When we reach the \$50,000,000,000 stage of debt we are in peril.

The CHAIRMAN. Mr. Leffingwell, are we anywhere near the \$50,000,000,000?

Mr. LEFFINGWELL. No; Senator; and let me say I think that estimate is grossly excessive. The testimony before the Ways and Means Committee showed the whole debt of the United States on January 31 was \$23,267,000,000.

Senator PENROSE. Now you are adding \$20,000,000,000 more in this bill.

Mr. LEFFINGWELL. Senator, the authorization of bonds or notes or Treasury certificates does not, as you know, create indebtedness.

Senator PENROSE. As certain as sunrise.

Mr. LEFFINGWELL. No. What creates indebtedness is the appropriations of Congress. We can not borrow money for the Treasury

which is not needed to meet the expenditures of the Government. This bill presents four authorizations for the issue of securities—in the form of war-saving certificates, in the form of Treasury certificates, in the form of notes, and in the form of bonds. Do not let us in our own minds add the amounts of those authorizations together and mislead ourselves as to the amount of the debt which will result. We issue Treasury certificates in anticipation of Liberty loans and taxes. The amount outstanding in anticipation of the Victory loan as of January 31 was, roughly, \$3,250,000,000. Treasury certificates have been refunded and retired heretofore by the issue of bonds. Under the bill which was introduced by the Ways and Means Committee we are given another alternative, of refunding those Treasury certificates by the issue of notes. It might in the course of time be desirable to refund those notes by the issue of bonds. But the true test, as Senator Simmons has said, is the expenditures of the Government, and no Treasury will ever succeed in borrowing more money than the situation requires. Nor is it to my mind at all likely that the war debt will exceed the sum, say, \$30,000,000,000, against which the Treasury would be in possession of some \$9,000,000,000 or \$10,000,000,000 of obligations of foreign Governments which are good and will be paid. The difficulties which present themselves to the Treasury at the present time are very great, and peculiarly great because of the approaching expiration of the life of this Congress, and the assumption that the new Congress could not be convened and organized in time to take action in anticipation of the Victory Liberty loan; yet there is nothing in the situation to cause apprehension or grave distress. The United States is going to come out of the war with its strength unimpaired and with the realization of resources which before had not been tested.

Senator PENROSE. Such as what?

Mr. LEFFINGWELL. Its financial resources, its material resources.

Senator PENROSE. You mean borrowing resources?

Mr. LEFFINGWELL. Well, borrowing resources if you like to put it that way; lending resources if you like to put it that way. We have become, as a result of the war a capitalist Nation instead of a debtor; a creditor Nation instead of a debtor Nation, and while the Treasury has spent a large part of its time in admonition to curtail expenditures and to restore normal conditions, the Treasury can not share in any apprehension as to the condition of America—financial, economic, industrial, or commercial. It is sound and strong. In comparison with all the competitive nations of the world it is the strongest to-day. There is every reason in the world why we should curtail our expenditures and remove the restraints and interferences with the ordinary laws of finance, of economics, of supply and demand; but let us not in the consideration of these difficult problems, allow ourselves to become terrified or discouraged about the future of America, which is as strong and clean and fine as any country could well be.

The CHAIRMAN. As I understand it, Mr. Leffingwell, our indebtedness, including the amount we have loaned to the allies, would be about \$30,000,000,000.

Mr. LEFFINGWELL. Senator, I want to excuse myself from making an estimate offhand, but what I said was this: That we had \$23,000,000,000 of debt on January 31, and there is nothing in the situa-

tion to lead me to believe that it will ever run above, say, \$30,000,000,000.

The CHAIRMAN. Well, that is his estimate, based upon the figures that are now before us.

Senator McCUMBER. That is assuming that there will be some retrenchment of our revenues. There has been no retrenchment. We are getting wilder and wilder in our voting of money to be paid.

The CHAIRMAN. He is speaking of conditions as they now exist; he is not speaking about wild appropriations that may or may not be made in the future.

Mr. LEFFINGWELL. The matter is in the control of the Appropriations Committee; but taking into account the items which Senator Lodge and Senator Penrose mentioned, and everything before us, it seemed to me that \$30,000,000,000 was a reasonable figure.

The CHAIRMAN. And of that sum nearly \$10,000,000,000 has been loaned to the allies, and, of course, we will get that back.

Senator McCUMBER. That is assuming that we will hereafter keep our appropriations within the limits of our taxation and will not have to issue bonds.

Senator SMOOT. It will be a couple of years before that can happen.

Senator ROBINSON. What about the bill?

Mr. LEFFINGWELL. The situation in which the Treasury finds itself is this: There is about to be another liberty loan. We have issued \$3,000,000,000 or \$4,000,000,000 of Treasury certificates in anticipation of that loan. The amount increases every two weeks by \$500,000,000 to \$600,000,000 in meeting the current expenditures of the Government. The first maturity of certificates of that character is on May 6. The plans for the loan contemplates beginning the campaign not later than the 21st of April. Under those circumstances it seemed to the Secretary of the Treasury that it was absolutely essential that the authority be conferred upon him by this Congress to deal with the situation. We had in that respect a peculiar problem to meet. Heretofore the Congress has taken final action upon the terms of the loan only a few days before the actual opening of the loan campaign. This time that would be impossible. It is a peculiar fact in connection with the sale of securities that an attempt to fix the terms and announce them to the public two months ahead of the offering practically kills the issue; and we were convinced in the Treasury, and the bankers and liberty loan workers and others whom we consulted were unanimous in their advice to the Treasury, that the attempt at this time to fix the terms of the issue would have two evils: In the first place, if we fix a maximum rate of interest now that maximum would be the minimum. I am not familiar with any instance in which the Government has fixed a maximum that did not prove to be the minimum.

The liberty bonds have never been sold at a rate lower than the maximum fixed by law.

Business conditions are changing. Things have slowed up. The industrial and commercial activity of the country is being held in check awaiting such important legislation as the railroad bill and the wheat guarantee bill and the informal contracts bill, and it is the earnest hope and belief of the Treasury that the enactment of that legislation will result in the liquidation of contracts, of bank debts,

and in such renewal of business activity as will create a situation in the country at large which will make possible the flotation of a loan on terms which to-day would seem impossible. And yet to accomplish that result we should be in the position to determine those terms as the situation then develops.

With those things in mind the Secretary asked authority to issue bonds and notes (as the Treasury previously had authority to issue Treasury certificates) without limitation as to interest rate, his view being that the imposition of any maximum limit under which we could safely undertake to finance the Government at this time would prove to be the establishment also of a minimum price at which he could get the money; that it was worth from a half to a quarter per cent per annum to the Government of the United States not to fix the rate in the bill at this time.

The advice of bankers throughout the country has been carefully considered. The correspondence of the Treasury has been very large. The Secretary himself has been in conference with many of the wisest thinkers on financial questions in the country. There were several things that stood out as representing the prevailing opinion. One was that the obligation should be of short maturity; another was that there should be some choice offered to investors; an effort to reach two classes of investors, the class which would be appealed to by high interest rates and not appealed to by exemptions from taxation, and the class which would be appealed to by exemption from taxation rather than by higher interest rates.

Senator LODGE. What are the loans of the United States? Has it been left to the Secretary to fix a rate of interest?

Mr. LEFFINGWELL. Only for Treasury certificates.

Senator SMOOT. And they are short-term certificates, Senator.

Mr. LEFFINGWELL. They are limited to one year.

Senator LODGE. I mean what loans. These are loans, although they are short loans. Were there any loans previously where the rate has not been fixed by Congress?

Mr. LEFFINGWELL. A maximum rate has always been fixed.

Senator PENROSE. You say that is the minimum rate. Therefore, Congress fixed the rate. Never in the history of the Government has Congress permitted the Secretary of the Treasury to fix the rate.

Mr. LEFFINGWELL. The Secretary of the Treasury asked authority, under the circumstances, to fix the rate also without limit in respect to bonds maturing in 10 years or less, but that was disapproved by the Ways and Means Committee, which, however, has now reported the bill giving him authority to fix the rate in respect to notes.

Senator LODGE. Well, that is simply changing the name.

Mr. LEFFINGWELL. No. It makes a difference as to the maturity. The provision in the bill proposed was that he should fix the rate as to bonds maturing in not more than 10 years, and striking that out limits the power to fix the interest rate to obligations of not more than 5 years.

Senator SMOOT. I fully agree with the position of the Treasury that we should issue short-time notes instead of bonds, but I do believe that there should be at least two classes of those notes. But I think that Congress ought to fix the rate. You know, Mr. Leffingwell, as we all do, that if these notes are to be sold universally all

over this country to all classes of people, it has got to be based largely upon the patriotism of the people. Enthusiasm will not be manifest as it has been in the past loans, but the amount that will be taken by the people has got to be taken because of their loyalty to the country. I think it was wisdom on the part of Congress to name in these classifications of notes the rate of interest that they are to be sold at. As you say, not only in our country, but other countries in the world, the maximum rate has always been the rate at which bonds have been sold when authorized. It will be so in this country, and we might as well know it, and in fixing the rates here at the maximum, as we have fixed it in the past, we will have it.

Senator GORE. What preexisting issues will be converted?

Senator SMOOT. Nothing under this bill. Under this bill the 3½ per cent and 4 per cent bonds have the privilege of conversion into the 4½. That is, the time is extended. There is no authority in this bill to convert those bonds.

Senator GORE. Is that observing the stipulation in the first law, particularly the privilege of conversion?

The CHAIRMAN. As I understand it, Senator Gore, if the department issues additional Liberty bonds at a higher rate than described in those already issued the privilege of conversion will apply.

Senator JONES. Is not that limited to subsequent bonds issued with a maturity of not less than five years, where the maturity must be more than five years?

Senator LODGE. There is no limitation of that kind. We get around the limitation by calling them notes.

Senator NUGENT. What is the advantage of issuing notes instead of bonds?

Senator LODGE. To get around the privilege of conversion.

The CHAIRMAN. If we issue these notes, as I understand it, at a higher rate of interest, that does not give the holders of these already issued the right to convert them at the higher rate?

Senator McCUMBER. Why does it not? Is the mere naming of an issues notes which in all respects is a bond going to make it without the right of conversion?

Senator LODGE. Yes; it removes the privilege of conversion by calling it a note.

Senator McCUMBER. Well how does it do it?

Senator LODGE. Because we have said conversion into bonds. We change the word "bond" into "note" and get rid of it.

The CHAIRMAN. We have been issuing Treasury certificates at a high rate, higher than the bonds, but it has never been contended that because we borrow some money on a Treasury certificate that that entitled the holders of the bonds to convert them at that rate.

Senator LODGE. You could call it a 20-year note if you wanted to.

Senator TOWNSEND. Mr. Leffingwell, how do you think this is avoided.

Mr. LEFFINGWELL. I have not considered the denomination of this issue as a note rather than a bond as finding its primary justification in any question of conversion.

Senator LODGE. Well, it is supposed to destroy the conversion privilege.

Mr. LEFFINGWELL. Hardly that. The reason these are called notes is that the Ways and Means Committee felt that was the proper

name for a short-time obligation, and were willing to confer a greater degree of discretion upon the Treasury with respect to an issue of short notes than an issue of bonds. It may be that they felt that a sentimental, rather than a legal, claim for conversion would be made if bonds were issued at a higher rate than $4\frac{1}{4}$ per cent. Among investment securities I think of no obligation of any Government, of any State, of any city, or any company, maturing in less than five years from the date of issue, which is designated a bond. Certainly to call an obligation maturing in less than five years a bond would be without precedent in the history of American finance, and it would be a misnomer.

The Congress in section 4 of the second Liberty bond act, in respect to all conversion privileges other than that of the first Liberty loan, expressly declared that an obligation maturing in five years or less was not to be regarded as a bond. In the case of the first Liberty issue the Secretary of the Treasury, for information to the public, inserted in parenthesis, in the circular offering the bonds, and in every bond, and in every paper relating to the conversion privilege, a statement to the effect that Treasury certificates of indebtedness and other short-time obligations were not to be regarded as bonds for the purpose of creation of the conversion privilege, and that is the present status. Undoubtedly if the Congress were to determine now, differently from its determination in the second Liberty bond act, that an obligation maturing in two or three or four years was a bond, notwithstanding the fact that such determination would be without precedent in the history of American finance, it might, by directing the Treasury to issue as a bond an obligation of that maturity, create a technical claim for conversion in respect to the $3\frac{1}{2}$ per cent bonds; although, in my opinion, such a claim would be wholly without merit except so far as the technical misnomer of the obligation so issued would create that claim. All bonds other than the $3\frac{1}{2}$ per cent bonds are by their terms entitled to no further conversion privilege whatever.

Senator LODGE. Limiting it to five years is an avoidance of conversion.

Mr. LEFFINGWELL. The point is the maturity and not the name, though you might by misnaming the obligation create a technical claim on behalf of the $3\frac{1}{2}$ per cent bondholders whose rights have been protected and who, so far as I know, are fully satisfied with the bonds they have.

Senator McCUMBER. And calling a 20-year bond a note would also defeat the life of conversion by the same process of reasoning.

Mr. LEFFINGWELL. Not in my opinion. I should not like to be a party to that operation.

Senator PENROSE. You said that the Secretary in these circulars states that the two-year certificates and other short-term obligations were not to be regarded as bonds for the purpose of the creation of a conversion. Did he define what a short-time note was?

Mr. LEFFINGWELL. No; the first definition of that was contained in the second Liberty bond act. That says five years or less. This statute in this bill follows the determination of the Congress in the second Liberty bond act.

Senator PENROSE. Well, it appears that Congress has defined, then, a short-term note.

Senator TOWNSEND. Do you know how many of those first Liberty bonds have been converted already?

Mr. LEFFINGWELL. About \$550,000,000.

Senator TOWNSEND. A small proportion of them.

Mr. LEFFINGWELL. A quarter.

Senator LODGE. They are held up on account of exemption.

Mr. LEFFINGWELL. Yes.

Senator TOWNSEND. Were many of the second issue converted into the third and fourth?

Mr. LEFFINGWELL. All but a billion dollars of the 4 per cent bonds were converted, and there is a provision in this bill which would authorize the Secretary of the Treasury to extend the conversion privilege to those holders of the 4 per cent bonds who did not avail themselves of the right.

Senator TOWNSEND. I did not hear the first part of your statement. Do you expect you can float these bonds at less than $4\frac{1}{4}$ per cent.

Mr. LEFFINGWELL. It depends upon the exemptions under which they are issued. Notes carrying full exemption from taxation could be issued at very much less than $4\frac{1}{4}$ per cent.

Senator TOWNSEND. Are you advising exemption?

Mr. LEFFINGWELL. I think that the Secretary ought to have power to make an alternative issue, giving the people the choice between an issue at a lower rate exempt from taxation, and an issue at a higher rate subject to taxation.

Senator PENROSE. What would be your idea about that high rate?

Mr. LEFFINGWELL. It is very nearly impossible at this time to fix the rate.

Senator PENROSE. It is only two months ahead of the drive for the loan.

Mr. LEFFINGWELL. That means everything to us.

Senator PENROSE. Have you any notion as to what it would be?

The CHAIRMAN. If you had any, would it be advisable to express it?

Mr. LEFFINGWELL. It is just because we do not believe that it would be advisable to fix the interest rate at this time, to give the people a definite answer to the question, that we have asked authority to determine it. My view is this: We can not now safely say at what rate the Government can borrow the money; that is, before the life of this Congress terminates. If you fix a rate which we may hope would be sufficient in April, the markets would adjust themselves to that rate; the attraction would be discounted; the prices of Liberty bonds and other securities would all reflect the decision; and by the time the drive begins, almost two months from to-day, as the bankers say, the bloom will be off the issue and you will not be able to sell a note upon terms which, if you had left the question open to the last minute, would seem at that time very attractive. We are very anxious that you should not ask us to make an estimate of the interest rate for that reason.

Senator GORE. Would that be the reaction at the time—if you wait until then?

Senator PENROSE. You would lead the taxpayer blindfolded into a Liberty loan drive.

Senator TOWNSEND. If you had the exemption privilege you say you would sell it at a lower rate. Would that rate, in your judgment, be $3\frac{1}{2}$ or less than $3\frac{1}{2}$?

Mr. LEFFINGWELL. The $3\frac{1}{2}$ per cent bonds are selling a shade under par now, and I think it is safe to say that it could not be as low as $3\frac{1}{2}$ per cent, Senator.

Senator LODGE. But you could place the loan at $3\frac{1}{2}$ per cent with complete exemption?

Senator SMOOT. I think, myself, Mr. Leffingwell, that it would be very much better in this bill to name the rate of interest. I would rather have the situation settled—definitely determined—by all of the investors in bonds and the people generally by the time the Liberty loan begins than have the changed condition taking place while we are selling the bonds.

Senator PENROSE. It seems to me the argument is rather specious to lead the loan contributor up to the table blindfolded and then take the bandage off his eyes and show him the interest. That does not seem to be straight dealing with the public.

Mr. LEFFINGWELL. If a man is told the bargain he is offered at the time it is offered to him, that is straight dealing. You are under no obligation to tell him two months ahead of time what it is you are going to offer him, and you never have done so. The bills which have been passed by the Congress in respect to every loan except the first have been passed within less than a week of the date of the loan offering.

I wonder if you will bear with me while I read the statement of the Secretary of the Treasury on this point, because it really seems to me to be vital to the situation. I realize the importance of the considerations which impressed you and I could not tell you how sincerely the Secretary of the Treasury regrets having to ask this authority. No man in his senses would willingly assume undivided responsibility for the determination of the interest rate, even if the Congress be willing to confer it upon him, if he could avoid it.

Senator SMOOT. There is no necessity of it. We can meet here in April and pass this a week before the sale begins, and I have not any doubt that it will pass without opposition. I think that would be the best way. But if we are not going to have an extra session called by the first week in April that would give ample time to pass the law. But I do believe that Congress ought to take the position that, "Here, we are going to sell these bonds; these are the rates and the different issues; those that are exempt from taxation entirely are so much at such a rate; those that are partially exempt from taxation are at such a rate; and those that are specified in exemption Nos. 3 and 4 here are at such a rate." I think Congress ought to do that and I do not think there is going to be any evil results follow from doing it, either.

Senator PENROSE. We will be in session at that time, and we can do it easily.

The CHAIRMAN. When?

Senator PENROSE. We ought to be in session not later than the 1st of April.

Senator SMOOT. In the Appropriations Committee to-day a situation developed that is really dangerous; that is, the appropriation

of \$750,000,000 for the railroads. Some of the Senators are insisting that, inasmuch as we are going into the railroad question, there should be an amendment authorizing the Interstate Commerce Commission to review the rates. I have heard some of them say that, unless it was agreed to in the committee, they were going to carry it to the floor of the Senate and, if necessary, to beat that bill.

Mr. LEFFINGWELL. There is just a brief statement of the Secretary of the Treasury made before the Ways and Means Committee of the House that contains an argument on this question. I read from page 9 of the hearings before that committee as follows:

In respect to the notes and also in respect to the bonds of a maturity of 10 years or less, I have asked authority to determine the interest rate as the situation may develop. I am by no means convinced that conditions will be such in April as to necessitate an increase in the interest rate over that provided in existing law to an important extent if at all; yet, if I were obliged to determine now what is the lowest rate at which I could undertake with certainty to finance the requirements of the Government when the issue is offered in April, I should be obliged to name a maximum rate much higher than that which, if developments are as favorable as I expect they will be in the interval, will, I hope, be sufficient to float the loan.

There is not, I venture to say, a solvent banking house in America which would enter into a firm obligation to-day to purchase in April any important amount of securities of any character at any price whatever—certainly not at a price which failed to make such an allowance for contingencies in the interval as would be regarded as prohibitive by the borrower. Yet that is exactly what the Congress would require the Secretary of the Treasury to do if it were to fix the interest rate to-day. I can not undertake the responsibility of saying now at what rate the bonds or the notes may be sold in April; and if you were to-day to fix a maximum rate, such as to be sufficient in any possible contingency, you would by that very act tend to force the adoption of that maximum rate when the loan is offered.

No Liberty loan has ever been sold at lower rate than the maximum fixed by the act under which it was issued. On the other hand, in the second Liberty bond act, which was approved nearly a year and a half ago, you conferred upon Secretary McAdoo authority to issue Treasury certificates of indebtedness without limit as to the rate of interest, and he and I have been able to maintain the rate of $4\frac{1}{2}$ per cent for such certificates during a full year, including the period when our war prospects were at their darkest and the recent period when the cessation of hostilities has made the problem of selling Government securities most difficult. The floating debt, represented by Treasury certificates now outstanding and to be issued in the interval before the Victory Liberty loan is offered, must be refunded, and bonds or notes must be sold to an amount sufficient to accomplish this purpose. To withhold from the Secretary of the Treasury the power to issue bonds or notes bearing such rate of interest as may be necessary to make this refunding possible might result in a catastrophe. To specify in the act the maximum amount of interest at a figure sufficient to cover all contingencies would be costly, because the maximum would surely be taken by the public as the minimum.

Senator TOWNSEND. Does the present Secretary still entertain the idea that the bonds might be issued at the higher rate with the privilege of converting them into $3\frac{1}{2}$ per cent bonds with exemption privileges?

Mr. LEFFINGWELL. He has a notion, having adopted his thought to the plan outlined in the Ways and Means Committee's bill, of the issue of two series of notes with a provision for the interchange of notes of those two series. One thing which has embarrassed the Treasury is the fact that some holders of $3\frac{1}{2}$ per cent bonds, having converted them into $4\frac{1}{4}$ per cent bonds and then found that the market value of the $3\frac{1}{2}$ per cent bonds was higher than the market value of the $4\frac{1}{4}$ per cent bonds, were disappointed. It is believed, by this

provision, which would permit the interchange of those two issues, we shall create a situation where there will be no similar disappointment on the part of the note holders.

Senator GORE. That would tend to hammer down the price of the $3\frac{1}{2}$ per cent bonds and raises the existing $4\frac{1}{4}$ per cent bonds.

Mr. LEFFINGWELL. Perhaps I have not made myself clear. This is a conversion between two issues of notes to be offered in the future. Under the existing law there would clearly arise no right of conversion in favor of any existing bondholder, if this plan were followed. There is, however, a provision in this bill, which is intended for the benefit of existing bondholders, in the form of additional exemptions from taxation, which would tend to stabilize the markets for those bonds; and, indeed, the market for the outstanding bonds responded favorably to the announcement of a short-time note issue, probably because the holders of the old bonds feel that a short note will not compete in the same way with their bonds as the issue of another bond. Indeed, I feel that the mere name note has a certain tendency to suggest a different character of security and be helpful.

Senator GORE. Yet it is certain that these will be refunded at their expiration?

Mr. LEFFINGWELL. The greater part of them certainly. The bill contains a provision for a sinking fund, beginning with 1920, which should very promptly become effective for the gradual retirement of the debt.

Senator GORE. Have you given any thought to the serial bond?

Mr. LEFFINGWELL. A good deal of thought. In effect, the bonds that we have out when this issue of notes is made will be serial. We have four liberty loan issues. One of them matures in 9 years from now; one matures in 30 years and is redeemable in 15 years; one matures in 25 years and is redeemable in 10 years; and one matures in 20 years and is redeemable in 15 years. So that the issue of short notes now and a brief refunding of a portion of them would result in a situation where the United States would at all times be able to use its sinking fund in the retirement of the public debt. These bonds have been adjusted as to maturity and redemption dates in such a way that the appropriate sinking fund could effectively retire the debt in a period of some 25 years.

The CHAIRMAN. Are you referring now to the whole debt or the war debt?

Mr. LEFFINGWELL. The funded war debt excluding the prewar debt, which was under a billion dollars, and the war-savings certificates, which will be paid when they are presented but which represent the best kind of security in the world to keep out if there is any to keep out.

Senator GORE. If these bonds were made real serial bonds would that detract from the market value?

Mr. LEFFINGWELL. The mechanical difficulty is so great that we have always rejected the plan of issuing serial bonds. We calculated that we sold the last loan upward of 20,000,000 subscribers, and with bonds as low as \$50. The issue of a serial bond under circumstances of that sort presents almost insurmountable difficulties. You could not divide a \$50 bond into half a dozen or a dozen maturities, and you could not make a choice between bonds of different maturities arbi-

trarily for the subscribers. You would have a variety of different markets. I think it is the undivided opinion of all the bankers and Liberty loan workers that a plan of that sort is impracticable and that we have accomplished the equivalent by the arrangements we have made.

Senator GORE. Each 25-year bond maturing every year?

Mr. LEFFINGWELL. Senator, that has social and economic objections which I would like to point out to you. We are trying by the sale of Liberty bonds to reach the investor; we are trying to teach saving; we are trying to make the American people owners of the Government war debt. If you were to receive back your principal sum at one time in 25 years or in 10 years you would recognize that as principal, but if you were to receive the interest plus a fractional part of the principal, if you were not accustomed to investment, your tendency would be to regard that as added income. At the end of 20 years you would have eaten up your principal and the interest.

Senator GORE. There are some investors that that would appeal to and some would object to it.

Mr. LEFFINGWELL. But it is our belief that a bond of that character is calculated to discourage saving and terminate capital investment rather than to encourage it.

Senator GORE. I have a serious fear that these billions maturing in a single day will never be paid.

Senator SMOOT. The two and a half sinking fund provided by this law will not take care of the notes and the additional certificates of indebtedness provided for in this bill.

Senator GORE. The sinking fund has never gotten us anywhere.

Senator SMOOT. The sinking fund if applied as intended here and they covered all of the applications of the Government and they all matured in 25 years and it began this year—the $2\frac{1}{2}$ per cent sinking fund—if applied only to the payment of the application yearly would stop the interest thereon—or the investment of that amount of sinking fund to bring the same amount of interest would bring the same thing—at the end of 25 years the obligation would be paid. There is no doubt as to that. But you were speaking of these notes, whether they would be refunded. Part of them will have to be refunded because the $2\frac{1}{2}$ per cent sinking fund in the five years will not take care of the \$9,000,000,000.

Senator LODGE. Now, that sinking fund has got to be provided for by taxation, of course?

Senator SMOOT. Of course.

Senator LODGE. How much annual taxes will that retire?

Senator SMOOT. If it is \$35,000,000,000 obligations of the Government it will be about \$875,000,000 for the sinking fund annually. The bill provides—I read that provision hastily last night—that it shall be the amount of $2\frac{1}{2}$ per cent upon the total obligations of the Government, whatever it may be.

Senator GORE. We have gone on the theory that the amortization privilege in these land-bank bonds was a great privilege and it was the best way to extinguish the debt without feeling it very much.

The CHAIRMAN. My recollection is that they calculate the sinking fund to a debt of \$28,000,000,000, is it not?

Mr. LEFFINGWELL. In the calculation that was made and submitted to the Ways and Means Committee, Senator, we estimated that the amount of the debt to which that sinking fund would apply would be some \$28,000,000 less, say, \$10,000,000 foreign notes. The sinking fund is reduced by the bonds of foreign governments which we hold.

Senator GORE. Is that set out in this pamphlet here? [Referring to the testimony taken before the Ways and Means Committee of the House.]

Mr. LEFFINGWELL. Yes.

Senator PENROSE. What are you figuring as to the proportion required out of taxes every year out of the sinking fund for the total national debt. We are talking about a \$35,000,000,000 debt.

Senator SMOOT. About \$875,000,000. That is to begin with.

Senator PENROSE. It will approximate \$1,000,000,000?

Senator SMOOT. No.

The CHAIRMAN. Do you not want to make any allowance at all for the foreign loans?

Senator PENROSE. Yes; Senator Smoot's figures, I understood, did deduct those.

Senator SMOOT. No; I did not deduct the foreign loans. My idea of the foreign loans is expressed in the bill that I introduced. I think they ought to be converted into bonds and debentures and sold. That is what I think we ought to do with that foreign obligation. When we do that we will reduce it to about nine billion before we get through. They would, of course, greatly reduce it, and if the obligation were \$25,000,000,000, the 2½ per cent of that amount would be \$625,000,000 annually.

Senator PENROSE. How much would be the annual interest charge on the probable debt of twenty-five billion?

Senator SMOOT. If you come to the interest charge, taking it in connection with the 2½ per cent sinking fund, you would have to divide the amount perhaps by 2, or, in other words, you would take the amount of interest that would be paid upon the whole amount, 4¼ per cent on \$25,000,000,000, which would be \$1,125,000,000; and then you would have to divide that only for 12½ years, but, of course, to begin with, it would be one billion and a quarter.

The CHAIRMAN. Senator Lodge, the Treasury Department has made a statement in these hearings in which they estimate that \$1,200,000,000 would cover the interest and the sinking-fund indebtedness that we would have to raise by taxation.

Senator PENROSE. I would like to have that read into our record.

Mr. LEFFINGWELL. If you will refer to page 59 of the testimony taken before the Ways and Means Committee you will find an estimate made by the Government actuary on the sinking fund. It is as follows:

TREASURY DEPARTMENT,
Washington, February 13, 1919.

Memorandum for Mr. Leffingwell:

The annual payment into a sinking fund with interest at 4½ per cent, reinvested annually, in order to amount to \$20,000,000,000 or \$18,000,000,000 in 25 years, will have to be as follows:

	Per cent.
For \$20,000,000,000 -----	\$464, 290, 591=2. 32
For \$18,000,000,000 -----	417, 861, 532=2. 32

Respectfully,

Jos. S. McCoy, *Government Actuary.*

When we talked this morning about \$30,000,000,000, we were talking of the total debt, which would have included no doubt a certain amount of savings certificates, and without deducting foreign loans.

Senator SMOOT. If you will remember, Mr. Leffingwell, some time ago I put into the Record what up to that time showed what the maximum debt of the Government would be, and it was \$31,000,000,000. In addition to that we have the \$1,000,000,000 for wheat; we have \$750,000,000 for the War Department; we have \$750,000,000 for the Railroad Administration.

Senator PENROSE. And your validated war contracts.

Senator SMOOT. I took that in as an estimated amount of 70 per cent. I estimated for that amount. It would be \$250,000,000,000, which would make \$33,500,000,000.

The CHAIRMAN. Senator Smoot, when you are dealing with railroad indebtedness you are not going to apply for the purpose of this calculation the same principle that you applied to the debts; as composed in part of our own expenditures and part of our loan? The money that we have been advancing for the railroads and which we expect to advance for the railroads is in large part to be returned.

Senator SMOOT. \$290,000,000 of it up to the 31st day of December, 1918. We had the revolving fund of \$500,000,000, and that is all gone.

The CHAIRMAN. It is estimated that of that we will lose what?

Senator ———. The estimate that was given was \$196,000,000.

Senator SMOOT. But, Senator, it does not cover it.

The CHAIRMAN. You have to lose over \$200,000,000 of that \$500,000,000. Of this \$750,000,000, which it is proposed to loan, I do not know that we are going to lose any of that.

Senator SMOOT. Of this \$750,000,000?

The CHAIRMAN. Yes.

Senator SMOOT. Of course we will.

The CHAIRMAN. Of course, if the expenses of operation are as great this year as they were the last year, then we will lose more. If they are more successful we will lose less. We can not tell exactly how much we are going to lose, but it is certain that we are not going to lose all of the \$750,000,000.

Senator SMOOT. That is true in the end.

The CHAIRMAN. \$265,000,000 of that, I think, is to pay for equipment that the Government has already purchased for the benefit of the roads, so it will be an obligation held by the Government against the roads.

Senator SMOOT. There are \$286,000,000 that will be held against the roads, and yet there are already contracts for the year 1919 unfilled that they expect to be filled and must be filled of \$109,000,000. That is the amount that is to be returned. Not granting that there is \$500,000,000 of this that is to be paid back then there is \$33,000,000,000 that we know of. But I am only figuring that roughly.

Senator PENROSE. It will never be paid back judging by the past record of Government ownership of the railroads.

The CHAIRMAN. I understand that of this \$750,000,000, \$290,000,000 is to pay money that the Government has already obligated itself to advance for the benefit of the roads. That is, the sum of

\$255,000,000 for materials that are hereafter to be furnished, but the railroads will owe that money to the Government. So there is over \$500,000,000 of that \$750,000,000 that the Government will invest for the benefit of the railroads that will have to be paid back by the railroads.

Senator SMOOT. If it is all paid for there will be about \$33,000,000,000.

Senator PENROSE. There is another item, the old familiar revolving fund of a billion dollars to loan to people exporting goods to foreign countries.

Senator SMOOT. We will get that back.

The CHAIRMAN. They are not going to get the money out of the Treasury; they are going to issue bonds under authority given them in the act. They are going to issue bonds and sell those bonds on the market as the bonds of the corporation.

Senator LODGE. Let the idea get abroad that the Government is not responsible for the bonds and you will sell very few of them.

(And thereupon, at 12 o'clock p. m., the committee adjourned to 10 o'clock a. m., Wednesday, February 26, 1919.)

FIFTH LIBERTY LOAN BILL.

WEDNESDAY, FEBRUARY 26, 1919.

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met at 10 o'clock a. m., Senator Simmons (chairman) presiding.

Present: Senators Simmons, Williams, Smith of Georgia, Thomas, Robinson, Penrose, Lodge, McCumber, Smoot, and La Follette.

The CHAIRMAN. The committee will come to order please.

Mr. Leffingwell, my recollection is that yesterday after spending an hour and a half we had gotten down finally to the bill.

Mr. LEFFINGWELL. I have taken the liberty of asking to come here this morning with me Mr. Lewis B. Franklin, director of war-loan organizations of the Treasury. Mr. Franklin came to Washington at the beginning of the war at Secretary McAdoo's request. He is a New York banker, is a former president of the Investment Bankers' Association of America, and has just completed a tour of the United States, during which he addressed and conferred with bankers throughout the country, and I am very anxious that you give him an opportunity to state to you briefly the practical considerations which lead the Treasury to ask legislation at this time and of this general character.

The CHAIRMAN. If you will yield to him, he can make a statement now.

STATEMENT OF MR. LEWIS B. FRANKLIN, DIRECTOR WAR LOAN ORGANIZATIONS.

Mr. FRANKLIN. Mr. Chairman, my trip throughout the country was principally for the purpose of conferring with the liberty loan organizations which have been built up under the supervision of the 12 Federal reserve banks acting under the direction of the Secretary of the Treasury. The trip was prompted very largely because of the fact that there were strong indications that, following the armistice, there was feeling that the war being over there was no further use for the great volunteer organization which had been built up. This volunteer organization consists of about 2,000,000 able men and women, and through their efforts we have succeeded in selling liberty bonds to upward of 20,000,000 of people throughout the country. Without the efforts of this large group of volunteers it would have been impossible to distribute the bonds to any such number of people. We would have had to rely on the usual normal bond buyers, numbering 300,000 or 500,000 people. We, in the Treasury,

felt that we must take immediate steps to hold this organization, so I started out, and I have visited most of the Federal reserve districts; all of the western ones. I found the situation was serious. This was in January. I found that a tendency was for chairmen of committees to tender their resignations and to get back to their business, which had been seriously affected: They had suffered financial loss on account of their devotion to this work without pay; they wanted to give up liberty loan work and get back to their normal peace-time duties.

We had meetings in nine of the districts, and I am glad to say that after a good deal of effort we were able to persuade these men and women to stick on the job. We were able to persuade them that their duties did not cease with the cessation of fighting but that they ought to stay on the job until the bills were paid, and to-day I am glad to tell you that the liberty loan organizations are in very excellent condition despite the general reaction of feeling throughout the country. But, gentlemen, that can not continue for an indefinite period; we have held them together on this basis; that the Secretary of the Treasury, I think very wisely, has authorized me to tell the liberty loan organizations throughout the country that this victory liberty loan would be the last campaign in which he would call on this great volunteer organization; that after it was successfully put over he would release them from any more obligation to serve the Government, and it is only that statement, that this is the last piece of work for which they will be called upon, that has enabled us to hold them in line. If we had set before them an indefinite task covering two or three more campaigns we could not have held them. We would have then had to resort to an entirely different method of sale, probably would have had to build up a large paid organization at tremendous expense, and change our entire method of distribution.

I am convinced that great danger exists in any postponement of this victory liberty loan campaign which has been positively set for the month of April. We have hard enough work to hold that organization until that time; and if this liberty loan campaign is postponed beyond the month of April, I believe that we will have a disintegration of the organization which will be disastrous, which will result in the Government selling its bonds to, possibly, the banks of the country or else increasing the rate of interest on them to such an extent that it will cost the Government a tremendous amount of money.

Senator SMITH. Has there been any indication of the rate of interest that you think it will be necessary to charge, Mr. Chairman? Has that been suggested by the Treasury?

The CHAIRMAN. The suggestion was made from the Treasury that it would be very unfortunate to have at this time to indicate the rate that will be charged.

Mr. FRANKLIN. We know this feeling of the organizations throughout the country. To-day they are all gloomy over the situation. The patriotic fervor is relaxed, and they all say that to-day they are thinking in terms of a high rate of interest. I feel convinced from my experience in selling bonds, which covers 20 years—I started very young, as you may imagine—that if the Treasury or the Congress is to name the rate of interest to-day they must name what will look a

very high rate of interest. Not only that, but if that rate of interest is up for discussion and the terms of the bonds are presented to the public within the next week, by the time we are able to offer those bonds or notes they will have become stale and will not sell readily, no matter what the rate of interest is. We have never heretofore announced the terms of the bonds until just before the campaign opened.

Senator SMOOT. You do not think the people generally are going to buy these bonds for the investment? They are going to buy them because of their patriotism for the country, and the mere fact of naming the rate of interest now will have no effect whatever on the general public.

Mr. FRANKLIN. I wish I could agree with you, but that was so before the armistice was signed. But that patriotic sentiment has disappeared to a very large extent.

Senator PENROSE. The people think their money has been wasted.

Senator WILLIAMS. When a man is through, his fighting blood is no longer excited.

Mr. FRANKLIN. With this organization of 2,000,000 men and women, we might say the pick of the country, because they have served for two years without any reward, or hardly any, we may renew that spirit of enthusiasm for a limited time; but it is absolutely impossible to whip up a spirit of enthusiasm and patriotic fervor on the 1st day of March and keep it going until the 1st day of May. It has got to be a short, sharp, snappy campaign.

The CHAIRMAN. Without this spirit of patriotism that we would rely on, to pass this before this was aroused would cause discussion; the bankers would begin to discuss, the investors would begin to discuss, the return on profits, and so on, and you would never be able to arouse it. But if you could arouse that spirit before they get an opportunity to take a distinctly business view of the matter, you think it will go on more smoothly?

Mr. FRANKLIN. That is it, exactly.

Senator SMOOT. Your idea of the people of America is very strange.

The CHAIRMAN. I think there is philosophy and psychology in that position. In other words, I think, Senator Smoot, if before you have stirred the patriotism of the people with respect to this matter, the terms have been discussed as a cold business proposition, and the bankers have given their views about it, and the public have read their conclusions about it, you are going to have difficulty in arousing the enthusiasm; if you arouse the enthusiasm and they begin this discussion after the enthusiasm is aroused, it will not be effective.

Senator SMITH. Do you feel like putting the strain upon yourself to buy Liberty bonds to-day that you did before the armistice was signed; have you the same enthusiasm about buying them to-day as you had when we were fighting the Germans and were obliged to have the money?

Senator SMOOT. No; I have not, and I do not think there is any other person that has, but it makes no difference to me whether we decide that the rate of interest should be $4\frac{1}{2}$, $4\frac{1}{4}$, or 4 per cent, whether it is named now by Congress, or whether it be named hereafter by the Secretary of the Treasury.

Senator SMITH. I was discussing the enthusiasm.

Senator SMOOT. Everybody recognizes that.

The CHAIRMAN. Suppose we hear the rest of this gentleman's statement and then we can discuss those things.

Mr. FRANKLIN. I have nothing more to say.

Senator SMOOT. I know the sale of this \$6,000,000,000 worth of notes is going to be a hard thing to do, and I know it can not be sold to the mass of the people as an investment at any rate of interest we are going to name.

Senator ROBINSON. I do not think that conclusion is indisputable at all.

Senator SMOOT. The bonds will be sold because of the people's loyalty to their country. I would not buy any more of the bonds as an investment, but I do expect to buy bonds, because I know we have got to pay the obligations.

Senator WILLIAMS. We both feel that our duty is as great and the necessity is as great as it was before the armistice, but the average citizen does not know that.

Senator SMOOT. And you are going to try to fool him and you can not do it.

The CHAIRMAN. There is one matter I wish you would discuss with the committee, if you have discussed it with the people with whom you came in contact: What is the feeling in reference to the sale of these suggested notes, as compared with the sale of bonds?

Mr. FRANKLIN. I returned from my trip on the 1st of February. The question of the use of the word "notes" had not been raised by anybody at that time. There was a preference shown throughout the country in favor of a short-term obligation.

The CHAIRMAN. When you say "short-term obligation," what length of time do you think they have in mind?

Mr. FRANKLIN. Five years or under, I should say.

Senator SMOOT. I think that is correct.

Mr. FRANKLIN. I feel convinced that if a low rate of, say, 4½ per cent interest were announced by Congress to-day the organization would disintegrate, because it would say that it could not do the job. On the other hand, if a very exorbitant rate—for instance, 5 per cent—were fixed by Congress to-day, I feel that while that rate is an extravagantly high rate, that it would be so talked about and become so familiar by April that it would not be considered a bargain.

Senator SMOOT. Do you not think the people that hold these notes know what they are selling for on the market and the interest they are drawing to-day?

Mr. FRANKLIN. The well-informed people know what the basis is; the average small holder does not.

Senator PENROSE. Do you think a 3½ issue, untaxed, would be readily absorbed?

Mr. FRANKLIN. I do not.

Senator PENROSE. I have asked that of very prominent financial people, and they say it would be taken up immediately.

Mr. FRANKLIN. I do not believe it would be taken up quickly.

Senator McCUMBER. What is the lowest rate of interest on untaxed, short-time notes you could sell without difficulty?

Mr. FRANKLIN. I have tried to indicate an opinion on that by saying that if the determination of that is left until just before the cam-

paign opens we can sell notes at a considerably lower rate of interest than we could sell them if the rate must be fixed now and become stale.

Senator SMITH. You call five years or less "notes" as distinguished from "bonds"?

Mr. FRANKLIN. Yes.

Senator McCUMBER. What I wanted to get at was your advice as to freeing these short-time notes from any character of taxation and then putting the interest as low as such a short-term obligation could be sold.

Mr. FRANKLIN. I do not quite understand your question.

Senator McCUMBER. My question is based upon this, upon the advisability of freeing these short-term obligations from any character of taxes and then allowing you to fix the lowest rate of interest that will bring a demand for them.

Mr. FRANKLIN. I do not think we should confine the authorization of that to tax free notes, because the rates would necessarily be low, and there are tens of millions of people who have bought bonds in the past who are not largely affected by the excess-profits tax and want a higher rate of interest and do not mind a taxable security. Therefore, we should have at least a part of the authorization in the form of bonds subject to supertax and bearing an equivalently higher rate of interest to suit the small buyer.

Senator WILLIAMS. I suppose you are confronted with two propositions. One is to make and issue a bond totally untaxed, and the other to make an issue taxed, as in this bill. What would be the percentage of interest difference between the two, in your opinion?

Mr. FRANKLIN. About 1 per cent.

Senator WILLIAMS. In other words, if under the provisions of this bill the $4\frac{1}{2}$ per cent bond would float at par or, say, a 5 per cent bond would float at par, under the provisions of the act where they were totally untaxed they could float at 4 per cent?

Mr. FRANKLIN. I think about 1 per cent expresses the situation.

Senator McCUMBER. Would it not be to the advantage of the Government to free them from taxes and leave a lower rate of interest?

Mr. FRANKLIN. I do not feel qualified to answer that. That is a very intricate calculation.

Senator SMOOT. I would answer that question by saying that the higher rate of interest was for the purpose of selling to people who would not be affected by the tax, and therefore it would be an advantage to the Government of the United States to issue the lower rate of bonds, untaxable, provided that the sales could be made sufficient to meet the obligations of the Government.

Mr. LEFFINGWELL. The notion of the Treasury is that it is to the advantage of the Government to devise such an issue as will get the best possible distribution among investors in the United States. The great peril at the present time, now that the war is over, is that we will not be able to get the wide distribution among the people of the country which relieves the banks and frees the banks' credit for the necessary commercial and industrial enterprises of the country. For that reason an optional issue which will appeal to the man of small income by a high rate of interest and low exemption, and to the man of large income by lower interest rates and

higher exemption, is to the great advantage of the country, although it is impossible to calculate the exact cost in interest and exemption from taxes of either issue without having precise data as to the character of the distribution.

Senator SMOOT. The very fact that the $3\frac{1}{2}$ per cent bonds are selling for more than the $4\frac{1}{4}$ per cent bonds demonstrates that the man that holds the $3\frac{1}{2}$ per cent does not want to pay taxes. I believe in the issue of both classes of bonds.

Senator SMITH. Undoubtedly that is true.

Senator SMOOT. But it is to the advantage of the Government in the matter of the interest rate to have them untaxable.

Mr. LEFFINGWELL. You are assuming you could sell them.

Senator SMOOT. I think you could sell them, but there would be a very restricted number of purchasers.

Senator PENROSE. Of course, the very rich men would absorb the untaxed bonds.

The CHAIRMAN. You want to reach the class that are not moved by a consideration of tax exemption?

Mr. FRANKLIN. In the fourth liberty bond campaign we sold about \$2,800,000,000 of bonds to people that took a thousand dollars and less. That kind of distribution we do not want to lose. That was out of nearly seven billions.

The CHAIRMAN. Nearly one-half.

Mr. FRANKLIN. About 40 per cent.

Senator SMOOT. How much of that amount has been resold?

Mr. FRANKLIN. There is no possible means of knowing; we can not identify the bonds.

Senator McCUMBER. You think the people that took two and a half billion of a thousand and less took it because they wanted to invest at that of interest, or did they take it simply because they felt they wanted to help the Government out, and will the same class of people now be appealed to?

Mr. FRANKLIN. They took that to help the Government, but the same class can be appealed to in a very large measure to buy an ordinary bond that will pay a little more money.

Senator SMITH. They want a bond that will pay par.

The CHAIRMAN. If there is no other statement that you wish to make, Mr. Leffingwell will continue.

STATEMENT OF HON. R. C. LEFFINGWELL, ASSISTANT SECRETARY OF THE TREASURY—Continued.

Mr. LEFFINGWELL. We had just come back to the bill yesterday, after some general discussion on finances.

Senator PENROSE. All of which related to the bill.

Mr. LEFFINGWELL. All of which more or less related to the bill. Would it be helpful if I were to attempt to summarize briefly the provisions of this bill and then answer questions? The provisions in relation to the note issue follow closely the line of thought of Mr. Franklin's discussion and your questions concerning it.

The CHAIRMAN. I think if the committee will let you go through first, we can interrogate you better when we get a general conception of it.

Senator PENROSE. I would be glad if Mr. Leffingwell would be permitted to go on in his own way.

Senator WILLIAMS. I ask unanimous consent that he make his statement first.

The CHAIRMAN. Without objection, that will be done.

Mr. LEFFINGWELL. May I read from the bill?

The CHAIRMAN. Yes.

Mr. LEFFINGWELL. Section 18A, which this bill would add to the second liberty-bond act, provides for the issue of \$7,000,000,000 of notes of the United States without limitation as to the interest rate, limited as to maturity to five years as a maximum and one year as a minimum. The existing statutes of the United States authorize the issue of bonds, and there is in the fourth section of the fourth liberty-bond act a parenthetical clause which declares that for the purpose of the conversion privilege Congress does not regard an obligation that matures in five years or less as a bond. Existing legislation also authorizes the issue of Treasury certificates of indebtedness of a maturity of one year or less, so that we have by the existing acts of Congress a gap of four years in the description of the kinds of securities that may be issued by the Treasury. The practically unanimous opinion of the bankers and liberty-loan workers of the country is that this is the time to issue a short-time obligation maturing in five years or less. It is for that reason that there was incorporated in the bill which was originally submitted to the Ways and Means Committee the provision for the issuance of notes, so called—for that reason and also because the practically universal practice of investment houses and of borrowers is to denominate anything maturing in less than five years a note rather than a bond. This would complete a plan of nomenclature by which the Congress would describe an obligation maturing in one year or less as a certificate of indebtedness, an obligation maturing between one year and five years as a note and in more than five years as a bond.

The existing legislation limits the interest rate of the bonds to 4½ per cent and the selling price to a minimum of par. It is safe to say that no bonds could be issued under existing conditions within the limitations imposed by existing law. The Ways and Means Committee, while unwilling to give the Treasury discretion to fix the interest rate in respect to bonds, following the analogy of the statutes in respect to Treasury certificates of indebtedness, felt that the authority to fix this rate in respect to notes might properly be reposed in the Treasury. They accepted the view of the Treasury, that the fixing of the interest rate at this time would not only force a higher rate than would otherwise be necessary but that the mere fixing of the rate would make it more difficult to sell the notes in April at that higher rate than it will be at a lower rate if the rate is not now fixed.

The same section provides that these notes may be issued in series, classified according to the exemptions from taxation which may be permitted with respect to those notes. Those exemptions are, roughly, (1) total exemption from taxation; (2) exemption from all taxation except supertaxes and profits taxes; (3) exemption, as last stated, and additional exemption up to \$30,000 of principal, from supertaxes and profits taxes; and (4) subject to all Federal taxes. I believe those are the main classes.

The CHAIRMAN. Explain the fourth one—about the \$20,000.

Mr. LEFFINGWELL. The \$20,000 exemption occurs in respect to the old bonds. It was the thought of the Ways and Means Committee that while they would not be willing to leave to the Secretary of the Treasury the determination of the exemption from taxation which might be offered to the holders of notes, they could properly and wisely determine certain general categories in which the notes might be issued in respect to taxation and leave it to the Secretary of the Treasury to offer notes in one or more of those series. This bill, therefore, would make it possible for the Treasury to offer a note bearing a higher rate of interest and carrying a limited exemption from taxation and a note bearing a lower rate of interest and carrying a greater exemption from taxation, those exemptions all being specified in the act. It is quite safe to say that not more than two series would be adopted, but it is premature to attempt to decide just which two could most advantageously be sold in April.

In order to avoid the very serious obstacle of forcing a choice between the two issues during a great patriotic public campaign, and in order to assure the subscribers for the Victory liberty loan a reasonable opportunity to make their choice as between the two notes issued, this section also provides that the note issues shall be convertible the one into the other.

This will make it possible for the Treasury, in the first instance, to deliver notes only of one series, greatly reducing the mechanical burdens of the Bureau of Engraving and Printing and of the patriotic salesman who is to carry around a subscription blank, and at the same time it would protect the small subscriber from any possible injustice due to his having made a selection of a bond which subsequently the market might rate lower. There would be no difference, if this clause appeared in the act, between the market quotations of the two obligations, because they will be convertible.

Section 2 of the act provides additional exemptions in respect to old bonds. The Treasury is greatly concerned that the interests of the patriotic people who made subscriptions for Liberty bonds during the period of the war should be protected. The provisions of this section are calculated to add to the value of existing bonds first by increasing the exemption of the holders by \$30,000 principal amount in the aggregate of all four series, and, second, by increasing the exemption of the holders by an additional \$20,000 provided that they subscribed to notes of the new issue to an amount that is at least equal to one-third of that additional exemption. Those provisions were written by the Ways and Means Committee with a view to meeting the problem presented by the existing market quotations for Liberty bonds, and at the same time recognizing the almost insuperable difficulty of giving at this time any privilege of conversion into bonds or notes bearing an increased interest rate, first, because it is perfectly clear that the Government is under no legal obligation to increase the interest rate and, second, because these bonds, having relatively long maturities and being clearly worth par and more than par before maturity, it would be the height of folly either to increase the interest rates for a long maturity or to convert them into a short maturity, thus imposing upon the future Secretary of the Treasury and upon the country the stupendous task of preparing to refund in

three or four or five years, not \$5,000,000,000 of short term notes, but \$25,000,000,000.

In the effort to meet the temporary situation in respect to the market price of existing liberty bonds, this clause was written. That situation grows, not out of any intrinsic weakness in the bonds; the bonds are worth more than par to-day. The reason you can not get it is because the demands of the Government were so great that there existed an excess of the supply of bonds over the demand. The present interest basis does not measure the credit of the United States, and when I say that I say it in entire confidence and with complete unanimity of the best financial judges. It simply is a recognition of the fact that in 18 months the Government had to go out in the market and borrow \$18,000,000,000 from people who did not really have \$18,000,000,000 to lend, and no interest, no terms could have sold \$18,000,000,000 of bonds at the market as a commercial proposition, or have maintained the market value during that period. We are now in the very fortunate position of having placed these bonds very well on the whole. The actual transactions in the bonds sold represent the smallest fraction of the total issue. There is, say, 80 per cent of first-rate holding of those bonds. The market prices are made by a relatively small fraction of holders who find themselves compelled to sell, or who are deluded into selling their bonds, or exchanging them for worthless securities as the result of the nefarious practices of the sharps. That problem will tend to be relieved by these additional exemptions from taxation. We can not reach in the secondary distribution of the bonds the many millions of patriotic people whom we reached on the original distribution of the drive.

Those people who subscribe originally can not be found by bond salesmen or brokers. We have no means of reaching them. They are not appealed to by any effort that has been made, or, so far as I can judge, could be made to reach them. Consequently the secondary market for Liberty bonds must be afforded by savings banks, corporations and individual investors having investment funds available, and the provision which this bill contains with respect to exemptions from taxation is calculated to benefit not merely the relatively prosperous citizens who are attracted by these exemptions to make a purchase of these bonds, but to benefit the small holder who finds himself compelled to sell and for whom a market would be provided in this manner.

Section 3 of the act increases the authority for the issue of Treasury certificates of indebtedness from \$8,000,000,000 to \$10,000,000,000. The issue of Treasury certificates of indebtedness on January 31, had reached \$4,798,000,000, not all of which, however, had then been covered into the Treasury. At the present rate of expenditure, and assuming that the rate will be continued as a result of validation of informal contracts and other pending legislation, the issue of Treasury certificates will increase at the rate of a billion and a quarter a month, so that the existing limitation of \$8,000,000,000 will probably be exceeded before the proceeds of the Victor liberty loan can reach the Treasury. The provision for deferred payments of income and profits taxes, the very wise provision for such payment in installments over the year, is one reason why it is necessary

that the Treasury should have authority to borrow in anticipation of those taxes, and increase the amount of Treasury certificates which may be outstanding at any one time. As you understand, Treasury certificates are for temporary borrowings in anticipations of liberty loans and taxes.

Section 4 of the act provides for total exemption from taxation of liberty bonds and war finance corporation bonds and notes issued under this act, in so far as they are held by foreigners. That provision is intended to make it possible to sell our liberty bonds in countries where the exchanges are at present adverse. There is considerable opportunity for this sale of those bonds made particularly attractive not only by existing market prices, but by the expectation of a speculative profit as the exchanges right themselves. The existing law provides that such exemptions shall exist in respect to bonds payable in foreign money only or in the alternative. This amendment extends the exemption to bonds payable in dollars. The termination of the war in February practically put an end to efforts to borrow money by the issue of obligations payable in foreign money, and the existing law does not give us the benefit of a foreign outlet for the surplus supply of liberty bonds. Such a provision as this, it is thought, will provide an outside market for an appreciable amount of liberty bonds and at the same time help to rectify the exchanges.

Section 5 of the act provides for extending the privilege of conversion in respect to existing 4 per cent bonds. The view of the Treasury Department was expressed by the Secretary himself in his letter to Mr. Kitchin, of which a copy was sent to Senator Simons some time ago. Briefly, it is this, that the United States lost nothing by the delay of the holders of those bonds in presenting them for conversion; that largely they were held among small subscribers who were ignorant to a certain extent of financial matters; and that an extension of the privilege should be given as a matter of good will to those small subscribers and in the interest of the success of the Government's further financing.

Section 6 of the act provides a sinking fund of $2\frac{1}{2}$ per cent on the amount of bonds and notes outstanding on July 1, 1920, after deducting the amount then held in the Treasury of the United States of obligations of foreign governments. That sinking fund is calculated to retire that part of the public debt covered by the sinking fund in a period of somewhat less than 25 years. A sinking fund of 2.32 per cent would retire the entire fund in 25 years. The sinking fund is a cumulative sinking fund—that is, to the $2\frac{1}{2}$ per cent will be added each year the interest on the bonds retired in previous years. This makes a stable charge for the service of the debt during the whole period of the existence of the debt. The calculation was based upon the roughly estimated amount of the public debt, less foreign loans, at \$20,000,000, and the Government actuary's certificate is in the record of the Ways and Means hearings, page 59, to the effect that a sinking fund of \$164,000,000 will retire that debt of \$20,000,000,000 in 25 years. I have just received a further certificate from the actuary, showing that a $2\frac{3}{4}$ per cent sinking fund, amounting to \$500,000,000, will retire a debt of \$20,000,000,000 in less than 24 years. It is as follows:

GOVERNMENT ACTUARY, TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, February 25, 1919.

Memorandum for Assistant Secretary Leffingwell:

In what number of years will a $2\frac{1}{2}$ per cent sinking fund reinvested annually at $4\frac{1}{2}$ per cent retire \$18,000,000,000 of bonds, \$20,000,000,000 of bonds, and \$23,000,000,000 of bonds? And what will be the amount in dollars of each such annual sinking-fund payment?

Answer:

A $2\frac{1}{2}$ per cent sinking fund, reinvested annually at $4\frac{1}{2}$ per cent, will amount to the principal in 23.863 years, whether this principal is \$18,000,000,000, \$20,000,000,000, or \$23,000,000,000. The annual amount to be paid into the sinking fund will be $2\frac{1}{2}$ per cent of the principal, or \$450,000,000, \$500,000,000, or \$575,000,000, respectively.

Jos. A. McCoy.

That supplements the statement contained in the reports of the Ways and Means Committee. In figuring that amount of debt there are excluded the prewar debt, the war-savings certificates, and an amount equal to \$10,000,000,000 as the assumed sum of our holdings of foreign obligations.

The section also contains a repeal of existing sinking-fund laws.

Section 7 of the bill contains authority to the Secretary of the Treasury to continue to make loans to foreign governments for certain limited purposes until the expiration of 18 months after the termination of the war. This carries no increase in the appropriation, but extends the period and the purposes for which these loans may be made.

Section 8 contains a provision in respect to the conversion of the short-time obligations of foreign governments, into long-time obligations. I was going to ask Mr. Rathbone to go into the details of that.

The CHAIRMAN. I think you ought to state what the purposes were that led up to continuing that.

Mr. LEFFINGWELL. The purposes for which these loans are authorized to be made are to provide the means to foreign governments for the purchase of property owned directly or indirectly by the United States, or of any wheat the price of which has been or may be guaranteed by the United States.

Those are the only purposes authorized by the act, although it does not disturb the existing authority to continue to make loans until the termination of the war.

Section 9 of the act contains the provision authorizing the War Finance Corporation to continue its operations and to extend them in the interest of foreign commerce, and I will ask your permission that Mr. Meyer explain that provision in more detail when the time comes.

The CHAIRMAN. We will get the statements in an orderly way in the record by having Mr. Meyer make his statement now.

**STATEMENT OF MR. EUGENE MEYER, JR., MANAGING DIRECTOR
WAR FINANCE CORPORATION.**

Mr. MEYER. As I stated, Mr. Chairman, before the Ways and Means Committee, at their hearing on the bill, a great many suggestions have been made during the war and since to extend and

enlarge the functions of the War Finance Corporation. The directors have never been able to see their way clear to indorse any of these suggestions because they did not as a whole or in each case fit in with the purposes and the emergency character of the original act. But the condition of our foreign trade has seemed to the directors to be of such an emergency character and so important to the whole country as well as to the international situation, that after very carefully going into the matter we united unanimously in making a recommendation to the Secretary of the Treasury which was practically incorporated into the bill before you.

In order to picture the situation, I would like to go back to the beginning of the war in Europe. In the beginning of the European war a great and sudden collapse in our foreign trade occurred. The prices of our products fell in almost every direction, with the exception of wheat and certain chemicals and a few other products. The winter of 1914 was one of suffering to industry and labor alike.

The great material requirements of the allies began to make themselves felt in the spring of 1915 and thereafter in ceaseless demand for limitless quantities, almost regardless of price, all of our products flowed steadily to the allied front in Europe.

The volume and value grew by leaps and bounds, and the absence of our normal export trade to the enemy countries, which was such a factor in the beginning of the war, soon disappeared as an influence upon our business situation.

Under the wild rush of activity involved in meeting the insatiable appetite of the all-consuming capacity of the allied armies and peoples, our industry ran at full speed.

At the outbreak of the war in 1914 we owed Europe great sums. These debts were represented by their holdings of our American investments, and by bankers' credits running into many hundreds of millions of dollars.

At first we shipped Europe large quantities of gold, but as European purchases mounted in volume and value we liquidated our banking indebtedness with these exported materials. Then we took back our securities in a steady stream. Next they shipped us large amounts of gold; later still, great loans were floated in our investment market, some unsecured, but later with collateral security under their short-term obligations.

Then in 1917 we came into the war, and our Treasury furnished the money to finance the huge purchases of the allied Governments. No possible way of financing the great volume of purchases for foreign Governments in the proportions required could have been otherwise found.

Now military operations are over. Foreign war contracts have been canceled; our own war contracts are canceled; military and diplomatic reasons prevent the immediate resumption of trade with enemy countries. Not only are prices here tumbling, but in many branches business is stagnant.

The countries associated with us in the war have used up an important part of their resources in the long struggle, especially when we consider their resources from the point of view of international trade. They must economize nationally and work to regain their lost peace industries, as must we as well.

They have endured a longer and greater economic and financial strain than we. Left to the limits of their own resources, it will take them long to build up their international commercial relations. Unless we extend credits to them they will be unable to buy from us largely until they can restore their exports and sell to us and to others.

There is no market here as yet to take their loans or to take over their holdings in investments in neutral countries. This will take time to develop.

We need at once, and on a large scale, an outlet for great quantities of our products. We can not sell, if we demand payment now, because our customers have neither the gold nor the goods nor securities marketable in this country with which to make payment. We should put our people in a position to extend credit for a long enough period of time to encourage and justify the purchase of our products.

Even long banking credit, as long as a year, would not meet the situation, because foreign countries can not with sufficient confidence foresee ability to pay within a year. But credits of longer periods than one year are beyond the realm of ordinary banking. This bill is designed to meet this unprecedented condition of the world's international trade, and should stimulate our bankers and our merchants to the greater courage and the prompter action that is necessary to meet the emergency. It is not designed to displace private enterprise or to put the Government permanently into general banking business. The amendment is limited as to time and as to purpose. It is intended, primarily, to help our own industry, our own labor, our own finance, and thus our own national well-being. Nevertheless, a prompt restoration of international trade will do much more; it will enable Europe to restore its industry and employment of labor, and thus to hasten its political and social peace. Unemployment and hunger are the surest sources of social disorder.

In extending credits at this time to foreign countries to enable our industries and theirs to resume normal activity promptly, I believe we would be making a most important contribution toward international peace and prosperity, and that the results arising would benefit alike the country extending the credits and the countries which receive them.

That is a picture of the situation as I see it, and I have been following closely these international relations for more than 20 years. I think in the practical application it means the temporary taking over of these security holdings from these European countries, temporarily holding them through our exporters or through the banks financing our exporters through the War Finance Corporation. Subsequently, as opportunity offers and our investment markets permit, these securities will probably be purchased by our investors and the amount liquidated with the War Finance Corporation, and that, I think, gentlemen, is a general picture.

I gave the Ways and Means Committee an analysis of 83 per cent of our exports in the prewar period, and I suppose that the committee has read that, but it touches every part of our country and all kinds of industries. I said in those hearings:

I brought with me a very short analysis of the situation of our foreign-exports business before the war merely to show you ap-

proximately what kind of an export business we may reasonably hope to return to some day. But there is no hope of returning to it immediately, in any event; and unless foreign Governments are able to get assistance here in the way of credit, the return will be delayed very materially. Eighty-three per cent of our exports in the fiscal year 1913 were made up as follows: Agricultural implements, \$10,000,000; corn, \$28,800,000 (that is, corn at 58 cents a bushel); wheat, \$89,000,000; \$53,000,000 of wheat flour; \$40,000,000 of other breadstuffs; \$26,000,000 of automobiles; \$27,000,000 of chemicals; \$65,000,000 of coal; \$138,000,000 of copper; \$547,000,000 of cotton; \$31,000,000 of cotton cloth; \$27,000,000 of electric machinery; \$36,000,000 of fruits; \$130,000,000 of other machinery; \$154,000,000 of meat and dairy products; \$174,000,000 of iron and steel and the manufactures thereof; \$137,000,000 of mineral oils; \$24,000,000 of vegetable oils; \$22,000,000 of paper and the manufactures of paper; \$49,000,000 of tobacco; \$116,000,000 of wood and manufactures therefrom, and \$64,000,000 of leather and manufactures therefrom.

I believe that cotton is normally the largest single item of our exports in dollar value, but the benefit arising from the stimulation of the export business is reflected in general business. Taking cotton as a foremost example, we will all recall that when cotton ceased to be exported the price fell, all of the industries which had been sellers in the South found their business cut off; there was no sale for automobiles in the winter of 1914 in the southern territory. Pianos, shoes, furniture, all products of the North, ceased to be marketable in the South because cotton could not be sold and because prices declined. I merely cite that because it is the most notable item in our export trade and because the indirect result is as important as the direct result.

The question was raised in the Ways and Means Committee as to whether or not the people of this country are interested in export trade and whether a Government institution such as the War Finance Corporation would be justified, in the opinion of the mass of the people, in helping export trade which it was thought might not perhaps be a matter of general interest. I gave the gentlemen of the Ways and Means Committee a copy of a resolution which I will put in the hearings to-day.

The CHAIRMAN. There is one fact in regard to the bill which I think you have omitted to state and which ought to go in with your statement, and that is that you are not permitted to make these loans until it is shown to you that they can not be secured through the regular banking channels.

Mr. MEYER. That is in the bill. As I was saying, the question was raised whether our export trade is a matter of general interest to the people of this country, and I gave the Ways and Means Committee a copy of a resolution which was passed by a meeting of 32 delegates from the mining districts of Montana, Mexico, and Arizona, and when these gentlemen came to the office of the Secretary of Labor and it was suggested that the meeting was called in order to explain the very difficult conditions throughout the copper industry, which they represented from the labor standpoint, and that the export trade was a factor of the greatest importance in peace times, over

60 per cent of copper being exported, and it was explained why the export business had practically ceased to exist, they passed a resolution asking the Congress to aid and encourage the financing of our export trade, because it is a matter in which they are directly interested. The resolution they passed is as follows:

Be it resolved, That this meeting of representatives of the labor of the copper industry do urge and recommend that Congress pass such legislation authorizing Government aid as will furnish the necessary long-term credits to facilitate the resumption of our export trade in raw materials, agricultural products, and manufactured goods.

J. C. Lowner, Butte, Mont.; F. S. Dunn, Utah; H. E. Gullaher, Great Falls, Mont.; Geo. Tucker, 1124 West Park Street, Butte, Mont.; J. P. Mahoney, 522 North Wyoming Street, Butte, Mont.; Pat. F. De Loughery, 525 North Franklin Street, Butte, Mont.; J. K. Field, Vrede Hotel, Clarkdale, Ariz.; L. E. Hart, box 162, Verele, Ariz.; John McMullen, 505 South Montana Street, Butte, Mont.; A. D. Chisholm, Hotel Jerome, Jerome, Ariz.; L. T. Scott, box 804, Miami, Ariz.; J. A. Walker, Warren, Ariz.; C. M. Reynolds, Anaconda, Mont.; James Walsh, Anaconda, Mont.; Homer Whitmore, Great Falls, Mont.; O. R. Henney, Salt Lake City, Utah; R. Hodge, Great Falls, Mont.; W. Miller, Globe, Ariz.; Joseph Lee, Salt Lake City, Utah; C. R. Clifford, Clifton, Ariz.; Geo. W. Fahy, Salt Lake City, Utah; D. G. Jacobs, Salt Lake City, Utah; Thomas E. Cary, Anaconda, Mont.; Antonio Lopez, Meicalf, Ariz.; P. M. Vargas, box 1042, Marinci, Ariz.; J. F. O'Brien, Butte, Mont., secretary; H. S. McCluskey, Ford Hotel, Phoenix, Ariz., chairman; J. F. Buckley, 207 Quartz Street, Salt Lake City, Utah; J. E. Munsey, Labor Temple, Salt Lake, Utah; Robt. Leggett, 1057 Sixteenth Street, South Douglas, Ariz.; Sam Verran, Bisbee, Ariz.

I think that the people of this country appreciate and understand more than we might imagine the value and importance of our export trade to our industrial structure, and I do not doubt, so far as the mass of the people are concerned, that the provisions of this bill designed to encourage our export trade will be received intelligently and appreciatively.

I would be glad to answer any questions, if desired.

The CHAIRMAN. Now, Mr. Leffingwell, that ends the bill.

Mr. LEFFINGWELL. I would be glad to have Mr. Rathbone make a statement now.

The CHAIRMAN. Mr. Rathbone. I think when you supplement this with your statement we will have a pretty good discussion in the record of the general purposes and effects of the bill.

STATEMENT OF HON. ALBERT RATHBONE, ASSISTANT SECRETARY OF THE TREASURY.

Mr. RATHBONE. Mr. Chairman, section 7 of the bill authorizes the Secretary of the Treasury for a period of 18 months after the war to continue to loan to foreign governments, from credits previously established in their favor, with the approval of the President, for the purposes specified in the bill, namely, to provide funds to the foreign governments for the purchase of property owned directly or indirectly by the United States, or of any wheat the price of which has been or may be guaranteed by the United States. That authority is in addition to the authority under the existing statutes to continue to loan to the foreign governments until the declaration of

peace for the purpose of our national security and defense and the prosecution of the war. For all loans to foreign governments under the provisions of this bill there must be received their obligations in an amount equal to the loans, which obligations must bear interest at not less than the rate of 5 per cent per annum, and must mature not later than October 15, 1938.

Under subdivision B, of the bill, the Secretary of the Treasury is authorized to convert obligations taken from foreign governments, under the provisions of this bill, into long-time obligations in exactly a similar way that the Secretary of the Treasury is now authorized to convert into long-time obligations short-time obligations taken under the existing statutes. The long-time obligations into which the short-time obligations, taken under this bill, are converted must, however, bear interest at a rate of not less than 5 per cent per annum and must mature not later than October 15, 1938.

Subdivision C of the section permits, for the purposes of this section, the use of the appropriation which has already been granted for the purchase of obligations of foreign governments to the extent that such appropriation has not been, nor shall not be, expended under the provisions of existing legislation.

Section 8 of the act provides that the long-time obligations of the foreign governments, into which their short-time obligations, acquired under existing legislation may be converted, must mature not later than June 15, 1947, so far as concerns obligations purchased under the provisions of the first liberty bond act—that is, the date of maturity of the first liberty bonds; and as to all other long-time obligations, into which short-time obligations, acquired under existing statutes may be converted, they must mature not later than October 15, 1938, which is the date of maturity of the liberty bonds last issued under the authority of the second liberty bond act as amended.

Section 8 does not change the present law as it exists to-day. The present law permits the conversion of short-time obligations of foreign governments which have been acquired by the Secretary of the Treasury into their long-time obligations and provides that the long-time obligations received on any such conversion must mature not later than the last issue of the bonds under the respective provisions of the first liberty-bond act and the second liberty-bond act, as amended. There was only one issue of bonds under the first liberty-bond act, and they mature June 15, 1947. The last issue of bonds under the second liberty-bond act mature October 15, 1948. On the other hand, if it was determined by the Congress that the next issue of liberty bonds should mature in, say, five years, and such bonds were issued, then, under present law, the long-time obligations of foreign governments which were received upon the conversion of their short time obligations acquired under the authority of the second liberty-bond act, as amended, would likewise have to mature in five years, that being when the last liberty bonds issued under the authority of the second liberty-band act, as amended, would mature.

So this section simply maintains the status to-day and permits the Secretary of the Treasury to hereafter convert such short-time obligations in the same manner as he may to-day convert the same.

As the bill was originally presented to the Ways and Means Committee it went somewhat further than the bill as submitted here. The

bill as a whole, taking the provisions as submitted to the Ways and Means Committee with regard to the loans to foreign Governments and the provisions authorizing the War Finance Corporation to make loans to exporters and to banks which had made loans to exporters, in the judgment of the Secretary of the Treasury provided a comprehensive plan for dealing with a situation which has been brought about by the war.

What I am about to say is contained in my testimony before the Ways and Means Committee, but perhaps I might restate it.

The CHAIRMAN. I think you had better cover them all here.

Mr. RATHBONE. I will do so. There are three reasons why authority should be given to continue to extend credits to foreign Governments that have been associated with us in the war, both in the interests of the foreign Governments and in the interest of the United States. First, certain of the countries that have been associated with us in the war have emerged from the war with their industrial and commercial organization badly out of joint.

If they are not given assistance from the countries that have been associated with them in the war and that are in a position to give them assistance, they must inevitably look forward to Germany whose factories are intact and whose commercial and industrial life has not been destroyed as is the case with France and Belgium and northern Italy; they must inevitably look forward to the loss of a large part of their commercial business and export trade to Germany. Second, the sooner the commercial and economic life of the countries to whom we have loaned money are restored and the sooner their factories are rebuilt the more secure are their obligations which we hold, and the quicker they can be repaid. Third, the extension of these credits will promote our foreign trade. Before the war our average favorable balance of visible foreign trade, the excess of our exports over our imports was, roughly, \$400,000,000 a year. That trade was, as you know, very largely with Great Britain, France, and Italy. During the 8 or 10 years preceding the war the balance of favorable trade balances of ours was not settled to any very great extent by the movement of gold.

It was settled by our expenditures abroad, by income paid on our securities held by foreign countries, by our payments for ocean freights, by profits of foreign insurance and other companies doing business in our country, and by remittances of immigrants. Those are the principal ways in which this \$400,000,000 was paid to this country each year. Assuming that we are to continue to have as favorable a trade balance as in the past, and disregarding the increase in prices which with the same amount of commodities would largely increase the amount of our favorable trade balance; disregarding that, and assuming that foreign countries will continue to owe us on trade balances \$400,000,000 a year, in addition the foreign governments will have to pay us interest on the foreign debt we hold of \$450,000,000 a year; assuming the foreign obligations we hold amount to \$9,000,000,000; assuming these foreign obligations aggregate \$8,000,000,000, that means the foreign governments would have to pay us \$800,000,000 a year for interest and for our favorable trade balance. Two of the items which I have stated enabled foreign governments to pay, say, half of the \$400,000,000 which they used to

pay us each year, namely, the income they received on our securities which they held and the freight-carrying charges, have largely disappeared. We now have our own mercantile marine, which certainly is at least going to save us some, certainly a large portion, of the amounts which we formerly had to pay in ocean freight charges, if, indeed, it does not give us a net revenue from this source, and our securities which were foreign owned have since the commencement of the war been sold back to us in very large amounts, thus reducing this means which the foreign countries had of paying our trade balances. So, instead of having a balance of \$400,000,000 to pay, they will hereafter have to pay annually, say, \$850,000,000, and their means of payment has been diminished by, say, \$200,000,000 a year.

That will leave the foreign countries with, say, \$200,000,000 a year to pay, say, \$850,000,000 a year. It can only be done by the establishment of credits in their favor. The people here are not now in a position to absorb the securities to the amount necessary; and it was the view of the Secretary of the Treasury that during the transition period, through Treasury loans to the Governments associated with us in the war and through loans by the War Finance Corporation to exporters, provision would be made to care for this deficit, thus enabling our goods to move to foreign countries as they have in the past, while the world adjusted itself to normal conditions which sooner or later must be reached.

I do not think it is necessary to dwell on the effect upon us if we lose our foreign trade and the consequences so serious to labor and to capital.

Senator SMOOT. I can understand why section 8 should be in the bill providing we issued bonds, but now that we are issuing short-term obligations and denominating them notes, section 8 is entirely useless, it seems to me.

Mr. RATHBONE. It is entirely useless unless somebody chooses to argue that what was meant by the word "bonds" in the previous act would comprise a note as we are issuing it under this act. In other words, it clarifies any such situation.

Senator SMOOT. If such a thing as that should arise and it was decided that this note was a bond, then whatever rate of interest we issued these notes with all the balance of the bonds would take.. that might be so, but that is never going to happen.

Mr. RATHBONE. I do not know what is going to happen, but it seems to me that section 8 merely clarifies the law; it does away with any possible question and it may clarify the situation with foreign governments, and it certainly can do no very great harm.

Senator SMOOT. I do not know that it can do any harm, but it is perfectly useless. In relation to your statement that if we do not extend these credits to the Governments that have been fighting this war as our allies, they have to go to Germany for credit, I think that is far-fetched.

Mr. RATHBONE. I do not say they have to go to Germany for credit.. I said Germany would be equipped to send out goods when France and Belgium would not be in a position to do so.

Senator SMOOT. England is better equipped than Germany, better equipped than she ever was in all her history. Her industries have not been touched but have increased manifold. Italy is the same.

way, and Japan is the same way. The neutral countries are the same way. Outside of Belgium and the part of France which was destroyed—and your statement would apply to those two countries, as to their industries—the industries of the world are in better shape than they ever were to manufacture goods and to carry on world commerce.

Mr. RATHBONE. My statement was meant to apply to the devastated regions of France and Belgium and Italy. As far as Great Britain is concerned, I presume they are in probably as good a position to send out their goods as they were before.

Senator SMOOT. Oh, better.

Mr. RATHBONE. But they have got to send out considerably more goods than before.

Senator SMOOT. They are doing that now. You will see that their export trade now is greater than it ever was in all the history of England.

Mr. RATHBONE. Their unfavorable balance of trade last year was \$3,800,000,000 as against \$2,200,000,000 the year before.

Senator SMOOT. That is absolutely true, but they are not going to buy those goods that the war compelled them to buy and caused that balance of trade to change.

The CHAIRMAN. Is not this true: We would not be able ourselves to buy as many of Great Britain's goods as they would be able to offer us unless we could sell our goods abroad. In other words, our capacity to buy their goods, which was unlimited during the war and unlimited now if our export business is destroyed, our capacity to buy, to import goods, would be also diminished.

Senator SMOOT. That is why we have section 9 in this bill. We are authorizing a billion dollar credit for that very purpose in this bill. As I said yesterday, I think it is absolutely necessary to do so; but we were discussing section 7 of this bill, and section 8. I only wanted to make that statement for the record. I do not care about going into the discussion of it any further.

The CHAIRMAN. You would be limited as to additional credit to foreign governments to the difference between the amount that we have loaned and the amount that we authorized. That is, we have authorized ten billion and we have loaned something over eight and a half billion, so that you will be limited to a billion and a half under this act.

Mr. RATHBONE. Of course the provisions affecting the War Finance Corporation do not provide for loans of money provided by the Government.

Senator SMOOT. It is practically the same thing. One is to put your hand in one pocket and the other is to put it in the other pocket.

Mr. RATHBONE. Not quite the same.

Senator SMITH. One is a loan to the Government and the other is by the Government.

Senator PENROSE. They use a different printing press.

The CHAIRMAN. The Government does not have to protect this by taxes. In this case the Finance Corporation sells its bonds in the market and loans the money.

Senator SMOOT. They get the money from the printing press, but they are obligated to pay it back unless the other fellow pays it. I think they will pay it back.

Senator SMITH. It is not intended to make any loans that are not going to be paid back.

Senator THOMAS. We have been making appropriations on the theory that they will not be paid back.

Senator PENROSE. I think they may be paid back, in some cases. Do you think they can be paid back from Chile or Mexico?

Mr. MEYER. I do not expect them to be paid back.

Senator PENROSE. Would you have more than a gamble in being paid back in the course of two or three years in the case of Mexico or Chile?

Mr. MEYER. Chile is one of the places that might require advances on account of adverse conditions due to the war. I would expect, however, that loans to Chile would be paid back. The reason for the situation in Chile is that Europe and the United States have such large stocks of Chilean nitrate that it has paralyzed the exchange. That is a very interesting special case.

Senator PENROSE. How about Mexico?

Mr. MEYER. I think as far as Mexico is concerned there will be little necessity. The export to us and our exports to Mexico have taken care of the situation so far as trade is concerned, I think, quite well. I do not know that Mexico is a situation that we would go into at all. Personally, I do not consider the authorization to the War Finance Corporation to aid exports means any and all exports to any and all countries. Unless there is an exchange situation to remedy I do not see any necessity for us to intervene.

The CHAIRMAN. You would not lend the money to anyone who was not properly secured?

Mr. MEYER. I would be very careful as to that.

Senator PENROSE. You would not lend it to anyone unless the solvency of the Government was good, and in Chile it is not very good at this time.

Mr. MEYER. I have not heard very much about Chilean obligations.

Senator PENROSE. It has been considerably disturbed.

Mr. MEYER. Chile has one asset, a large asset the world must have and that is a large supply of nitrates. We did not happen to need it this year, because we had large supplies of nitrates imported for military purposes. That is a business the Chilean Government must sustain, because it gets its principal revenue from it. It creates an ordinary trade balance for Chile, but this year it has not. In the course of years it will do so again, and I do not doubt that any money loaned for exporting to Chile temporarily will be repaid as promptly, perhaps, as any.

Senator PENROSE. I do not pretend to know the situation.

Mr. MEYER. It happened to be a very interesting and pertinent illustration.

Senator McCUMBER. You made one statement in your remarks that appealed to me, and that was that prices were everywhere tumbling. I was wondering on what class of articles produced in the United States outside of war materials were tumbling in prices at this time.

Mr. MEYER. The index figures show a very considerable decrease in prices on the average, and not only are the prices falling, but business in many cases is not resulting from the decline in prices. There is very little steel or iron business, very little metals; cotton is down to prices where everybody that I know from the South says it does not pay to produce it. Ordinarily this country ought to be producing and selling at least 16,000,000 bales of cotton a year.

Senator McCUMBER. What manufactured products outside of those which can properly be said to be war material have declined materially?

Mr. MEYER. As to manufactured products I would not say there has been so much decline as yet, but it is certainly coming. The markets are weak and buyers are slow, because they are expecting a decline, and because a decline is expected, business is bad. If you will name a commodity I might discuss it with you. For instance, the lumber business is in bad shape.

Senator McCUMBER. I will agree with you that business is at more or less of a standstill.

Mr. MEYERS. That precedes the decline.

Senator McCUMBER. I have not experienced a decline anywhere as yet.

Senator THOMAS. Not with your landlord.

Mr. MEYER. Rents have been going up. That is the only thing I know of lately that has gone up.

Senator McCUMBER. Mr. Leffingwell, on the matter of maintaining the selling value of securities heretofore issued what particular obligation is there upon the part of the Government to maintain the selling price of any of those bonds? We all purchase bonds according to our ability to assist in the war. We knew just what interest those bonds were going to pay us; we are going to receive that payment of interest as it falls due. Now, that being the case, what obligation is there upon the Government to say to me or anyone else, "I will assist you in holding up the value, the selling value, of your thousand or two thousand dollar bonds to par?"

Mr. LEFFINGWELL. There is no legal obligation, and I consider that there is no moral obligation. I regard it as a practical business question for the United States to consider what will be the effect upon its further borrowing of the existing market value of those bonds and its effect on the holders of those bonds. Undoubtedly if the existing four and a quarter bonds were selling at par or better we should not be confronted by a demand for an increased interest rate in connection with the new loan, and undoubtedly the fact that to-day our bonds are selling at a discount when the new loan is offered will appreciably affect the interest rate which we will have to pay for the new money. The Treasury has never suggested giving away any exemption from taxation or any increase in interest rates, and so far as the provisions of the bond bill now before you contemplate the conferring of an additional exemption without subscription for new notes the Treasury has accepted it, but not suggested it. The Treasury's suggestion was that additional exemption should be conferred upon holders of existing bonds in a definite relation to their subscription to the new loan.

Senator McCUMBER. Would it not be far better for us to give an exemption upon our new bonds to enable them to sell them readily

than to free from taxation or any portion of taxation the billions of dollars that we have already issued? These are only short-time bonds and we will have them paid back within five years, while these exemptions you are granting run from 20 to 40 years.

Mr. LEFFINGWELL. No; Senator. The exemptions are expressly limited to five years after the termination of the war.

Senator SMITH. The exemptions are only to the new issue?

Mr. LEFFINGWELL. We are now speaking of the exemptions in relation to the old issues contemplated by section 2, page 4, of the bill, which provides that those additional exemptions shall continue until the expiration of five years after the date of the termination of the war. The second clause of that section follows the lines of the provision contained in the supplement to the second liberty bond act, which was approved by the President last September, and which conferred additional exemptions in respect to old bonds upon subscribers for the new loan. That is as far as the Treasury has gone in any recommendations which it has made. The bill which the Treasury is quite content to accept provides for exemption of \$30,000 without reference to subscription to the new loan. No borrower who has more money to borrow is ever indifferent to the market quotation of his outstanding obligations, and the United States can no more afford as a practical business matter to be indifferent to the market quotations of its outstanding obligations than any other borrower who has a large amount of money yet to borrow.

Senator McCUMBER. The only thing I question in the propriety of changing the law in relation to old bonds for the purpose of getting a greater number of bidders for the new bonds, but rather to have the new bonds sell upon their own merits.

Senator THOMAS. I think you have by inserting this noncirculation privilege in the law deprived this scheme of its very best possible feature, and I am very free to say that if it were not so near the end of the term and the exigencies were not so great I would make a fight for that on the floor of the Senate. If you had that you would not be bothered with all these various technical and other alternatives to get your market for your bonds.

Senator McCUMBER. I also wanted to ask you what class were now selling bonds and forcing them on the market. Are they not merely those who held \$50 and \$100 bonds, and are they not selling them simply because the interest on such a small investment is a mere bagatelle and it does not pay to hold them and fool with them?

Mr. LEFFINGWELL. It is impossible to give a specific answer to that question, but I should say the selling came from approximately the following sources: Corporations and individuals of large means who had in the patriotic effort to make a success of the great Fourth Liberty Loan subscribed for amounts in excess of their ability to hold, particularly in respect to corporations who were engaged in war industries.

Many of those corporations made great purchases of liberty bonds and the termination of the war curtailed their orders, and they have endeavored to keep their plants open and their labor employed and wages up during a period when very small orders have been coming in, and they have been forced to liquidate their holdings of liberty bonds in order to keep cash in the box. Then there

has been very great selling from laboring men and other patriotic citizens of small means who find their incomes reduced or find themselves out of work as a result of the termination of the war, and there has been selling from others who have been fooled by swindlers, and I regret to say that represents an important part of the selling. I should be inclined to think that those are the principal factors. On the other hand, there has been excellent buying from savings banks and other investors to whom the bonds are extremely attractive at these prices, and I regard the present position of the bonds very favorably. I think they have reflected favorably the plan suggested by the bill of the Ways and Means Committee of an issue of short notes, which they feel will be successful and still not compete with existing bonds in the market, as a relatively long bond would do. It seems to me that the market position of liberty bonds is not one to give us concern, but that a provision (not necessarily this provision, although I think it is a good provision) calculated to induce buying by the investing class is sensible, not because it particularly favors the investing class but because it enlarges the market for the man of small means who subscribes beyond his ability and finds himself in these days of relative business inactivity forced to realize on his investment.

Senator McCUMBER. Do you not think the average clerk or laboring man that buys a \$100 bond will buy because the interest appeals to him as an investment, rather than because some other bond that could not be sold for less than 98 per cent?

Mr. LEFFINGWELL. No, Senator. Our observation of the situation leads us to precisely the opposite conclusion, that while the great middle class of well-to-do people are influenced by the consideration of the interest rate, the \$50-bond man is interested solely in the market value, and the thing that affects him is the question whether he can get par for his bond if he has to. Whether he gets 4½ per cent or 4¼ per cent or 5 per cent interest is a small matter to him.

Senator McCUMBER. I thought it was the opposite.

(Thereupon, at 12.05 o'clock p. m., the committee took a recess until 2.30 o'clock p. m.)

AFTER RECESS.

The committee met, pursuant to the taking of recess, at 2.30 o'clock p. m.

TESTIMONY OF HON. R. C. LEFFINGWELL—Resumed.

The CHAIRMAN. Senator, do you want to ask any questions of Mr. Leffingwell?

Senator SMOOT. I want to ask Mr. Leffingwell if I understand him in relation to the item on page 5 under paragraph B, section 2. I understood you to say that the party that would buy notes to three times the amount of the bonds that he may be holding would be entitled to exemption up to \$20,000. Is not that just the reverse of what the bill says?

Mr. LEFFINGWELL. You misunderstand me, or I misspoke.

Senator SMOOT. It is just the reverse?

Mr. LEFFINGWELL. If you buy one-third of the amount of your bonds in notes you get the exemption.

Senator SMOOT. What I want to know is, why not make him buy dollar for dollar of the notes in order to give him that exemption?

Mr. LEFFINGWELL. The theory on which that was written was this (and it was about the theory which the Congress adopted in giving the similar exemption in connection with the fourth loan): We have outstanding, roughly speaking, after deducting the $3\frac{1}{2}$ per cent bonds, which did not enter into this calculation, \$15,000,000,000 of bonds. We will offer, say, \$5,000,000,000 of notes. A man who does his pro-rata share of all the war financing, will have to make a subscription for the new issue of one-third of his present holdings, and it would probably not be fair or reasonable to ask him to do more.

Senator SMOOT. Well, what I was thinking of was this. Now he has made his investment up to, say, \$20,000. He bought that on the exemptions granted at that time.

Mr. LEFFINGWELL. Correct.

Senator SMOOT. Now, there is a note issue, and it seems to me that if we say to him, "You have a perfect right to buy these notes and claim the exemption up to \$20,000," but this proviso says that if he buys \$6,666 worth of notes he has the exemption on the full \$20,000. I thought that really as an exemption that was not necessary, particularly so as we expect the notes to draw a higher rate of interest than the bonds.

Mr. LEFFINGWELL. The thought behind all the provisions of this section is to improve the market position of the old bonds, and this exemption is calculated to accomplish that and at the same time to stimulate subscriptions for the new notes. The ratio is the approximate ratio which the new issue will bear to the outstanding issues, and in that respect follows the precedent of the supplement to the fourth Liberty bond act, which provided a similar exemption in respect to the old bonds to the amount of one and one-half times the amount of the new subscription. That one and one-half times was figured on the probable amount of the fourth loan in relation to the then outstanding bonds in the same way.

Senator SMOOT. At that time the exemptions were changed on identically the same class of obligations, but here we are giving a short-time obligation—five years the maximum—with a higher rate of interest, and at the same time giving an exemption upon bonds that are already purchased. I thought it was a little extreme.

Mr. LEFFINGWELL. Well, it is true the exemption in clause (a) is given away; but, as I pointed out this morning, that was not the suggestion of the Treasury.

Senator SMOOT. Did the House put that in?

Mr. LEFFINGWELL. The Ways and Means Committee put that in, and there is a great deal to be said for it. They thought that it was better that this additional exemption up to \$30,000 should be conferred upon the old bonds for the improvement of their market condition, and it is safe to say that anything that actually betters the position of the old bonds will make it easier for the Government of the United States to borrow the money that it has to borrow on the new note issue.

Senator SMOOT. In section 3, on page 6 of the bill, you have provided that "certificates of indebtedness of the United States and bonds of the War Finance Corporation shall, while beneficially

owned by a nonresident alien individual or a foreign corporation, partnership," etc. Now, it seems to me that if we give that right here of exemption to nonresident alien individuals that these bonds drawing 4 per cent could be transferred to some foreign alien, not in substance a transfer, or really a transfer, but a fictitious transfer, and then they would escape all of the taxes imposed under existing law. Now, I do not know that that would be resorted to very often, but I think under this provision it can be. In other words, if I had a friend in England and I could go to work and transfer these notes, he is a nonresident alien, and he could collect the interest. He could ostensibly be the bondholder and simply act as the agent for me and collect the interest and escape taxes. Do you construe it in that light?

Mr. LEFFINGWELL. I think that is a suggestion which the Treasury would have to guard against. The Commissioner of Internal Revenue would have to prevent frauds just as he does now. I do not think there is any danger in this amendment in that respect, because we always have to be on guard for frauds.

Senator WILLIAMS. The man committing the fraud would have to trust the other fellow to a large extent.

Senator SMOOT. That is often done. For instance, in my own State the legislature passed a law taxing mortgages. What was the result? Nearly every mortgage that was on property in the State of Utah was held by some foreign individual, and I know that those mortgages were transferred to friends somewhere else in the United States.

Senator WILLIAMS. On the record?

Senator SMOOT. Yes.

Senator WILLIAMS. So that the fellow could not dispute the record.

Senator SMOOT. Absolutely.

Senator WILLIAMS. He was taking a lot of blind chances.

Senator SMOOT. He held the notes indorsed to him.

Senator PENROSE. He could get security.

Senator SMOOT. And he escaped the 2 per cent tax all right.

Senator PENROSE. It is easy enough to get security of some sort.

Senator SMOOT. All I wanted to do was to call attention to that.

Mr. LEFFINGWELL. It does not open the door to new frauds. We collect income taxes on sworn returns and we have the problem of frauds to guard against under the existing law and will always have.

Senator SMOOT. The least you can say is this: That the nonresident alien individual is better off owning Government bonds than an individual citizen.

Senator LODGE. Of course he is.

Mr. LEFFINGWELL. Any taxable American would have to make a fraudulent return and subject himself to the penalties imposed upon people who make fraudulent returns.

Senator LODGE. Of the general policy of exempting the foreign owner, do you think it the wise policy?

Mr. LEFFINGWELL. Yes, Senator. You were not here when I mentioned that clause this morning. The existing fourth Liberty bond act provides in just this language for those obligations that are expressed in foreign money. The war brought about a termination of our sale of the obligations of the United States expressed in foreign

money. But it remains that we might obtain a substantial market for the secondary distribution of Liberty bonds in foreign countries, if the purchaser in foreign countries, who now pays no taxes to the United States because he keeps his investments elsewhere, could be assured by buying the bonds of the United States that he would not subject himself to taxation in the United States. That would not only make it possible to sell some millions of dollars of bonds now undigested in our markets, but it would be a great assistance to us in our efforts to correct those foreign exchanges which are adverse to the United States. These bonds would offer an extremely attractive investment.

Senator LODGE. Very attractive.

Mr. LEFFINGWELL. To residents in neutral countries where the exchange situation would offer a speculative profit in addition to an assured return on the investment.

Senator LODGE. Is there any considerable amount held by foreign holders?

Mr. LEFFINGWELL. Practically none.

Senator LODGE. I do not suppose many of them have money to invest.

Mr. LEFFINGWELL. Holland may have some, and some South American countries and Spain. Every effort that we have made to interest neutrals in our bonds has stopped short with our inability to say that they would not by buying them subject themselves to taxes here.

Senator SMOOT. There is no country now that gives the same terms of nontaxation upon the obligations that they issue and that may be held by a nonresident alien?

Mr. LEFFINGWELL. To the best of my knowledge there is no country which does not give total exemption on foreign investments in its bonds.

Senator SMOOT. I have not looked it up, but the other day discussion came up in relation to Canada, and I was informed then that Canada does not give this privilege.

Mr. LEFFINGWELL. Canada's Government bonds are exempt from all taxation, even at home, so I think your informants must have misled you.

Senator SMOOT. I telephoned up to the department and inquired about the Canadian bonds, and also the English bonds—or my clerk did—and that is the answer he gave me.

Mr. LEFFINGWELL. They gave you an incorrect answer. All Canadian Government bonds are exempt from taxation even at home.

Senator LODGE. Is that the case with the English bonds?

Mr. LEFFINGWELL. No; they are subject to tax at home. But all the English bonds in this country are exempt from taxation.

Senator SMOOT. They issued two classes of bonds in England?

Mr. LEFFINGWELL. In England they issued two classes of bonds, but no bonds that are wholly exempt.

Mr. MAYER. American holders of income from dividends from English corporations were exempted, in part at least, from any income tax.

Senator LODGE. The French are not taxed?

Mr. LEFFINGWELL. They are not taxed. French and Canadian bonds are all exempt from taxation. British bonds are, I think, the only ones besides our own that are subject to taxation.

Senator WILLIAMS. Are these bonds to be expressed in foreign money or in dollars?

Mr. LEFFINGWELL. Dollars.

Senator WILLIAMS. That is what I want. I want Senator Lodge to understand that.

Senator LODGE. Yes; I knew that. We had that provision before.

Senator WILLIAMS. The others were expressed in foreign money.

Senator LODGE. I wanted to know how much it amounted to because at this time I suppose we can only hope for investments from some of the neutral countries.

Mr. LEFFINGWELL. That is all, Senator, and my impression is that it will open a market in a few South American countries, possibly Spain, possibly Holland to a limited extent. I should not want you to get the impression that any great expectations are held as to the sale of bonds in foreign countries. If as the result of such a provision we should be able to sell \$50,000,000 or \$100,000,000 in Government bonds abroad, it would be desirable.

Senator LODGE. Very desirable.

Mr. LEFFINGWELL. And we would not lose so far as I can discover, any revenue, because those people who would buy do not pay taxes anyway.

Senator SMOOT. Have you sold any bonds in Japan?

Mr. LEFFINGWELL. No.

Senator SMOOT. Have you offered them any?

Mr. LEFFINGWELL. The Japanese Government, after consultation with the Treasury, have made purchases of American Government Treasury certificates here, which has precisely the same effect upon the exchange as our selling bonds over there. They have been very helpful in that respect. They have bought \$85,000,000 of Treasury certificates within the last few weeks.

Senator SMOOT. I want to call your attention to this 2½ per cent sinking fund and see if we understand that. As I understand it, the 2½ per cent for the sinking fund is on the aggregate amount of all bonds that have already been issued, that is, that may be outstanding on July 1, 1920.

Mr. LEFFINGWELL. Liberty bonds and notes. It does not include prewar bonds.

Senator SMOOT. Yes; I am speaking now of liberty bonds.

Senator LODGE. And that includes the war loans?

Mr. LEFFINGWELL. Other than war-saving stamps.

Senator SMOOT. Supposing, we will say, there are \$20,000,000,000 of them, at 2½ per cent would be \$500,000,000 a year. Now, you will be compelled to continue receiving that \$500,000,000 during the 23.80 years, or nearly 24 years?

Mr. LEFFINGWELL. Yes.

Senator SMOOT. And the sinking fund that would be collected, \$500,000,000, would be used each year for the purchase of the bonds that were outstanding; but, notwithstanding that, the \$500,000,000 would be collected for the full 24 years?

Mr. LEFFINGWELL. Yes; \$500,000,000 plus interest.

Senator SMOOT. That is the way I understood it, and I did not know whether that was what was intended.

Mr. FRANKLIN. Otherwise it would take 40 years.

Senator SMOOT. Because if it were not that way it would be impossible to buy them in in 24 years?

Mr. LEFFINGWELL. May I add just a word? It is a repetition of what I said before the Ways and Means Committee. That is what is called a cumulative sinking fund. It makes a fixed calculable annual charge for the service of the debt for the whole period the debt is outstanding. It greatly simplifies the problem of the preparation of revenue bills and accomplishes the purpose of retiring the debt within a given period without making a heavy burden on the taxpayers in the early years immediately after the termination of the war.

The CHAIRMAN. That is to say, the interest charge would be abated from year to year as the bonds were paid, but the sinking fund would not be abated until the last?

Mr. LEFFINGWELL. Just so much as you reduce the interest payment do you increase the principal payments and retire a greater amount each year of your debt.

Mr. SMOOT. If it were not that way, of course, it would take some 35 or 40 years to pay off the debt?

Mr. LEFFINGWELL. It would, or the sinking fund would overburden the country during the early years of readjustment after the war.

Senator LODGE. This will add to the taxes.

Mr. LEFFINGWELL. The amount on which it is calculated is the amount of the war debt less the foreign obligations held in the Treasury.

Senator SMOOT. Yes; I understood that. Of course I would like very much to see a special tax raised for this purpose, rather than to make an appropriation direct for it. That is what I would prefer. I suggested it before, but it was not acted upon, and no effort made that it should be at the last session of Congress. I suggested then that a selling tax of 1 per cent on all sales in the United States should be collected for the purpose of a sinking fund. Now, if this is adopted here of course it would do away with that, and it could be taken out of the general taxation, and I suppose this is as high a rate of sinking fund as would be wise to impose under the conditions existing to-day. It would be a very, very onerous burden on the taxpayers for 25 years, whereas I think the other, if we had a 1 per cent sale tax, would never be felt particularly in business, and it would be paid day by day and in the end be paid off much more easily than this way.

Senator WILLIAMS. The $2\frac{1}{2}$ per cent of the total amount of the bonded indebtedness outstanding when it begins, would, if the system continued long enough, amount to something like 100 per cent of the total indebtedness outstanding. That is what you mean by cumulative?

Mr. LEFFINGWELL. What I mean by this being cumulative is that we add to $2\frac{1}{2}$ per cent in each year after the first interest interest on so many bonds as have been retired by the use of the sinking fund in previous years, so that the sinking fund cumulates by the addition of interest.

Senator WILLIAMS. But the percentage of the sinking fund is the percentage upon the outstanding bonds at the beginning?

Mr. LEFFINGWELL. Yes.

Senator WILLIAMS. If the system were continued long enough after reinvestment it would finally amount to 100 per cent of the total indebtedness outstanding?

Mr. LEFFINGWELL. Yes, sir.

Senator WILLIAMS. And so the indebtedness would be self-liquidating in that way?

Mr. LEFFINGWELL. Yes.

The CHAIRMAN. Mr. Leffingwell, in order to make these notes attractive, I assume that one series you will make attractive by somewhat increasing the rate of interest over the present rate?

Mr. LEFFINGWELL. I think so.

The CHAIRMAN. And the other series you will make attractive by somewhat enlarging the tax exemption?

Mr. LEFFINGWELL. Yes.

The CHAIRMAN. But without changing the interest rate. It might even be lower?

Mr. LEFFINGWELL. It might well be lower, and it would be much lower if exempt from taxation.

The CHAIRMAN. The first class is exempt, "both as to principal and interest, from all taxation (except the State or inheritance taxes), now or hereafter imposed by the United States, any State, or any of the possessions of the United States." That exemption is the same as now enjoyed by the holder of the first liberty bonds.

Mr. LEFFINGWELL. Yes, sir; that is the same exemption.

Senator LODGE. Mr. Leffingwell, if nobody else wants to ask any questions, I want to just ask you for my own information, the first exemption is perfectly clear, and so is the second exemption. The third, I take it, relates to that arrangement we made as a sort of premium for buying bonds in the new loan. As to the fourth, is the only distinction there that the tax is on all incomes, and that in No. 2 it is only on surtaxes?

Mr. LEFFINGWELL. That is correct.

Senator LODGE. That is the only difference.

Mr. LEFFINGWELL. That is the only difference.

Senator LODGE. What is the value of that fourth type of exemption?

Mr. LEFFINGWELL. It makes it possible for the Treasury to issue a note which is subject to the normal income tax as well as to the surtax, as the British Government, for instance, has done.

Senator LODGE. It would have to carry a much higher rate of interest?

Mr. LEFFINGWELL. They would have to carry a higher rate of interest. It is always a question whether you get full value for the exemptions that you confer, and I confess that I should be hard put to it to tell you to-day whether it would be wise in April to select as alternative issues one and two or one and four or one and three. The Ways and Means Committee felt that it would be content to allow the Treasury to make the choice as it might then determine.

Senator LODGE. How about the proposition to issue part of this in long-term bonds?

Mr. LEFFINGWELL. The judgment of the people we have consulted is practically unanimous that this is a time for a short-term obligation. We have outstanding now \$17,000,000,000 in bonds, none of

which mature before nine years. The Treasury is in a peculiarly fortunate position in respect to the retirement of the debt if it should issue a short obligation at this time. If this bill be enacted, there will be created a sinking fund which will be immediately operative for the retirement of the debt and substantial amounts will be paid off from year to year. The whole war debt will have the advantages of a serial debt without the mechanical difficulties due to it. Maturities have been arranged with that end in view. If the remainder of the war debt could have maturities between nine years and three years, that would ideally suit the situation. The bill originally suggested to the Ways and Means Committee contained a provision for the issue also of bonds the maturity of which should not exceed 10 years, the Secretary of the Treasury fixing the interest rate. That has been struck out of the bill, and the action of the Ways and Means Committee has been fully accepted by the Treasury, because it does not present an immediate emergency. We can use this legislation effectively.

(Thereupon the committee, at 3.30 o'clock p. m., adjourned until to-morrow, Thursday, February 27, at 10 o'clock a. m.)

