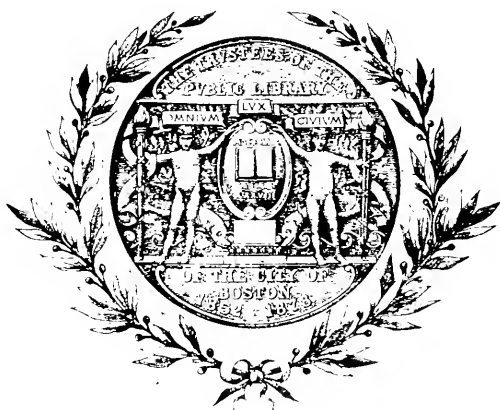


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74TH CONGRESS }
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SENATE

{ REPORT
No. 944
Part 2 }

MUNITIONS INDUSTRY

PRELIMINARY REPORT ON WARTIME TAXATION
AND PRICE CONTROL

BY THE

SPECIAL COMMITTEE ON
INVESTIGATION OF THE MUNITIONS INDUSTRY
UNITED STATES SENATE

PURSUANT TO

S. Res. 206 (73d Congress)

A RESOLUTION TO MAKE CERTAIN INVESTIGATIONS
CONCERNING THE MANUFACTURE AND SALE
OF ARMS AND OTHER WAR MUNITIONS



JULY 29 (calendar day, AUGUST 20), 1935.—Ordered to be printed
with illustrations

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MUNITIONS INDUSTRY

JULY 29 (calendar day, August 20), 1935.—Ordered to be printed with illustrations

Mr. NYE, from the Special Committee on Investigation of the Munitions Industry, submitted the following

PARTIAL PRELIMINARY REPORT—WARTIME TAXATION AND PRICE CONTROL

[Pursuant to S. Res. 206 and 244, 73d Cong.; S. Res. 8, 74th Cong.]

The Special Committee on Investigation of the Munitions Industry, authorized by Senate Resolution 206¹ of the Seventy-third Congress to investigate the munitions industry, to review the findings of the War Policies Commission, and to inquire into the desirability of creating a Government monopoly in respect to the manufacture of munitions, submits the accompanying introductory statement and partial report:

INTRODUCTORY STATEMENT

On April 12, 1934, the Special Committee on Investigation of the Munitions Industry was authorized and directed by Senate Resolution No. 206 of the Seventy-third Congress, among other things, to review the findings of the War Policies Commission and to recommend such specific legislation as may be deemed desirable to accomplish the purposes set forth in such findings and in the preamble to Senate Resolution No. 206. The preamble referred, among other things, to the long standing demands of American War Veterans, speaking through the American Legion, for legislation to take the profits out of war.

Pursuant to these clauses of the resolution public hearings were held in September and December of 1934 and throughout the first 4 months of 1935. Because many of the witnesses and the companies whom they represented were required to be examined with respect to other provisions in the resolution as well as with respect to those directing a review of the findings of the War Policies Commission, the committee's hearings on this latter topic were in many instances not held separately from its hearings relating to other provisions of the resolution.

¹ By S. Res. 244 of the 73d Cong. and S. Res. 8 and 129 of the 74th Cong. the amount which the Committee was authorized to expend was increased.

This report is designed to cover in a preliminary ² way the results of that part of the committee's investigations carried on in connection with its review of the findings of the War Policies Commission. The primary obligation imposed upon the War Policies Commission by Public Resolution No. 98 of the Seventy-first Congress was—

to study and consider amending the Constitution of the United States to provide that private property may be taken by Congress for public use during war, and methods of equalizing the burdens and removing the profits of war, together with a study of policies to be pursued in the event of war.

The two chief means of equalizing the burdens and removing the profits of war which have been employed in the past and which were considered by the War Policies Commission are (1) taxation, and (2) control of prices. These two methods have received serious consideration by this committee which has heard testimony of Government officials and of private citizens familiar with these fields.

In the case of all witnesses and companies investigated by the committee that were engaged in substantial business activities during the World War the committee has endeavored to ascertain the facts relating to the effect on the war profits of such witnesses and companies of taxation and price control. The committee has also examined the official records of the Government relating to the use of these two methods during the World War. The accompanying preliminary report sets forth the results of the committee's investigations as to wartime taxation and control of prices as a means of removing profits from war and equalizing the burdens of war.

² Because of the extent of testimony taken by the committee in the course of its investigations the complete testimony is not in final printed form. Consequently, in many instances the citations to the record contained in this report have had to be made to galley proof sheets rather than to the final pages of the testimony.

FINDINGS AND RECOMMENDATIONS

The committee has in Senate Report No. 577 recommended that H. R. 5529 with the amendments proposed in that report be enacted into law. That bill is designed to prevent, so far as legislation can cope with such forces, the distressing inequalities, the shameless profiteering, and the staggering aftermath of the last war.

The committee reaffirms its recommendation that H. R. 5529 as amended should pass and is firmly of the opinion that the bill represents a long advance toward its purposes.

The committee recognizes, however, the importance of the question of whether there is complete assurance that the Federal Government has all the necessary powers to achieve this goal.

This question has been raised before at various times. It was raised during the war by industrial groups, in an endeavor to weaken any attempt by the Government to fix low prices. It was raised again in the creation of the War Policies Commission of 1930. In fact, one of the chief duties laid upon that Commission was to consider the necessity of amending the Constitution. It was raised again in 1934 when this committee was created and charged with the duty of reviewing the findings of the War Policies Commission.

The committee now undertakes to discharge this duty. On the basis of a careful review of the World War experience with price-fixing, based on the study of all the minutes of all the governmental bodies involved in that price-fixing, together with studies and analyses of large groups of profit figures and income tax returns, the committee finds that in order to prevent wide-spread profiteering in a national war emergency several amendments to the Constitution will probably be necessary.

The committee takes into consideration the serious objections to these amendments. It realizes the possibility that the adoption of such amendments may create other situations far worse than the situation of profiteering in a national emergency. It simply states its findings, based on the evidence in this report and in report no. 577, that if the sole purpose under consideration is the avoidance of profiteering, the following amendments to the national Constitution must be made:

1. The first of these amendments should permit the commandeering of plant, goods, and industrial equipment for public use in time of war without the determination of "fair compensation" in the present way through review by the courts which results in payment at the highest possible price levels. This is not an amendment to abolish the payment of fair compensation, but to allow for the determination of fair compensation according to the directions of Congress rather than of the courts. (See pp. 111 to 116.)

2. The second of these amendments should make certain the power of Congress to tax for war-profits control on such bases of investment or fixed capital assets as it finds to be fair and just regardless of the

possible inequality among taxpayers of such bases and without the elaborate procedure which may be unavoidable under existing law. Without this amendment the tax bases proposed in H. R. 5529 may be successfully attacked by those bent upon securing larger profits than it permits. (See p. 8, note 3; p. 26, notes 70 and 72 and see pp. 19-20.)

3. The third of these amendments should permit Congress to tax the interest of tax-exempt securities during a national emergency. (See p. 52.)

These three amendments would give to the Government the necessary power to fix prices and pay the costs of a war through taxation. The other possible effects of these amendments are considered later.

While the Government would, with the passage of H. R. 5529 and the adoption of these three amendments, have full and adequate power to control the economic forces of the Nation in the carrying on of a war, it is still open to question whether these powers would be so used by the officials of the Government as to eliminate all profiteering. There are two reasons for believing that these powers would not be so used.

1. The main interest during war time of all concerned with the conduct of the war is not that of saving money, but of securing production as rapidly and as fully as possible. Lowered prices, higher taxes, avoidance of inflation are all secondary interests. As Mr. Charles Hayden told the Price Fixing Committee in May 1918:

Our Allies are crying for copper; representatives of foreign governments are telling me as an individual: "What do we care about a cent or more in price? What we want is the stuff."

The moment an industry threatens that lowered prices will slow down its production, or that high taxes will make it impossible for it to secure working capital, the Government will yield as it yielded in the last war. In January 1918 the War Industries Board approved a large contract with the Hercules Powder Co. at a price which it thought too high for the reason that "it was either necessary to pay the 70 cents per pound or go without the powder."

The apparent alternative of commandeering industry is in fact not an available alternative. If the owners of industry are compensated to their own satisfaction and surrender their enterprises and the benefits of their operating experience to the Government, as in the case of the railroads during the World War, the cost is as great as the cost of meeting industry's demands for its services. On the other hand, if any significant part of industry were to be arbitrarily confiscated against the wishes of the majority of the business community, the chaotic condition resulting from the great social and political animosity which would be aroused thereby would definitely retard the production which is of paramount necessity for the prosecution of a modern war.

During the World War the copper industry simply refused to produce at even the liberal prices first proposed by the Government. (See p. 95 et seq.) The steel industry similarly refused to fill Government orders until prices had been stabilized at levels satisfactory to the industry. (See p. 100 et seq.) Judge Gary, representing the steel industry, told the Price Fixing Committee that "manufacturers must have reasonable profits in order to do their duty." The du Pont Co. refused to build a great powder plant which it alone was qualified to

build until it was assured of what it considered sufficient profits. (See p. 107 et seq.) Mr. Pierre du Pont wrote that "we cannot assent to allowing our own patriotism to interfere with our duties as trustees."

The Government is more at the mercy of such a strike by capital or management than at the mercy of a strike by labor. The War Department bills, which have been prepared for adoption upon the outbreak of a war, provide in effect that labor can be drafted and that men must either work or fight. It will be entirely within the power of the Government, under these bills, to require men to work where they are told and to select any leaders of a labor strike and draft them into the military service the moment any strike is threatened. With these powers, and with a whole labor pool to draw on in the form of the conscript army, there is no question that the Army can break any labor strike. As pointed out above, it is in no similar situation in regard to a strike by capital or management.

There is also another factor which makes a strike by capital or management harder for the Government to handle than a strike by labor. The latter is open and advertised. All the force of patriotic public opinion can be brought to bear to stop it. The former is neither open nor advertised. It was not until the hearings of this committee, some 17 or 18 years after the event, that the strikes of certain of our industrial companies in connection with war-time price fixing became known.

2. While this incapacity of the Government to take over or to dispense with the function of any industry is the main reason for the expectation that even complete theoretical authority and power will never be invoked, there is another subsidiary reason. The administration of prices and procurement is inevitably put into the hands of people who have been industrially trained and who are sympathetic to private industry's demands.

During the last war the interests of the administrative officials were definitely close to the interests of the regulated industries. (See pp. 13 to 83.) Mr. Brookings told the nickel industry: "We are not in an attitude of envying you your profits; we are more in the attitude of justifying them if we can. That is the way we approach these things." The experience of such men must be used by the Government and yet their attitude toward the contentions of industry is inevitably favorable. Such men will not use theoretically full powers to eliminate profiteering even if they have them.

With these two considerations in mind the committee makes the following findings with respect to war-time taxation and price control as means of equalizing the burdens of war and of removing the profits from war:

1. It must be recognized that war inevitably involves waste and increased living costs. The increase of costs due to the shift of production from peace-time to war purposes, to the use of untrained labor to replace men drafted into the army, to the high risks of war-time production in many industries, and to the necessity for rapid production and delivery, requires an increase in some prices in war time whatever form of price control is exercised. The interrelation of our industries will spread the effect of these increases throughout our economy. This means that no arbitrary plan of keeping all prices at a given level is practicable and individual prices must be fixed by governmental agencies. (See pp. 117 to 126.)

2. The necessity that the governmental price-control agencies must largely rely upon industry for their information as to costs, capacity, production needs, and other fundamental information, and the fact that the personnel of these agencies must be largely made up of men who have been industrially trained and who are sympathetic to private industry's contentions, when added to the critical importance of increasing industrial output in war time, prevent the fixing of prices below such a level of profitability as the bulk of the producers in any industry agree is fair. (See pp. 73 to 83 and pp. 55; and 62-63.)

3. The fact that costs are in the last analysis matters of opinion and are not susceptible of scientific determination, and the gigantic nature of the administrative task involved in enforcing any price provisions opposed by a substantial portion of industry make it impossible to eliminate war profits by price control except to the extent that industry agrees to accept a limitation of its profit-making potentialities. (See pp. 84 to 91 and pp. 92 to 94.)

4. There are large profits and there is inequality in peace time. The strain and stress of war is not conducive to the adoption of fundamental reforms which cannot secure acceptance even in time of peace. We must guard against a blind belief that all profiteering can be ended by proposals for war-time taxes and industrial control.

5. Severe war-time taxation ensures the subjecting of the administrative officials responsible for its operation to heavy direct and indirect pressure for the alleviation of tax burdens, it increases resistance to tax collection, and if it reaches a level which the majority of business men feel is confiscatory, will discourage or prevent the volume of production so essential to the successful prosecution of a major war and thus defeat its own ends. (See pp. 37 to 43 and pp. 10 to 12.)

6. Because of the difficulties of determining in any exact manner the costs of all business and hence the profits from business and because of the impossibility of closing all loopholes in legislation designed to apply uniformly to our immense and complicated business and industrial structure, income taxation cannot eliminate all war profits. (See pp. 27 to 34; 84 to 91; 44 to 52 and 25-26.)

The committee recognizes that the first two of the constitutional amendments herein described as necessary to any effective control of profiteering contain dangers that may be far worse than the evil of profiteering. The power of commandeering and the power of taxing without uniformity—both without our customary elaborate court review—increase enormously the power of the Federal Government. If that Government should in the next war be run in the interests of any industrial group or class its power to destroy the competitors of that group or class would be without the traditional protections so familiar to this country. The opportunities for militaristic control in war-time are well known; the relaxing of constitutional restrictions will increase these opportunities.

Furthermore, under these proposed amendments, in the event that any group controlling the Treasury, Army, Navy, or the future equivalent of the War Industries Board, wishes to punish those who may have opposed the war before its declaration, or those who have criticized the allocation of war orders, or wishes to eliminate certain competitors, that group can utilize its power to do so. If there is, therefore, the least danger that any group of industrialists, through the

sheer size of their investment, or through their absolute necessity for war purposes, such as, for example, the steel and chemical industries, should be in a position of power in a war-time administration, the first two amendments would be dangerous weapons to place in their hands. Even a temporary abuse of power by such a group might result in the destruction of the financial independence of another group.

To the amendment providing for the war-time taxation of interest on tax-exempt securities there can be no similar objections.

PART I. WARTIME TAXATION

I. CONSIDERATION OF THE EFFECTS OF SEVERE WARTIME TAXATION

The purposes of wartime taxation as viewed by this committee are twofold: First, the normal purpose of raising revenue, which in time of war is increased in importance because of the heavy demands upon the Treasury; and, second, the removal of profits made from the war.³ It is assumed by the committee that the combination of these two purposes will result in much more severe taxation in wartime than in peacetime. Not only will the amount of total collections be increased, because the increase in industrial activity almost certain to be incident to war will make a larger amount of profits available for taxation—but the rate of taxation must be increased sufficiently to take more than the war profits, since obviously the total cost of a war, substantially all of which is borne by the Government, must be greater than the element of profit in that cost and it is clearly desirable for the Government to pay as much of the current expenses of the war out of current revenue as is possible.

It must be recognized that in determining the degree of severity of taxation which should be employed in war time, it is important to study the effects of severe wartime taxation upon the economic condition of the country generally, and in particular upon its ability to produce materials essential for the conduct of war.

(1) TENDENCY TO PASS INCREASED TAXES ON BY INCREASING PRICES

There can be no doubt that business men in general regard taxes as a cost of doing business and consequently attempt to recoup taxes, as well as other costs, out of sales prices. This means that, ordinarily, an increase in the severity of taxation does itself tend to raise the price level, and to the extent it is passed on does not result in any decrease of the total volume of profits. The statements of two men familiar with the taxes in effect during the last war may be quoted on this subject. Mr. Baruch in testifying before the War Policies Commission made the following statement:

Excess-profits taxes—standing alone—have no effect whatever to check inflation. Their only effect is to increase it. Thus 20 percent of \$500,000 profit is \$100,000 and 20 percent of \$1,000,000 profit is \$200,000. One way to increase \$500,000 profit to \$1,000,000 profit without increased risk or effort is to double price. For this reason there is more incentive to increase prices—and therefore profits—under an 80-percent excess-profits tax than there is without it. Indeed, the main result of such a system is to induce rapid price increases to absorb the

³ It is recognized that the use of the taxing power to remove profits from war-time production and commerce may not be permissible under the Federal Constitution without amendment. The attempt to make all profits uniform, at the same time that the Government has power to commandeer products or plants that are not freely made available for the prosecution of the war, is more nearly analogous to the governmental authority exercised in the field of public utilities than to the power to raise revenue. The use of any of the Federal powers may be limited to the effecting of its direct purposes. Cf. the recent United States Supreme Court case, *Louisville Joint Stock Land Bank v. Radford*, decided May 27, 1935, dealing with the bankruptcy powers of the Federal Government, and see *Bailey v. Drexel Furniture Co.* (259 U. S. 20). On the other hand it is, of course, impossible to forecast with any substantial certainty the extent to which the war powers of the Federal Government may be construed to permit the removal of war profits. Furthermore, it is well settled that the motives which prompt Congress to pass revenue measures will not be reviewed by the courts and that incidental effects of tax statutes will not invalidate such statutes. (See *Bailey v. Drexel*, *supra*, at pp. 33, 40, 41.)

tax. Precisely because it accelerates and in nowise checks inflation the excess-profits tax—without more—offers no cure at all for war evils. On the contrary, it aggravates them.⁴

Mr. Colver, who was chairman of the Federal Trade Commission during the war, made the following statement:

* * * the way to make anything expensive is to tax it; and if you levy a tax on war, you make war cost more than it should. A study of the actual working out of our excess profits tax during the last war will demonstrate beyond any possible question that it did not recover the excess profits; that it did not keep prices down, and that it did not stimulate production, but that on the contrary, it slowed production down, it stimulated prices, and it made the cost of the war to the taxpayers, I should say, twice what it should have been. I would say that for every dollar collected in excess-profits taxes that got into the Treasury it cost the people of the United States, or it will cost them \$10 unnecessarily.⁵

The ineffectiveness in recapturing profits derived from the Great War, of taxes based upon a percentage of profit appears from the figures discussed at pages 13-15 and 65-66.

Another statement of Mr. Colver's stresses the point that since the Government in war times becomes the largest consumer, a passing on of taxes in the form of higher prices paid by the Government as consumer not only permits war profits but, by decreasing the purchasing power of the Government, tends to defeat the primary purpose of war-time taxation—the raising of sufficient revenue to finance the war—and so to make governmental borrowing inevitable:

I dissent wholly and entirely from the theory that excess-profit taxes justify unreasonable price structures and purge unreasonable profits. Not a penny of excess-profit tax has been or will be paid to the Government that has not first been collected with many other pennies from the people of the country, either as consumers or as tax payers. Since the Government itself is by far the largest of all buyers at fixed prices, it seems to be absurd to take an excess dollar out of the Treasury in order to get 34 cents of it back in by way of excess-profit taxes. The net result of such a transaction is merely creating the necessity of raising an otherwise unnecessary 66 cents by some other means of taxation or by bond sale. In the main, it is not industry which ultimately pays excess-profit taxes, but the consumer, and only a small part of the excess which the consumer pays reaches the Treasury in the form of taxes. The whole excess-profit tax theory is an attempt to lift oneself by his boot straps, and there is lost from 20 to 80 percent of the energy employed in the process.⁶

The difficulty of determining with any substantial degree of certainty the costs of business operations makes the fixing of prices by governmental agencies an unsatisfactory means of eliminating widespread tendencies toward price increases. (See pt. II of this report). Since, for the reasons pointed out above, a tax of a percentage of profits does cause a wide-spread tendency to inflate prices, it is felt that the evils of such a tax are inseparably linked to it and that the principle of taxing a percentage of profits must itself be avoided. Consequently, this committee has recommended that corporate income be completely confiscated beyond an exemption which is itself not based upon a percentage of profit. Such a tax would remove

⁴ War Policies Commission, H. Doc. No. 163, 72d Cong., 1st sess. (1931), p. 798.

⁵ Hearings before the Committee on Military Affairs, House of Representatives, 68th Cong., 1st sess., Mar. 11, 13, and 20, 1924, p. 237.

⁶ Garrett, Government Control over Prices (1920), p. 361.

the incentive to pass on its burden in the form of higher prices⁷ since, regardless of the volume of business or the total income, only a definitely limited amount of profit—determined without regard to the amount of income received—could be retained by the taxpayer. It must be noted, however, that such a tax raises other problems, the chief of which is the effect upon production of a limitation of profit which ensures that beyond that limitation an increase of industrial activity will bring no return.

(2) EFFECT OF SEVERE TAXATION ON PRODUCTIVITY

The profits of any business do not appear entirely as cash but are also in large part in the form of such assets as accounts receivable and inventories. Consequently, the average company does not have sufficient cash available to pay as taxes anything like the entire amount of its current profits. Furthermore, cash reserves are vital to most businesses to finance current operation and will be particularly needed in war time to finance the conversion from peace to war production. Therefore, in order to assure productivity, cash reserves should not be drained by taxation even in the cases of companies having surpluses sufficiently large to pay severe taxes.

In addition, in the case of a severe tax any mechanical error in favor of the Government in the computation of the tax (which involves the complications inherent in the accounts of modern large-scale business where depreciation, depletion, and many other items are largely matters of judgment) may mean the destruction of the taxpayer's business. It was for this last reason that Mr. Ballantine when Assistant Secretary of the Treasury testified before the War Policies Commission that at the outside a tax of 90 percent of profit was the maximum that could be used safely:

In the case of any business which is at all complicated the determination of the profit for a particular year can rarely be exact but must rest in part upon assumptions and estimates. Almost never does the entire profit take the form of an actual excess of cash or securities at the end of the year. Generally speaking, part of the profit is in the form of inventories and in the form of improvements or additions to factories. Where the rate of tax is moderate, errors in determination do not have vital consequences and average out over the years. If, however, the entire profit is to be taken out of the business, errors in computation might be disastrous. Without elaborating on this difficulty, it may be stated that to allow some margin for error, any workable tax would presumably have to be computed on some percentage less than 100 percent—say, 80 percent or, perhaps, at the outside, 90 percent. Eighty percent was the rate urged by the Treasury and adopted as the maximum in 1918 and was the rate finally used in the British excess-profits tax. Leaving some relatively small margin of profit also serves the

⁷ It would, however, have an inflationary influence in that it would encourage (1) the treatment of doubtful items as cost rather than as income, and (2) higher costs in general than would be normal. Increases in cost, of course, result in a tendency to increase prices. For example, during the World War in the desire to avoid having the Government get the lion's share of the profits, salaries of executives were increased inordinately and bonuses liberally distributed. Compare the report on the American Metal Mining Co. in the Federal Trade Commission Report re "Profiteering" (65th Cong., 2d sess., Doc. 248 (1918), pp. 19-20). The expansion of advertising to a volume beyond what certain authorities have argued to be socially desirable dates from the war period. "Only the shortage of paper limited the expenditure for advertising according to one Treasury official." Haig, *Taxation of Excess Profits in Great Britain* (1925), p. 148, note 5.

Furthermore, expenditures were encouraged which were neither extravagant nor designed to be evasive, but were of the type aiming at future speculative profits, such as "repairs and betterments not presently needed or made with an eye to the future and in anticipation of a return to peace-time basis. Further, expenditures are lavishly made by big concerns out of rapidly accumulating surpluses which are in the nature of strategic advances upon other weaker competitors and which, upon a return to peace-time basis, will tend to result in a permanent elimination of weaker competitors and the rapid extension of monopolistic conditions. These expenditures are made on the theory that out of every dollar so spent, the Government itself contributes anywhere from 20 to 80 cents of the cost." (Garrett, *Government Control over Prices* (1920), pp. 391-392.)

purpose of furnishing a guaranty to the Government that the taxpayer will see to the administration of the business with efficiency and economy.⁸

These considerations were restated in substantially the same form by the Secretary of the Treasury in responding to a resolution of the Senate for recommendations and opinions as to the proposal, resulting from the War Policies Commission's investigations, that war profits over and above the pre-war average be taxed at a rate of 95 percent.⁹

In time of war increased production in many lines of industry and uninterrupted output in most fields of industry are essential and are far more important than eliminating profiteering or preventing a heavy debt being passed on to post-war administrations. Consequently, if the absolute rate of any war-time tax is so severe as to discourage investment required for reconditioning idle plants, converting plants from nonessential to essential production, building new facilities, financing larger purchases of raw materials and increased pay rolls—to name a few of the wartime requirements for capital in expanding production and eliminating any consideration of the effect of such a tax on existing production—it cannot be permitted.

The operation of investment in our economy is quite distinct from any question of the willingness of any individual to forego profits for a patriotic reason. The scale of profit is the routine method by which industrial activity is carried out. The investor is guided not by general questions of usefulness or national need, about which he is in most cases not advised, but simply by the prospect of profit held out to him.¹⁰ If this is cut off, expansion of industrial activity may cease, and will in any event be seriously curtailed, and even existing production will be reduced. In such an event the financing of a large part of the needed expansion, without considering existing production, by the Government might well mean a greater financial burden on the Government than would be the case under a more moderate rate of tax. Government expenditures in loans would be increased without any assurance that Government expenditures for supplies would be correspondingly decreased. Government revenue from a tax at a lower rate applied to a larger volume of privately financed business might actually be greater than the revenue from a tax fixed at a rate so high as to discourage expansion of private business. The administrative burdens imposed on the Government in carrying out such financing, and the resultant necessary supervision of operations, would in addition be enormous and would be imposed at the very time when administrative capacity would already be sorely overburdened by other war duties.

Once the country has been launched upon a major war any serious threat to the stability of production would be disastrous and the introduction of the Government into business on the large scale that might be required by a confiscatory tax rate could not be effected without such a threat.

⁸ War Policies Commission, House Document No. 163, 72d Cong., 1st sess. (1931), pp. 691-2.

⁹ 72d Cong., 1st sess., Senate Doc. 105, p. 3.

¹⁰ See letter of B. M. Baruch to committee dated Apr. 12, 1935: "Much as it may be decried, the cold fact remains that ours is an economy motivated by profits. A certain return on money is necessary to make our industrial system work * * * Much was said at the hearing about this being a new war psychology * * * Our whole industrial system is a complex massive machine built and geared to run on investment and profit. There is no proof that it will run on psychology and there is much that it will not. Certainly we should not select an hour when the enemy is at the gates to find out whether it will or not * * * Money will not invest and run the extreme risks of war production for a fraction of 3 percent."

Furthermore, if a wartime tax is so burdensome as to be considered unfair by the public at large, the resulting increase in the all too normal tendency to avoid or evade taxation¹¹ may, quite apart from its economic and social effects, result in a decrease in net revenue to the Government.

(3). SEVERITY OF TAXATION DURING WORLD WAR

Patriotism in the last war was tested in a situation where the highest excess-profits tax rate continued in existence for only 1 year, was 80 percent of profits over and above an exemption of at least 10 percent of investment, which as pointed out above at page 8, is not a check on the absolute amount of profits. Mr. Haig, in speaking of the British experience on the subject, indicated that abuses would develop even with a rate far below 80 percent:

Best informed British opinion places the maximum share which can be safely taken by the Government at about 50 percent. If the Government takes more than the half of the pound of profit, abuses, it is believed, are certain to develop.¹²

The 1917 Revenue Act imposed income taxes up to 4 percent on corporate incomes remaining after payment of excess-profits taxes and relied primarily on the excess-profits taxes for revenue. These taxes were based upon a pre-war earnings standard that required a determination of invested capital. To a flat exemption of \$3,000 was added an exemption computed by applying to the invested capital employed during the taxable year a percentage equal to the percentage which pre-war income (1911-13, inclusive) was of pre-war invested capital. (Secs. 203, 200). This involved a computation of invested capital and income for two periods, but since the act fixed the maximum percentage of current invested capital at 9 and the minimum at 7 the importance of pre-war invested capital and income was lessened as compared with the significance of current invested capital, to which the definitely limited percentage was to be applied, and current net income.

Net income over and above the 7 to 9 percent of invested capital was taxed at varying percentages—income equal to 15 percent of invested capital less the credit was taxed at 20 percent, income equal to an amount between 15 and 20 percent of invested capital was taxed at 25 percent, between 20 and 25 percent of invested capital at 35 percent, between 25 and 33 percent of invested capital at 45 percent, and over 33 percent of invested capital at 60 percent. (Sec. 201).

The 1917 act also imposed an excise tax of 10 percent upon the net profits of munitions manufacturers derived from the sale of specified articles.¹³

The excess profits provisions described above were also applicable to individuals and partnerships engaged in trade or business and having an invested capital.¹⁴ Individual incomes were subjected to surtaxes ranging from 1 percent on net incomes between \$5,000 and \$7,500 to 50 percent on net incomes over \$1,000,000, in addition

¹¹ See pp. 44 to 52 *infra*, for a discussion of the problems raised in the field of taxation by the normal tendency to avoid paying taxes.

¹² Haig, *Taxation of Excess Profits in Great Britain*, 1920, p. 149.

¹³ Revenue Act of 1917, sec. 214. The articles are listed in sec. 301 (1) of the Revenue Act of 1916.

¹⁴ Sec. 201. If the trade or business had no invested capital, or had only a nominal capital, a flat 8 percent tax against income above an exemption of \$6,000 was applicable. (Sec. 209).

to the surtaxes already in effect under the 1916 act on income brackets from \$20,000 up.¹⁵ (Sec. 2.) Individual incomes were also subject to a 2 percent tax on the first \$2,000 of income above the ordinary personal exemptions and a 4 percent tax on the balance.

The 1918 rates were considerably more severe and resulted in much greater revenues—\$4,286,500,000 as contrasted with \$2,937,800,000 reported due in the original unaudited returns.¹⁶

The corporate taxes¹⁷ again combined a pre-war income standard with an invested capital standard but in a different manner. In addition to an income tax of 12 percent on income over \$2,000, all corporations were subjected to an excess profits tax of (1) 30 percent of net income up to an amount equal to 20 percent of invested capital less a credit (computed by adding to \$3,000 an amount equal to 8 percent of invested capital) and (2) 65 percent of all income over 20 percent of invested capital. In addition all corporations were subjected to what was referred to as "a war profits" tax at a rate of 80 percent. This appeared as a third bracket of the excess profits tax and was commonly called the 80 percent bracket. This tax was not, however, based upon invested capital. It was levied against income in excess of a special credit which was computed by (1) adding to \$3,000 the average pre-war net income, adjusted for capital changes by adding or subtracting 10 percent of the increase or decrease, as the case might be, of current invested capital as contrasted with pre-war capital¹⁸ or (2) taking 10 percent of invested capital, whichever was greater.

This 80 percent tax on income less at least 10 percent of invested capital was only payable, however, to the extent that it exceeded the excess profits tax set forth in the two preceding brackets. In other words the excess profits tax of 30 percent, or of a combination of 30 percent and 65 percent (depending on the income bracket of the taxpayer), of income in excess of \$3,000 plus 8 percent of invested capital, and the war profits tax of 80 percent of income in excess of at least 10 percent of invested capital, were alternative taxes, the higher of which was applicable.

In 1919 the 80 percent tax was eliminated and the rates of the excess profits tax were reduced from 30 percent and 65 percent to 20 percent and 40 percent. On December 31, 1921, these reduced taxes disappeared.

Exhibit 1388, reprinted in the appendix at page 132, sets forth in tabular form the corporation income and profits tax rates in effect from 1909 to 1928, inclusive.

Except in individual instances, the effectiveness of the wartime taxes in recapturing profits can be estimated only roughly. Mr. Ballantine testified before the War Policies Commission that corporations reported average annual net incomes, after deduction of their estimated taxes, of \$5,900,000,000 for the years 1914 to 1916, inclusive,

¹⁵ The total surtaxes in effect are given in a table at pp. 704-5 of H. Doc. 163, 72d Cong., 1st sess. (War Policies Commission Hearings.)

¹⁶ 72d Cong., 1st sess., H. Doc. No. 163 (War Policies Commission Hearings), p. 701, table no. 1.

¹⁷ Individuals and partnerships engaged in business were not subject to the 1918 excess profits tax or war profits tax. (Sec. 301a.) Individual incomes were subject to surtaxes of increased severity. (See pp. 704-5, H. Doc. 163, 72d Cong., 1st sess.) The ordinary income tax rates were increased to 6 percent on the first \$4,000 above the ordinary personal exemptions and to 12 percent on the balance.

¹⁸ If the corporation was not in existence during at least one of the pre-war years (1911 to 1913, inclusive), the first alternative means of computation was the use of the same percentage of invested capital that the average pre-war income of representative corporations was of their average pre-war invested capital.

and average annual net incomes, after the estimated wartime taxes, of \$7,000,000,000 for 1917 to 1919, inclusive.¹⁹ On this basis the war—despite the wartime taxes—added \$1,100,000,000 a year to the final tax-free profits of corporations which had already profited largely by the huge sales to the Allies made by this country before April 6, 1917. As contrasted with the years 1911 to 1913, inclusive, which the wartime tax statutes fixed as the pre-war years for measuring war profits, corporation profits after taxes increased 69 percent during the war, or from an average of approximately \$4,123,000,000 to \$7,000,000,000, and only 44 percent of the increase in annual profit from \$4,123,000,000 to \$9,500,000,000 was taken in income and excess-profits taxes.²⁰

Exhibit 1756, which is reprinted in the appendix at page 136, shows that a group of the largest manufacturing and mining companies in the country paid in taxes (including both the normal income and the excess and war-profits taxes) only 25 percent of their net taxable income for 1917 and only 34.9 percent of their 1918 income, according to the final figures of the Bureau of Internal Revenue. If the revenue agents' determinations of net taxable income are used 22.8 percent of 1917 income was paid as taxes and 32.8 percent of 1918 income. It must be remembered that these computations do not include income received by these corporations, but excluded from taxable income because (1) invested in tax-free securities (see p. 52) or (2) allowed as deductions for amortization, depreciation, or depletion, i. e., set up as reserves against ordinary business risks (see p. 27 et seq.), to mention a few of the allowable deductions from income. The 1917 net income of these companies after deducting payment of their final tax liability was 26 percent of their invested capital and their 1918 income on the same basis was 10.5 percent of capital, the Bureau of Internal Revenue's final figures show. Before taxes, the 1917 income was 34.8 percent, and the 1918 income 15.6 percent, of capital. If the revenue agents' determinations are used, the results are 39 percent profit in 1917 and 11.8 percent in 1918 after taxes and 50.5 percent in 1917 and 17 percent in 1918 before taxes. Obviously, the 80-percent tax was not a tax of 80 percent of all profits.

Individual instances further illustrating that the tax rates in practice were not of the severity usually ascribed to them appear at page 65-66 of this report.

It should be further remembered that estimates of taxes as contrasted with income, or of income as contrasted with investment, are based upon (1) the taxpayers' own estimates of those two highly variable items, income and investment,²¹ or (2) estimates which the taxpayers consented to or which withstood the rigors of legal proof, or (3) estimates by Government agents whose time and expense accounts were limited, whose estimates were primarily based upon the taxpayers' figures and whose estimates were made not only with an eye to the necessity of substantiation under vigorous attack, but also within the limitations of technical statutory standards which permitted the elimination from income of many items which would be

¹⁹ 72d Cong., 1st sess., H. Doc. 163, p. 690. While these figures are the taxpayers' own estimates and consequently may be underestimates, the ratio between the two sets of figures should reflect with substantial accuracy the ratio between the actual income in each of the two periods. The basic figures on which Mr. Ballantine apparently relied appear in Statistics of Income for 1925, U. S. Treasury Department, pp. 22-23.

²⁰ Statistics of Income for 1925, U. S. Treas. Dept., pp. 22-23.

²¹ See pp. 19 to 36 for an analysis of the impossibility of arriving at exact determinations of income and investment.

considered as income for ordinary purposes. As Senator Vandenberg pointed out in his examination of Homer L. Ferguson, president of the Newport News Shipbuilding & Dry Dock Co., the taxes paid were less severe and the profits retained greater than such figures indicate by (1) the amount which the estimates of income excluded debatable or hidden items and by (2) the amount by which the estimates of investment included debatable or fictitious items:

Senator VANDENBERG. What you are saying, Mr. Ferguson, is that an attempt to tax war profits becomes more or less of a mathematical maze, dependent upon an agreement as to what base you are going to start from?

Mr. FERGUSON. Our war-profits tax got up to a point of about 86 percent, I think, on this invested capital.

Senator VANDENBERG. But whether or not it is a comprehensive or adequate tax depends primarily upon the base to which the tax is going to be applied?

Mr. FERGUSON. Absolutely.²²

²² Feb. 12, 1935.

II. CONSIDERATION OF PARTICULAR TYPES OF TAXES

Because of the complicated and infinitely varied structure of the country's economic life, achieving a taxation scheme which will in fact leave uniform profits to all concerns is enormously more difficult than the determination of what is a socially desirable profit for any single concern, difficult though the latter determination is as indicated by the foregoing part of this report. By and large, the needs of individuals can be stated in absolute amounts of dollars and, at the cost of hardship in particular cases, an arbitrary uniform exemption could be fixed that would raise with substantial clarity the issue of the extent to which taxation of individuals should be carried. But in the case of commercial and industrial enterprise the business unit's claim to profits cannot be so uniformly determined.

Even though the preponderant public opinion should come to be that in time of war a business unit should receive no more tax-free income not distributed to individuals than individuals should themselves receive, the economic effects of such a tax would probably be so adverse as to make it undesirable. If all business units, regardless of size, natural location, patent position, amount of investment, degree of risk, and the many other causes of variances in profits, were to receive only the same ultimate profit, new investment would be encouraged to go into small, safe, low-capitalized fields. Existing large and efficient firms would be encouraged to subdivide without consideration of efficiency, since increased costs would not lower the owners' ultimate profits as a general rule. Although much of this could and probably would be accomplished by purely formal corporate reorganizations, it is clear that confusion and a consequent general slowing up of the productive and expansive processes in industry would occur at the very time that no interference with maximum productive capacity can be tolerated.

At all events, it seems likely that any wartime taxation measure that can hope to receive serious consideration must choose for a tax on corporations—if not on all business units²³—a basis or standard that will recognize in some manner general differences in profitability of business enterprise. The two bases most frequently referred to in theoretical discussion are (1) average peacetime profits and (2) the amount of investment. These two bases were both used during the World War in this country and in Europe.

(1) AVERAGE PRE-WAR INCOME AS A TAX BASE

The War Policies Commission recommended a tax of 95 percent on all earnings above the average income during the 3 years imme-

²³ The 1917 Revenue Act based the excess-profits tax on noncorporate business concerns on the invested capital of those concerns, just as it did in the case of corporations. (Secs. 201, 203, 204, 207). This was eliminated from the war profits and excess-profits tax contained in the 1918 act, in part, at least, because of the infinite difficulties of administration as contrasted with the relatively small amount of revenue involved. (Sec. 301). See report of the House Committee on Ways and Means on the revenue bill of 1918, 65th Cong., 2d sess., H. Rept. 767, p. 16.

diately preceding the next war.²⁴ Mr. Baruch in a statement filed with the committee repeated this recommendation but advocated increasing the tax to 100 percent of the excess.²⁵

This base has been urged largely because of the fantastic complications of the invested capital approach. The invested capital base involves not only much physical difficulty and consequent delay due to the size and complexity of modern business but also many decisions in the realm of discretionary judgment where no ruling, unless distinctly favorable to the taxpayer or acquiesced in by him, can be safely regarded as final without prolonged litigation.

T. S. Adams, formerly chairman of the Advisory Tax Board of the Bureau of Internal Revenue, stated that:

The intricacy of the excess-profits tax is such that it is hardly an exaggeration to say that it takes more time to teach an accountant to master its mysteries than the average accountant can be retained in the service after he has attained such mastery. * * * Ten years would be a radically short estimate of the time required in which to bring the taxpayers and the administrative authorities of the country to a point where the excess-profits tax could be reasonably well enforced.²⁶

Professor Seligman said:

What constitutes invested capital, however, is so elusive as to be virtually impossible of computation.²⁷

The War Policies Commission analysis of testimony, prepared by its executive secretary, Mr. Robert H. Montgomery, a recognized expert on taxation, states that:

Some of the provisions of the laws were so highly complicated that they could not even be litigated because they could not be reduced to logical argument pro and con. The determination of what constituted invested capital was an insoluble problem during the continuance of the tax, and is still unsolved. Some of the fundamental principles of invested capital are now in the courts and will be there for years to come.²⁸

However, the pre-war earnings standard involves so many necessary exceptions that in practice it is coupled with the invested capital base to such an extent as to lose its separate identity.

²⁴ No final report was ever submitted by the War Policies Commission but in the Analysis of Testimony prepared by the Commission's executive secretary and transmitted by President Hoover to Congress, there appears the following:

"Tax on income is the simplest method of applying a war tax. Most people are afraid to falsify their income-tax returns. The Government machinery for collection of such taxes already exists. Its method of operation is generally understood. From every standpoint, excess profits should be devised on the basis of income, and not on the basis of invested capital.

"Individual and corporation Federal income taxes in force when war is declared should be continued. These may be increased if desired. In addition, and retroactive to a period which will embrace any inflation or profit due to war activities, there should be imposed an excess-income tax of 95 percent applicable to individuals and corporations alike, not graduated nor affected by invested capital, but it should be a straight income tax, computed somewhat as follows:

"From net income as now computed deduct:

"1. Average net income for the 3 years next preceding the war period.

"2. The cost of additional capital facilities required for the war and in due course to be authorized by the proper governmental war agency. Tax deficiencies to bear interest at 6-percent per annum to prevent the taking of deductions which are not likely to be approved. At the end of the war the residual value of the additional facilities to be adjusted.

"3. Receipts of income in excess of a reasonable annual accrual thereof, where the income has been accruing over a period of years and contains no element of war profits, such as fees and commissions of executors and trustees.

"4. After deducting 1, 2, and 3, above, impose a tax of 95 percent on the balance.

"One of the advantages of the foregoing is that it should tend to prevent the extravagances which a tax on the excess profits of corporations is supposed to encourage, because it imposes the same high rate on individuals." (Documents by War Policies Commission, 72d Cong., 1st sess., H. Doc. 271, pp. 22-3.)

²⁵ Letter of Apr. 12, 1935, from Bernard M. Baruch to the committee: " * * * I propose * * * to take, by special taxes, 100 percent of all profits and income in war above the average of the preceding 3 years of peace * * * Taxes on new enterprises will have to be adjusted and worked out separately * * * At the same time, to increase the regular individual and corporate income tax to the absolute point of diminishing returns * * * I do not propose to make * * * asset values any factor in determining the tax, or to repeat the partial futility of the World War excess profits tax * * * "

²⁶ Thirty-five Quarterly Journal of Economics, p. 372, Should the Excess-Profits Tax be Repealed? (1920-21).

²⁷ Essays on Taxation (1925), p. 704.

²⁸ Documents of War Policies Commission, H. Doc. No. 271, 72d Cong., 1st sess. (1932), p. 21.

Although the size of a company's investment is not the sole or even chief factor in its profit-making capacity and so the invested capital base fails to reflect accurately the normal gradations of profitability in competitive business, still the base of earnings for any arbitrary period is more Procrustean. All investors seek a return on their investment. This fundamental fact is recognized in the use of invested capital, although the degree of risk, especial skill, and other important factors making for gradations of profitability are ignored. But the pre-war earnings base overlooks production and profit cycles and guarantees rich returns to the fortunate company that was at its peak in the pre-war period and, unless an exception be made, condemns to bankruptcy the concern that pulled through a pre-war slump by the use of reserves.²⁹ Similarly, new companies and expansion by existing companies would be absolutely profitless, unless exceptions be made in the theory.

Because production must be encouraged and not discouraged in war time, these exceptions are vital and can only be taken care of by an application of the invested capital base in these cases. The addition of new capital to existing concerns is so continuous and widespread,³⁰ and it is so difficult to restrict effectively the device of new incorporation by companies desiring to place their full capital under the exception where the exception for additions to capital does not give them the exemption they desire, that the tendency is irresistible for the whole scheme to become merely an alternative tax base to be chosen by the taxpayer when it is to his interest to do so.

Indeed in most foreign countries that used the device it was specifically made optional with the taxpayer. See *Taxation of Incomes, Excess Profits, and Luxuries in Certain Foreign Countries*, Legislative Reference Division, United States Library of Congress; and Haig, *Taxation of Excess Profits in Great Britain*, 1920, page 174.

Finally, this plan is open to the fundamental objection that it is based upon the theory that only profits allocable exclusively to the increase of industrial activity due to war should be taxed. As pointed out above at page 8, any war-time taxation measure must increase the absolute severity of taxation as contrasted with peace-time taxes. Ordinary peace-time earnings cannot be left untaxed in time of war, much less the unduly enhanced earnings that may occur in a period immediately preceding a war.²⁹ Consequently, with or without its necessary exceptions the pre-war earnings standard cannot furnish a complete war time taxation plan. It would have to be supplemented with some other plan to raise the needed additional revenue. The complexity of administration which would result from the use of two conjunctive taxes, one of which would have lost most of its purpose

²⁹ "Abnormally high profits in the past should constitute no ground for immunity from a future tax on supernormal profits. This is not word play; it is a mere suggestion of the truth that an abnormal state may continue for a considerable time without becoming 'normal.' Consider finally the concern which has had abnormally low profits in the past," Adams, 35 *Quarterly Journal of Economics* (1921), pp. 388-9. See also the statement of the British Chancellor of the Exchequer in 1920: "I would remind the committee that under the provisions of the excess profits duty prosperous concerns with a large pre-war standard may escape liability for the tax because their present profits, though high, are not in excess of their standard, and at any rate, they pay tax on what all of us think an unduly low scale." *Ibid.*, p. 389.

³⁰ The net worth of 200 leading American corporations increased in the period 1916 to 1921 from \$6,291,000,000 to \$11,363,000,000. House Military Affairs Committee, Hearings on Universal Mobilization for War Purposes, 68th Cong., 1st sess., p. 178.

Whenever new capital is added and earnings allocable to it are to be excepted from the pre-war standard it is necessary to compute the entire investment, in order to determine, by computing the proportion between the new and the total investment, that proportion of the total income allocable to the new capital. See Haig, *Taxation of Excess Profits in Great Britain*, (1920), p. 81.

through exceptions, makes the pre-war income standard an undesirable base for war-time taxation.

(2) INVESTED CAPITAL AS A TAX BASE

The primary theoretical objection to invested capital as a basis for computing the amount of income which is to be tax free is that the amount of investment is not, in ordinary commercial and industrial enterprises, the sole yardstick of the rate of profit.³¹ As pointed out above at p. 16, the degree of risk, geographical location, business skill, patent rights, and any number of other factors condition profitability and a tax which exempts income up to the same percentage of the invested capital for all business does not treat all business ratably. However, the chief objections to the use of the invested capital base in the event of another war are to its administrative difficulties.³²

The basic administrative difficulty encountered in applying the invested capital standard is in the valuation of the assets constituting the investment.

The late T. S. Adams of Yale University, an adviser to the Treasury Department and one of the leading tax experts in this country, gave his opinion as follows:

I think that no one thing so conduces to delay and complexities of the tax laws as the necessity for valuation.

I think it may be possible, and I hope that the Department, some representatives of which are present, will bestir themselves to make suggestions to get away from * * * problems of valuation, *the solution of which problems means the exercises of judgment* and differences of opinion, mistakes, and delay. If there is any human way of getting away from that, the Government of the United States ought to get away from it.³³

As a matter of definition, the higher the valuation permitted for invested capital, the greater the exemption allowed the taxpayer, since the whole purpose of providing for the determination of invested capital is to fix the amount of tax exemption. In 1917, the East Butte Copper Mining Co. made \$1,268,788; the Government collected taxes of only \$69,071. The ratio of net income to invested capital before taxes was 19.7 percent; after taxes it was 18.7 percent, a collection of only 1 percent.³⁴ Indeed, a sufficiently high estimate of the invested capital of any company would make all of its income tax free. Consequently it is to each taxpayer's interest to secure as high a valuation for its invested capital as possible.

Cash can be valued without difficulty, but there the simplicity ceases. The values of all other things, as Professor Adams observed, are matters of judgment. The process is described by the Supreme Court as follows:

The ascertainment of value is not controlled by artificial rules. It is not a matter of formulas but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts.³⁵

³¹ "There is the even more damning criticism that * * * in actual operation the standard of invested capital does not perform the function of determining the richness of profits even reasonably well; * * * the results of its application are eccentric and unfair * * * " (R. H. Montgomery, Excess Profits Tax Procedure (1921), p. 122).

³² See the statements quoted supra at p. 17. Letter of B. M. Baruch to the committee dated Apr. 12, 1935: " * * * it has been proved that any excess-profits tax based on asset values is too complex for war administration * * * for this reason, millions of dollars in taxes escaped the Government in the World War * * * "

³³ 69th Cong., 1st sess., S. Rpt. 27, p. 116. (Italics added.)

³⁴ Exhibit No. 1722.

³⁵ *Standard Oil Co. of New Jersey v. Southern Pacific Co.*, et al., 268 U. S. 146, 50 Sup. Ct. 465.

The difficulties and delays involved in applying such a general rule to intangible items like goodwill and patents³⁶ and to the capital assets of heavy industry, which have no market values because they are not the subject of general commerce, is obvious. Most corporate assets are acquired not for cash, which would afford some index of value, but for stock the value of which depends upon the value of the very assets whose value has to be determined by the Government. To reach valuations which will withstand the scrutiny of courts one of whose primary functions is to protect the rights of individuals and before whom the burden of proof is borne by the Government, is still more difficult.³⁷

The legal difficulties are described as follows in a letter of January 28, 1935, from the Acting Secretary of the Treasury to the chairman of this committee, which appears in the appendix to this report at p. 139, and which deals at length with the difficulties involved in valuation:

The legal difficulty and uncertainty in the determination of value of property not subject to frequent sales, and as to which market quotations are not published daily, arises because it is so largely to be determined from factual and opinion evidence, none of which is legally conclusive. Such evidence is the best available. Upon such evidence the value is determined by a judge or jury, in certain instances inexperienced in valuation procedure and with inadequate knowledge of considerations governing market value. The weight to be given to the evidence is entirely within their discretion and short of the adoption of a fundamentally unsound principle or an erroneous theory by the court in its instructions, it is impossible to secure a reversal of their finding if there is any evidence in support thereof in the record. It is a rare case where some evidence is not admitted which will support a most unsound finding of value.

Valuation for the excess-profits taxes of the World War was not current valuation, but value as of the time of investment. Retroactive valuations are of course difficult because records are not preserved indefinitely and because, in any event, the task of reconstructing a whole scale of industrial values to contrast with the existing records of the value of the items concerned adds to the uncertainties and controversies. However, most companies have some valuation data as of the date of acquisition of assets, whereas the task of valuing all of American industry as of any single date would be colossal if not impossible. Opinion and judgment would in those cases where no market was available as a check, be practically unfettered and the impossibility of conclusive legal determination would force the Government to compromise again and again and would prolong final valuation indefinitely.

Each computation of a tax on the basis of invested capital involves the determination of two variables—the income to be subjected to the tax and the investment to be used in fixing the exemption. This section of this report is concerned only with the latter problem but it should be noted that since income carried over into the capital of any concern becomes a part of the investment, the latter item cannot in most cases be determined without a simultaneous determination of the income of prior years. The determination of income, which is re-

³⁶ During the World War there was of course a strong tendency to write up the values of such items in order to increase the base on which the exemption was computed. 69th Cong., 1st sess., S. Rpt. 27, pp. 207-212; American Economic Review, vol. IX, no. 1, Supp. no. 2, pp. 20-22; Report of Committee on War Finance of the American Economic Association. (1919).

³⁷ A striking example of recent Federal difficulties in this regard is the experience of the Interstate Commerce Commission with the recapture provisions of the Transportation Act of 1920. After 10 years' work the Commission was virtually ordered by the Supreme Court to begin all over again because of failure to give proper attention to the factor of reproduction cost in its valuation. *St. Louis, etc. v. O'Fallon*, 279 U. S. 461 (1929). See examples in table appearing in appendix at p. 146.

ferred to at page 27 et seq., raises questions as much in the realm of judgment as are those here referred to. Taxable income, roughly speaking, is the difference between costs and total revenue. Costs include the valuation of many articles as difficult to value as those referred to above.

The investment of a corporation was determined as of the time it was formed. Consequently reorganization of a corporation just before or during the war resulted in an increase in the valuation of the assets acquired by the new company because of the rising price level.³⁸ Consequently avoidance of taxes by corporate reorganizations was common. A flagrant example of this is to be found in the 1917 transactions of the Old Dominion companies. The revenue agent's report indicates that by means of a fictitious transfer the invested capital was increased \$10,000,000 for tax purposes. On February 12, 1917, when the Old Dominion Co. of Maine held virtual ownership of the Old Dominion Co. of New Jersey through possession of 96 per cent of its stock, a sale was made of the New Jersey Company to the Maine corporation for the sum of \$10,000,000. The fact that neither company had cash in hand anywhere near this sum was not an obstacle. The New Jersey Company, which had a bank balance of \$350,000, paid a dividend of \$9,969,875 to the parent corporation. At the same time the parent corporation drew a check for \$10,000,000 in favor of the subsidiary in payment for the property.

It was admitted by Mr. C. H. Altmiller, treasurer of the Old Dominion Co., that the deposits were made and checks drawn simultaneously and that the transaction was purely a bookkeeping one.³⁹

The judgment of the revenue agent was that—

this transaction had the appearance of a transfer of assets substantially their own property and for the purpose of increasing their invested capital for excess-profits tax results.³⁹

The history of the Newport News Shipbuilding & Dry Dock Co.'s controversies with the Government over its 1917 taxes illustrates the difficulties in fixing invested capital. It took until 1931—or 14 years—to settle these taxes because of the difficulties of determining invested capital⁴⁰ and then the settlement was only made by the Bureau of Internal Revenue giving up the task and deciding that it could not determine the invested capital of the company but must make a special assessment.⁴¹ Under such an assessment, the exemption was the same percentage of the company's net income as the average exemption of representative concerns in the same or a similar business, was of the average net income of such concerns.

The revenue agent's report fixed the company's invested capital in 1917 at \$3,826,316 and its income for that year at \$3,467,605 or a profit of 90.6 per cent.⁴² The company's 1917 tax return, made under oath, listed its capital at \$10,377,605 and its income at \$3,368,238 or a profit of 32.4 per cent.⁴³ The revenue agent refused to allow as part of the invested capital an item of \$2,198,965 which was

³⁸ Testimony of Arthur A. Ballentine before War Policies Commission, H. Doc. No. 163, 72d Cong., 1st sess. (1931), p. 692.

³⁹ Exhibit no. 1717.

⁴⁰ Homer L. Ferguson, Feb. 12, 1935, 70 ZO; Walter G. Mitchell, Feb. 12, 1935, 80 ZO.

⁴¹ Homer L. Ferguson, Feb. 12, 1935, 67 ZO. The special assessment provision, which appeared as sec. 210 of the 1917 Revenue Act and as sections 327 and 328 of the 1918 act, is discussed in more detail at pp. 45-47. *infra*. In the 1917 Act it was to be applicable "if the Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital" * * *

⁴² Exhibit 1556.

⁴³ *Ibid.*

part of the total loss in 14 years' operations and which the company added to its estimated value of its physical assets on the grounds that it should be regarded as part of the cost of the plant and that the plant was worth its cost. In other words, the company felt that due to unfortunate business conditions which caused the company to lose money, its real estate increased \$885,000 in value, its dry docks \$813,965, and its patterns and drawings \$500,000.⁴⁴

The revenue agent further disallowed an item of \$2,167,233 which was the difference between stock of a par value of \$8,000,000 and assets received in exchange of a value of only \$5,832,766. This item the company also considered an original cost, because the stock was issued to the Huntington family and Mr. Huntington had lost more than \$2,167,233 in the course of the company's business history.⁴⁵

Another sum which the revenue agent decided did not represent an element of value was a bond discount of \$1,000,000 involved in the issuance in 1903 of \$5,000,000 in bonds for \$4,000,000 in cash and other assets.⁴⁶ Further discounts on stocks and bonds of \$1,508,849 were similarly disallowed by the revenue agent.⁴⁷

The Bureau of Internal Revenue on reviewing the agent's report determined that the company's invested capital was \$3,822,549⁴⁸ and its income \$3,298,601⁴⁹ or a profit of 86.3 percent although, as stated above, no tax was assessed on this basis because of the final decision to use the special assessment provisions. This valuation figure was strenuously attacked by the company's president, Mr. Homer L. Ferguson, in his appearance before this committee. Mr. Ferguson testified that the company in 1917 was actually carrying the plant at about \$20,000,000 and had fixed the value of \$10,377,605 in its return under protest and only because of regulations of the Bureau of Internal Revenue.⁵⁰ On a \$20,000,000 investment, a profit of only 16.4 percent was made. Mr. Ferguson also introduced into the record what he described as the dollar cost of the plant and assets used in the business which amounted to \$14,500,000.⁵¹ On this basis a return of 22.7 percent was made by the company.

Of 11 valuations made by the metal valuation section of the Bureau of Internal Revenue the original valuations of \$37,517,093 were 157.19 percent of the revised valuations of \$23,867,624.⁵² See also the examples as to variations in mineral valuations collected under the section on Depletion at page 29.

⁴⁴ Walter G. Mitchell and Homer L. Ferguson, Feb. 12, 1935, 80 ZO.

⁴⁵ *Ibid.*

⁴⁶ Walter G. Mitchell, Feb. 12, 1935, 81 ZO.

⁴⁷ *Ibid.*, Mr. Mitchell testified that the total of appreciation and discount items disallowed by the revenue agent was \$6,875,047 and that an additional \$360,000 was disallowed because it had been allowed as depreciation and deducted from income in the company's 1916 return. The difference between these figures and the net disallowance of \$6,551,289, represented by the revenue agent's estimate of \$3,826,316 and the company's return of \$10,377,605, is due to net additions to invested capital made by the revenue agent because of other items not referred to in the testimony.

⁴⁸ Letter from Secretary of Treasury to committee, May 3, 1935, which states that "Prior to the determination by the Commissioner of Internal Revenue that the profits taxes for the taxable years 1917 and 1918 should be computed under those provisions of law, i. e. the special assessment provisions, computations had been made in the Bureau of Internal Revenue which disclosed the invested capital of the taxpayer corporation as \$3,822,549.44 for the taxable year 1917 and \$5,500,091.75 for the taxable year 1918. Such computations may be termed final in that they were the last made in the Bureau of Internal Revenue and, accordingly, represent the Bureau's final determination but the files disclose that the taxpayer was not in agreement with the Bureau's determination. Differences in opinion with respect to the correct computation of statutory invested capital for such years became immaterial, however, when the Commissioner of Internal Revenue granted the taxpayer's contention that the profits tax liability should be computed under the relief sections of the law and not on the basis of statutory invested capital and net income."

⁴⁹ Exhibit No. 1556.

⁵⁰ Homer L. Ferguson, Feb. 12, 1935, 69 ZO.

⁵¹ *Ibid.*, 67 ZO-68 ZO.

⁵² 69th Cong., 1st sess., S. Rept. 27, pp. 109-110.

A group of 47 copper mining companies were valued by the Bureau as of March 1, 1913, for depletion purposes at \$1,750,024,787 on the first valuation and at only \$530,217,893, or a difference of \$1,219,806,894, on the second valuation.⁵³ These same properties were again valued as of January 1, 1919, at \$1,456,327,002 on the first valuation and at only \$323,707,404, or \$1,132,619,598 less, on the second valuation.⁵⁴ The first valuations as of January 1, 1919, average 449.9 percent of the second valuations.⁵⁵

Mr. Baruch, who since before the World War has owned 26 percent of the stock of one of the largest tungsten mines in the world,⁵⁶ testified in the following manner as to valuation of mining properties:

Mr. HISS. It is a very difficult matter from time to time to estimate the value of ore still in the ground, is it not?

Mr. BARUCH. It is almost impossible. With a tungsten mine it is absolutely impossible.⁵⁷

The Government's experience with valuation difficulties is not limited to taxation. By 1926 the Interstate Commerce Commission had expended \$27,000,000 in 13 years' efforts devoted to valuing the railroads of the country⁵⁸ and did not complete its primary valuations until 6 years later.⁵⁹ For examples of the difficulties of valuation in the railroad and public-utility as well as taxation fields, see the excerpts from Exhibit No. 1343 and the letter, referred to above, of the Acting Secretary of the Treasury dated January 28, 1935, which appear in the appendix to this report at page 147 and page 139, respectively.

The uncertainties in the field of valuing capital assets are forcibly illustrated by the variances between the estimates of invested capital contained in the tax returns filed by a group of the country's largest industrial concerns, as contrasted with the estimates of the revenue agents' reports on the same companies and with the final determinations by the Bureau of Internal Revenue.

The total invested capital reported for 1917 by 15 such corporations was \$775,799,312. The revenue agents' reports estimated the total investment of these same companies at only \$547,642,452—a difference of \$228,156,860. The final determinations by the Bureau totaled \$717,284,142.⁶⁰

For 1918 the total invested capital reported by substantially the same group of corporations was \$878,920,120. The revenue agents reported a total capital of \$746,789,162 and the total of the amounts finally determined upon by the Bureau was \$770,212,390.⁵⁹

It must be remembered that the final figures are those which are either determined after litigation or are accepted by the taxpayers. The increase between the reports of the various agents and the final figures, which meant an increase in the taxpayers' exemptions also, is undoubtedly in large part due to the impossibility of strict legal proof of the estimates arrived at by the agents. Other factors which presumably played some part in this increase are referred to at page 37 et seq. Of course, no official figures of invested capital in themselves

⁵³ *Ibid.*

⁵⁴ *Ibid.*

⁵⁵ *Ibid.*

⁵⁶ Testimony of Bernard M. Baruch, Mar. 29, 1935.

⁵⁷ *Ibid.*

⁵⁸ Mr. Ernst's report, Senate Investigation of the Bureau of Internal Revenue (1926), report no. 27, pt. 3, p. 4.

⁵⁹ Forty-sixth Annual Report of the Interstate Commerce Commission (1932), p. 86.

⁶⁰ Exhibit No. 1756, appendix p. 136.

indicate fully the difficulties of determining invested capital, since in many cases the Bureau of Internal Revenue decided that it could not ascertain invested capital and made use of the exception of "special assessments" described at page 45 et seq., of this report. In other words, for the most difficult cases no figures are available to illustrate the difficulties since invested capital was never determined.

As indicated by the foregoing, the impossibility of any exact and scientific determination of value makes the invested capital base a slow and expensive method of determining tax liability as well as one which offers undoubted opportunities for tax avoidance. It has accordingly been almost universally condemned.⁶¹

Mr. Arthur Ballantine, whose record as Solicitor of Internal Revenue in 1918, as Assistant Secretary of the Treasury from 1932 to 1933, and as a leading tax lawyer, makes him one of the foremost experts in taxation, testified before the War Policies Commission:

There is no question that the experience of the Government and taxpayers with the determination of invested capital was unsatisfactory and that this basis should not be used again except as a last resort.⁶²

The War Policies Commission's Analysis of Testimony, prepared by its executive secretary, Robert H. Montgomery, who is an author and a recognized expert in the field of taxation and a member of the well-known accounting firm of Lybrand, Ross Bros. & Montgomery, states as apparently based upon uncontradicted evidence:

Most of the administrative difficulties arising out of the excess-profits tax laws were due to the necessity of ascertaining invested capital. This base should not be used in another war.⁶³

Mr. Ogden Mills, when Secretary of the Treasury, adopted Mr. Ballantine's exact language, quoted above, in responding to a resolution of the Senate requesting recommendations and opinions as to the recommendations of the War Policies Commission for wartime taxation.⁶⁴ Mr. Mills' letter also stated that "the experience of the World War clearly demonstrated 'the invested capital basis' to be impracticable for general application."⁶⁵

Nevertheless, the fashioning of an excess-profits tax on the base of investment has the distinct merit not only of historical familiarity, but also of furnishing at least a rough approximation of (1) popular notions of fair return and (2) of business realities. It seems clear, however, that the advantages of this type of tax can be retained without the delays, uncertainties, and loss of revenue attendant upon valuing the investment only by adopting as a base some more or less arbitrary estimate not open to varying judgments and opinions.

The Treasury Department has pointed out that practically all the physical assets of business property have been valued at fair market value for depreciation, exhaustion, or depletion allowances under the income-tax laws.⁶⁶ However, these valuations do not include land or mineral deposits discovered since March 1, 1913, or any of the intangible assets, such as patents and goodwill, which bulk so large in the actual value of any business enterprise. In addition, they would not cover the new plants which war demands will require. Consequently they leave a wide field open to the difficulties enumerated.

⁶¹ For comments in addition to those quoted in the text on this page, see p. 16 and p. 19, supra.

⁶² 72d Cong., 1st sess., House Doc. No. 163, p. 692.

⁶³ Documents of the War Policies Commission, 72d Cong. 1st sess., House Doc. No. 271, p. 21.

⁶⁴ 72d Cong., 1st sess., Senate Doc. No. 105, p. 4.

⁶⁵ *Ibid.*, p. 5.

⁶⁶ Letter of Acting Secretary of Treasury, Jan. 28, 1935, appendix, p. 139.

This committee has recommended that the declared capital value provided for by section 701 of the Revenue Act of 1934 should be adopted.⁶⁷ This section imposed, as an excise tax on corporations, a tax of \$1 per \$1,000 of the value of capital stock "declared by the corporation in its first return." Section 702 imposed an excess-profits tax of 5 percent on net income in excess of 12½ percent of this declared value. These sections replaced the similar provisions applicable to 1933 appearing in sections 215 and 216 of the National Industrial Recovery Act.

The Treasury Department made it clear that the declared value was to be exclusively within the discretion of the taxpayer and could not be challenged by the Government.⁶⁸

The legislative history of these provisions makes it plain that Congress regarded only the capital-stock provision as important from a revenue point of view and accordingly wished to encourage high valuations.⁶⁹ The excess-profit provision was included in order to insure high valuations.⁷⁰

Whatever the Congressional intent, it would appear that corporations anticipating large earnings in 1934 and immediately succeeding years, would find it to their advantage to insure exemption from the 5-percent tax on net income at the expense of increasing the relatively less severe capital-stock tax.⁷¹ The sharp increase in profits actually experienced by many corporations prior to May 10, 1934, the date of the Revenue Act of 1934, and the widespread hope of a substantial revival of business conditions, would indicate that the

⁶⁷ 74th Cong., 1st sess., S. Report No. 577, p. 4.

⁶⁸ " * * * the corporation should then determine the original declared value for its entire capital stock according to its best judgment." (Instructions on reverse side of 1933 Capital Stock Tax Return, forms 707 and 708, Treasury Department, Internal Revenue Service, revised June 1933.) " * * * a corporation * * * may assign any value it desires to its capital stock * * *." U. S. Treasury Department, Bureau of Internal Revenue, Regulations 64 (1934 edition), p. vii.

⁶⁹ Report of the Senate Finance Committee on the Revenue Bill of 1934, 73rd Cong., 2d sess., S. Rept. No. 558, p. 6.

⁷⁰ *Ibid.*, pp. 6-7: "A reasonable original declared value is assured by means of the excess-profits tax, which is based on the relation of the net income of the corporation to such declared value" (p. 6). "The primary purpose of this [excess profits] tax is to induce corporations automatically to declare a fair value for their corporate stock under sec. 701" (p. 7).

⁷¹ The Prentice Hall Federal Tax Service, par. 27, 101 states:

"An illustration showing the importance of making the original declared value in the 1934 capital-stock tax return high enough to take care of future contingencies is given below. The example shows corporations A and B both of which have the same net income and dividend distributions over a 3-year period. A uses a declared value of \$1,000,000 in its 1934 capital-stock tax return and B uses \$1,500,000.

	Declared value		Net income	Dividends paid	Capital-stock tax		Excess-profits tax		Total tax	
	A	B			A	B	A	B	A	B
1934.....	\$1,000,000	\$1,500,000	\$100,000	\$50,000	\$1,000	\$1,500	None	None	\$1,000	\$1,500
1935.....	1,050,000	1,550,000	90,000	40,000	1,050	1,550	None	None	1,050	1,550
1936.....	1,100,000	1,600,000	200,000	180,000	1,100	1,600	\$3,125	None	4,225	1,600
Total capital-stock and excess-profits tax for 3-year period.....									6,275	4,650

Compare in this regard R. H. Montgomery, Federal Tax Handbook 1934-1935 p. 1007: "The rate of excess-profits tax is so much higher than the corresponding rate of capital-stock tax that in all instances of doubt as to future earnings it is desirable to increase the declared value of stock as an offset to the application of the excess-profits tax. It will be seen that for every \$10,000 undervaluation of the capital stock, while \$10 is saved on the capital stock tax, the excess profits tax is increased by \$62.50."

values declared by many concerns under section 701 would be unduly high.⁷²

To the extent that these factors have made the declared values too high, there would be a loss of revenue because the exemption based upon value would be correspondingly too high.⁷³ An attempt has been made to permit appraisals in cases where the declared value is found to be unduly high. However, the scope of the items to be included in any such appraisal means that the most difficult type of valuation—determination of current-market value or going-concern value—will have to be undertaken.⁷⁴ The uncertainties of such a valuation in the case of the average industrial corporation make it likely that an appraisal would be practicable only in the most flagrant cases of overvaluation.⁷⁵

As to companies formed in wartime and as to all wartime additions to capital, valuation of the familiar type will be necessary. It is further recognized that the peacetime adoption of the declared value base for wartime taxation purposes may encourage attempts to secure extravagant valuations of current additions to capital in an effort to increase the wartime exemption.⁷⁶

⁷² The Atolia Mining Co., with an original investment of \$63,000 and a deficit of \$42,243 in its capital account, declared a value of \$1,500,000 in its 1933 return. The Chase Brass & Copper Co., with a capital deficit on its books of \$2,100,724, fixed a value of \$3,000,000 in its 1933 return. The Freeport Sulphur Co., with a capital of \$5,577,775 on its books, set its value for 1933 at \$16,950,000. The General Electric Co. and subsidiaries, with a 1933 book value given its capital of \$429,088,823, declared a 1933 value of \$148,729,254 and a 1934 value of \$583,911,000; the Aviation Corporation and subsidiaries, with a 1933 book value given its capital of \$1,844,525, declared a 1933 valuation of \$12,019,000 and a 1934 valuation of \$8,250,000.

⁷³ On the other hand, a company which, because of anticipated low earnings for the immediate future, fixed an abnormally low value on its capital stock may be able to object to the use of that value for a wartime excess-profits tax, if it saved its rights. The Inspiration Consolidated Copper Co., in making its 1933 capital stock tax return, stated that its declared value "did not represent the fair market value nor the actual value * * * of the outstanding capital stock nor of the property owned * * * and the said original declared value shown on the annexed return may not be taken nor used for any other purpose nor in any other proceeding whatsoever." The company stated in its return that its balance sheet showed a capital account of \$46,283,616, but it declared a capital stock value of only \$2,807,172. Whether such an obviously arbitrary valuation figure can constitutionally be used as the base of an excess-profits tax, where, as in this case, the taxpayer clearly cannot be said to have estopped itself to deny that it is a fair valuation, is at least open to question. *Heiner v. Donnan*, 285 U. S. 312, 325-326, 328-329, 332, and see also *LaBelle Iron Works v. U. S.*, 254 U. S. 377, in which the court denied a claim of lack of uniformity in the application of the invested capital standards of the World War taxes, and *Cumberland Coal Co. v. Board of Revision*, 284 U. S. 23, 28-29, in which discriminatory valuation for State taxation was held a denial of due process; the extent, if any, to which discrimination may be recognized as a defense to taxation which is neither arbitrary nor discriminatory cannot be predicted. Cf. *Louisville Joint Stock Land Bank v. Radford*, U. S. Sup. Ct., May 27, 1935, No. 717. Certainly an excess profits tax that took more than income would not be authorized by the sixteenth amendment. *Eisner v. Macomber*, 252 U. S. 189. Other instances of an apparently low valuation accompanied by a limitation of its use to taxes covered by particular returns are: *Bethlehem Steel and subsidiaries*, book value in 1933 of capital, \$609,476,208, 1933 declared value \$100,000,000, 1934 declared value \$150,066,000; *Anaconda Copper Co. and subsidiaries*, book value in 1933 of capital, \$897,602,469, 1933 declared value \$72,156,625, 1934 declared value \$273,964,125. If the taxpayers' contention in any such case were sustained, some other method of determining invested capital would be required. See following footnote.

⁷⁴ The Revenue Act of 1934 did not define the value to be declared. The Treasury Department directed corporations to consider "the value of the corporation's business and property as an entirety and as a going concern" and in doing so to look not only to surplus and undivided profits—which depend upon the valuation accorded to plant and other assets usually recognized by corporate accounting practices—but also "the franchise, goodwill, outstanding contracts, the earning capacity of the corporation, and the market value of its shares of stock." (Instructions on reverse side of 1933 Capital Stock Tax Return, forms 707 and 708, Treasury Department, Internal Revenue Service, revised June 1933.)

⁷⁵ It is very doubtful whether the Constitution would permit the exclusion of judicial review of administrative determination of such a value. See *Phillips v. Commissioner*, 283 U. S. 589, 595-600 and *Ilagar v. Reclamation District*, 111 U. S. 701. Indeed it is not unlikely that the classes of cases in which judicial determination of facts is required by the Constitution (*Ohio Valley Water Co. v. Ben Avon*, 253 U. S. 287; *Crowell v. Benson*, 285 U. S. 22) would, in case of a severe tax, be extended to cover the valuation issues raised in determining income. In any event court review of questions of law is so familiar to our courts that any but the clearest language will be construed as not intended to cut off all judicial review. *U. S. v. Jefferson Electric Co.*, 291 U. S. 386, 397-400. But even if it were possible to avoid judicial review the uncertainties present, and consequent delay, in the administrative determination would make an appraisal impractical except in rare cases. See that portion of the letter of Jan. 28, 1935, of the Acting Secretary of the Treasury (Appendix, p. 139), which discusses "analytic appraisals."

⁷⁶ Sec. 701 (f) of the Revenue Act of 1934 provides for adjustments, under the supervision of the Commissioner of Internal Revenue, of the original declared value for additions to or withdrawals from capital.

III. DIFFICULTIES INVOLVED IN DETERMINING NET INCOME

The base is, of course, important in an excess-profits-tax scheme only as a yardstick for measuring the amount of income which is to remain exempt from taxation. The more fundamental problem is the determination of taxable income to which not only the exemption computed from the base, but also the tax itself is applied. Net income or profit is merely a bookkeeping item for any business enterprise. It is the difference between the total amount received, or gross income, and the costs of operating the business. For ordinary purposes each individual business estimates those costs to suit itself. For tax purposes, however, costs assume a critical importance. If costs plus the tax exemption equal gross income there is nothing left for the tax.

(1) DEPRECIATION

Ordinary business costs include many items which are purely matters of opinion, largely opinion as to the value of things consumed in whole or in part in the operation of the business.⁷⁷ One of the major cost items of this type is depreciation. The factory building and its machines are used up, in whole or in part, by the process of production. Their cost is part of the cost of production. How much they are used up in each profit-taking period by various operations is a matter of judgment. As most businesses are run on a going basis, the cost of used facilities is not a matter of the cash laid out for them, but an estimate of their value in terms of repair or replacement. Consequently, the uncertainties of valuation referred to at pages 19 to 24 of this report are an inevitable part of the taxing process even though they are to be eliminated from the establishment of the base for exemption.

An example of the opportunity for increasing the item of depreciation, and thus decreasing the amount of income subject to the tax, is furnished by the sale of the New York Shipbuilding Co. to the American International Corporation in 1916 for a price of \$2,929,573 above the New York Shipbuilding Co.'s previous estimate of the value of its property. The American International Corporation was building ships for the Navy and the Emergency Fleet Corporation under cost plus a percentage of cost contracts. The higher the costs the greater the cost payments and the percentage fee, and the smaller the taxes on the total amount received.

⁷⁷ It is, of course, impossible to catalog all the difficulties involved in the determination of costs. This part of the report merely discusses certain of those difficulties most frequently encountered in the field of costs. It should also be noted that the mere physical task of examining the books of a large corporation is staggering, as is illustrated by the following excerpt from exhibit 1435, a Treasury Department memorandum relating to the taxes of the New York Shipbuilding Co.:

"After a very careful study of conditions, viz, the system of bookkeeping and record keeping, the practices of the corporation, etc., it is the opinion of your examiners that it is an utterly impossible task to attempt to determine correct costs in connection with each contract. It is our unqualified opinion that even a large corps of men working for an indefinite time could not even approach accuracy. Thousands and probably hundreds of thousands of vouchers, labor tickets, store requisitions, etc., would have to be examined and reanalyzed, and the books all recast. During the war emergency the plant employed in the neighborhood of 22,000 men."

It took, approximately, 22 men 5 years to audit the 1917 and 1918 returns of the United States Steel Corporation. Exhibit 1740. Obviously, the Government must largely accept the books kept by the taxpayer, which means that on many doubtful items of cost neither the taxpayer's veracity nor its judgment is questioned.

Mr. RAUSHENBUSH. This profit of \$2,929,000, which you had paid in excess of the value of the plant, the purchasing company had paid, that was immediately written onto the books, was it not; I mean distributed among the property? You tried to allocate that to ways and yards and the like, and did so allocate it almost immediately.

Mr. PARKER. The new corporation paid a certain price for the assets, plant, land, buildings, and all the price they paid for it was the price at which the new corporation set it up on its books.

Mr. RAUSHENBUSH. That price was \$2,929,573 above the old price, and you then distributed it among various assets, assigned so much to this and so much to that, did you not?

Mr. PARKER. The corporation set it up on its books, and it did not make any difference at what it was held on the books of the previous company.

Mr. RAUSHENBUSH. But my point is, it did not set it up as goodwill?

Mr. PARKER. Not at all. It was an actual purchase of tangible property, a tangible asset.

Senator CLARK. Two and a quarter million dollars above what the old company carried it on its books?

Mr. PARKER. Exactly, sir.

Mr. RAUSHENBUSH. Almost \$3,000,000, Senator.

All through the following years, when you were doing work for the Navy and the Emergency Fleet Corporation, you tried to depreciate that \$2,929,000, did you not?

Mr. PARKER. I believe properly so.

Mr. RAUSHENBUSH. And to have that depreciated against the naval vessels and the Emergency Fleet Corporation vessels. You believe they did so?

Mr. PARKER. Yes, sir.

Mr. RAUSHENBUSH. And you remember quite accurately, do you not, that both the Navy and the Emergency Fleet Corporation constantly insisted that was a nondepreciable item, a goodwill item that you had paid for?

Mr. PARKER. That is correct.

Mr. RAUSHENBUSH. So that for a period all through the war and later years, when the tax matters became important, there was a constant fight, let us say, between the company and the Navy and the Emergency Fleet Corporation and the Internal Revenue Department, on the question of whether or not the Government would really pay for that depreciation on the goodwill you had paid for?

Mr. PARKER. Not quite a fight, but, say, a conference.

Senator CLARK. A controversy, was it not?⁷⁸

(2) DEPLETION

Mining companies include as a cost item depletion of their ores. That is, they fix a value for their ore properties in the ground and as each unit is mined and sold charge a proportionate amount of that value as a cost.

Mr. Baruch, who has had long experience with mining properties, testified as follows as to the difficulties involved in valuing sulphur mines:

Mr. HISS. This indicates again, does it not, Mr. Baruch, the difficulty of fixing a value on any mining property?

Mr. BARUCH. And especially one like that. You cannot see anything. You sink way down into the bowels of the earth and put in hot water and the sulphur comes out. I do not see how you can determine the value of a property like that.⁷⁹

The Texas Gulf Sulphur Co., of which Mr. Baruch is a dominant stockholder, was purchased for \$250,000 but was allowed a value for depletion purposes of \$38,920,000 by the Bureau of Internal Revenue.⁸⁰

Additional examples of the uncertainty and impossibility of exact ascertainment of mineral valuations are as follows:

⁷⁷ Testimony of N. R. Parker, Jan. 21, 1935.

⁷⁸ Testimony of Bernard M. Baruch, Mar. 29, 1935.

⁷⁹ 69th Cong., 1st sess., Sen. Rep. No. 27, p. 68.

HOUSTON COAL & COKE CO.

On this basis the lease is given a value of \$918,884.60 and the depletion unit is given 21.3 cents. As a royalty of 10 cents was stipulated in the lease, the coal in the ground was thus valued at 31.3 cents, when it was established, undisputed fact, agreed to between the Income Tax Unit and the Pocahontas operators, that the market price of coal in the ground on March 1, 1913, was 17.9 cents.

* * *

In this case nearly \$718,000 of value, due entirely to good will and selling ability, is attributed to coal in the ground and returned to the taxpayer as tax-free depletion.⁸¹

UNION SULPHUR CO.

In 1896 Herman Frasch, who had invented and patented a process which it was believed would be successful, organized the Union Sulphur Co. with a capital of \$200,000. The property in question was acquired, subject to a mortgage of \$165,000 in exchange for \$100,000 par value of the capital stock of the company. The remaining \$100,000 of capital stock was issued to Frasch in exchange for his patent.

The value of the deposit, as of date of acquisition, allowed by the Income Tax Unit for invested capital purposes, was \$3,000,000.⁸²

UNITED STATES GRAPHITE CO.

This property was acquired in 1893 in exchange for stock of the taxpayer of the par value of \$35,000. The value allowed for invested capital purposes for 1917 was \$335,000, or \$300,000 in excess of the par value of the stock. * * *⁸³

TEMPLE COAL CO.

The mining property of this company was acquired on June 24, 1914, at public auction, by the promoter of the company for \$5,609,423.33 cash. This cash bid was based upon and exactly equaled the value which had been placed upon the property by an engineer employed by the vendor.

On July 1, 1914, 7 days after its purchase for cash, this property was turned over to the taxpayer in exchange for capital stock.

The value allowed upon this property, for invested capital purposes, as of July 1, 1914, was \$10,443,678.29.⁸⁴

BORDER ISLAND CO.

The valuation of \$130,000, as of June 15, 1923, for invested capital purposes was accepted by the taxpayer, but a protest was filed as to the valuation of \$121,082.25, as of March 1, 1913, for depletion purposes, and the case was reviewed by the solicitor's office. * * * The solicitor's office made a valuation, by an analytic appraisal, of \$196,159.99 as of March 1, 1913. * * *⁸⁵

UNITED STATES GRAPHITE CO.

The taxpayer claimed a March 1, 1913, value on this mine, for depletion purposes of \$516,926.45. Mr. A. R. Shepherd, a special conferee, designated by and working directly under Mr. S. M. Greenidge, head of the engineering division, was permitted to overrule the nonmetals section and allowed a March 1, 1913, value of \$1,043,044.56.⁸⁶

NEW JERSEY CALCITE CO.

The taxpayer claimed a value of \$130,000 on these leases as of April 1916 to be depleted in annual installments between April 1916 and the expiration of the leases. * * * The valuation engineers fixed the value of these leases at \$8,950.93.

The taxpayer appealed from this determination to the committee on appeals and review, which allowed a value of \$106,000 on these leases.⁸⁷

⁸¹ 69th Cong., 1st sess., S. Rept. 27, p. 52.

⁸² *Ibid.*, p. 65.

⁸³ *Ibid.*, pp. 60-61.

⁸⁴ *Ibid.*, p. 59.

⁸⁵ *Ibid.*, p. 61.

⁸⁶ *Ibid.*, p. 48.

⁸⁷ *Ibid.*, p. 53.

(3) AMORTIZATION

Another important item that appears in the costs of many industrial concerns is that of amortization. Not only is the replacement and repair of plant, which appears as depreciation, a cost of doing business; in addition there is an attempt to collect the total original cost of plant and facilities. This is comparable to the depletion of mineral properties; but in ordinary peace time, business enterprises have distinguished between industries like mining, whose capital assets are by their very nature used up in operation, and those whose capital assets merely require repair and replacement from ordinary wear and tear. However, during war time, when the erection of new plants and additions to plants is vitally necessary to furnish the needed increased production called for by wartime demands, amortization takes on added significance. If some return on investment is necessary to secure expansion of industry, it is clear that some assurance that the investment itself will not be lost must also be furnished. And the mere fact that war calls for new facilities indicates that without the war demand those facilities may be useless. The prospect of tax avoidance increases industry's natural war-time demand for liberal amortization allowances and the Government's desire to encourage expanded production conflicts with its need of revenue.

Because it was felt that equity required a recognition of the substantial risk that wartime construction would be valueless after the war, provision was made in the 1918 Revenue Act for the reduction of net taxable income by the amount paid out for the creation of facilities constructed or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war.⁸⁸

The erection of large capital facilities is a process which may extend over a great period of time, and may be subject to many changes therein. Specifications for construction may change. By mutual agreement or otherwise what may have been contracted for originally may be different from what is erected ultimately. Furthermore, it is difficult, as a matter of equity, to determine whether facilities which have been contracted for before the war, are actually required for a war, as distinguished from a peace-time use. It is therefore an oversimplification to speak of capital expenditures or facilities erected or acquired within the war period:

Practically every large claim for amortization includes allowances upon facilities for the construction or acquisition of which the taxpayer was bound by contract prior to April 6, 1917, but which were not fully paid for on that date.⁸⁹

Many plants were not completed until after the war was over. Although the original incentive for commencing construction may have been a war-time demand, it cannot be said that the continuance of such construction represented a response to war-time needs. Nevertheless, it would be ruinous to interrupt building operations once they have proceeded beyond a certain stage, and a failure to recognize this would add to the difficulty of getting large scale construction started at a time when no one can foresee the duration of war needs.⁹⁰

⁸⁸ Revenue Act of 1918, secs. 214 (a) (9); 234 (a) (8). See Report of the House Ways and Means Committee on the Revenue Bill of 1918, 65th Cong., 2d sess., H. Rep. No. 767, pp. 10, 13. The sections cited also permitted amortization for the construction or acquisition of vessels on or after Apr. 6, 1917, for the transportation of articles or men contributing to the prosecution of the war.

⁸⁹ 64th Cong., 1st sess., S. Rept. 27, p. 135.

⁹⁰ *Ibid.*, pp. 136-137.

Industrial development, it must also be remembered, possesses a continuity of its own apart from war conditions. It is accordingly very difficult to separate mushroom war-time growth from normal industrial development.

Considerable difficulty may be experienced with corporate entities set up during the war that take over capital plants which have been erected by other companies prior to the war. In fact amortization was frequently allowed in this situation:

This statute has been construed by Income Tax Unit to allow amortization upon the mere legal fiction of acquisition, where there was no increase in productive capacity for war purposes, and where the acquisition and subsequent discarding of plants was for the sole purpose of consolidating an industry and killing competition.⁹¹

The device of incorporation was subject to another artifice which clearly illustrates the difficulty of defining what are articles contributed for the prosecution of the war, and segregating them from articles not required for the prosecution of the war. For example, railroads were specifically held by the Bureau of Internal Revenue and by the courts not to fall under the scope of the amortization provisions, inasmuch as they did not contribute to the manufacture of articles required for the war. Nevertheless, amortization amounting to \$2,789,185.49 was allowed to common-carrier railroad corporations whose stock was owned by the United States Steel Corporation and its subsidiaries, upon facilities owned not by a producer of articles but by a railroad corporation possessing only the attribute of having its stock owned by a company which also owned stock of a war-use producer:

The United States Steel Corporation produced nothing, but it is the owner of the stock of other corporations, which did produce articles contributing to the prosecution of the war. Thus, we have railroad companies allowed amortization, because their stock was owned by a corporation, which owns the stock of another corporation, which comes within the class entitled to amortization.⁹²

Pipe lines were also allowed amortization on the ground that their stock was owned by the oil-producing companies. Among the oil companies thus benefited was the Texas Co., the Sun Oil Co., and the Sinclair Oil & Refining Co. Although the practice was condemned by the Solicitor of the Bureau in a ruling, allowances were made to housing corporations which were subsidiaries of various steel corporations, etc., on the ground that the parent company was entitled to amortization, although a corporation organized to erect houses in the first place would not be entitled to amortization. Similarly, amortization was allowed on tank and refrigerator cars, and even on land, to corporations on the ground that they were otherwise eligible for amortization.⁹³

There is abundant opportunity for discrimination, and for administrative confusion, in the case of facilities erected during the war for a war purpose, but as replacements for facilities which were becoming obsolete and deteriorating at the time when the new facilities were being erected. The problem is to gage adequately the extent to which a facility is being erected because of a wartime demand, as contrasted with being installed in a situation where natural depreciation factors would have rendered its installation essential anyway.

⁹¹ *Ibid.*, p. 137.

⁹² *Ibid.*, p. 142.

⁹³ *Ibid.*, pp. 123-144.

Probably because of the complexity of the engineering problem, old and new facilities had, when comparative capacity in the production in the post-war period was being taken into consideration, to be grouped together in determining the value in use⁹⁴ of facilities installed during the war:

All of the taxpayers to whom the larger allowances for amortization were made were going concerns before the war. They all had facilities of age and condition varying from practically new to scrap. There was no attempt made in any of the larger cases to determine the actual usefulness or comparative remaining useful life of the facilities amortized for loss of useful value.⁹⁵

An indication of the advantageous treatment that could be procured by a company in a condition to consider in the aggregate its antiquated and modern plants, is supplied by the following illustration:

Thus, although this war plant was the only plant owned by the taxpayer which could be economically operated, and was in full use to 95 percent of its rated capacity, and although its full rated capacity would be reached in 1 year, it was considered to be surplus capacity and to represent a loss to the extent of 47.4 percent of its cost, because the company had on the scrap pile, charged to scrap, a collection of antiquated plants which could not be economically operated.⁹⁶

Indeed, it may well be doubted whether in practice any real distinction can be drawn between facilities erected for wartime use, and those erected during wartime but which do not directly produce articles for which the Government has a need.

The fundamental difficulty with amortization provisions, however, is the impossibility of valuing the loss of usefulness in a plant constructed in wartime which a return to peace-time conditions will involve.⁹⁷ Not only are the familiar difficulties of valuation of the plant encountered; in addition, a forecast must be made of future usefulness—at best a matter of opinion based on many guesses even for a future period of time in which conditions can be foretold. But post-war conditions can never be foretold with accuracy:

The deduction is largely founded upon the idea of normalcy. It presupposes a return to stable-post-war conditions of a normal character. The difficulty is that the words normal and abnormal, stable and unstable, ordinary and extraordinary, or whatever comparatives are used are relative words. Amortization to this extent involves a theoretical impossibility, a fixed standard of normalcy in connection with business and industrial conditions. The difficulty here is that every large war is followed for a more or less extended period by chaotic business and industrial conditions. In order to work equitably and without discrimination the provision must be applied with a degree of discretion and judgment probably never before demanded in the administration of our income-tax laws.⁹⁸

Furthermore, one frequent result of war is an increase in the total peace-time business not only of victor nations but of individual corporations, as is indicated by the history of the Aluminum Co. of America, referred to on the following page.

It is small wonder that the Bureau of Internal Revenue did not find it easy to administer the amortization provision as applied to a loss of value in use:

⁹⁴ See footnote 94, *infra*.

⁹⁵ *Ibid.*, p. 153.

⁹⁶ *Ibid.*, p. 154.

⁹⁷ There were three situations in which amortization allowances were made after the last war; (a) where property was completely discarded or sold; (b) where there was involved reduced replacement cost, i. e., war-time facilities being discarded although not totally useless and replaced by less costly equipment adequate for peace-time demands; (c) where "value in use" had been reduced. In connection with the first type of situation there is always present the possibility of collusive sales of war-time equipment in order to write off amortization allowances. The second class of situations involved the usual difficulties of valuation. However, most criticism has been concentrated upon amortization allowances based upon loss of value in use.

⁹⁸ Holmes, *Federal Taxes*, p. 853.

While the amortization provision was first inserted in the 1918 act, it was not until August 19, 1923, that the first ruling by anyone in authority interpreting this provision [dealing with loss of value in use] of the regulations was made. This ruling was made by Solicitor Hartson in the *J. I. Case Threshing Machine Co. case* and condemned the basis upon which every large amortization allowance for reduced value in use had been made. This ruling was not published until November 3, 1924, 8 months after the expiration of the period within which redetermination of amortization allowances could be made. Although this ruling was made 7 months before the expiration of the period within which redetermination could be made, there was not only no attempt to redetermine allowances made upon the condemned basis, but this ruling has not been followed in a single case, not excepting the case in which it was made.⁹⁹

The reliability of any valuation of post-war usefulness is illustrated by the case of the Aluminum Co. of America. The tax liability of this company for 1917 was \$9,114,909; in 1918 it was reduced to \$2,260,230. The chief reason for the decrease was the change downward that had been effected in net taxable income, which appeared in 1917 as \$25,840,326 and as \$10,417,814 in 1918. The major part of this reduction of more than 50 percent in taxable income was not due to a fall in business but to the fact that the company was allowed an amortization deduction of \$10,650,059, distributed as follows:¹

On property completed in time for war production.....	\$2, 167, 565
On property not completed in time for war production.....	8, 482, 494
Total.....	10, 650, 059

If this deduction had not been allowed, the net taxable income would have been over \$21,000,000, and a higher tax than that paid for 1917 might well have resulted because of the higher 1918 rates.

The basis for the amortization allowance was the assumption that all the production capacity of the company in excess of 82,000,000 pounds represented a loss.² The inaccuracy of this estimate of value in use may be seen from the fact that in 1919 the Aluminum Co.'s production was 128,476,872 pounds, in 1920 it was 138,042,272 pounds and from 1923 to 1931 it varied from a low of 128,658,222 pounds in 1923 to a high of 229,036,636 pounds in 1930.³ Indeed, although production and sales have both fallen off since the beginning of the depression, the capacity of the company has been substantially increased since 1929-30.⁴ And yet the Aluminum Co. was permitted to deduct \$10,000,000 from income on the theory that the plant capacity of a less productive period, which had cost it that amount, was not usable in times of peace. Furthermore, questionable as this decision was as demonstrated by later facts, it is certain that as to four-fifths of the plant capacity acquired by the \$10,000,000 expenditure, the Government received no benefit, since that part of the plant which was represented by the \$8,000,000 amortization allowance was not in production until after the conclusion of the war.

The importance of the amortization section for the reduction of taxes may be seen in the fact that in 168 cases amortization allowances up to April 30, 1925, totaled \$425,921,945.⁵ Most of these allowances were, naturally, to companies who profited most heavily by the war, i. e., companies manufacturing primary war materials, such as steel,

⁹⁹ 69th Cong., 1st sess., S. Rept. 27, p. 149.

¹ Exhibit no. 1746.

² Exhibit No. 1746-A.

³ Letter of May 23, 1935 from the Aluminum Co. of America, appendix to that part of hearings containing "Exhibit No. 1746-B." The company's war-time production was: 1917, 129,860,592 pounds; 1918, 124,724,924 pounds. *Ibid.*

⁴ *Ibid.*

⁵ Exhibit 1405, reprinted in the appendix to this report at p. 159.

ships, machinery, chemicals, and munitions, because their expansion due to war needs was largest. More than \$600,000,000 was claimed by these companies, who each got an allowance of at least \$500,000. Some of the larger allowances, in addition to that of the Aluminum Co., follow:

United States Steel.....	\$55, 000, 000
Bethlehem Steel.....	22, 000, 000
Du Pont de Nemours.....	15, 000, 000

The impossibility of estimating with dispatch and with finality the items of depreciation, depletion, and amortization has led this committee to recommend that (1) an arbitrary maximum of 2 percent of gross income, or of an adjusted cost of the property, be set for depreciation deductions, (2) an arbitrary percentage of gross income be used to fix depletion deductions of 9 percent in the case of gas and oil wells, of 2½ percent in the case of coal mines, of 5 percent in the case of metal mines, and of 7½ percent in the case of sulphur mines, with an overall limitation that in no event shall the amount so computed exceed 50 percent of net income, and (3) no amortization allowances be permitted, but instead governmental loans be authorized for such construction as it is found is required for the prosecution of the war and cannot otherwise be financed. It is recognized that, in the case of depreciation, the maximum percentage allowance is likely to become the fixed allowance and that, in the case of such allowances as well as of the fixed depletion allowances, tax avoidance will result to the extent that in individual cases the fixed allowances are in excess of the amounts which would be arrived at on the basis of a reasonable valuation. It is further recognized that if allowances for amortization are eliminated there will be considerable insistence that new construction must be paid for by outright governmental subsidy. Most expansion is financed by borrowed capital and the mere fact that the lender is the United States will not remove the demand for assurance against loss of the amount invested in assets which may prove valueless upon the conclusion of the war. Consequently, it must be realized that the reasons causing the normal demand for alleviation of governmental burdens on industry upon a return to peace (see p. 37 et seq., *infra*, in relation to pressure for compromise or reduction of back taxes) will make it inevitable that strong pressure will be exerted for the reduction, by compromise or otherwise, of any Government war-time construction loans outstanding when the war ends. For similar reasons it is likely that substantial amounts of any such loans as are not reduced or compromised will be defaulted. Finally, it is to be noted that under either a subsidy or a loan plan the Federal Government will, following the termination of the war, own extensive plants and equipment, the usefulness and value of which as a whole will be conjectural. To the extent that these plants and equipment are made up of integral parts of various private corporations, their value will be less than the general level of war-time construction. As to the plant and equipment which the Government has acquired, the choice will be between Government operation and sale for little, if any, better than salvage prices.

(4) TIME OF ACCRUAL OF INCOME

Furthermore, since large-scale modern business is not run on a cash-and-carry basis, the time when income is earned is not a matter

of black and white. Taxes are collected annually but profits upon any one transaction may be due to more than a year of operation and the apportionment to the periods when they were "earned" is in part purely a matter of opinion. The fact that war-time tax rates are higher than peace-time rates makes the determination of when profits accrue an important element in war-time taxation.

An example of this is furnished by the case of the Newport News Shipbuilding & Drydock Co., which naturally wished to state its profits as accruing in 1922 rather than in 1921, because the excess-profits taxes ended on December 31, 1921. The revenue agent in a confidential report to his superior stated that:

About the time of closing the books each year many memoranda are not actually issued until January of the following year, and the auditor is told by Mr. Ferguson (dictated often by Mr. Gatewood) how to close certain long-term contracts. Particular reference is made to memorandum dated January 11, 1922, pertaining to 1921 closing, regarding contracts for hulls 261 and 262, which states "no change from present instructions." This memorandum bears initials of Mr. Gatewood. These are the contracts where \$2,283,474.88 profits were not reported until 1922, although contracts were fully paid and work had ceased for several months prior in 1921. Mr. Gatewood and Mr. Ferguson should each be required to state under each [oath(?)] why this large amount of income was not reported in 1920 and 1921, when only 10 percent of expenses was taken as profits each month in those years. Certainly at the end of 1920 they knew what percentage of the contract was completed and should have adjusted the profits in 1920 to show the proper income for 1920 as required by article 36 of regulations 62. Again, they should have restated their profits at the end of 1921 when the contract was actually closed. The same condition appears in many other contracts, which are detailed in my report in exhibit H.

I do not wish to accuse these gentlemen of any wrong intent, or even intimate such, but I cannot help but feel that such action was intentional, whatever the motive. But I have refrained from making any suggestions of wrong-doing in my report, but I hold that the income properly belongs in 1920 and 1921 and a penalty for negligence should be added for not restating same.⁶

The position of the company as to the two ships mentioned by the agent was stated by the company's president as follows:

Mr. FERGUSON. May I state in connection with 261 and 262, which were mentioned, that they were two oil ships, the largest ever built, for the Standard Oil Co. of New Jersey. These vessels were of new design and were much larger than any ships that had ever been built up to that time. The guaranty on those ships ran for 1 year after delivery.

The company was liable for the ships for a year. The income-tax people said that the profit should be taken at the time when the money was paid. We held that on account of the risk involved through a year's guaranty on a ship of tremendous size, and different from any other oil ship, that we or anyone else had built up to that time, that we should be protected until our guaranty period should elapse.⁷

This was also the advice given by the company's lawyers.⁸ The revenue agent felt that "where both parties to the contract are responsible, as in the case of contracts for hulls 261 and 262, the contract can be closed and adjustments subsequently made for any differences."⁹ This view was reinforced by the fact that actually "only a few small adjustments for material were made in 1922."¹⁰ But Mr. Ferguson, the president, was anxious to be able to report to Mr. Huntington, the substantial owner¹¹ of the company:

⁶ Exhibit No. 1557.

⁷ Feb. 12, 1935, 72 ZO

⁸ Exhibit no. 1557

⁹ Ibid.

¹⁰ Ibid.

¹¹ Ibid.

In going over our tax situation in detail, we find that our taxes for last year will be very much less than I have heretofore indicated to you, as the two Standard Oil ships have guaranties which do not expire until the latter part of this year.¹²

As Mr. Ferguson agreed in connection with a similar report on the situation, he was simply trying to put profits, earned in part at least in high tax years, into the lower tax years.¹³ The significance of his efforts appears from the figures set forth in Exhibit No. 1615. The Bureau of Internal Revenue transferred to the years 1920-21 profits totaling \$3,149,189.73 which the company had reported as earned in later years. Instead of a tax of \$393,648.72 on these profits this would call for a tax of \$1,448,627.27, without taking into account the additional tax due if any of the contracts from which the \$3,149,189.73 profits were derived were entered into during the war. The profits allocable to such contracts would be taxed at the war-time rate of 80 percent (see p. 50, *infra*) instead of at the normal 1920-21 rate of 40 percent used in preparing Exhibit No. 1615.

¹² Letter from Mr. Ferguson to Mr. Huntington of Feb. 2, 1922, read into the record on Feb. 12, 1935, galley 73 ZO.

¹³ Feb. 12, 1935, 73 ZO.

IV. DEGREE OF ADMINISTRATIVE DISCRETION DESIRABLE IN TAX STATUTES IN VIEW OF POST-WAR ATTITUDES AS TO BACK TAXES

The complexities of any excess-profits tax naturally suggest the possibility of increasing the flexibility of the administration of taxes to avoid delays and injustices alike.

The Joint Committee on Internal Revenue Taxation reported in 1927 that—

The recommendation that tax cases should be settled by administrative action, rather than through litigation, and the abandonment of the policy that all cases must be decided upon the basis of absolute accuracy, have been discussed. It is believed that the adoption of these recommendations is vital.¹⁴

It should, however, be noted that the high tax rates of wartime encourage the use of administrative discretion for leniency to taxpayers. The British experience in this connection is described by Professor Haig as follows:

In the case of the excess-profits duty particularly, with its high rates and its many opportunities for disagreement, it has been considered wise to conduct the administration along broad lines. The assessors have not failed to utilize their administrative discretion. As one of them remarked: "We wipe off £20,000 one way or another as though it were a halfpenny." The Board of Inland Revenue has specifically said to the local surveyors that "owing to the present high rates of taxation" they desired "that in doubtful cases the allowances granted in calculating excess-profits duty should err on the side of generosity rather than otherwise."¹⁵

The results of the wide discretion vested in the administrative officials by the special assessment provisions, discussed at p. 45 et seq. of this report, resulted in considerable loss of revenue in cases that do not appear particularly deserving of leniency.

There is the further consideration that, by and large, controversy as to taxes arises in post-war years. Even though it be assumed that the traditional American hostility to taxes is substantially lessened during wartime for patriotic reasons, this can affect only the taxes paid during war on the basis of the taxpayer's own return. He does not know until after the war, in many cases, that the Government believes additional taxes are due.

Exhibit 1756, appendix, p. 136, shows that 17 of the largest corporations engaged in the production of steel and aluminum and in the mining of sulphur, copper, and tungsten¹⁶ reported as due for 1917 taxes only \$49,927,931. The revenue agents, upon investigation and audit, determined that almost \$40,000,000 more should have been paid, or a total of \$89,882,631. Substantially this same group reported taxes of \$45,993,859 as due for 1918. The revenue agents reported that the total should have been \$59,580,309.

¹⁴ Report of the Joint Committee on Internal Revenue Taxation (1927), vol. III, p. 45.

¹⁵ Haig, *Taxation of Excess Profits in Great Britain* (1920), p. 97.

¹⁶ Bethlehem Steel Corporation, Republic Iron & Steel Co., Crucible Steel Co., Lukens Steel Co., Allegheny Steel Corporation, Otis Steel Co., Calumet & Hecla Co., Inspiration Consolidated Co., Kennecott Copper Co., Phelps Dodge Corporation, Ahmeek Mining Co., Union Sulphur Co., Freeport Texas Co., Atofia Mining Co., Wolf Tongue Mining Co., Primus Chemical Co., and Aluminum Co. of America.

The delay involved in auditing returns is, of course, considerable, but the above figures show its necessity if revenue is to be secured.¹⁷ The audit of the income, excess-profits, and war-profits tax returns of the United States Steel Corporation and its subsidiaries for 1917 and 1918 required, approximately, the services of 22 men for a period of 5 years.¹⁸

Obviously the physical work of auditing returns is not of itself the major cause of delay in completing excess-profits tax collection. The many doubtful items, such as invested capital, depreciation, depletion, amortization, require consultation and conference that, of course, become protracted. The 1917 Colt's Patent Firearms Co. taxes were not settled until 1926 or later.¹⁹ The Newport News Shipbuilding and Drydock Co.'s 1917 taxes were not settled until 1931.²⁰ The Republic Iron and Steel Co.'s 1918 taxes were finally settled in 1932.²¹ The Phelps Dodge 1917 and 1918 taxes were finally determined in 1929.²² The 1918 taxes of the New York Shipbuilding Co. required 10 years for settlement.²³ If litigation has to be resorted to, the delay is increased. The Joint Committee on Internal Revenue Taxation reported that as late as 1927—

The controversies under the excess-profits-tax acts impose by far the greater burden upon the Board of Tax Appeals. For example, 53 percent of the tax years involved in cases before the Board are under the Revenue Acts of 1917 and 1918. Thirty-three percent are under the Revenue Act of 1921. That is, 86 percent are under the Revenue Acts of 1917, 1918, and 1921. The provisions of the Revenue Act of 1918 appear 18,472 times, and the provisions of the Revenue Act of 1921 appear 16,042 times in the cases pending before the Board.²⁴

It is also largely after the war that the taxpayer's demands for refunds and credits are acted upon. As an example of this, it may be pointed out that in the year 1930 the Bureau of Internal Revenue granted \$11,488,524 refunds of taxes, by admitting overassessments of that amount, for amortization. The only amortization allowances which have been permitted by the internal revenue laws have been for the construction or acquisition of facilities on or after April 6, 1917, for the production of articles contributing to the prosecution of the war, and for the construction or acquisition of vessels on or after April 6, 1917, for the transportation of articles or men contributing to the prosecution of the war. This was 14.23 percent of the overassessments determined in 1930 for all taxes. Similarly, in that year overassessments were determined of \$12,263,512 for invested capital and \$3,596,501.44 for special assessments.²⁵ These provisions appeared only in the Revenue Acts for the years 1917 to 1921. On December 5, 1932, the chief of the staff of the Joint Committee on Internal Revenue Taxation stated that:

¹⁷ The New York Shipbuilding Corporation's taxes for the years 1918 to 1921, inclusive, furnish a further striking example. The company's return for 1918 reported income of \$1,595,042 and taxes due of \$684,422. In 1926 examination by revenue agents resulted in a determination by these agents that income had been \$4,563,844 and taxes should have been \$3,210,500. For 1919, 1920, and 1921 the company's returns showed \$1,674,386, \$3,370,170, and \$2,296,417 as income and \$535,296, \$1,288,790, and \$433,117 as taxes. The revenue agents' corresponding figures were \$6,495,913, \$8,708,894, and \$3,707,360 for income and \$4,419,109, \$5,561,611, and \$1,599,870 for taxes. For the 4 years the company reported a total of \$2,941,627 due in taxes; the revenue agents found \$14,561,091 due. The final tax settlement in 1928 was for \$5,705,308. Exhibit No. 1421.

¹⁸ Letter of Apr. 4, 1935, of the Acting Secretary of the Treasury, exhibit 1740.

¹⁹ Testimony of H. D. Fairweather, treasurer, pt. 9, p. 2105.

²⁰ Testimony of Homer L. Ferguson, president (70 ZO), and Walter G. Mitchell (80 ZO), Feb. 12, 1935.

²¹ Exhibit 1740-D.

²² Exhibit 1721.

²³ Testimony of Walter G. Mitchell, Jan. 21, 1935.

²⁴ Report of the Joint Committee on Internal Revenue Taxation (1927), vol. III, p. 41.

²⁵ Report of Joint Committee on Internal Revenue Taxation, Mar. 3, 1931, p. 19.

The most important factor in connection with overassessments are the old excess-profits-tax cases. When these cases are finally settled, overassessments should be substantially less. The following table shows to what large extent these excess-profits-tax cases have affected the overassessment total:

Percent of total overassessments represented by overassessments for the excess-profits tax years

	Percent
14 months' period, Feb. 28, 1927-Apr. 24, 1928.....	88
7 months' period, May 29, 1928-Dec. 31, 1928.....	77
12 months' period, Jan. 1, 1929-Dec. 31, 1929.....	71
12 months' period, Jan. 1, 1930-Dec. 31, 1930.....	59
12 months' period, Jan. 1, 1931-Dec. 31, 1931.....	53

Over one-half of the total over assessment still results from adjustments for the years 1917 to 1921, inclusive. These tax cases are over 12 years old. Moreover, the interest attributable to the excess-profits tax years represents 73 percent of the total interest paid on all overassessments reported to the committee during the calendar year 1931. It is true that the table shows considerable progress in settling these old cases, but it is evident that the work is far from concluded.²⁶

In the 12-month period, January 1 to December 31, 1932, the percent of total overassessments attributable to the excess-profits tax years was 54 and in 1933 it was 51.²⁷

The following table compiled by this committee's staff from official sources and limited to refunds for invested capital, amortization, and special assessment, gives some idea of the amounts involved in refunds of excess-profits taxes after the war:

Refunds, credits, and abatements of internal-revenue taxes on grounds listed

	Invested capital		Amortization		Special assessments	
	Amount	Percent of total refunds, etc. for all causes and for all taxes during periods listed	Amount	Percent of total refunds, etc. for all causes and for all taxes during periods listed	Amount	Percent of total refunds, etc. for all causes and for all taxes during period's listed
July 1, 1921, to Apr. 30, 1925 ¹	\$34,155,615.29	19.91	\$11,457,030.06	6.66	\$39,686,500.00	23.13
Apr. 30, 1925, to Mar. 1, 1927.....	(2)	-----	(2)	-----	(2)	-----
Mar. 1, 1927, to Dec. 31, 1928 ³	32,584,357.74	17.93	18,196,096.81	10.01	26,008,452.53	14.31
Jan. 1, 1929, to Dec. 31, 1929 ⁴	2,279,938.56	3.52	1,502,326.29	2.32	2,617,706.97	4.04
Jan. 1, 1930, to Dec. 31, 1930 ⁵	12,263,512.08	15.19	11,488,524.70	14.23	3,596,501.44	4.45
Jan. 1, 1931, to Dec. 31, 1931 ⁶	2,772,406.99	9.49	1,156,337.37	3.96	2,823,582.80	9.67
Jan. 1, 1932, to Dec. 31, 1932 ⁷	1,059,610.16	3.88	2,249,743.59	8.23	193,800.98	.71
Jan. 1, 1933, to Dec. 31, 1933 ⁸	-----	-----	631,521.38	4.38	90,718.07	.63
Total.....	85,115,450.82	-----	46,681,580.20	-----	75,019,262.79	-----

¹ Limited to refunds, etc., of \$250,000 and over. Report of the Select Committee on Investigation of the Bureau of Internal Revenue, 69th Cong., 1st sess., S. Rept. 27, p. 194. Dates for this period have been supplied by the staff of the Joint Committee on Internal Revenue Taxation.

² No figures available.

³ The figures for these and the succeeding years are limited to refunds, etc., of \$75,000 and over. No figures available for the period of Apr. 24, 1928, to June 1, 1928. H. Doc. 43, 71st Cong., 1st sess., p. 25.

⁴ H. Doc. 478, 71st Cong., 2d sess., p. 32.

⁵ H. Doc. 223, 72d Cong., 1st sess., p. 19.

⁶ H. Doc. 535, 72d Cong., 2d sess., p. 19.

⁷ H. Doc. 279, 73d Cong., 2d sess., p. 20.

⁸ H. Doc. 145, 74th Cong., 1st sess., p. 16.

²⁶ Report of Joint Committee on Internal Revenue Taxation, Dec. 5, 1932, p. 63.

²⁷ Report of Joint Committee on Internal Revenue Taxation, Jan. 1, 1935, p. 46.

It should be noted that for the years prior to July 1, 1921, and for the 22-month period from April 30, 1925, to March 1, 1927,²⁸ and for the month of May 1928, no figures are available. From July 1, 1921, to December 31, 1933 (excluding the 23-month period from April 30, 1925, to March 1, 1927, and from April 24, 1928, to June 1, 1928, for which no figures are available), a period of 10 years and 7 months, the total refunds, credits, and abatements for the three listed items amounted to \$206,816,293.81. As pointed out in the notes to the above table no refund, credit, or abatement of less than \$75,000 has been included in these figures and for the period April 1, 1921, to April 30, 1925, only refunds, etc., of \$250,000 and over are included.

Vast sums of money were involved in taxes in the last war and in the next there is every reason to believe that with a higher rate of tax even larger sums will be involved. Without attempting to increase administrative discretion, decisions either way can be rationally sustained with equal validity—which virtually amounts to saying that one man's judgment is as good as another's:

It is a common thing for a million dollars or more in taxes to turn on some accident of organization, or some fine-spun distinction about which nearly as much can be said upon one side as upon the other.²⁹

The administrative discretion vested in the Bureau of Internal Revenue by any wartime taxation scheme must be great inasmuch as so many of the items to be determined are matters of judgment.³⁰ Furthermore, the power of compromising taxes admittedly due where collection of the full amount would make the taxpayer insolvent,³¹ obviously offers large room for the exercise of discretion in the determination of how much a corporation can pay and remain solvent.³²

The inevitability of the delay in the collection of war taxes and the amounts involved create a post-war political situation in the tax field. It is obvious, as Mr. Baruch stated in his testimony, that a taxpayer would "rather have somebody friendly than unfriendly" in the administrative post.³³ Upon a return to peace-time conditions there is inevitably the strongest kind of demand for leniency in regard to disputed war taxes. Business is seriously handicapped by the colossal readjustments required by the transition to peace-time production. Public opinion is not vitally interested in the technical questions involved in tax liability to pay for a war which has passed. Alleviation of the tax burden can become an important, if a seldom expressed, political slogan. Professor Adams has described the situation as follows:

²⁸ Some idea of the refunds that must have been made during this 22-month period for the listed causes can be obtained from a comparison with the \$76,000,000 refunded during the following 22-month period of Mar. 1, 1927, to Dec. 31, 1928.

²⁹ Needed Tax Reform in the United States, T. S. Adams, 2d ed. 1920, p. 9.

³⁰ Furthermore, an effect of delay, and the taxpayer can in many cases bring about delay regardless of the flexibility of administration granted, is to encourage the administrative officials to close cases as quickly as possible, with at times a minimum of care, in order to keep up with current work. Although it took 10 years to settle the 1918 taxes of the New York Shipbuilding Co. (testimony of Walter G. Mitchell, Jan. 21, 1935), the only audit of the company's gross sales of \$470,000,000 for 1922 to 1925 was an office audit requiring half an hour. Exhibit no. 1425. The easiest way to close the case of a taxpayer who uses dilatory tactics or who closely contests each point is to agree with his contentions. There is an undoubted incentive for administrative discretion to be used in such a way as to lighten administrative burdens, i. e., in favor of the taxpayer.

³¹ Rev. Stat. 3229. This has been narrowly construed by the Attorney General. 16 Opin. Atty. Gen. 249. The Bureau of Internal Revenue has in practice restricted the use of this section in the manner stated in the text, 69th Cong., 1st sess., S. Rept. 27, pp. 184-185.

³² See the criticisms of various compromises by the Bureau contained in 69th Cong., 1st sess., S. Rept. 27, pp. 184-193. See also p. 42 *infra*, for two examples of compromise.

³³ Bernard M. Baruch, Mar. 28, 1935.

The real evil is found in the resulting uncertainty, the accumulation in the Treasury of claims for back taxes and penalties aggregating billions of dollars, the dread with which these claims must inspire the business world, the invitation which this situation offers to political jobbery and the wrongful mixture of big business in tax politics.³⁴

The necessarily wide latitude for administrative judgment will be subjected to the most compelling of influences. A striking example of this can be found in the experiences of the period following the last war. On December 16, 1922, Mr. Andrew W. Mellon, then Secretary of the Treasury, wrote to C. F. Kelley, president of the Anaconda Copper Mining Co., about a proposed revaluation of copper mines for taxation purposes:

After full consideration of this question I am convinced that the values heretofore placed upon the copper mines for purposes of determining invested capital and of computing the deduction for depletion are excessive; the depletion rate previously allowed, based upon these values, is so high as to practically wipe out the operating income of many of the copper companies in ordinary years. The data show that due to the excessive values placed upon the ore bodies of the copper companies for invested capital and depletion purposes, the copper industry for 1917 and subsequent years has not paid a fair and equitable tax. On the other hand, however, these valuations of the copper mines were made by the Bureau of Internal Revenue, and in many cases the copper companies contend that they were given to understand that the values fixed on their properties by the Bureau were final values. Consequently the operations of the companies since the determination of these values by the Bureau were based upon the consideration of the tax liability for prior years have [having?] been settled. Furthermore, representations have been made that a readjustment of taxes of the copper companies for prior years upon the basis of the revaluation now recommended by the Income Tax Unit would impose a tremendous hardship, and, in some cases, would result in insolvency. After full consideration of the question it is believed that the matter should be settled upon a compromise basis. In accordance with this view the valuation of the copper mines for invested capital and depletion purposes for the years 1917 and 1918 will be allowed to stand upon the basis heretofore fixed by the Department, but for 1919 and subsequent years the valuation will be corrected to conform to what the Department regards as a more proper method of valuing the copper mines.³⁵

As was too frequently the case, the "compromise" meant a waiver by the Government of its claim—in this instance for additional taxes during the war years. The only quid pro quo furnished by the taxpayers that could have been received by the Government in exchange, is the possibility—not referred to by Mr. Mellon—of an agreement that the taxpayers would not exercise their inalienable right to delay settlement as to subsequent years for which the wartime tax rates had been lowered.

Wartime taxes when computed in peacetime seem unduly high. This also helps to encourage administrative leniency. Mr. Parker, the chief engineer for the Select Committee of the Senate on Investigation of the Bureau of Internal Revenue, who later became the chief of staff of the Joint Committee on Internal Revenue, referred to this at the end of his report on the administration of the special assessment provisions:

In closing our report on this subject, we wish to make clear that the time available for the investigation of this feature of the revenue act was not sufficient for as thorough and complete a study as the importance of the subject demands. We hope we have brought out that the special assessment section of the bureau has it within their power to hand back millions in taxes by the stroke of a pen. If a company makes \$38,000,000 and has to pay a tax of \$19,000,000, the tax looks high so the Bureau finds a way to hand the taxpayer back \$5,000,000. It is

³⁴ Adams, *Needed Tax Reform in the United States*, 2d ed. (1920), p. 9.

³⁵ Exhibit no. 1713.

a big tax, but surely Congress would not have set up an 80 percent bracket in 1918 if it did not expect anybody to be taxed at this rate.

The Bureau appears to have forgotten that there was a World War in 1918; that our boys were giving their lives for their country in foreign lands; and that the industries of the country were also supposed to do their part by contributing the larger portion of their profits. Surely, lives are as important as dollars, and too much sympathy should not be given to large companies whose very profits depended in a large measure to [on?] the extraordinary demands for production in nearly all lines. The Bureau has also forgotten that inasmuch as taxes are necessary in a fixed amount to meet the expenses and obligations of the Government, then every dollar improperly refunded to a taxpayer, means another dollar taken away from the present taxpaying public. The allowances under the excuse of special assessment look very much like grand larceny from our present day taxpayers.³⁶

The power of compromising taxes, referred to above at page 40, puts a great burden upon the administrative officials. No administrative official likes to assume the responsibility of putting a company out of business. The sudden change in industrial conditions due to the cessation of war activities meant that many companies that had made and distributed large profits during the war contended that they could not pay additional taxes, assessed after the war following audit and investigation, upon those profits. It is difficult for an administrative official, unfamiliar with the details of a given business, to pit his judgment against the judgment of those in charge of the business. The Atolia Mining Co., one of the largest producers of tungsten in the world,³⁷ had a very profitable history during the war because of the great need for this alloy in the manufacture of high-speed cutting tools used in the manufacture of armaments.³⁸ Dividends of \$4,715,100 were distributed in 1916 to 1918,³⁹ inclusive, to stockholders whose original investment was only \$63,000.⁴⁰ At the conclusion of the war the demand ceased and with it the market fell. Because of the difficulty in valuing the properties the Government was unable to complete its check of the Atolia tax returns until after the war, when an additional assessment of \$345,000 was made.⁴¹ The company, in which Mr. Bernard M. Baruch held a 26-percent interest,⁴² alleged inability to pay more than \$165,000 in view of the adverse business conditions, and asserted that all its liquid assets amounted to only \$100,000,⁴³ although in its sworn income-tax return for that same year (1923) the company valued its ores alone at \$5,000,000.⁴⁴ A compromise settlement of \$200,000⁴⁵ was finally effected, a loss of \$145,000 to the Treasury, or more than one-third of the additional assessment.

The 1918 taxes of the New York Shipbuilding Co. were settled in 1928 by a compromise based upon the company's contention that it would be forced into liquidation if a full tax were collected.⁴⁶ The

³⁶ 69th Cong., 1st sess., S. Rept. 27, pt. 2, p. 267.

³⁷ Testimony of Bernard M. Baruch, Mar. 29, 1935, 95 BBQ.

³⁸ American Industry in the War, report of the War Industries Board, by Bernard M. Baruch, chairman (1921), p. 144.

³⁹ Exhibit no. 1744 E.

⁴⁰ Exhibits nos. 1741; 1748 A.

⁴¹ This amount included taxes for the period 1906 to 1919, but substantially all of it was for the war years. Exhibit 1748. Even this was a reduction of the maximum amount of tax found to be due. Originally the company was assessed additional taxes of \$600,000. Exhibits 1744 and 1741 A. Apparently by virtue of the special assessment provisions of the wartime tax laws (see p. — of this report) this was reduced to \$345,000. Exhibits 1741, 1744 D, 1743.

⁴² Testimony of Bernard M. Baruch, Mar. 29, 1935, 95 EBQ.

⁴³ Exhibit 1743.

⁴⁴ Exhibit 1748 B.

⁴⁵ Exhibit 1743 A.

⁴⁶ Exhibits 1420, 1421; testimony of Walter G. Mitchell, Jan. 21, 1935, 28GP.

company estimated it had a liquidating value of \$3,000,000 and an appraisal value of \$4,250,000,⁴⁷ although in its report to its stockholders it stated the value of a comparable part of its assets as \$11,000,000.⁴⁸

Any increase in discretionary power to administrative officials may mean a loss in revenue greater than the savings in administrative expense resulting from the administrative flexibility.

⁴⁷ Exhibit 1430; testimony of N. R. Parker, Jan. 22, 1935, 43GP.

⁴⁸ Testimony of N. R. Parker, Jan. 22, 1935, 43GP.

V. TAX EVASION AND AVOIDANCE

Any analysis of the problems involved in war-time taxation of the kind contemplated by this report must take account of the question of tax avoidance⁴⁹ and of outright evasion.

It will be remembered that the Senate Committee on Banking and Currency uncovered the fact that for the year 1930, 17 of the partners of J. P. Morgan & Co., including Mr. J. P. Morgan, paid no taxes, and 5 paid taxes aggregating \$56,000, and that for the years 1931 and 1932, no partner paid any tax.⁵⁰

It is important to distinguish tax avoidance from tax evasion since the two are frequently confused in the popular mind. One reason for this confusion is the substantial similarity of the motives for employing the devices. Whether the action is legal or illegal, the purpose is to reduce or to eliminate the amount payable as a tax. Because the end result is the same, there is a popular feeling that any action intended to accomplish this must of necessity be illegal.

This confusion, of course, ignores the whole Anglo-American concept of the function of law as furnishing a definite and predictable set of rules. Mr. Justice Holmes said:

We do not speak of evasion because *when the law draws a line, a case is on one side of it or the other, and if on the safe side is none the worse legally that a party has availed himself to the full of what the law permits.* When an act is condemned as an evasion, what is meant is that it is on the wrong side of the line indicated by the policy if not the mere letter of the law.⁵¹ (Italics added.)

By definition a transaction which has for its purpose the reduction of taxes is not illegal if the means employed are in themselves part of the applicable rules. (See *U. S. v. Isham* (17 Wall. 476, 84 U. S. 496); *Weeks v. Libby* (269 Fed. 155); *Fidelity Trust Co. v. Lederer*, (276 Fed. 51).)

The legal concept merely reflects the general attitude that taxes are a necessary evil to be minimized as far as possible:

As a group, men are patriotic; as individuals, they will pay as small a tax as can be calculated and will secure as high prices and extract as great profits as can be extracted.⁵²

The methods of avoidance depend upon the rules specified by the tax statutes. However, it should be noted that provisions ostensibly intended for one purpose are often logically applicable for other purposes. Provisions apparently designed to prevent burdens generally conceded to be undue as applied to certain taxpayers, are

⁴⁹ Tax avoidance is, of course, not purely a war-time phenomenon. It is, however, so much a part of the traditional American attitude toward Government that it is to be doubted whether settled forms of avoidance that have grown up in times of peace will disappear under the stimulus of war-time patriotism. Accordingly, in the examples of tax avoidance discussed in this part of the report, both war-time and peacetime illustrations have been included. The instances of avoidance set forth in this report are meant to be illustrative of a general tendency and not a full list of loopholes which if stopped up would eliminate avoidance of taxes. As indicated in the text, some avoidance is inevitable because of the combination of (1) avoiding undue hardship on certain classes of taxpayers and (2) uniformity of taxation, as goals of American tax measures. Furthermore, the ingenuity of accountants and lawyers tends to make any list of means of avoidance incomplete almost as soon as it is drafted.

⁵⁰ Report on Stock Exchange Practices, 72d Cong., 2d sess., S. Rept. 1475, p. 321.

⁵¹ *Bullen v. Wisconsin* (240 U. S. 625).

⁵² Garrett, Government Control Over Prices (1920) p. 381.

often also equally available for the avoidance of large amounts of taxes the burden of which appears less obviously unfair. It is the frequent use of such provisions for the avoidance of large sums of apparently fair taxes which is probably the real basis for the popular confusion between evasion and avoidance. Although the legal distinction between the two is no less clear whether the scope of the exemption is generally approved or not, the social distinction between evasion and avoidance is in many cases not so clear. However the individual taxpayer can usually formulate a justification for using what the popular mind regards as "loopholes" in the tax laws:

There has been a hue and cry against so-called "tax evaders." Many speeches were made in the last Congress which should be characterized as dishonest, but I will merely call them the "unintelligent mutterings of the ignorant and uninformed." [sic] Many charges were made that certain rich men—names of 10 being used—had been guilty of evading income taxes. I will assume that most of those who made the charges are too ignorant to know the difference between tax avoidance—which is legal—and tax evasion, which is illegal. * * *

Avoidance does not even involve moral turpitude. When tax rates are oppressive and unscientific, the instinct of self-preservation asserts itself strongly. When there is no concealment of facts, there can be no "willful" evasion. There is not even negligence. The law purports to define in meticulous detail what sort of transactions are taxable. If taxpayers can think of a way of doing something, which way is not forbidden in the law, there is no fraud, nor attempted evasion. The courts uniformly protect taxpayers who merely select methods of transacting business which involve the least or no liability for tax. The position of taxpayers under a highly intricate tax law is not that of an independent, impartial judge trying to be fair, no matter who is hurt. No possible criticism can be directed at taxpayers who follow the law as it is, rather than as it would be, if Congress had said something else.⁵³

The literal applicability of exemption provisions not only to cases of exceptional hardship but to cases in which the justness of the tax is practically beyond dispute, makes the traditional resistance of the taxpayer to the tax collector present a dilemma to those drafting tax laws designed not only to raise revenue but to equalize the burdens of war. On the one hand it is important that the tax statutes be not so inflexible or so harsh as to penalize particular groups in a way that would arouse widespread public disapproval of the entire taxation scheme; on the other hand exemptions made in situations universally admitted to justify a relaxation of the severity of the tax are certain to be "availed * * * to the full of what the law permits" by those whose claims to mitigation of tax burdens are less obviously valid.

(1) SPECIAL ASSESSMENTS

A signal example of this is to be found in the "special assessments" of excess-profits taxes during the World War. The complexity of the problem encountered in determining invested capital was recognized by Congress in the 1917 Revenue Act as likely to result in cases in which it would actually be impossible to carry out the statutory mandate.⁵⁴ In the 1918 act, which bore greatly increased rates, the exception was extended also to cases in which the Commissioner of Internal Revenue found that—

⁵³ Robert A. Montgomery, *Federal Tax Handbook 1934-35*, p. iv.

⁵⁴ Sec. 210, Revenue Act of 1917. Mr. Montgomery states that, despite the express limitation of this provision to cases where the Secretary of the Treasury was "unable * * * satisfactorily to determine the invested capital," in practice "through the exercise of administrative discretion to an extent which can be justified only when one considers the seriousness of the issues involved, this section was applied when invested capital, even though definitely known, was 'serious & disproportionate' to the taxable income." Montgomery, *Excess Profits Tax Procedure 1921*, p. 7.

the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in paragraph 328.⁵⁵

The "special assessment" so made available subjected the taxpayer to a tax of the same proportionate size as the average tax paid by a group of "representative corporations [partnerships and individuals] engaged in a like or similar trade or business."⁵⁶

The 1918 act apparently attempted to safeguard this provision against use as a means of easy avoidance of taxes by specifying that it was not to apply to cases in which the tax computed normally— is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital.⁵⁷

The vagueness of such a standard as the special-assessment provisions and the consequent opportunity for disagreement and delay are apparent. Mr. Ballantine testified before the War Policies Commission that:

This special-assessment provision, while perhaps necessary, was found to be uncertain and vague in its application and was one of the most troublesome features of the excess-profits tax.⁵⁸

Instances of the effects of this provision in operation show that the R. J. Reynolds Tobacco Co., which was in the highest income brackets, was—

allowed abatements and credits amounting to \$1,698,265 for the year 1918. Their statutory tax would have amounted to \$10,226,521; this has been reduced under section 328 to \$8,528,266. The percentage of final profits tax to net-income amounts to 40 percent.⁵⁹

The American Car & Foundry Co. was—

refunded and abated under section 328 of the act of 1918 the amount of \$5,209,204 on account of its 1918 tax. The net income of this taxpayer was \$37,443,246, the final profits tax under special assessment was \$17,244,552, the final percentage of profits tax to net income amount to 46 percent.

We would call attention to the fact that the United States Steel Corporation, an allied industry, was in the 80 percent bracket in 1918 and was assessed a total tax amounting to about 57 percent of their net income.⁵⁹

Similar illustrations concerning the Youngstown Sheet & Tube Co., the Northwest Steel Co., and the Pittsburgh Steel Products Co. indicate to what extent some of the big corporations took advantage of

⁵⁵ Sec. 327, Revenue Act of 1918.

⁵⁶ Revenue Act of 1917, sec. 210; Revenue Act of 1918, sec. 328. The language quoted in the text was identical in the two acts except that only the 1917 act contained the reference to partnerships and individuals, since the excess-profits tax of the 1918 act applied only to corporations. The manner of determining the special assessment was slightly different in the two acts: In the 1917 act the deduction from income for which invested capital was supposed normally to be used, was determined by applying to the taxpayer's income a percentage equal to the ratio between the average deduction and the average income of the representative concerns. In the 1918 act the tax itself was determined by applying to the taxpayer's income a percentage equal to the ratio between the average tax and the average income of the representative corporations.

⁵⁷ Sec. 328, Revenue Act of 1918. Cf. Mr. Montgomery's statement in footnote 51, *supra*, that even the 1917 provision was used where invested capital was seriously disproportionate to taxable income.

⁵⁸ House Document 163, 72d Cong., 1st sess., p. 693.

⁵⁹ Senate Report 27, 69th Cong., 1st sess., p. 222.

the special-assessment procedure in effect to reduce the excess-profits tax rate to a much lower one than that the statute provided for.⁶⁰

Name	Amount of regular tax	Amount of refund due to special assessment
Youngstown Sheet & Tube Co., Youngstown, Ohio.....	\$19,469,794	\$3,482,610
Northwest Steel Co., Portland, Ore.....	1,380,692	923,236
Pittsburgh Steel Products Co., Pittsburgh, Pa.....	4,698,161	1,830,227

A list of refunds in excess of \$250,000 allowed from July 1, 1921, to December 31, 1925, due to the special assessment provisions, is reprinted at page 164 of the appendix to this report and total refunds under these provisions during other periods of time appear at p. 39, supra. The amount of tax which was never assessed because of allowances under these provisions cannot be estimated although the committee's record contains examples, developed in the course of examining the tax records of isolated companies, which indicate the extent of the practice.⁶¹

(2) DEDUCTION OF CAPITAL LOSSES

The customary provision in American income-tax statutes permitting deduction of capital losses from taxable income has frequently been used to avoid taxes which the generality of public opinion may well believe could have been paid without undue hardship.

In the course of this committee's investigation, it has been found that the late Alfred I. du Pont paid no income tax during the 7 years 1920 to 1926. His gross income in that period was over \$29,000,000. The following explanation of these transactions, showing the part which deductions of capital losses played in reducing Mr. du Pont's tax liability, was furnished to this committee by the Treasury Department:

Taxable years	1 Income tax paid	2 Refunds allowed	3 Gross income	4 Losses on security transactions	
				Nemours trading	Other
1920.....	None	None	\$6,199,639.98	\$2,499,900.00	\$152,823.65
1921.....	None	None	1,031,713.46	1,249,875.00	31,703.74
1922.....	None	None	5,946,324.82	1,000,599.00	4,918,771.43
1923.....	None	None	5,047,012.94	999,900.00	1,777,681.50
1924.....	None	None	1,837,886.48	None	804,115.72
1925.....	None	None	3,947,641.39	None	828,121.75
1926.....	None	None	5,575,954.57	26,950.00	335,969.32
1927.....	\$7,800.76	None	1,022,990.92	None	4,252.50
1928.....	115,791.78	None	1,054,482.38	None	159,246.90
1929.....	108,584.16	None	1,300,423.51	None	15,229.35
1930.....	100,134.68	None	713,814.55	None	11,364.28

¹ Indicates profit rather than loss.

⁶⁰ Ibid, pp. 222-223.

⁶¹ See the case of the Newport News Shipbuilding & Drydock Co., whose 1917 taxes are referred to at pp. 21-22; the Atolla Mining Co., whose war-time taxes are discussed at p. 42, had taxes reduced from \$600,000 to \$345,000, apparently primarily through this provision; the United Verde Extension Mining Co.'s taxes for 1917 were estimated at \$5,548,823 by the revenue agent and at \$5,739,100 by the engineers of the Senate Committee on Investigation of Bureau of Internal Revenue, but by virtue of the special assessment provision only \$2,845,070 was assessed against the company. Exhibit 1715 A; 69th Cong., 1st sess., S. Rept. 27, pt. 2, p. 258. See general report on special assessment made to Senate Committee on Investigation of Bureau of Internal Revenue, 69th Cong., 1st sess., S. Rept. 27, pt. 2, pp. 247-267, the conclusions of which are quoted at pp. 41-42 of this report.

The amounts shown in the first column under item 4, "Nemours Trading", are losses claimed on sale or other disposition of stock of Nemours Trading Corporation.⁶² In addition to these items, the taxpayer claimed deductions for worthlessness of debts due from Nemours Trading Corporation in the sums of \$499,993.70 for the year 1924, \$809,704.95 for the year 1925 and \$1,670,749.92 for the year 1926.

* * * * *

The amounts shown in the second column under item 4 above as losses on "Other" security transactions cover all losses on all securities such as stocks, bonds, and mortgages except the losses incurred in connection with Nemours Trading Corporation. Although your letter refers only to losses on stock transactions, it is impossible from the information at hand to distinguish between the losses on stock transactions and losses on bond transactions for all years and for this reason the amounts stated above under the second column of item 4 cover all other security transactions rather than all other stock transactions.

The figures stated under item 3, "Gross income", above, should not be confused with amounts shown in individual income-tax returns as "Total income", as for example, the amount shown on line 12 of form 1040, individual income-tax return for the calendar year 1930, which is, in effect, net income with the exception of deductions to be taken on lines 13 to 18, inclusive, for interest; taxes; losses by fire, storm, etc.; bad debts; contributions and "Other deductions authorized by law" (and not claimed elsewhere in the return). The figures stated under the gross income column above have been compiled from the various items of gross income for each year without diminution for such items as cost of securities sold, depreciation and other expenses of rented properties and other items which are applied against gross income items in the income-tax returns in computing the "Total income" figure as contrasted with the "Net income" figure. This explanation of the gross income figures stated above is given somewhat in detail in order that it may be clearly understood that cost of securities sold has not been deducted in computing these figures, which accounts for the fact that, while large gross income figures are reflected for several years, no income taxes were assessed or paid for those years as the cost of securities sold, bad debts, and other deductions allowable under the various revenue acts exceeded the gross income.

It is shown under item 2, above, that no refunds have been allowed. It is to be understood that this refers to refund of taxes paid with respect to the taxable years 1920 to 1930, both inclusive, and that it has no reference to any refunds which might have been made during any of those years of income taxes paid for any taxable year outside of the period 1920 to 1930, both inclusive.

The figures shown above are as reflected in the returns as originally filed by the taxpayer but adjusted to show any corrections made thereto by the Bureau of Internal Revenue before final approval of the returns.

The returns filed for the years 1921 to 1926, both inclusive, were joint returns of Albert I. du Pont and his wife Jessie Ball du Pont, and the various items gross income and deductions of each spouse are not segregated in the returns, therefore, the figures stated for such years cover the income and deductions of both Mr. and Mrs. du Pont.⁶³

The Senate Committee on Banking and Currency brought out the prevalence of the avoidance of taxes by sales, involving capital losses, to relatives of the taxpayer who obligingly resold back to the taxpayer:

This device was exceedingly favored by leaders of American finance, whose relatives were generally possessed of considerable wealth in their own right.

⁶² A frequent concomitant of the use of the provision for deduction of capital losses has been the setting up of a personal holding company. This device was described as follows by the House Ways and Means Committee report on the revenue bill of 1934:

"Perhaps the most prevalent form of tax avoidance practiced by individuals with large incomes is the scheme of the 'incorporated pocketbook'. That is, an individual forms a corporation and exchanges for its stock his personal holdings in stocks, bonds, or other income-producing property. By this means the income from the property pays corporation tax, but no surtax is paid by the individual if the income is not distributed.

"For instance, suppose a man has \$1,000,000 annual income from taxable bonds. His tax under existing law will be \$571,100. However, if he forms a holding company to take title to the bonds and to receive the income therefrom, the only tax paid will be a corporate tax of \$137,500 as long as there is no distribution of dividends. Thus a tax saving of \$433,600 has been effected." (73d Cong., 2d sess., II. Rept. No. 704, p. 11.)

This permits an individual taxpayer to realize his income in the years and in the amounts he desires and so to avoid the high taxes in effect in war years. The connection between this device and the provision for deducting capital losses is apparent when it is recognized that the shares of a personal holding company are not, of course, registered on any market. As a result of this absence of any market value, the opportunity for establishing apparent losses by the sale of the stock of such a company is considerable.

⁶³ Exhibit no. 1398. See also exhibits nos. 1397 and 1397-A.

Thus, Thomas S. Lamont, a partner of J. P. Morgan & Co. established losses amounting to \$114,807.35 in the sale of securities to his wife on December 31, 1930. The tax on the amount of loss thus established would have been \$20,365. In April 1931 he repurchased the securities from his wife. Both sides of the transaction were effected without the intervention of any intermediary. The payments were evidenced by entries on the books of J. P. Morgan & Co.

Mr. PECORA. Now, in what form did she make payment to you for these securities on December 31, 1930?

Mr. LAMONT. Her account in the office of J. P. Morgan & Co. was debited, was charged with the cost of these securities, and my account was credited.

* * * * *

Mr. PECORA. * * * How was that sale of those securities by your wife to you effected in April 1931?

Mr. LAMONT. I bought it back direct from her. Didn't occur to me to do it in any other manner.

Mr. PECORA. That is, there was no broker?

Mr. LAMONT. There was no broker.

Mr. PECORA. Or any other agent or intermediary involved in the purchase of these securities by you from your wife?

Mr. LAMONT. That is right.

Otto H. Kahn, of Kuhn, Loeb & Co., testified that on December 30, 1930, he sold five blocks of securities to his daughter, Maude E. Marriot, which he later reacquired by assignment in writing. Although the assignment was dated December 31, 1930, he stated that the document was actually executed in March 1931, thereby placing the retransfer just beyond the 60-day limitation period. Through this method, a loss of \$117,584 was established whereby Kahn was enabled to deduct upward of \$16,000 from his income tax for 1930.

Charles E. Mitchell, chairman of the National City Bank, sold to his wife in 1929, 18,300 shares of National City Bank stock at a loss of \$2,872,305.50. This transaction, Mr. Mitchell admitted, was entered into for the express purpose of establishing the loss for income-tax purposes. He later repurchased the stock from his wife.

Senator BROOKHART. What price did you pay for those last purchases?

Mr. MITCHELL. I sold this stock, frankly, for tax purposes.

Senator BROOKHART. That was to avoid income tax?

Mr. MITCHELL. Throwing my fortune into the breach as I did for the benefit of this institution, Senator Brookhart, in 1929, I had a definite loss in that stock which I was forced to take.

Senator BROOKHART. In other words, by making a sale of it that showed a loss in your income?

Mr. MITCHELL. That certainly did.

Senator BROOKHART. And then you bought it back afterward?

Mr. MITCHELL. Yes, sir.

* * * * *

Senator BROOKHART. That sale was just really a sale of convenience, to reduce your income tax?

Mr. MITCHELL. You can call it that if you will.

Senator BROOKHART. Well, is that right?

Mr. MITCHELL. Yes; it was a sale, frankly, for that purpose * * *.

As a result of this transaction, Mitchell paid no income tax in 1929.⁶⁴

(3) INSTANCES OF READINESS OF TAXPAYERS TO RELY ON TECHNICALITIES TO AVOID TAXES

In the year 1916 when the du Pont Co. was making large profits from the sale of war products to the Allies, it objected to the imposition of the income tax on that part of its income derived from exports, on the ground that such income was made immune from taxation by section 9, article I of the Constitution, which provides that "no tax or duty shall be laid on articles exported from any State."⁶⁵

⁶⁴ Report on Stock Exchange Practices, 73d Cong., 2d sess., Senate Rept. No. 1455, p. 322 et seq.

⁶⁵ Exhibit No. 1403.

The Revenue Act of 1918 in section 301 (c) provided that the high 1918 tax rates should be applicable to that part of the income derived in 1919 and later years from war-time contracts with the Government. The Newport News Shipbuilding & Drydock Co., which had made a profit of 32.4 percent in 1917 on its investment according to its own return,⁶⁶ 90.6 percent according to the revenue agent's report,⁶⁷ and 86.3 percent according to the invested capital as determined by the Bureau of Internal Revenue in revision of the agent's report,⁶⁸ protested against imposition of the tax on that part of its income which was derived from work done pursuant to the mandatory orders of the President. The theory of the protest was that these were "forced orders" and that the statute when it was phrased to read "Government contracts" did not envisage such orders.

Compulsory contracts were most frequently used to afford protection to governmental contractors from third parties whose contractual rights antedated the governmental orders.⁶⁹ The concept of the sovereign's commandeering power permitted priority to be given to the Government without the contractor incurring liability under his precedent private obligations.⁷⁰ Certainly, as the company's record shows⁷¹ and as the fees provided in the contracts indicate, the Newport News Co.'s "forced orders" were profitable:

Senator VANDENBERG. Mr. Ferguson, when we are discussing this so-called "force contract", are we discussing the cost-plus 10-percent contracts?

Mr. FERGUSON. Some of them were cost plus 10 percent. They were all changed to cost plus a fixed fee. Some of them were cost plus a fixed fee in the first place. The only cost-plus 10-percent contracts which we ever completed was the first of a group of destroyers—

Senator CLARK. Was that during the war, Mr. Ferguson?

Mr. FERGUSON. Yes. The battle cruiser contracts were signed in 1916, and they were cost plus 10 percent, but later on changed to cost plus a fixed fee of \$2,000,000. The battleship *Iowa* was cost plus a fixed fee from the beginning. A group of tankers we built for the Navy Department were cost plus a fixed fee, plus one-half of the savings under a certain price.

Senator VANDENBERG. This is after the war, is it not?

Mr. FERGUSON. No; this was during the war. It was during the war period. I do not remember just when the battleship *Iowa* contract was settled.⁷²

Indeed, since the 1918 tax rates permitted an exemption of income up to an amount equal to at least 8 percent of invested capital in all cases, the issue raised by the Newport News Co. could not have arisen unless the contracts yielded substantial profits.

The claim of the company was stated in a brief prepared by Robert H. Montgomery:

It was clearly not the intention of Congress to tax at what are really penalty rates, income derived from the execution of the President's orders.

* * * * *

Section 301 (c) of the Revenue Act of 1918 was inserted by the Conference Committee, and in explaining it to the House, the Chairman of the Ways and Means Committee said:

"Though the 80-percent war profits tax is eliminated for the next fiscal year—since there are no war profits for 1919–20—the conferees put in a provision extending the 80-percent war profits tax for the calendar year 1919 to catch the profits that are derived in 1919 from war contracts made in 1918 and 1917, so that the profiteers will not get off with 80 percent eliminated after January 1, 1919."

* * * * *

⁶⁶ Exhibit 1556.

⁶⁷ *Ibid.*

⁶⁸ Letter from Secretary of Treasury to committee, May 3, 1935, quoted in part on p. 22, note 45.

⁶⁹ Testimony of Lt. E. M. Brannon, Dec. 21, 1934, 95-96 FM.

⁷⁰ *Ibid.*, cf. Exhibit No. 1694 quoted at p. 96 and cf. pp. 111-115.

⁷¹ Exhibit No. 1556.

⁷² Feb. 12, 1935, 74ZO.

The owners of shipyards who were prevented from undertaking lucrative commercial work and were commanded to devote all their facilities to the production of vessels for the Government at prices stipulated by the Government, can hardly be considered the profiteers the conference committee intended to reach.⁷³

The company felt no hesitation about relying upon such a technical means of avoiding taxes; as a matter of routine, taxes were reduced whenever, and as far as, possible:

Senator VANDENBERG. What was there about a cost-plus-10-percent contract which so invaded the ordinary contractual prerogative that it ought not to be considered in ordinary tax practice?

Mr. FERGUSON. I take it—it is a legal question with which I am not acquainted—but I take it that being a Presidential order contract—

Senator VANDENBERG. I am not asking about the legal phase. I would not undertake to enter that field, either. I am talking about the practical phase. Do you not invite the inference that if you consider a cost-plus-10-percent contract an invasion of your ordinary contractual privileges, do you not invite the presumption that a 10-percent profit above all cost items is a great hardship, and a great invasion of your usual opportunity of doing a great deal better than that?

Mr. FERGUSON. No.

Senator VANDENBERG. It seems to me that you do. Go ahead, Mr. Raushenbush.

Mr. RAUSHENBUSH. The point that you were to accomplish by these protests which were laid before them by Mr. Montgomery and your learned attorneys and others, was simply to reduce the taxes on all the Government work during the war, on the ground that it was a forced contract? That is not to say that 10 percent was too much or too little, but that the taxes were too much. Was not that the point of it?

Mr. FERGUSON. I presume so.⁷⁴

The United Verde Extension Mining Co. stated on March 30, 1918, when it filed its 1917 tax return, that it could not determine its tax liability because it could not determine its invested capital. The Bureau of Internal Revenue replied on June 10, 1918, that—

A final conclusion has not been reached but from the consideration so far given, it is apparent that the amount of taxes owing will probably not be less than that indicated below * * * [\$2,123,809.55] * * *. Upon final audit of your returns you will be advised of the conclusion reached and if the amount determined to be due is in excess of amount above stated, a further assessment will be made; if less, you may file a claim for refund of the amount overpaid.

The collector at Baltimore assessed the same amount in a duplicate assessment and on September 27, 1918, notified the Bureau that an abatement should be allowed as to his assessment because the amount assessed had already been paid. On February 19, 1919, the company was notified:

Your claim for the abatement of internal-revenue tax has been allowed as shown above. No further demand for the payment of the amount allowed and abated will be made upon you.

This was a standard paragraph used in allowing abatements in the case of duplicate assessments. On January 24, 1923, the company was notified of a further assessment of \$721,260.

The company resisted this additional assessment on the ground that the letter of February 19, 1919, closed the case and that under section 1313 of the Revenue Act of 1921, which made decisions of the Commissioner of Internal Revenue free from review by any other administrative official, the case could not be reopened.⁷⁵

⁷³ Exhibit no. 1561.

⁷⁴ Feb. 12, 1935, 74 Z O.

⁷⁵ Exhibits 1715; 1715A. For examples of the use of the device of incorporation to avoid taxes see p. 21 and p. 31, supra.

(4) OBSTRUCTIVE TACTICS

The traditional resistance to paying taxes at times assumes forms which justify—without much room for plausible arguments of the kind quoted above at page 45 the popular confusion between evasion and avoidance. All profits taxes depend finally upon records kept by the taxpayer and known in their entirety only by him.

A memorandum of revenue agents assigned to the New York Shipbuilding Co. tells how a company official informed them every day for 3 weeks that he was going to produce certain schedules and then finally admitted that he was “stalling”:

To verify the correctness of the taxpayer's returns, or books, it is most essential to procure the schedules referred to and to examine the computations of earned profit on each contract that was made by the taxpayer and appear thereon. Such schedules have been requested of the taxpayer, first over 3 weeks ago, and photostats thereof were promised by Mr. Norman F. Parker, assistant treasurer, almost daily after the first request.

Last Saturday, on request again for the schedules, Mr. Parker informed us that he had been “stalling” and that we knew it, but that the corporation's counsel had advised him to delay giving the schedules to us. He called his counsel by telephone, a Mr. Orr, connected with White & Case, attorneys, while we were present, and explained the situation, and stated to Mr. Orr that he believed we were entitled to the schedules and should get them. Mr. Orr's advice, we were informed, was not to deliver them.

To date, the situation remains the same, the schedules have been refused on the advice of counsel, so we are informed by Mr. Parker and Mr. J. T. Wickersham, the treasurer.

The points raised by the Solicitor have developed other points that make it imperative, in the opinion of your examiners, after their investigation thus far, that a reexamination be made of the taxpayer's books for the period extending from 1918 to 1921, inclusive.

Their investigation thus far, with the information we have been able to gather, results in an increase in income over income as determined by the revenue agent from Trenton, who made the last examination for the period 1918 to 1921, inclusive, of approximately \$8,000,000.

It is the positive opinion of your examiners, with the information gained thus far, that there should be recommended to the Commissioner that a reexamination be made of all of the taxpayer's books and records for the years 1918 to 1921, inclusive; and that the taxpayer should be duly notified under the provisions of section 1105 of the Revenue Act of 1926 that such investigation has been ordered.⁷⁶

The truth of this charge was conceded by Mr. Parker in his testimony:

Mr. RAUSHENBUSH. Do you have any comment to make on the statement here that you had been “stalling” under the advice of your attorneys?

Mr. PARKER. None, except that that was true.⁷⁷

Such subterfuges as this last, and open evasion, cannot be prevented by the terms of any tax statute, except to the extent that penalties are effective, and in the case of delays and generally obstructive tactics, as contrasted with open evasion, there is usually no evidence sufficiently conclusive to impose penalties. However, the effect in loss of revenue, or in serious delay in the receipt of revenue, is important in any realistic statement of the problems of taxation.

(5) TAX-EXEMPT SECURITIES

An additional source of tax avoidance is the large amount of tax-exempt securities available for investment by corporations and individuals. Because of the doctrine of the immunity of State

⁷⁶ Exhibit No. 1428.

⁷⁷ N. F. Parker, Feb. 13, 1935.

instrumentalities from interference by the Federal Government, income derived from the securities of any State or political subdivision of a State cannot be taxed by the Federal Government.⁷⁸ Consequently, in the absence of a constitutional amendment any war-profits tax can be defeated to the extent of the interest paid on State, county, and city indebtedness. This has been estimated by the staff of the Joint Committee on Internal Revenue Taxation as amounting to \$980,000,000 per year.⁷⁹ So far as individuals are concerned, the bulk of State and local securities is held by persons in the high-income brackets and the amount so held has been steadily increasing. Of all tax-exempt income from State and local securities reported by individuals in 1924, persons having net incomes of over \$100,000 reported 58 percent; in 1925 the figure was 64 percent; in 1929 it was 70 percent; and in 1930, the latest year for which complete income-tax statistics were available, 74 percent of the income from tax-exempt State and local securities reported in individual income tax returns was reported by taxpayers having net incomes of over \$100,000.⁸⁰

Similarly a large amount of Federal securities are completely tax exempt from Federal taxation.

On August 31, 1933, the total interest-bearing debt of the United States, outstanding, amounted to \$22,722,597,530, of which amount \$12,860,055,350 was subject to surtax, and \$9,862,542,180 was wholly tax exempt as to both income and surtax. It appears that the average annual interest charge on this Federal debt will be approximately \$825,000,000, indicating an average interest rate of approximately 3½ percent.⁸¹

It is at least doubtful whether the war power will permit the abrogation of the right to receive wholly tax free the interest on more than 40 percent of the total Federal debt, as of August 31, 1933, without a constitutional amendment.⁸²

⁷⁸ *Pollock v. Farmers' Loan & Trust Co.* (157 U. S. 429).

⁷⁹ *Prevention of Tax Avoidance*, 73d Cong., 2d sess., House Committee Print (1933), p. 25.

⁸⁰ *Ibid.*, p. 26.

⁸¹ *Ibid.*

⁸² The United States as a sovereign may remove the remedies necessary for the enforcement of a right against it, but it appears that it may not abrogate the right itself. See *Lynch v. United States*, 292 U. S. 571, *Perry v. United States* (U. S. Sup. Ct., Feb. 18, 1935, No. 532). The distinction is important in the Federal taxation of Federal bonds containing tax-free covenants, since the United States must there assert a positive right to tax collection which is met by the countervailing right of exemption. Cf. *Lynch v. United States*, *supra*. The Supreme Court has recognized that the fifth amendment limits the taxing power (*Heiner v. Donnan*, 285 U. S. 312, 326; see *Louisville Joint Stock Land Bank v. Radford*, May 27, 1935, No. 717.) If such an analysis is adopted by the Supreme Court and the taxpayer's right is also held to be immune from the war power (cf. *Ex parte Milligan*, 4 Wall. 2, 120-127), it seems hardly possible that Government credit in war time would permit the drastic alternative of threatening removal of remedies of enforcement of the rights to interest or principal unless consent were given to taxation of interest.

PART II. PRICE CONTROL

The purposes of price control, whether in the form of the war-time practice or in that of the Baruch price ceiling proposal, are generally viewed as putting a limit to war profits and as aiding in the prevention of inflation. In considering the methods of their achievement it is necessary to take into account the existence and significance of other war-time policies. Primary among these is the policy of stimulating the production of goods deemed essential for the successful prosecution of the war.

The general bearing of this factor on the height of prices may be seen from the statements of Government officials who were actually engaged in the work of fixing prices during the war. Mr. Brookings, who was chairman of the Price Fixing Committee, stated to the representatives of the steel industry at a meeting on March 20, 1918:

Take the cost of producing ore, assemble it, and follow it around through the production of the different grades of steel. I find it difficult to justify in my mind the prices that exist today, but we have not that sort of a problem. We believe it necessary to stimulate production.¹

The dominant policy of the committee was, as Lt. Col. Robert H. Montgomery, its Army member, has said, "to stimulate production by one way or another."² Gen. Palmer E. Pierce, who was a member of the War Industries Board, which controlled prices before the organization of the Price Fixing Committee, testified as follows in the War Policies Commission hearings:

Senator ROBINSON. In your view, I assume the prime necessity is adequate supply?

General PIERCE. Yes, sir.

Senator ROBINSON. And prompt supply?

General PIERCE. There is no question about that.

Senator ROBINSON. Were the prices you fixed made with regard to that consideration?

General PIERCE. Yes, sir; and the protection of the Government.³

When Lieutenant Colonel Harris, who is director of the Planning Branch of the War Department, was asked in his appearance before this committee what policy he felt would be pursued in the event of another war, he testified:

If it relates to materials we have to have, and cannot get, we have got to put the prices high enough to draw out the required amount.⁴

¹ Minutes of the Price Fixing Committee, Mar. 20, 1918.

² Garrett, Government Control over Prices, War Industries Board Price Bulletin No. 3, p. 244.

³ 72d Cong., 1st sess., H. Doc. No. 163, p. 148.

⁴ Lieutenant Colonel Harris, Dec. 20, 1934.

I. PRICE CONTROL AS A MEANS OF ELIMINATING WAR PROFITS.

(1) VARYING COSTS OF INDUSTRY AND THE PROFITS OF LOW-COST PRODUCERS

In ordinary times, any industry in which one company does not completely monopolize the field, as in aluminum and nickel, contains producers whose costs vary. The causes of this variation rest in the inevitable differences between companies in degree of integration, advantage of natural resource, skill of labor, and efficiency of management. An even greater tendency toward cost dispersion arises from war, which brings in numbers of new producers who are faced with the alternative of using less efficient factors of production, constructing new facilities, or bidding existing facilities away from established companies.

Under these conditions of varying costs a single commodity price, set at a level which enables high-cost producers to exist, naturally results in excessive profits for low-cost producers. These profits increase as the war need for production becomes more pressing and a greater tendency expresses itself to increase the number of producers.

When the United States entered the World War, industry already contained many high-cost producers who had been encouraged by the inflated price level brought on by the European war activities. The price-control bodies, in attempting to retain their production and, if possible, add to it, announced a rule of fixing prices at the bulk line of cost of production. From its definition—

The term "bulk line" of production, as it came into use during the war, meant the indispensable amount of any commodity that the war program required should be produced, and the "bulk line" of cost meant the unit cost to produce the last unit lot of that requirement by the marginal producer.⁵

It is apparent that the rule simply meant that prices would be fixed at that point which would bring in what was deemed to be all the necessary production.

The amount of profits which could be gained in any industry whose prices were set by such a standard would, of course, be dependent upon the actual cost conditions in that industry. Particularly significant would be the extent of the difference in costs and the proportion of the industry producing at a low cost. In the following table of costs and production percentages, as determined by the Federal Trade Commission, it is possible to estimate how large both these factors were in the iron and steel industry:

⁵ Garrett, *op. cit.* p. 400.

Costs found by the Federal Trade Commission for September 1918 ^d

BEEHIVE COKE

[Government price \$6 per net ton]

	Production cost per gross ton
Companies producing up to 60 percent of total.....	\$2.93- \$4.44
Companies producing over—	
60 to 70 percent of total.....	4.44- 4.99
70 to 80 percent of total.....	4.99- 5.44
80 to 90 percent of total.....	5.44- 6.47
90 to 100 percent of total.....	6.47- 11.45

PIG IRON (BASIC)

[Government price \$32 per ton]

Companies producing up to 60 percent of total.....	\$18.14-\$22.06
Companies producing over—	
60 to 70 percent of total.....	22.06- 24.32
70 to 80 percent of total.....	24.32- 25.41
80 to 90 percent of total.....	25.41- 27.49
90 to 100 percent of total.....	27.49- 45.72

INGOTS (OPEN HEARTH)

[Government price \$73 per ton]

Companies producing up to 60 percent of total.....	\$30.60-\$33.42
Companies producing over—	
60 to 70 percent of total.....	33.42- 35.16
70 to 80 percent of total.....	35.16- 39.77
80 to 90 percent of total.....	39.77- 41.86
90 to 100 percent of total.....	41.86- 66.34

STRUCTURAL SHAPES

[Government price \$3 per 100 pounds; \$67.20 per gross ton]

Companies producing up to 60 percent of total.....	\$45.54-\$—
Companies producing over—	
60 to 70 percent of total.....	45.54- 49.37
70 to 80 percent of total.....	49.37- 52.07
80 to 90 percent of total.....	52.07- 57.69
90 to 100 percent of total.....	57.69- 76.79

PLATES—SHEARED

[Government price \$3.25 per 100 pounds; \$72.80 per gross ton]

Companies producing up to 60 percent of total.....	\$46.30-\$56.80
Companies producing over—	
60 to 70 percent of total.....	56.80- 59.56
70 to 80 percent of total.....	59.56- 66.28
80 to 90 percent of total.....	59.56- 66.28
90 to 100 percent of total.....	66.28- 82.25

MERCHANT BAR

[Government price \$3.50 per 100 pounds; \$78.40 per gross ton]

Companies producing up to 60 percent of total.....	\$41.82-\$48.74
Companies producing over—	
60 to 70 percent of total.....	48.45- 48.74
70 to 80 percent of total.....	48.74- 53.38
80 to 90 percent of total.....	53.38- 68.98
90 to 100 percent of total.....	68.98- 87.15

^d Garrett, op. cit., p. 404.

The figures show that at the set prices the lowest-cost producers were able to make extremely large profits. In the case of beehive coke, for instance, the \$6 price constituted a margin of \$3.07 or 104 percent over the low cost of \$2.93. Large profit percentages are also visible for the lowest-cost producers of the other commodities. The margins have been computed to be as follows: 76 percent for basic pig iron; 139 percent for open-hearth ingots; 48 percent for structural shapes; 57 percent for sheared plates; and 75 percent for merchant bar.

Furthermore, the cost conditions of the majority of the producers were such as to enable even the average producer to secure large profit margins from these prices. For 60 percent of the companies producing beehive coke, the fixed price constituted a profit margin of at least 35 percent. Computed percentages for the same proportion of the other industries follow: Basic pig iron, 45 percent; open-hearth ingots, 118 percent; structural shapes, 48 percent; sheared plates, 28 percent; and merchant bar, 62 percent.

Similarly wide profit margins for large proportions of the bituminous coal and beet-sugar industries may be seen in the charts facing page 58 and at page 59.

Just as the necessity for maintaining the marginal producer was found to be a major cause of high profits and prices during the World War, it will be found to have a good deal of significance for any evaluation of the effectiveness of the price ceiling proposal.

The proposal, as outlined by Mr. Baruch to this committee, would take the entire price structure existing on a pre-war day and set that up as a ceiling of maximum prices for the duration of the war. Operating in conjunction with special taxation it is claimed that war would thereby be prevented from being a profitable industry and its unpleasant aftermaths for future generations would also be forestalled:

Briefly, my proposal is that Congress, after it declares an emergency exists, shall authorize the President to clamp a ceiling down over the whole price structure in effect on or about the date of declaration of war, when there is a fair relationship among human activities and their rewards, and make it unlawful thereafter to charge a higher price for any service or thing. But, coincident with that, a fair-price commission shall be set up to make adjustments upward or downward as necessity may require. Money, like other things, would be controlled and directed, and told for what purpose it could be used and the charge for such use.

By heavily increasing the present peace taxes and placing an excess war-profit tax on all earnings above peace-time earnings, any war profits which might strain through the price-stabilization sieve would be captured, and thus war would be prevented from being a profitable industry. And, finally, the plan of "paying as you fight" would save generations unborn, as well as ourselves, untold misery.⁷

Provision would be made, however, for upward and downward price changes. Mr. Baruch made this very clear in his testimony before the War Policies Commission:

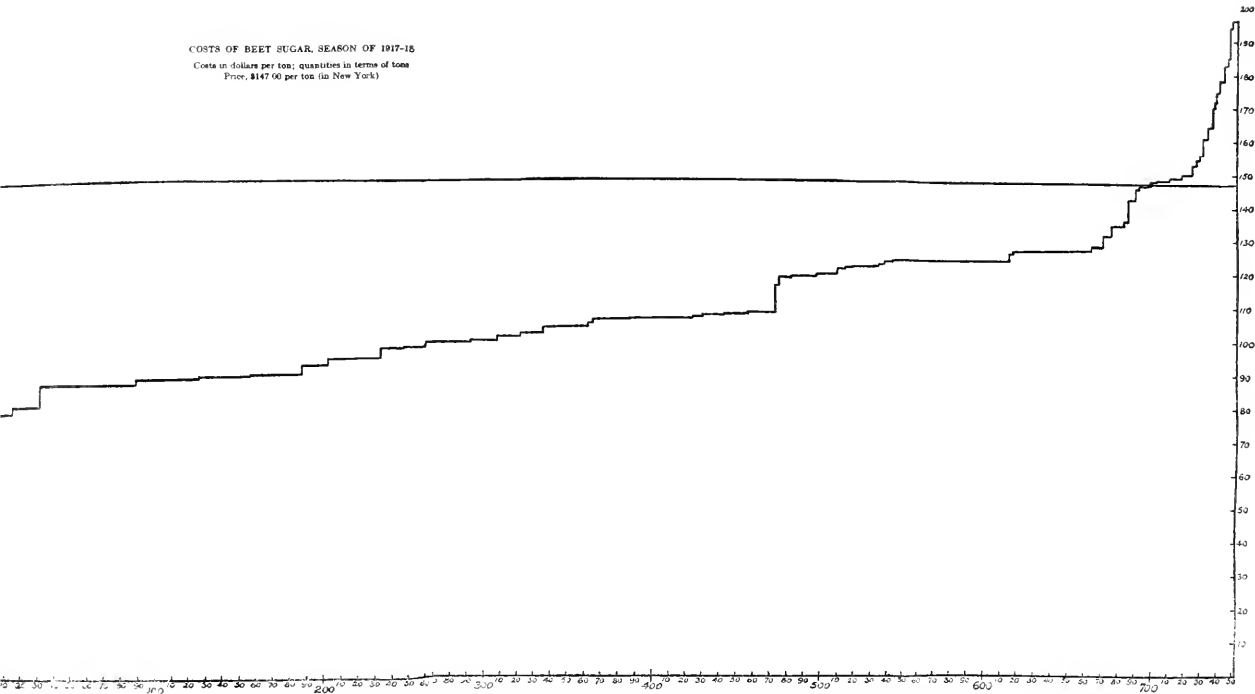
Some witnesses seem to think that, once this existing maximum is established there are to be no changes. I tried to make it clear that there is at once to be set up a competent tribunal to adjust any maximum prices, either upward or downward, whether to cure incidental injustice or hardship or to increase production. That, of course, will inject artificiality, but artificiality will be the exception and not the rule as would be the case with plans which propose fixing the prices of base commodities separately. On the other hand some witnesses say "He proposes to freeze prices and then immediately to unfreeze them." I propose to unfreeze nothing. I propose to adjust the few exceptions.⁸

⁷ Bernard M. Baruch, Mar. 27, 1935 (galley 49 BBQ).

⁸ 72d Cong., 1st sess., H. Doc. No. 163, p. 796.

COSTS OF BEET SUGAR, SEASON OF 1917-18

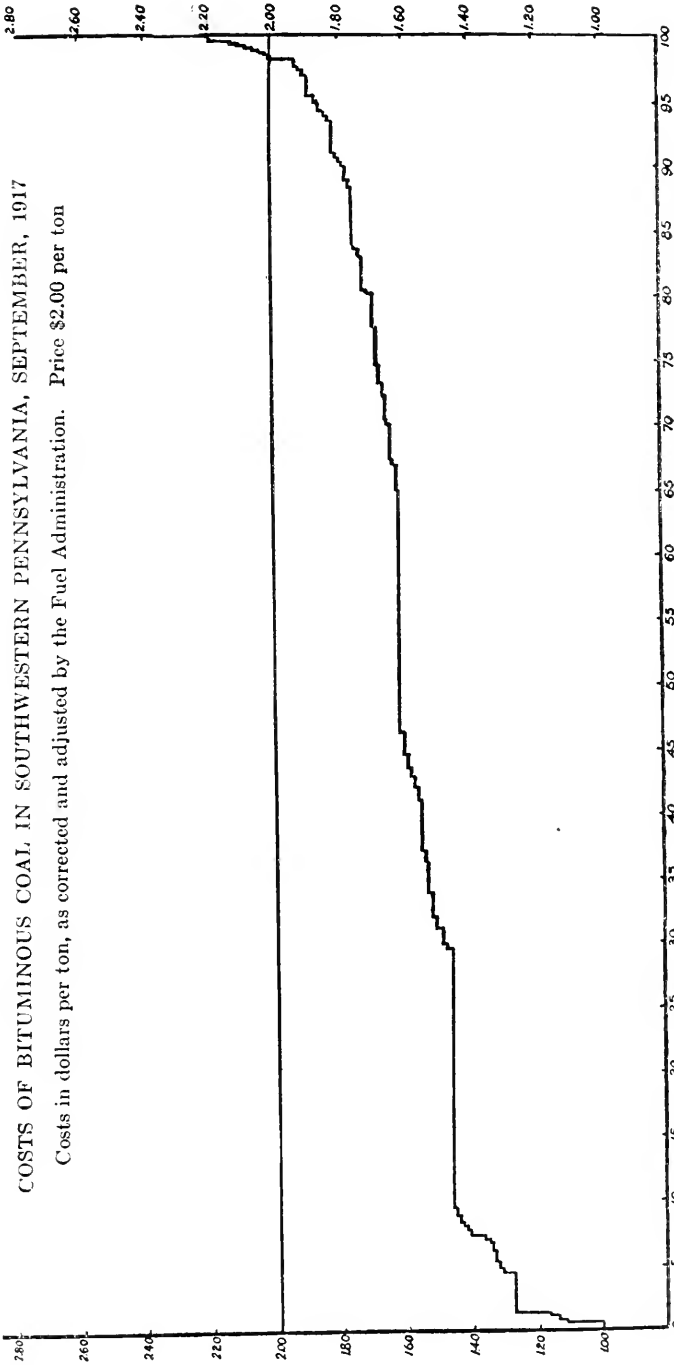
Costs in dollars per ton; quantities in terms of tons
Price, \$147.00 per ton (in New York)



(Source—Tausig, Price Fixing as seen by a Price Fixer Quarterly Journal of Economics Vol. 33, facing p. 218)

11570—35. (Face p. 58.)

PRICE-FIXING



(Source—Taussig op. cit. p. 221.)

The high cost producer situation would furnish an important occasion for such adjustment. Mr. Baruch in his testimony before this committee agreed that it would be necessary to raise prices to bring the marginal concerns into production. He stated that this was the method used in the last war and that he knew of no other way to meet this production problem:

Mr. HISS. Mr. Baruch, there are a few questions relating to the price-ceiling plan which you have discussed that I would like to ask you.

In time of war, is it not true, taking any industry in which there are marginal producers, high-cost producers, at that time not in production but whose production is needed, is it not true that the only way to bring them into production is by increasing the price of their product above the prevailing price?

Mr. BARUCH. There might be other devices, but that is the one into which we were forced during the war.

Mr. HISS. Directing it now toward a future time of war, do you know of any other way to bring in these marginal producers who at that time are not in production but whose production is needed?

Mr. BARUCH. No.

Mr. HISS. Then, in any price-ceiling scheme there will have to be exceptions over the prevailing prices for such industries?

Mr. BARUCH. There might be.

Mr. HISS. Is it not true that the reason the marginal producers are not in production is because they cannot produce profitably at the prevailing price level?

Mr. BARUCH. Yes, sir.⁹

Ascertaining the magnitude of this factor will aid in determining to what extent the price ceiling will vanish with the creation of openings in it through the medium of so-called exceptions.

Its fundamental strength is in the fact that the desire to prevent a price rise may be largely overshadowed by the need for production to which it is tied up. In explaining the importance of the marginal producer for the World War price fixing, Professor Taussig, who was a member of the Price Fixing Committee, has said:

The guiding factor was the necessity of maintaining output. The commodities dealt with were, to repeat, such as were wanted in great quantity by the Government. A large output was imperatively needed, or at least was supposed by the military authorities to be needed. This was the real justification for bolstering up the marginal concern and fixing a price at which the marginal concern could continue in business. This too was the ground for excluding from consideration the extraordinarily high costs of the producers at the extreme right of the curve, sporadic contributors who probably could not have operated with profit under any price conditions, and whose output would be no more and no less whether prices were fixed at a somewhat higher or somewhat lower figure. But the bulk line producers had to be maintained. Their output was needed, and the only way to secure it was to pay them a price which would induce the continuance of operations. It was this situation which caused the marginal producers to occupy such a dominant place in the price fixing operations.¹⁰

The draft report assembled by General Hugh S. Johnson for the chairman of the War Industries Board, now published as Committee Print No. 3, makes the point that in the light of the need for production prices in most cases would not be lowered if any part of the high cost output would thereby be lost:

* * * In most of these cases the need for increased production was so great that wherever increased demand had inflated a price the Government could not afford to fix a price so low as to cut off one single source of production. It mattered not, therefore, that some highly organized business showed a cost of production low beyond all proportion to some small and independent producer. The needs of our men in France would brook no price that would decrease the

⁹ Bernard M. Baruch, Mar. 29, 1935 (galley 77 BBQ).

¹⁰ Price Fixing as Seen by a Price Fixer, Quarterly Journal of Economics, vol. 33, p. 228.

output of even the high-cost producer. The proposition to fix a price on cost plus profit was explored and found utterly impracticable.¹¹

The number of commodities affected by the high-cost producer exception is closely correlated with the number of commodities whose production it would be deemed necessary to stimulate in time of war and it is necessary to recognize that the demand of the military forces is not confined to the direct implements of war such as ordnance, ships, and ammunition, but reaches also to the many items needed for the equipage and maintenance of the military forces. In each such industry an easy method of gaining additional production will be to increase prices to a level which will permit the existence of high cost producers.

Furthermore, the manufacturers who supply the military demands in the first instance must increase their purchases of raw materials. Consequently the price control body must stimulate the production of industries which are seemingly far removed from the theater of war. The consequent price increases of basic materials set up demands for price increases by the producers of nonwar materials who find the increases in the prices of basic materials reflected in their costs. Forces are thus set in motion throughout the entire price structure which will contend with the legislative declaration that prices shall not rise.

It is clear that the need for increasing the production of any commodity is not a matter susceptible of exact mathematical calculation. The military need, even though expressing itself as a more or less unified demand, varies from month to month according to the fortunes of war and the reaction of the authorities to them. It is also necessary to estimate the civilian demand, which is largely a matter of guesswork, because of the many different companies involved. Finally, account must be taken of the demand set up for raw materials by the manufacturers of finished products. Throughout the process of determination, judgment is the major factor.

This consideration was stressed by the War Industries Board in its reply to the Department of Justice's inquiry regarding the fixing of prices for cement.¹² The statement was drafted on March 4, 1918, at a meeting of the Board attended by Mr. Baruch, Mr. Brookings, Judge Lovett, Admiral Fletcher, and Mr. Ingels, and reads as follows:

MARCH 4, 1918.

HON. G. CARROLL TODD,
*Assistant to the Attorney General,
Department of Justice, Washington.*

DEAR SIR: Mr. Eugene Meyer, Jr., has referred to the War Industries Board your letter of the 13th ultimo addressed to him, and which came in his absence, about the cement industry; and I am directed by the Board to write you as follows:

The only documentary evidence upon which the War Industries Board acted in determining the price to be paid by the Government (not by the public) for cement was the report of the Federal Trade Commission, the report of Mr. Humphrey, and Mr. Meyer's recommendation, copies of all of which the Board understands are not [now?] in your possession. The War Industries Board in dealing with question[s?] of price of materials required by the Government considers a great variety of circumstances—cost data, changing element[s?] therein, former prices, especially the urgency of the need and availability of the needed supply, etc.; and without undertaking to weigh evidence as in judicial proceedings, the Board applied its business judgment and common sense in the light of all the

¹¹ Committee Print No. 3, p. 38.

¹² Exhibit no. 1274.

circumstances to the particular object in hand, which is to get what the Government needs when it is needed upon the fairest terms the Board is able to arrive at, and the time allowed, and the lights before it. Thus it dealt with the question of cement prices which it fixed for the first four months in 1918, and the Board is not disposed to reconsider the subject during that period, except as to prices that are to become effective thereafter.

The Board does not consider that its action should interfere in any way with any measures the Department of Justice may contemplate for the enforcement of any law that the cement producers or dealers may have violated at any time. The Board did not make any investigation as to any such violations. The Federal Trade Commission has made apparently an exhaustive study of the cement business. The War Industries Board did not conceive it to be the duty of the Board, and it had not the facilities to institute investigations to ascertain whether there was any illegal conspiracy in the trade. The result of its action in fixing prices in any case should be considered in the light of the circumstances under which and the purposes for which it acts—getting within the time required an adequate supply of war materials which the Government needs, and the price question though, always important, is after all not the first consideration, and there should always be considered the fact, as illustrated by its action with respect to steel prices, that it uses a very broad business judgment in a great emergency without regard to strictly Federal Trade Commission reports or other cost data.

Very respectfully,

(Signed) H. P. INGELS,
Acting Secretary.

Another factor conditioning the extent of rise is the nature of the cost information. Although figures were available in the World War it was found that for a variety of reasons, which are treated in a later section of this report, they were extremely unreliable.

Furthermore, there was such a wide variation in costs that the discretion of the price-fixing body was in good measure unlimited in its choice of the marginal cost. The following table of cost variations in the iron and steel industry shows how wide the cost range was, both in absolute dollar amounts and in percentages. It has been derived from the table appearing at page 57 of this report.

Range of costs from lowest-cost to highest-cost producer

Commodity	Lowest cost	Highest cost	Amount of difference	Percent range of highest cost to lowest cost
Beehive coke.....	\$2.93	\$11.45	\$8.52	230
Pig iron (basic).....	18.14	45.72	27.58	152
Ingots (open hearth).....	30.60	66.34	35.74	117
Structural shapes.....	45.54	76.79	31.25	69
Plates (sheared).....	46.30	82.25	35.95	78
Merchant bar.....	44.82	87.15	42.33	94

The judgment of the Price Fixing Committee in the revision of the copper price in the World War apparently was exercised largely in favor of the producers. In May 1918 the copper producers demanded an increase over the 23½-cent price fixed on September 21, 1917. The minutes of June 27, 1918, show that their primary arguments were based on the increase in freight charges which were shown in the testimony before this committee to amount to only one-fifth of a cent per pound¹³ and upon a wage increase which had not yet been granted. The revised price determined July 2, 1918, was set at 26 cents, an advance of 2½ cents over the September 1917 determination.

¹³ Bernard M. Baruch, Mar. 28, 1935 (galley 63BBQ).

The attitude of the Price Fixing Committee toward the industry was illustrated by Mr. Brooking's statement in the minutes of July 2, 1918:

Just as soon as this information commenced to come in on increased cost, we did try to protect the producer in asking the Government not to place any large orders of copper with the producer, because we would be responsible for that, and having it in mind, we feel that we ought to at least spare you all that.¹⁴

Envisaging price increase the Price Fixing Committee discouraged governmental purchases at the prevailing lower prices. Mr. Baruch agreed in his testimony that this action would result in increased cost to the Army and Navy:

Senator CLARK. Would you assume from the language in Mr. Brookings' statement, that that was the policy of the Price Fixing Committee, sometime in advance of fixing a higher price, to ask the Government to refrain from placing orders at the lower price?

Mr. BARUCH. If they did, it was a silly thing to do. It seems so stupid that it is hard to characterize it without getting hot about it.

Senator CLARK. It would seem to me that if that was the policy, it would have resulted in very great cost to the Government. The consumption of copper by the Government at that time was very large, and if the Government knew a month before that the price was going to be used, which was ultimately reached, and deliberately refrained from placing any orders at the lower price, it would naturally result in a greatly increased cost to the Army and Navy, would it not?

Mr. BARUCH. Unquestionably.¹⁵

The need for encouragement of production was another matter stressed by the copper representatives in their successful negotiations for a higher price. Mr. Cotton made the following statement at the May 22, 1918, meeting of the Price Fixing Committee:

Now I must say in all seriousness that we yield to no man or any set of men in our patriotic devotion to this country and this Nation in this great crisis. I am quite willing that all sorts of bouquets be thrown to various enterprises, but I will insist that the smaller copper producers in this country are just as patriotic as any portion of the industry itself. I was very happy to hear the chairman of this committee say this morning that you need copper and you need production. It was as we understood it—you have about a month's supply on hand. You have sold 119,000 tons for July delivery ahead of your production. That is perfectly evident. So it stands conceded upon the face of the record here that the United States needs to encourage the production of copper. That being so, it seems to me every angle of this question should be carefully considered by your committee in undertaking to represent a fair price for the metal.¹⁶

At the time of the armistice, however, the copper producers had a surplus stock on hand of 750,000,000 pounds, which represented 4 months' production.¹⁷ Furthermore, on June 20, 1918, the Federal Trade Commission reported that "In addition to the advantage gained in cost by many companies, attention is called to the fact that the output is being so materially increased that it is believed that the additional production will more than care for the loss of the production of several very high-cost producers who may find it necessary to close down during 1918."¹⁸ Disregarding this information, presented by a Government agency, the Price Fixing Committee increased the price ostensibly to stimulate production.

(a) *Ineffectiveness of excess-profits taxes to equalize profits of low-cost producers.*—In the World War it was impossible to overlook the fact that a policy of setting a price at cost of production plus a reasonable

¹⁴ Exhibit No. 1707.

¹⁵ Bernard M. Baruch, Mar. 28, 1935 (galley 64BBQ).

¹⁶ Exhibit No. 1711.

¹⁷ Bernard M. Baruch, Mar. 28, 1935 (galley 64 BBQ).

¹⁸ Exhibit No. 1712.

profit to the marginal company meant the acquisition of excessive profits by the large low-cost companies. In suggesting means for handling this dilemma, Judge Gary, of the United States Steel Corporation, counseled utilization of the excess-profits tax, but only in order to equalize the profits of the low-cost producer. It was his opinion that reasonable profits had to be assured to all manufacturers in order that they might "do their duty." At a meeting of the Price Fixing Committee with the steel representatives, held March 20, 1918, he stated:

Now you wish to arrive at a basis which will not permit those companies best integrated to receive any more than a reasonable profit and yet permit the smaller, less integrated plant, with high costs, to receive also a reasonable profit. I may say that the larger concerns, including our own, are willing to assist a few of the smaller plants if a practicable basis would be ascertained. This question is being studied. I don't know yet how it can be done. The chairman and some of his associates at least, are familiar with the views of our general committee as to what ought to be the basis of settling this question, and I must say I have been surprised that the Government representatives generally have not fully considered and adopted this basis. That is, by allowing every branch of industry to realize fair and liberal profits and then by taxation, in our case the excess-profits tax, leveling these profits. It seems to all of us so simple, so easy, that the Government should adopt that method. Increasing the excess-profits tax if it is desired so as to compel such a corporation as ours, for instance, to pay enough taxes to bring down its net results to practically the basis which would be fair and reasonable to the smaller manufacturers and at the same time allowing them to realize a good profit, fair profit. That would be entirely satisfactory to all of us and certainly ought to be satisfactory to the Government, because by adopting that you are maintaining prosperity to the company, and it would enable all manufacturers to realize reasonable profits. It would be an easy as well as logical method. It would protect all concerned, especially the Government. There must be reasonable profits in all lines of business. The manufacturers must have reasonable profits in order to do their duty.¹⁹

Mr. Brookings, of the Price-Fixing Committee, apparently entertained the same view:

At an executive session of the Price-Fixing Committee, held July 8, 1918, a discussion took place to determine to what extent, if any, the excess-profits tax should be considered in the fixing of prices. Mr. Brookings submitted a memorandum stating that the Price-Fixing Committee was created to stabilize values and prevent extortionately high prices. It was not intended, however, unnecessarily to depress values to a point where there would be little or no excess-profits tax. The policy of the committee should be, he believed, so to shape price that the less efficient or small producer would receive a fair profit, even though that gave the larger and more efficient producer a very liberal profit. It was expected that the new excess-profit tax would equalize this discrepancy by taking a larger proportion of the liberal profits earned.²⁰

The effect of such views was, of course, to shift the responsibility for the limitation of profits to a different administration—the Treasury—and to postpone the determination of how far profits should be limited. A corresponding tendency was thus set up for the Price-Fixing Committee not to be concerned overmuch about the height of prices from the point of view of limitation of profit. In Garrett, *Government Control Over Prices*, it is stated that—

The Price-Fixing Committee gave frank recognition to the fact that a determination to fix prices at the "bulk line" would give the low-cost producers enormously large profits. They relied, however, upon the Government getting those profits through the operation of the excess-profits tax. Chairman Brookings gave voice to the sentiment that it made no especial difference to the Government whether those profits were held in check by the committee or taken by tax.²¹

¹⁹ Minutes of the Price-Fixing Committee, Mar. 20, 1918.

²⁰ Garrett, *op. cit.*, p. 241.

²¹ P. 409.

It can be seen, however, that the World War tax legislation was not designed to accomplish even the restricted purpose of profits equalization. The taxation section of this report pointed out that the highest rate levied during the war was 80 percent of net income, less a large exemption equal to either the taxpayer's pre-war profits, or 10 percent of its invested capital, whichever amount was greater. Leaving 20 percent of the profits untaxed meant that higher prices and consequently higher earnings ensured larger absolute amounts of profits after tax and consequently higher ratios of earnings to capital. For example, at a price which enabled a company to earn \$1,000,000 profit, \$200,000 plus exemptions would be immune from tax. But if the price were raised so that earnings doubled to \$2,000,000, immune income would now amount to \$400,000—twice as high a ratio to capital. It would, therefore, make a good deal of difference to the low-cost producer whether his profits were checked by price control or were left to taxation.

Even more important than this consideration was the fact that once a low-cost company had in its possession the excessive profits rendered possible by the single price system, all the devices outlined in the taxation section of this report were available to retain them and to avoid payment of even the war-tax rates. The committee's study of the tax returns of a group of important companies²² shows that according to the final determination of the Bureau of Internal Revenue, taxes were paid of only 25.1 percent of their 1917 net taxable income and 34.9 percent of their 1918 income. Due account should be taken of the large amount of profits which do not appear as net taxable income because they were either deemed not to be income or not taxable by one device or another.²³

The committee's staff has compiled a table of the income and taxes of major steel companies, as finally determined by the Bureau of Internal Revenue. The amounts of tax collected in comparison with the net taxable income earned shows why steelmakers such as Judge Gary were content to have the Government rely upon taxation to remove excess profits. Bethlehem Steel Corporation, for instance, made the large sum of over \$61,000,000 in 1918, but it paid a tax of about \$14,500,000. In 1918, when 80 percent of war profits was supposed to be taken away, it paid taxes of only \$2,155,000 on its income of over \$16,000,000. It is indicative of the understatement in figures of net income before taxes, that although Bethlehem's net taxable income was decided by the Bureau of Internal Revenue to have decreased from 1917 to 1918 when higher rates went into effect, yet the company increased its dividend payments from \$8,100,000 in 1917 to \$9,300,000 in 1918, and the Republic Iron & Steel Co. paid the same dividends in 1918 as in 1917, although its net taxable income had decreased.

²² See appendix, p. 139.

²³ See supra, p. 27 et seq. for an analysis of the problems involved in computing taxable net income and see p. 44 et seq., for an analysis of some of the devices referred to in the text.

Final tax settlements of steel companies

Company	Year	Net income before taxes	Taxes	Net income after taxes	Dividends
Bethlehem Steel Corporation and subsidiaries ¹	1917	\$61,859,308	\$14,417,948	\$47,441,359	\$8,177,320
	1918	16,645,269	2,155,777	14,489,491	9,386,160
Republic Iron & Steel Co. and subsidiaries ²	1917	26,631,989	9,904,339	16,727,650	3,381,460
	1918	12,201,728	5,290,685	6,911,042	3,381,460
Jones & Laughlin Steel Co. ³	1917	51,358,012	20,081,271	31,276,741	(⁴)
	1918	32,767,507	17,090,598	15,676,908	(⁴)
Crucible Steel Co. of America and subsidiaries ⁵	1917	30,299,964	6,853,968	23,445,995	7,562,500
	1918	24,573,323	14,121,973	10,451,350	1,750,000
Otis Steel Co. ⁶	1917	9,989,355	4,654,689	5,334,666	(⁴)
	1918	5,820,047	3,716,275	2,103,772	(⁴)
Allegheny Steel Co. ⁷	1917	7,510,947	3,168,965	4,341,981	(⁴)
	1918	3,430,477	1,755,314	1,675,163	(⁴)
Lukens Steel Co. and subsidiaries ⁸	1917	8,639,477	2,839,156	5,800,320	(⁴)
	1918	6,181,250	1,588,422	4,592,827	629,000

¹ Exhibit No. 1740-A.² Exhibit No. 1740-D.³ Exhibit No. 1740-F.⁴ Dividend figures not available.⁵ Exhibit No. 1740-E—Tax computations for fiscal years ending Aug. 31, 1917, and Aug. 31, 1918.⁶ Exhibit No. 1740-C.⁷ Exhibit No. 1740-B.⁸ Exhibit No. 1738—Tax computations for fiscal years ending Oct. 31, 1917, and Oct. 31, 1918.

The failure of taxes to remove excessive profits is equally apparent in the copper industry. Kennecott Copper Corporation, a low-cost producer, whose 1917 costs were 8 cents per pound, compared with the average of 13½ cents per pound,²⁴ made more than \$22,000,000 profit in that year, of which the Government collected back only \$2,036,000.²⁵ Likewise the Inspiration Consolidated Copper Co., whose 1917 costs were 11½ cents,²⁶ made over \$9,000,000, of which it paid back to the Government less than \$1,000,000.²⁷

Final tax settlements of copper companies

Company	Year	Net income before taxes	Taxes	Net income after taxes	Dividends
Kennecott Copper Corporation ¹	1917	\$22,423,325	\$2,035,797	\$20,387,528	\$15,885,643
	1918	8,090,863	1,053,500	7,037,363	11,359,636
Ahmeek Mining Co. ²	1917	2,330,699	928,492	1,402,206	2,800,000
	1918	2,618,137	1,455,168	1,162,968	1,600,000
Inspiration Consolidated Copper Co. ³	1917	9,230,254	1,071,357	8,158,897	9,451,227
	1918	6,331,882	761,492	5,570,390	9,455,736
Phelps Dodge Corporation ⁴	1917	23,850,821	3,546,667	20,304,154	10,500,000
	1918	14,323,215	3,496,881	10,826,334	10,500,000
East Butte Copper Mining Co. ⁵	1917	1,268,788	69,071	1,199,717	831,731
	1918	167,170	19,325	147,844	632,774
Calumet and Hecla and Torch Lake Canal Co., Consolidated. ⁶	1917	13,293,597	2,872,773	10,420,824	8,500,000
	1918	4,142,465	706,167	3,436,298	5,500,000
Miami Copper Co. ⁷	1917	4,837,704	1,083,810	3,753,893	6,537,247
	1918	5,323,975	3,034,690	2,289,285	3,362,013

¹ Exhibit No. 1716.² Exhibit No. 1718.³ Exhibit No. 1719.⁴ Exhibit No. 1721.⁵ Exhibit No. 1722.⁶ Exhibit No. 1723.⁷ Exhibit No. 1720.

(b) *Impracticability of the individual prices proposal.*—Recognizing the inefficacy of the tax system, William B. Colver, the Federal Trade

²⁴ Exhibit No. 1712.²⁵ Exhibit No. 1716.²⁶ Exhibit No. 1712.²⁷ Exhibit No. 1719.

Commission member of the Price-Fixing Committee, suggested adoption of the individual prices proposal. Under this plan, instead of fixing a single price on the basis of the marginal cost producer for the entire industry, separate prices would be set for each producer on the basis of his individual costs. Lower-cost producers would therefore receive lower prices and there would be less profits for the tax system to collect back.

Although the proposal appeared to hold low-cost producers to reasonable profits, the almost insuperable difficulties of administration prevailed against its adoption. Primary among these was the necessity for checking the books of large numbers of producers in order to prevent the addition to profit by means of cost padding. R. H. Montgomery, also a member of the Price-Fixing Committee, believed that there were not enough accountants within the country to undertake this task. In a memorandum to the committee, he wrote:

Cannot be effectively administered, because it is expected that the machinery of control will include a system of reports and inspection emanating from hundreds of producers, who have every interest to overstate their costs. The available supply of skilled accountants in this country is exhausted. The present demand from legitimate sources greatly exceeds the supply. My familiarity with this matter leads me to object to setting up a system of control which is not operatively possible.²⁸

At pages 87-89 of this report the difficulties of auditing costs even where skilled men are available are noted.

Under this proposal there would also have been raised the problem of valuation since provision was made for taking account of cost differences which were due to the size of the investment. In his memorandum to the Price-Fixing Committee, Mr. Colver wrote:

Equity as between producers requires consideration of the amount of the investment and its character. For instance, it is often found that a low-furnace cost has only been obtained by the expense of a high investment per ton of output, while frequently a high-furnace cost may be coupled with a low investment. It is obvious that the application of a uniform unit profit without reasonable consideration and scrutiny of investment will be inequitable.²⁹

The inherent complexities of valuation which have been noted at pages 19-24 of this report further indicate that the results of actual administration of the proposal would probably have been very different from the description of its theoretical operation.

The provision for governmental pooling of individual production and resale under uniform prices in order to put all consumers on a uniform basis would also have raised difficult administrative problems. This provision, however, is essential to prevent (1) the instability of production on the part of high-cost producers who would be uncertain of customers at their higher-than-average prices and (2) the colossal administrative task of policing the requirement that low-cost producers must not receive, in the form of purchase price or rebate, the increased price which many buyers would be willing to pay. The plan contemplated the conduct of business on the usual basis, producers making deliveries directly to their customers but receiving their payment from the pool at their individual prices, while consumers paid the composite price to the pool. Where the product was in great demand, there would have arisen a tremendous task of

²⁸ Garrett, *op. cit.*, p. 386.

²⁹ *Ibid.*, p. 393.

policing industry to prevent direct payments to sellers at other than Government prices, and even where bills were routed through the Government pool of preventing the payment of rebates. In addition, it would have been necessary to create a central bookkeeping agency through which all the bills of transactions between individual buyers and sellers would pass. Obviously, if such a plan were applied to any large part of the country's industry, the central recording of every purchase and sale would cause in itself a strong tendency toward delay in industrial production.

Furthermore, theoretical limitation of per unit profits of low-cost producers by means of the lower prices supposedly guaranteed under this plan or under the price-ceiling scheme overlooks the tremendous profits which are gained by the war-time increase in the volume of business.

An increased turnover means greater profits because the same rate of earnings is being multiplied by the extent of the turn-over increase. Many of the most profitable peace-time businesses rely upon a low price with a small per unit profit because of the quantity sales that are thereby insured. To this increase in total volume of profits must be added the increased profit due to increase in the rate of profit which comes from the fact that increased war sales are procured with relatively little increased sales cost and the fact that where there has been idle capacity there is also relatively little increase in overhead costs.

As an example of the operation of these factors Mr. Baruch has cited a company which, if it increased its turn-over four times, would be able to increase its profits 830 percent of its normal profit of 10 percent on its invested capital; and even after paying an excess-profits tax of 80 percent would still retain earnings amounting to 160 percent of its normal profits:

Consider, for example, the simple case of a company capitalized for \$1,000,000, selling \$1,000,000 worth of goods annually, making 20-percent gross profit, or \$200,000 on its turn-over, and having \$100,000 of expenses of administration and selling, leaving a net profit of \$100,000, or 10 percent, on both its normal turn-over and its capital. Suppose also that 10 percent of its cost of manufacture, or \$80,000, are fixed overhead charges—depreciation, maintenance, supervision, taxes, etc. Then its costs for material and direct labor are \$720,000 for every million dollars' worth of goods it sells. Now, suppose that war comes and we need the full capacity of that plant. We give it orders for \$4,000,000 worth of goods, to be delivered in a single year. It has no increased selling and general administrative expense, because the demand is so great that no such effort is required. Neither do the fixed overhead elements of its manufacturing costs increase greatly—say, only to \$90,000. What happens to the profits of that plant? Its material and direct labor costs on its \$4,000,000 sales are \$2,880,000. To this it must add \$90,000 for fixed overhead charges in its factory and \$100,000 for general and administrative expense, making a total cost for goods sold of \$3,070,000. Its net profit is, therefore, \$930,000, or 930 percent,³⁰ of its normal profits in peace. It is making nearly 100 percent on its investment, and its net profit on turn-over has increased from 10 to 23 percent. Even if we assess a tax of 80 percent on the \$830,000 of excess over peace profit, that plant will still be making \$260,000, or 260 percent³¹ of its normal profits.

I want you particularly to note that this example considers no increase in price whatever.³²

(c) *Price regulation of monopoly business.*—Where excessive profits are gained by well integrated low-cost companies in nonmonopolistic fields of business it becomes exceedingly difficult to limit the profits

³⁰ Corrected to 830 percent.

³¹ Corrected to 160 percent.

³² War Policies Commission hearings, op. cit., p. 798.

of monopolies who may point to these other companies as the basis for a plea of uniformity of treatment and who may even invoke the Constitution on the ground that their property is being subjected to confiscation. Study of these industries in the last war shows that even with the reduced difficulty of administration, war profits were not limited.

(1) *The aluminum industry.*—In aluminum price fixing the complicating factor of high-cost producers was absent inasmuch as there was only one important operator, i. e., the Aluminum Co. of America. According to the report of the War Industries Board.³³

The industry in the United States is in the hands of one concern, the Aluminum Company of America, which owns numerous plants in the United States and one in Quebec, Canada. It is the sole producer of virgin metal, and it controls properties covering practically every step and process in the industry from the mining of bauxite ore through the finished castings and utensils.

The committee has found, however, that the single producer in this field had a consolidated net taxable income for the year 1917 of \$25,840,326 which was 40.8 percent of its consolidated invested capital. Of this profit a tax of \$9,114,909 was collected. Taxes in the year 1918 decreased to a sum of \$2,260,230. Net taxable income decreased to \$10,417,814 but income before amortization deductions was \$21,386,360,³⁴ and the production of aluminum by the company only changed from 129,860,592 pounds in 1917 to 124,724,924 in 1918.³⁵

The first price determination in the aluminum industry was in connection with the preparedness campaign. In April 1917, an agreement was entered into with the Government for the sale of 8,000,000 pounds of aluminum ingots at 27½ cents a pound.³⁶ The price was apparently fixed on the same basis as the remainder of the preparedness campaign, i. e., "to sell their own Government its war needs at pre-war prices."³⁷ It should be noted, however, that the 10-year average of prices from 1907 to 1917 of 25.543 cents was increased to 27½ cents because of a claimed increase in the cost of production³⁸ and that inclusion of the inflated values of the war years prior to our entry raised the price 7½ cents above the normal level of 20 cents prevailing before the commencement of the European war.³⁹

Furthermore, on the basis of the Federal Trade Commission's report that the cost of production of aluminum ingots was 15¼ cents in 1917,⁴⁰ a per-unit profit margin of more than 80 percent was obtainable. It must also be realized that this gift price applied only to a small percentage of the total primary aluminum production of the United States, which in 1917, was approximately 143,300,000 pounds.⁴¹

The bulk of production was sold at much higher prices. In September 1917 the Aluminum Co. agreed with the War Industries Board "to accept direct and indirect orders at the prevailing contract prices" which were 38 cents, provision being made, however, for refund by the company of any differences between this and the future fixed price.⁴²

³³ P. 148.

³⁴ Exhibit No. 1746.

³⁵ Aluminum Co. of America letter to the committee dated May 23, 1935, printed in appendix to that part of Hearings in which Exhibit No. 1746-B appears.

³⁶ Report of the War Industries Board, p. 149.

³⁷ *Ibid.*, p. 131.

³⁸ Exhibit no. 1747.

³⁹ In August 1914 the contract price of 98-99 percent aluminum was \$0.19 per pound and the open-market price was \$0.1983 per pound. War Industries Board Price Bulletin No. 34, p. 84.

⁴⁰ Exhibit no. 1747.

⁴¹ Exhibit no. 1746.

⁴² Report of the War Industries Board, p. 149.

On February 28, 1918, the price of ingots was fixed at 32 cents per pound, which represented a decrease of 6 cents from the prevailing contract price. The usual method of computing the price reduction from the spot price of 60 cents per pound creates an erroneous impression since most of the aluminum production was sold on a contract basis. Mr. Davis, president of the Aluminum Co., testified before the House Committee on Foreign Affairs on June 6, 1917, as follows:

In this way our entire product has been shipped and delivered to the United States consumers from the beginning of the war to the present time at prices in no case in excess of 37 cents a pound, and averaging, perhaps, about 32 cents a pound. The average price that we received for all of our products during the month of April 1917 just passed was 35 cents per pound.

You will see, therefore, that the statement or impression that we are selling our product to the United States consumers at 60 cents a pound is as erroneous as such a statement could possibly be.⁴³

On the basis of the 15¼-cent cost estimate of the Federal Trade Commission, there was a per-unit profit margin of more than 100 percent. But even this price was raised to 33 cents per pound on May 9, 1918.

We also find an allegation of the Government that the Aluminum Co. of America has not fulfilled its obligation in respect to refunding the difference between the contract and fixed prices. In a recent suit by the Aluminum Co. of America against the United States, the Government's counterclaim states that although a joint audit has settled that \$1,540,473 is the amount to be refunded, the Aluminum Co. has repaid \$263 directly and a similar amount indirectly.⁴⁴ To the extent that the Aluminum Co. succeeds in this course of action it will have nullified the attempt at price fixing.

One of the company's defenses to the counterclaim attempts to accomplish the same end by way of a constitutional objection. It contends that:

If these attempts [the price announcements of Feb. 28, 1918, and May 9, 1918] were price-fixing proclamations, and were intended to apply to contracts made prior to September 24, 1917, they would, with respect to such contracts, deprive the plaintiff of its property without due process of law and take the said property for public use without just compensation in violation of the fifth amendment to the United States.⁴⁵

although almost all the 1917 and 1918 deliveries had been contracted for prior to the commencement of price fixing. Committee Print No. 3 states:

The Aluminum Co. advanced its base price on contracts from 37 cents to 38 cents in March 1917, and it is stated that practically all of the metal for 1917 and 1918 deliveries was contracted for in March and April of the earlier year.⁴⁶

(2) *The nickel industry.*—The nickel industry is controlled by the International Nickel Co., according to the report of the War Industries Board—⁴⁷

The war required directly or indirectly nearly 90 percent of our nickel supply, but the problem of controlling the price and distribution was a very simple one,

⁴³ Exhibit no. 1747.

⁴⁴ Exhibit no. 1747.

⁴⁵ Exhibit no. 1745.

⁴⁷ P. 182.

⁴⁶ P. 152.

because the country's production is practically all in the hands of one company, the International Nickel Co. This company brings the raw material, in the form of "matte" and ore, from the Sudbury deposits, Ontario, Canada, and refines them at Bayonne, N. J. A small quantity of "matte" comes also from New Caledonia and from Tasmania.

Again the committee finds that even with the absence of a number of producers operating at varying costs and the consequent necessity for a high price to keep high-cost producers in operation, that the company having the monopoly in this field had a high net income, namely, \$13,992,729 in the year ended March 31, 1918, according to the final determination of the Bureau of Internal Revenue. Taxes in that period were \$3,131,422. The amount of profit taken away by taxation is represented in the decrease of the percentage of income to invested capital from 23 percent to 17.7 percent, a difference of 5.3 percent of invested capital. Dividends paid for the fiscal year ending March 31, 1918, were \$8,483,330.⁴⁸

The first price was agreed upon in August 1917. The figure of 40 cents per pound of ingot nickel was determined by reference to the price International Nickel was charging the Canadian Government. Apparently it was not felt that the United States should get the benefit of a price lower than the charge to the Allies. The minutes of the War Industries Board, August 17, 1917, reported:

Mr. Baruch presented a communication dated August 15 from the Ordnance Department, No. G-4701 7/11 relative to an arrangement with the nickel interests for supplying nickel to the Government at the same price as to the Canadian Government, and stated that the price of 40 cents was now offered by the Nickel interests.

It was moved and carried by the Board that this price should be considered satisfactory.⁴⁹

A Federal Trade Commission study shows that it cost International Nickel less than half of this price to produce ingot nickel, the exact amount being \$0.18786.⁵⁰

On January 8, 1918, a new schedule of prices was agreed upon. There are set forth the prices fixed by the War Industries Board and the costs of the International Nickel Co. as determined by the Federal Trade Commission:⁵¹

	Jan. 8, 1918 (prices per pound)	July 1917 (costs per pound)	February 1918 (costs per pound)
Ingot nickel	\$0.35	\$0.18786	\$0.2201
Electrolytic nickel.....	.30	.23787	.2072
Monel metal.....	.32	.17313	.2121

These prices prevailed for the remainder of the continuance of the war. Mr. Pope Yeatman, chief of the nonferrous metals section of the War Industries Board, sent a memorandum to Mr. Brookings, Chairman of the Price Fixing Committee, recommending that there be no downward revision in prices. He felt that the Federal trade figures of 26.58 cents based upon \$0.22 costs plus 10 percent allow-

⁴⁸ Exhibit No. 1750.

⁴⁹ Exhibit No. 1749.

⁵⁰ Ibid.

⁵¹ Ibid.

ance on the investment was entirely too small. The major factor in his argument was that, before the war, prices of 35 cents to 40 cents a pound were quoted. Even though these prices represented a margin of more than 100 percent of the cost, Mr. Yeatman thought that "while high prices have been received, there has been nothing savoring of profiteering."⁵²

The increased profits resulting from increased production were not thought by the Price Fixing Committee to be a factor justifying price decrease. Its attitude is represented in the following statement made by Mr. Brookings at the May 20, 1918, meeting:

Of course we know that our war needs have enormously increased the consumption of nickel. The Navy program and the Army program have required nickel for alloying certain steel and has doubled your production and has, of course, enormously increased your profits. We are not in an attitude of envying you your profits; we are more in the attitude of justifying them if we can. That is the way we approach these things.⁵³

The Canadian source of nickel represents an additional difficulty involved in attempting to control war profits, namely, those gained on goods produced in foreign countries. The costs of an American company may be increased by the simple device of increasing the price of the raw material as it is conveyed to it by the foreign branch. Determination of the foreign costs will in general depend upon the company's unverifiable statements.

(3) *The sulphur industry.*—During the war period, sulphur was sold to the Government at a price of \$22 per long ton, which was the uniform price quoted for every month from January 1913 to March 1916, when the first rise was registered.⁵⁴ The field was in the hands of only two companies, the Union Sulphur Co. and the Freeport Sulphur Co.

On August 6, 1917, a letter was sent to Mr. Henry Whiton, chairman of the committee on sulphur, at the direction of the Paymaster General of the Navy, asking for an opinion as to what constituted a reasonable price based upon cost of production rather than prevailing or pre-war market price. The letter reads in part as follows:

At the time of the last purchase of Navy requirements, the Union Sulphur Co. offered the amount required at a price of \$22.50 per ton. In view of the market prices current at that time and the fact that the offer of the Union Sulphur Co. was apparently based upon pre-war prices, the quotation of the Union Sulphur Co. was accepted and appreciated by the Navy.

Since that time, the Government's price policy has been more definitely established and, so far as it can now be interpreted, it is that manufacturers should supply the Government's demands at fair and just prices and in fact, authority has been granted to the Government to place orders with producers on such a basis.

The difficulty of determining what constitutes a fair and just price is obvious. However, the present policy is to base this price upon the cost of production plus a reasonable profit, considering industry as a whole; in other words, to judge of the reasonableness of prices from the standpoint of the cost of production rather than from the prevailing or previously current market prices. Under this plan, the purpose is to be as liberal as possible allowing manufacturers the benefit resulting from efficient methods of production, in case after [other?] domestic manufacturers in the same line produce at higher costs and provided that the products of these other manufacturers are required to meet Government needs.⁵⁵

⁵² Exhibit No. 1749.

⁵³ Exhibit No. 1747.

⁵⁴ War Industries Board Price Bulletin No. 45, Prices of Mineral Acids, p. 16.

⁵⁵ Exhibit No. 1751.

Union Sulphur Co.'s unit costs including depletion were \$6.82 per ton in 1917 according to its own income tax returns.⁵⁶ Application of the cost of production formula to this industry would thus have shown that at the Government price a monopoly company was making a per unit profit of more than 200 percent.

On August 20, 1917, the Paymaster General reiterated the Navy's request for a statement of the basis upon which it was decided by the committee on chemicals that \$22 per long ton was a reasonable price. The Paymaster wrote:

In view of the fact that the committee on chemicals has thoroughly canvassed the situation in regard to sulphur with a view of determining upon a reasonable price and believes that \$22 per long ton at the mines represents such a price, it is suggested that the committee formulate a statement of the basis upon which this conclusion was reached for the approval of the War Industries Board and for submission by the War Industries Board to the various departments for their formal approval.⁵⁷

In response to this request, Mr. Nichols, chairman of the committee on chemicals, explained:

In suggesting to the Union Sulphur Co. that they quote the Navy \$22 per ton f. o. b. mines, it was with the idea of carrying out exactly what is being done for everybody else except that no ordinary buyer is permitted to contract, not knowing what the Government needs will be. In the case of the Navy, I asked the Union Sulphur Co. to arrange in case a lower price was made for anyone that the Navy should have the benefit of it on the undelivered portions.⁵⁸

On September 7, 1917 Mr. Bingham, secretary of the War Industries Board, stated in a memorandum to Admiral Fletcher relating to the method by which the sulphur price was determined:

Second, asking how recommendations were arrived at, it was the opinion of the Board that it was unnecessary and impossible for the Board to present their reasons for decisions when making recommendations.⁵⁹

Finally on September 12, 1917, the War Industries Board wrote the Paymaster General that the price was fair but gave no reason for its determination:

This matter has been investigated by a committee, and it has been found that considering the condition of the market and other circumstances, that a price of \$22 per ton at the mine is as fair and just a price as can be obtained at present.⁶⁰

The tax statements of the Union Sulphur Co., however, show that in 1917, according to the final determination of the Bureau of Internal Revenue, its net taxable income was \$7,211,000, representing a return of 49 percent of its invested capital of which it paid \$2,613,000 in taxes. In 1918 its net taxable income according to its own report was \$10,568,000, representing a return of 58 percent of its invested capital, of which it paid taxes of \$5,794,000.⁶¹

(2) BUSINESS INTERESTS OF THE PRICE-FIXING ADMINISTRATION

In the last war there was a very close connection between business and the price-control administration, either through the actual presence of interested parties in governmental posts, or through the reli-

⁵⁶ Bernard M. Baruch, Mar. 29, 1935.

⁵⁷ Exhibit No. 1752.

⁵⁸ Exhibit No. 1753.

⁵⁹ Exhibit No. 1754.

⁶⁰ Exhibit No. 1755.

⁶¹ Exhibit No. 1755-A.

ance on business representatives for advice and information concerning their own industries. This condition, which must prevail if the persons who are in direction of industry in peacetime are to aid in its wartime control, results in the creation of a powerful counterpoise in the shape of double interest to the elimination of war profits. It is necessary to recognize that such devices as the formal severance of relationships or the discontinuance of company compensation for the duration of the war do not extinguish the real interest of the official in his company since in most cases he will return to it with the coming of peace. Furthermore, there will always be a strong tendency not to antagonize business connections which may have been built up over a long period of years and from which future benefit can be expected. Finally, as was the case in the World War, there is the very direct interest which comes from stock ownership in companies subject to regulation.

These definite interests, combined with the habits of thought and the personal associations of men who have spent their lives in private enterprise, make for a sympathetic attitude toward the complaints of those who remain in charge of industrial operations and a willingness to rely upon the information presented by industry.

The parent body of the many administrative agencies set up to control industry during the war was the Council of National Defense. Its creation was authorized in the Army Appropriation Act approved August 29, 1916, and its formal organization occurred on October 11, 1916. There were two bodies in the Council, one composed of 6 Cabinet Secretaries, and the other known as the Advisory Commission, composed of 7 private citizens. These latter were Bernard M. Baruch, Daniel Willard, Hollis Godfrey, Howard E. Coffin, Franklin H. Martin, Samuel Gompers, and Julius Rosenwald.

Divisions and committees were soon added to the Council. On February 28, 1917, a body known as the Munitions Standards Board was formed and a month later the General Munitions Board was organized with Frank A. Scott as chairman. According to the War Industries Board report,⁶² this body had the same chairman and included the same civilian personnel as the Munitions Standards Board.

The names and industrial connections of the members of this Board were read by Chairman Willard at the February 28, 1917, meeting of the Council of National Defense. They are as follows:

W. H. Vandervoort, Root & Vandervoort, builders of special machine tools and president of the Moline Automobile Co.

E. A. Deeds, formerly general manager of the National Cash Register Co., president of the Dayton Engineering Laboratories Co., and interested in many industrial activities.

Frank A. Scott, Warner & Swasey Co., Cleveland, manufacturers of automatic machinery and optical instruments.

Frank Pratt, General Electric Co., Schenectady.

Samuel Vauclain, Baldwin Locomotive Works, Remington, and Westinghouse Cos.

John E. Otterson, vice president, Winchester Arms Co.⁶³

⁶² P. 21.

⁶³ Exhibit No. 1245.

With the commencement of the speculative price rises which attended our entrance into the war, the Advisory Commission of the Council of National Defense formed a number of committees to deal with the commodities that were especially subject to war demand. The report of the War Industries Board states the purpose of the organization of these committees to have been the provision of a source of information for the Government as to the supply capacities of industry and a similar source for industry as to the needs of the Government. Also:

The question of fair prices and suitable methods for making equitable distribution of Government orders could be discussed by the Advisory Commission with these committee members, who were for the most part the most influential and best informed men in their respective lines of business.⁶⁴

It was found that the very qualities which made the members of the committees and the boards useful because of their experience also raised the question of double interest. For instance, at the June 5, 1917, meeting of the General Munitions Board the minutes state that Chairman Frank Scott retired when consideration was made of a communication from the Ordnance Department regarding a proposed arrangement with the Warner & Swasey Co. for the manufacture of 3,000 panoramic sights for the field artillery. The Board, proceeding on its deliberations in the absence of Mr. Scott, found the price to be fair and just and recommended that the orders be placed.⁶⁵

In the minutes of July 13, 1917, there is report of the Board's acceptance of the resignation of Mr. Hanson as chairman of the machine-gun committee. He tendered his resignation "due to his having accepted a position with the Colt's Patent Fire Arms Manufacturing Co., who were to receive and had received Government orders for machine guns."⁶⁶

A memorandum approved by the Secretary of War was presented at the June 20, 1917, meeting asking the Board to reconsider its recommendation of the Thompson-Starrett Co. to build the cantonment at Yaphank, Long Island, because of the interest in that company of W. A. Starrett who was Chairman of the Committee on Emergency Construction. The Board referred the matter of Mr. Starrett's interest in the Thompson-Starrett Co. and the George A. Fuller Co. for investigation. On the next day it was reported that his interest in the former company had ceased about 4 years ago and that his brother was the president of the latter.⁶⁷

The report of the War Industries Board hints at the difficulties which arose from the nature of the personnel of the committees that were aiding in the procurement work of the Government. It states that—

Dissatisfaction began to come to light on the part of firms not directly represented on the committees. The possible misconception of the position of the committees in appearing to represent, even in a vague sense, both the buying and selling interests, was very soon felt.⁶⁸

The Munitions Board itself began to respond to the criticism. On June 19, 1917, Major Stimpson was requested by the Board to investi-

⁶⁴ Report of the War Industries Board, p. 21.

⁶⁵ Exhibit No. 1251.

⁶⁶ *Ibid.*

⁶⁷ *Ibid.*

⁶⁸ Report of War Industries Board, p. 22.

gate new methods of organization which would settle the problem of double interest. It was said at the meeting:

This is particularly necessary in relationship to the membership on a board or subcommittee of a man who is actively interested in a concern which may benefit by the awarding of a contract concerning the recommendation of which the subcommittee or board has some authority.⁶⁹

However, on July 28, 1917, the minutes of the executive committee of the General Munitions Board contain a copy of a telegram which was sent by Mr. Julius Rosenwald, a member of the Board, to President Wilson. This registered vigorous protest against a provision in a pending bill which attempted to handle the problem of interest in corporations receiving Government orders by men in advisory capacity to the Government. The telegram follows:

DEAR MR. PRESIDENT. It is of the most vital importance that the rider in the food bill referring to the Advisory Commission and its method of securing supplies be stricken out. To cast suspicion on men in many industries who without exception have been eager to serve the Government rather than themselves will destroy a spirit which should be encouraged. The committees representing these industries have succeeded in instilling and securing a loyalty to the Government from many in their own lines that could never have been produced under the old system. Even at this early stage of the war the savings to the Government due to this desire to serve, runs into many tens of millions of dollars. Having been entrusted with a responsibility to protect and serve their Government interests a patriotism has been aroused in these men which is absolutely necessary to secure rapid production. It is probably impossible to devise any plan which is dishonesty proof but any man of standing in his profession or industry will sacrifice everything rather than be unfaithful to his trust. At any rate, such has been my experience with the men who have served as advisers to the Commission which I have had the honor to appoint. The present system should not be destroyed until a better one is found. If changes in method are desirable they can be made after proper investigation. It is vital that the cooperation which has already been established should be maintained and, furthermore, it is of greatest importance that confidence exist between Government and industry and that suspicion which has existed on the part of both be eliminated.⁷⁰

On July 28, 1917, the General Munitions Board was superseded by the War Industries Board. This action was taken "with the approval of the President", and its purpose was stated in the minutes of the meeting of the Council of National Defense as follows:

—to expedite the work of the Government, to furnish needed assistance to the departments engaged in making war purchases, to devolve clearly and definitely the important tasks indicated upon direct representatives of the Government not interested in commercial and industrial activities with which they will be called upon to deal, and to make clear that there is total disassociation of the industrial committees from the actual arrangement of purchases on behalf of the Government. It will lodge responsibility for effective action as definitely as is possible under existing law. It does not minimize or dispense with the splendid service which representatives of industry and labor have so unselfishly placed at the disposal of the Government.⁷¹

Unlike the practice in the change of the Munitions Standard Board to the General Munitions Board, some change was made in the personnel of the War Industries Board. Robert S. Brookings was named commissioner of finished products; Robert S. Lovett, priorities commissioner; Hugh A. Frayne, labor commissioner; Col. Palmer E. Pierce, Army representative; Rear Adm. T. F. Fletcher, Navy

⁶⁹ Exhibit No. 1251.

⁷⁰ *Ibid.*

⁷¹ Exhibit No. 1269.

representative; Bernard M. Baruch, commissioner of raw materials; and Frank A. Scott, chairman of the board.⁷²

In March 1918, the President separated the War Industries Board from the Council of National Defense and made it responsible directly to himself. Later in that same month the Price Fixing Committee was organized, also as an independent body reporting directly to the President. It is stated in the report of the War Industries Board⁷³ that, "It was the purpose of the President in choosing the committee to name on it no one having a personal financial interest in any result of the committee's recommendations."

The War Industries Board itself was divided into 57 commodity sections which were relied on for the information which was the basis of the development of policy and its administration of those policies. There were also created war-service committees to represent the various industries whose interests were involved before the War Industries Board. According to the report of the War Industries Board⁷⁴ "a war service committee spoke and acted as agent and representative of an industry and not as agent of the Board."

Judge Gary, of the United States Steel Co., however, did not think of the war service committee as representing industry alone. At the meeting of the Price Fixing Committee with the representatives of the iron ore, pig iron, and steel industries held June 21, 1918, he said;

Our committee does not appear here as an advocate, but more as a judge or as an advisory committee, having in consideration the interests of the Government and the interests of the steel producing and the iron producing fraternity.⁷⁵

When this statement was presented to Lieutenant Colonel Harris, Director of the Planning Branch of the War Department, he testified:

I do not know what he could mean by that. Certainly the detailed negotiations of that particular conference would show that Judge Gary was not a judge on that occasion.⁷⁶

In the minutes of the Price Fixing Committee March 20, 1918, Judge Gary stated his conception of the relationship between the Government and the manufacturers:

We are anxious to get at facts and figures, and to arrive at some conclusion that is fair and reasonable to all concerned. If it was a question of bargain only, then the manufacturers would be trying to secure as much as possible for their product, and your board would be endeavoring to secure as low prices for the Government, its Allies, and the general public as possible. But we don't feel like approaching the subject from any such point, and I am sure you don't.⁷⁷

That there was no dealing at arm's length between the Government and business was further indicated by the statements of Mr. Brookings at the same meeting made in response to Judge Gary's remarks:

We appreciate the attitude the steel people have always shown. We are in entire sympathy with practically all of the things you have stated. None of us are steel people and therefore we have been perfectly willing to be more or less guided by you, and I think we have been wisely guided.⁷⁸

⁷² Report of the War Industries Board, p. 22.

⁷³ P. 78.

⁷⁴ P. 103.

⁷⁵ Exhibit No. 1273.

⁷⁶ Lieut. Col. Harris, Dec. 14, 1934.

⁷⁷ Exhibit No. 1270.

⁷⁸ Ibid.

In fact the steel industry through a committee of the American Iron & Steel Institute was given the work of computing the price differentials for finished steel products. The Government only fixed the raw material prices.⁷⁹

An indication of the War Industries Board's varied work with complex problems, which offered opportunities for industrial members of war service committees to give advice which controlled decisions, may be gathered from the committee's study of the proceedings of the Board from December 10, 1917, to January 10, 1918. This covers only the meetings held by the Board and does not include the many problems that were presented to it outside of meetings. The following tabulation is of dates of meetings and of the subjects presented:⁸⁰

- December 10, 1917. Special meeting to consider steel prices with representatives of the steel industries.
- December 13, 1917. (1) Plan from war minerals committee to increase supply of pyrites; (2) arrangements covering royalties for Lewis machine gun patents; (3) compact for power for Muscle Shoals nitrate plant.
- December 14, 1917. Special meeting with copper industry to consider conditions as bearing on possible revision of prices.
- December 20, 1917. Royalty agreement with Flurschein for manufacture of T. N. A.
- December 21, 1917. Order for smokeless powder with Aetna Explosives Co.
- December 22, 1917. Price fixing of steel.
- December 24, 1917. Price fixing of steel.
- December 28, 1917. Price fixing of steel.
- January 2, 1918. (1) Attitude of Swiss manufacturers; (2) order for 30,000,000 pounds of smokeless powder from the Hercules Powder Co.; (3) action to secure necessary raw materials for explosive program; (4) request for assistance in securing explosives from Ordnance Department; (5) cooperation of Allies.
- January 4, 1918. (1) Crude T. N. T. explosives; (2) price fixing of nickel.
- January 9, 1918. (1) Price fixing of copper; (2) price fixing of aluminum.
- January 10, 1918. Price fixing of aluminum.

At the December 10, 1917, meeting to consider steel prices a large number of businessmen representing the steel industry were present. A list of the men, with their industrial connections, follows:

Representing the steel industry: F. N. Beegle, president, Union Drawn Steel Co., Pittsburgh, Pa.; James B. Bonner, representative, American Iron and Steel Institute, Washington; James A. Burdon, president, Burdon Iron Co., Troy, N. Y.; E. A. S. Clarke, president Lackawanna Steel Co., New York, N. Y.; A. C. Dinkey, president, Midvale Steel & Ordnance Corp., Philadelphia, Pa.; James A. Farrell, president United States Steel Corp., New York, N. Y.; W. J. Filbert, comptroller United States Steel Corp., New York, N. Y.; Judge E. H. Gary, chairman United States Steel Corp., New York, N. Y.; F. H. Gordon, gen. mgr. of sales, Lukens Steel Co., Coatesville, Pa.; E. G. Grace, president Bethlehem Steel Co., South Bethlehem, Pa.; W. S. Horner, president Nat'l Ass'n of Sheet & T. P. Mfrs., Pittsburgh, Pa.; A. F. Huston, president Lukens Steel Co., Coatesville, Pa.; Eli Joseph, member of firm, Joseph, Joseph & Bro., New York, N. Y.; Willis L. King, vice president Jones & Laughlin Steel Co., Pittsburgh, Pa.; W. Vernon Phillips, president, F. R. Phillips & Sons Co., Philadelphia, Pa.; Karl C. Roebing, gen. mgr. of sales, John A. Roebing's Sons Co., Trenton, N. J.; Chas. M. Schwab, chairman Bethlehem Steel Co., South Bethlehem, Pa.; John A. Topping, president Republic Iron & Steel Co., New York, N. Y.; Roy A. Rainey, Rainey Coke Co., New York, N. Y.; Scott Stewart, ass't to Roy A. Rainey, Rainey Coke Co., New York, N. Y.⁸¹

The chairman of the Board did not conceive of the function of these men as simply to plead the cause of the steel industry. He explained—

⁷⁹ See *infra*, pp. 104, 106.

⁸⁰ Exhibit No. 1271.

⁸¹ *Ibid.*

that while the cost data in course of preparation by the Federal Trade Commission was not yet at hand it had been felt advisable to call the representatives of the steel industry to Washington to discuss the general situation as brought about by the prices fixed and by general conditions in order that the Board could approach the subject more intelligently and a decision be arrived at more expeditiously when the Federal Trade Commission data came to hand, it being understood that in the terms of the previous price agreements it had been stipulated that prices would be reconsidered prior to January 1st, 1918.⁸²

Even when the cost information was available, the lack of familiarity of the Government officials with it encouraged reliance upon the interpretation of this information offered by industry. In Garrett, Government Control Over Prices, it is stated, "Neither the price-fixing committee nor the Food Administration to any extent availed themselves of a detached scientific committee whose business it was to analyze for them and interpret cost sheets prepared by the Federal Trade Commission."⁸³

In fact, there were occasions when the cost information of the industry regulated was substituted for that of the Federal Trade Commission. When the fixing of tanning prices was considered, the Federal Trade Commission's figures showed an average cost of 12 cents. Figures were presented by the industry showing costs of 13.5 cents. Prices were fixed on the basis suggested by the tanners.⁸⁴

The following table which has been prepared by this committee's staff indicates some of the industrial connections and sources of income of the principal officials concerned with the work of price fixing and the general control of industry during the war:

⁸² Exhibit No. 1271.

⁸³ P. 179.

⁸⁴ *Ibid.*, p. 321.

EXHIBIT No. 1338

War Industries Board and war-time agencies—principal officials

[Source: The information on the following chart has been taken from official War Industries Board and Counsel of National Defense records, from the Handbook of Economic Agencies during the World War, General Staff Planning Division, from the Directory of Directors, and from income-tax returns]

Name	Governmental position	Industrial connections	Sources of income during war years
Bernard M. Baruch.....	Mar. 17, 1917, to May 26, 1918, member advisory committee and chairman Raw Materials Division, Council of National Defense; May 27, 1918, to Jan. 1, 1919, chairman War Industries Board. Appointed various committees on raw materials. Member Allied Purchasing Commission Aug. 27, 1917, to Dec. 14, 1918.	Private banker and financier.....	1917—Atolia Mining Co., San Francisco, Calif. 1918—Returns destroyed by Internal Revenue Bureau. 1919—Returns destroyed by Internal Revenue Bureau.
Harry Payne Bingham.....	Apr. 6, 1917, to Jan. 7, 1918, expert, Council of National Defense, and secretary War Industries Board.	Director Cleveland Trust Co.	1917—Income from Lewis Cass Ledyard and Lewis Cass Ledyard, Jr., trustees; Northern Finance Co. 1918—Income from Lewis Cass Ledyard Trust and from Cleveland Trust Co.; profit from sale of securities, First National Bank, New York. 1919—Profit from sale of securities, Northern Finance Corporation; income from trusts of Lewis Cass Ledyard and Cleveland Trust Co.
Robert S. Brookings.....	Aug. 1, 1917, to May 27, 1918, expert, Council of National Defense. May 28, 1918, to February 28, 1919, Chairman Price Fixing Committee, War Industries Board. Member, Allied Purchasing Commission Aug. 27, 1917, to Dec. 14, 1918.	Vice president and director, St. Louis Union Trust Co., Supplies Wholesale Co., St. Louis; varied lumber interests.	1917—No record. 1918—No record. 1919—No record.
March F. Chase.....	Oct. 24, 1917, to May 27, 1918, expert, Council of National Defense. May 28, 1918, to Nov. 30, 1918, director, Explosives Division, War Industries Board.	Vice president, Commercial Acid Co., St. Louis, Mo.	1917—Salary, Commercial Acid Co.; income as consultant, American Zinc, Lead & Smelter Co.; Swansea Vale Smelter Co.; England & Burma Co.; profit from stocks and bonds. 1918—Destroyed. 1919—No record.
Clarence Dillon.....	May 28, 1918, to Dec. 31, 1918, assistant to Chairman War Industries Board.	Member, Dillon, Read & Co.; American Foreign Securities Corporation; Brazilian Traction, Light & Power Co.; Central Trust Co., New York; various oil companies and utilities.	1917—Income from partnership profit, Win. A. Read & Co.; interest in Newport Mining Co. contracts; profit from chemical contracts; dividends, Win. A. Read & Co.; directors' fees. 1918—Income as partner, Win. A. Read & Co.; Newport Mining Co.; stock dividends, corporations unknown. 1919—Income from stocks, Win. A. Read & Co.; Newport Mining Co.; director, Central Union Trust Co.

Rear Admiral F. F. Fletcher.....	Navy Department representative, War Industries Board; Priorities Board.	-----	1917—Salary, officer in U. S. Navy; profit from sale of stocks and bonds; dividends, corporations unknown. 1918—No record. 1919—Destroyed. 1917—Not in file. 1918—No record. 1919—No record.
Hugh Frayne.....	May 28, 1918, to Feb. 14, 1919, Chairman Labor Division, War Industries Board.	General organizer, American Federation of Labor.	1917—Salary, general manager, Philadelphia Co., Pittsburgh, Pa.; profit on stocks; dividends from corporations, unknown. 1918—Salary, general manager, Philadelphia Co.; dividends from stock in domestic corporations. 1919—Salary, President Atlantic Gulf Oil Corporation; trustee, American Metals Co.; director's fee, Gutley & Gillespie Oil Co.; profit various stock transactions; various cash dividends.
Joseph F. Guffey.....	Oct. 4, 1917, to (no record of termination of service), expert Raw Materials Division, Council of National Defense; Chief, Petroleum Section, War Industries Board.	Various oil companies and utilities.....	1917—Salary and bonus, Realty Guarantee & Trust Co.; dividends, corporations unknown. 1918—Destroyed. 1919—No record.
H. P. Ingels.....	May 28, 1917, to May 27, 1918, expert, Munitions Division, Council of National Defense. May 28, 1918, to Feb. 14, 1919, secretary, War Industries Board.	Second vice president, Realty Guaranty & Trust Co., Youngstown, Ohio.	1917—Salary, U. S. Army officer. 1918—No record. 1919—No record.
Brig. Gen. Hugh S. Johnson.....	War Department representative, War Industries Board.	Vice president and general manager International Harvester Co.	1917—Dividends from International Harvester Co.; salary, general manager, International Harvester Co. 1918—Destroyed. 1919—Salary, International Harvester Co.; salary, \$1, War Industries Board; director's fees; and dividends, corporations unknown.
Alexander Legge.....	May 28, 1918, to Feb. 28, 1919, Vice Chairman, War Industries Board; Chairman, Requirements Division; business manager, Allied Purchasing Commission until May 1, 1918.	Chairman, executive committee, Union Pacific R. R., director, various railroads; director, National City Bank; director, American International Corporation.	1917—No record. 1918—No record. 1919—No record.
Robert S. Lovett.....	Aug. 1, 1917, to Mar. 5, 1918, expert, Priorities Division, Council of National Defense. Member War Industries Board Purchasing Committee (Priorities). Committee on Transportation and Communications, etc., no dates given. Member, Allied Purchasing Commission Aug. 27, 1917, to Dec. 14, 1918.	President, Armour Fertilizer Works, Chicago, Ill.	1917—Salary, president, Armour Fertilizer Co.; profit from sale of United States Steel Corporation stock; dividends from other stocks. 1918—No record. 1919—Destroyed.
C. H. MacDowell.....	May 27, 1918, to Dec. 31, 1918, director, Chemical Division, War Industries Board.		

War Industries Board and war-time agencies—principal officials—Continued

Name	Governmental position	Industrial connections	Sources of income during war years
Engene Meyer	Apr. 6, 1917, to May 13, 1918, expert, Raw Materials Division, Council of National Defense; director, National War Savings Committee; chief, Nonferrous Metals Section, War Industries Board; director, War Finance Corporation.	Firm, Engene Meyer, Jr., & Co.; Alabama Marble Co., Alaska Juneau Gold Mining Co., Costen Oil & Gas Co.; Fidelity Phenix Fire Insurance Co.; Inspiration Consolidated Copper Co.; Mongollon Mines Co.; New York Stock Exchange; Pan American Petroleum & Transport Co.; Utah Copper Co.; W. Beekets Analine & Chemical Works, Inc.	1917—Sundry director's fees; dividend received from partnership, Engene Meyer, Jr., & Co. (taxpayer dealt in Anaconda Copper Co., American Smelters, W. Beekets Analine, Chemical Co., Kennicott Copper, Westinghouse Electric, Maxwell Motor, Inspiration Copper, Utah Copper, Royal Dutch Petroleum, United States Steel, American Can, American Radiator); dividends from Anaconda Copper, American Smelters, Kennicott Copper, Pan American Petroleum, Utah Copper, Westinghouse Electric, Inspiration Copper, United States Steel, American Radiator. 1918—Income from War Finance Corporation, salary; income from brokerage business; dividends from domestic corporation stock; dealt in Anaconda Copper, Inspiration Copper, Utah Copper, Westinghouse Electric dividends from Pan American Petroleum, Inspiration Copper, Westinghouse Electric, Anaconda Copper, Utah Copper, American Radiator, National Analine. 1919—Income from business, banker and broker; salary, managing director War Finance Corporation; dividends from stocks of domestic corporations; dealt in Anaconda Copper, Analine Frederick, Westinghouse Electric, War Finance; dividends from Utah Copper, American Radiator, National Analine, Pan-American, Westinghouse, Fisher Body, Pierce-Arrow, Anaconda.
Robert H. Montgomery	Board of Appraisers, War Department; member, Price Fixing Committee, War Industries Board, representing the Army.	Member, Lybrand, Ross Bros. & Montgomery, director, Acceptance Corporation; American Taxi-Meter Co.; Eniz Motor Patents Corporation; Lane Bryant, Inc.; Mitchell Motor Car Co.; R. M. Owen & Co. Member of firm, Otis & Co., Cleveland, Ohio; various industries; director, Cleveland Life Insurance Co.; member, Cleveland Stock Exchange.	1917—Income from partnership of Lybrand Ross Bros. & Montgomery; dividends from a fund accumulated in 1917. 1918—Income from Lybrand Ross Bros. & Montgomery and U. S. Army. 1919—Income from Lybrand Ross Bros. & Montgomery and U. S. Army.
Charles A. Otis	May 15, 1918, to May 27, 1918, expert, Council of National Defense. May 28, 1918, to Dec. 9, 1918, expert, Finished Products Division, War Industries Board; Chief, Resources and Conversion Section, War Industries Board.	Member, Lybrand, Ross Bros. & Montgomery, director, Acceptance Corporation; American Taxi-Meter Co.; Eniz Motor Patents Corporation; Lane Bryant, Inc.; Mitchell Motor Car Co.; R. M. Owen & Co. Member of firm, Otis & Co., Cleveland, Ohio; various industries; director, Cleveland Life Insurance Co.; member, Cleveland Stock Exchange.	1917—Income from partnership of Lybrand Ross Bros. & Montgomery; dividends from a fund accumulated in 1917. 1918—Income from Lybrand Ross Bros. & Montgomery and U. S. Army. 1919—Income from Lybrand Ross Bros. & Montgomery and U. S. Army.
George N. Peek	Dec. 5, 1917, to May 27, 1918, expert, Council of National Defense. May 28, 1918, to Jan. 31, 1919, Commissioner, Finished Products Division, War Industries Board. May 28, 1918, to Jan. 14, 1919, Administrator, Steel Division, War Industries Board.	Vice president, Deere & Co., Moline, Ill.	1918—Destroyed. 1919—Income as partner, Otis & Co.; salary president, Otis-Ito Mines Co., Colorado Springs, Colo.; dividends and director's fees; dividends from Chandler Motors, Otis-Ito Mines, National Car Wheel, Producers & Refiners Co., various banks, and partnership. 1917—Salary, Deere & Co., dividends accumulated. 1918—Destroyed. 1919—Salary, Deere & Co., dividends accumulated.
J. L. Replogle	May 28, 1918, to Jan. 14, 1919, Administrator, Steel Division, War Industries Board.	American Vanadium Co.; Wharton Steel Co.; and railroads.	1917—Not in files. 1918—No record. 1919—No record.

Albert C. Ritchie.....	June 3, 1918, to (no record of termination of service) expert, Administrative Division, War Industries Board; general counsel, War Industries Board.	1916-17—Firm of C. H. & J. A. Young, 76 William Street, New York.	1917—Income from law business, Ritchie & Janney, Baltimore, Md.; professor, University of Maryland; dividends, companies unknown; salary, attorney general of Maryland. 1918—Salary, attorney general of Maryland; income from law business; salary, counsel, War Industries Board; professor, University of Maryland; dividends, corporations unknown. 1919—Salary, attorney general of Maryland; income from law business; salary, War Industries Board; dividends from stock or personal service corporations. 1917—Warner-Swasey Co., Cleveland Trust Co., Bank of Commerce. 1918—Sources of income, salaries, director's fees, and dividends Warner-Swasey Co., Cleveland Trust Co., Union Commerce National Bank. 1919—Sources of income, salaries and dividends Warner-Swasey Co., Union Commerce National Bank, Cleveland Trust Co., The White Co. 1917—Income from L. L. Summers, engineers; profit on stock sales. 1918—No record. 1919—Income from engineering services.
Frank A. Scott.....	Aug. 1, 1917, to Oct. 26, 1917, Chairman, Munitions Standards Board; Chairman, General Industries Board; Chairman, War Industries Board of the Council of National Defense, until Oct. 26, 1917; Chairman, Clearance Committee.	Vice president Warner & Swasey Co., Cleveland, Ohio; Cleveland Trust Co.	1917—Salaries, Baldwin Locomotive Works, Standard Steel Works; director's fees; profit from sale of land to Baldwin Locomotive Works; income from unimproved land of Edlystone Ammunition Corporation; dividends from stock in domestic corporations through Philadelphia Trust Co., agent; deal in Midvale Steel and Lima Locomotive. 1918—Salary, Baldwin Locomotive Works and Standard Steel Works; dividends, director's fees. 1919—Salary and director's fees, Baldwin Locomotive Works, Standard Steel Works, Cambria Steel, Westinghouse, Union Oil, Philadelphia Trust, Philadelphia National Bank; income from land through J. P. Morgan & Co., Edlystone, Pa.; dividends, corporations unknown. 1917—Dividends and salaries. 1918—Dividends and salaries. 1919—Dividends and salaries.
L. L. Summers.....	Mar. 28, 1917, to May 27, 1918, expert, General Munitions Board; Council of National Defense, May 28, 1918, to July 25, 1918, expert, Chemicals and Explosives Division, War Industries Board; Chairman, Foreign Mission.	L. L. Summers & Co., New York, N. Y.	1917—No record. 1918—No record. 1919—No record.
Samuel Vauchain.....	Mar. 17, 1917 to (no record of termination of service) member Munitions Standards Board; Chairman, Committee on Army and Navy Artillery, General Munitions Board; Member Committee on Transportation and Communication; member, Cooperative Committee on Locomotives (his last position came under his duties as Chairman of Advisory Commission on Plants and Munitions).	Senior vice president, Baldwin Locomotive Works; Midvale Steel & Ordnance Co.	1917—Salaries, Baldwin Locomotive Works, Standard Steel Works; director's fees; profit from sale of land to Baldwin Locomotive Works; income from unimproved land of Edlystone Ammunition Corporation; dividends from stock in domestic corporations through Philadelphia Trust Co., agent; deal in Midvale Steel and Lima Locomotive. 1918—Salary, Baldwin Locomotive Works and Standard Steel Works; dividends, director's fees. 1919—Salary and director's fees, Baldwin Locomotive Works, Standard Steel Works, Cambria Steel, Westinghouse, Union Oil, Philadelphia Trust, Philadelphia National Bank; income from land through J. P. Morgan & Co., Edlystone, Pa.; dividends, corporations unknown. 1917—Dividends and salaries. 1918—Dividends and salaries. 1919—Dividends and salaries.
Daniel Willard.....	Oct. 11, 1916, to Jan. 11, 1918, member Advisory Commission, member ex officio executive committee, Council of National Defense; chairman Committee on Transportation and Communication, chairman War Industries Board.	Officer and director, various railroads; Baltimore & Ohio, etc.	1917—No record. 1918—No record. 1919—No record.
Pope Yeatman.....	Nov. 8, 1917, to May 27, 1918, expert, Council of National Defense, May 28, 1918, to Jan. 4, 1919, expert, Nonferrous Metals Section, War Industries Board.	Consulting engineer, New York, N. Y.; Chile Copper Co. of Delaware.	1917—No record. 1918—No record. 1919—No record.

(3) DIFFICULTIES OF COST DETERMINATIONS

The policy of setting prices at cost of production plus a reasonable profit involves the necessity of procuring accurate cost information. Profits and prices increase as unjustifiable additions to cost are allowed and failure to note decreases in cost persists. The opportunities for such errors are numerous.

(a) *The necessity for estimating future costs.*—Prices must be set for a substantial period of time in the future since it is obviously impossible from the standpoint of Government and business alike to have continued price redeterminations. It is therefore necessary for the Government body to take account of probable future changes in cost, upon which the price is supposedly based. In doing so, it should be recognized that there will be at least as great force in the maintenance of production contention as in the motive to limit profits and inflation, especially since producers can point to the general condition of increasing war-time cost.

Price fixing for the aluminum industry in the World War indicates the tendency of price-control bodies to err on the side of generosity. At a meeting of the Price Fixing Committee held May 9, 1918, Mr. Brookings said:

We felt after hearing all Mr. Davis [president of the Aluminum Co. of America] had to say about it, and taking into consideration the probable increase as raises [sic] were going up, and we fixed the price at 32 cents.⁵⁵

Since the costs of the Aluminum Co., practically the only producer, were 17½ cents a pound by their own statement⁵⁶ and 15¼ cents according to the Federal Trade Commission,⁵⁷ this price of 32 cents a pound was certainly designed to cover any probable increases in costs.

With this consideration in mind, it becomes very important that cost figures be as recent as possible. Yet we find that in the World War, according to the chairman of the Price Fixing Committee, reliable figures could not be obtained for a period closer than 2 months prior to the Committee's meeting. Mr. Brookings said at a meeting with the copper representatives:

We have gone into that very exhaustively and as I have explained to you, we have had the cost sheets for the month of March; that is the latest month we could get; we never can bring figures much closer than 60 days to a meeting of this kind if we get reliable figures.⁵⁸

Where a single price is to be determined, it is necessary to obtain figures of the proportion of the output coming in at the various costs in order to determine the point of marginal production. According to the report of the War Industries Board, the time required for the completion of such studies was in some cases more than 3 months:⁵⁹

As the exigencies of the day pointed to industry after industry as necessary fields for the exercise of price control, the Federal Trade Commission was invited to assign to each a corps of these experts to investigate and report on the costs of production. The studies usually extended to all producing plants, or where this was impracticable, to a large number of typical plants, from the lowest to the highest cost producers, and their prosecution required usually from 1 to 3 or more months.

It should be recognized that these time estimates were for the relatively limited scope of price fixing in the World War. Retail prices,

⁵⁵ Minutes of Price Fixing Committee, May 9, 1918.

⁵⁶ *Ibid.*, Jan. 9, 1918.

⁵⁷ *Ibid.*, May 9, 1918.

⁵⁸ *Ibid.*, May 22, 1918.

⁵⁹ Report of War Industries Board, p. 76.

with the exception of food and fuel, were generally unregulated⁹⁰ and in the field of wholesale prices only 573 of the 1,366 commodities comprising the War Industries Board Price Index, were subject to control at the termination of the war.⁹¹ Furthermore, in the case of iron and steel, the Government only set the prices of the basic raw materials. It left the task of determining thousands of price differentials for the finished products to the American Iron and Steel Institute.⁹² Obviously, if a scheme such as the suggested price ceiling were adopted, the delay would be multiplied many times over.

(b) *Cost padding*.—In addition to bald misstatements of amounts, it is possible to manipulate accounts so that what normally appears on the financial sheet as profit is converted into cost. Inventories may be over-valued and depreciation reserves increased to levels which are distinctly not usual.

On other cost items, padding enables business to reap a double advantage at the expense of the Government. Extravagant increases in salary are made to justify price advances, at the same time that the recipients are gaining exceptional benefits therefrom; similarly new construction of capital facilities is accounted for as an operating cost of making repairs.

The incentive to engage in this type of practice is especially strong where the individual price system is used, as was the case in the World War Food Administration, because of the direct connection between the individual producer's price and cost. This increases with impairment of the possibility of effective check-up, and where there is no auditing of cost records whatever, manufacturers can, of course, use these devices with impunity. Surprising as it may seem, the Milling Division of the Food Administration at one time refused to avail itself of the independent auditing facilities of the Federal Trade Commission because it—

took the view that it was not its business to police the industry and that to discipline millers or to attempt anything of the sort would perhaps defeat that spirit of voluntary cooperation which it was anxious to develop.⁹³

The result has been described as follows:

Not a few millers took advantage of the situation and loaded their cost reports with improper items. Some came to believe that they would never be investigated or molested if they should pad their cost reports. Such items as new construction and equipment, largely increased salaries to officers (in some cases made retroactive to include a fiscal period closed before the beginning of Food Administration control), bad debts of ancient standing, excessive depreciation charges, losses on miscellaneous outside investments, etc., were added to current costs of production and so charged to the consuming public. Under the conditions of demand which then existed prices inflated in this way could be easily obtained for the flour; in fact, flour could be sold for almost any price limited only by the flexibility of the seller's conscience.⁹⁴

In the case of the steel industry, where a single price was set, the Federal Trade Commission was able to make only a limited cost study directly from the books of companies. This inquiry was begun in June 1917 and was confined to the question of the costs of plates and shapes. It was also limited to the few large companies which were responsible for the greater part of the country's steel

⁹⁰ Garrett, *op. cit.*, p. 550.

⁹¹ *Ibid.*, p. 417.

⁹² *Ibid.*, p. 267.

⁹³ Wilfred Eldred, *Wheat and Flour Trade, 1917-18*, *Quarterly Journal of Economics*, vol. 33, p. 47.

⁹⁴ *Ibid.*, p. 47.

capacity. However, it was not until September 8, 1917, that a brief summary report was made to the President.⁹⁵

Thereafter the Government relied primarily on the monthly cost sheets that were sent in by the companies. The plan of ascertaining costs directly from the books was ruled out by the practical circumstances of the war. The necessity for speed in handling a great volume of work—the Commission received over 5,000 cost sheets per month—also restricted the process of checking up on the accuracy of the cost sheets. It was only in the cases of important high-cost companies, where “the figures seemed as if they might possibly be inaccurate”,⁹⁶ that the Commission asked explanation or correction by correspondence. Comparison of the figures on the sheets with those on the books of account was probably confined to an even smaller number of cases.

That reliance simply on the uncorroborated statement of the producers would result in a general tendency to overstatement of cost and understatement of profit may be seen from the fact that companies urged higher prices on the ground of inability to profit from the low levels, although later check-ups showed high earnings. The Federal Trade Commission letter of June 1918 on profiteering stated:

Recently, mills in class 3 made objection that the Government prices were too low for them. A special examination of their profits by the Federal Trade Commission showed that in almost every case these objecting mills were enjoying unusual returns. The following table of percentage of return on investment in 10 mills in class 3 will show the profits in 1917:⁹⁷

Alan Wood Iron & Steel Co.....	52.63
Allegheny Steel Co.....	78.92
American Tube & Stamping Co.....	40.03
Central Iron & Steel Co.....	71.35
Eastern Steel Co.....	30.24
Forged Steel Wheel Co.....	105.40
Follansbee Bros. Co.....	112.48
Nagle Steel Co.....	319.67
West Penn Steel Co.....	159.01
West Leechburg Steel Co.....	109.05

At a meeting of the Price-Fixing Committee with the copper producers, Mr. Brookings made the unqualified statement that his figures were absolutely contrary to those of the industry every time the latter were presented:

We told you the figures were so conflicting that we had little confidence in them. We are going to get the facts; we are going to find some ways and means of taking care of the small producer. We want information. Every time you presented anything, I presented other figures that were absolutely contrary, based upon such information as we had on some of these low-cost producers—based upon the conditions as they have existed for years as well as they exist today.⁹⁸

The tendency to shape figures with an eye to the necessities of Government regulation is illustrated by the following letter which passed between the members of Swift & Co.:⁹⁹

CHICAGO, November 26, 1917.

Mr. EDWARD F. SWIFT, second floor:

We have had a virtual statement from Mr. Cotton that the Government expects to establish profit control in the leather industry. With this notice, I think we should at least consider the advisability of reappraising the properties of the

⁹⁵ Federal Trade Commission Report on War-Time Profits and Costs of the Steel Industry, p. 44.

⁹⁶ *Ibid.*

⁹⁷ 65th Cong., 2d sess., S. Doc. No. 248, p. 9.

⁹⁸ Exhibit No. 1711.

⁹⁹ 65th Cong., 2d sess., S. Doc. No. 248, pp. 16 and 17.

following companies: A. C. Lawrence Leather Co., National Calfskin Co., Winchester Tannery Co., St. Paul Tannery Co., Ashland Leather Co., St. Joseph Tanning Co. (in which we have only 50 percent ownership).

If it is agreeable to you, will arrange with Mr. Moon to go into the matter and submit figures. Awaiting your reply,

LOUIS F. SWIFT.

I approve if done quietly and promptly.

L. F. S. (Sic)

Even where the Government made strenuous attempts to audit and check the costs stated by business, the process of auditing was found to be difficult, slow and expensive. As an indication of this, the experience in checking the Bethlehem Shipbuilding Company's books in regard to its war-time contracts with the Emergency Fleet Corporation may be cited. The announced policy of the management of the parent company, the Bethlehem Steel Corporation, was one of cooperation with the Government auditors. The following situation, however, prevailed at the shipbuilding company's Harlan plant located in Wilmington, Del., according to the final report of the Government auditor:¹

The working conditions at this plant were very unsatisfactory.

The works accountant was far from even being agreeable and his assistance during the whole period of reaudit was practically useless and of no value whatever. The writer cannot recall even one instance where anything but misleading replies were given to questions asked pertaining to a proper solution of the various questionable conditions that were brought to light throughout the entire course of the reaudit. * * *

Certain valuable cost records pertinent to our needs on the overhead audit were withheld, some were never handed over, and others given after we were forced to build up the costs from amounts shown on controlling-journal vouchers.

Of those cost records which we were unable to obtain, the entire stores requisitions for the years 1916 and 1917 and a part of 1918, 1919, and 1920, totaling about \$30,000, were an outstanding feature.

Of those records which the contractor withheld until we had completed our build-up, the following were the most important:

1. Detail cost ledger for repair and renewal orders.
2. Contractors' detailed statement of items credited cost and charged disallowed cost.

The time employed to work up these two features practically covered a period of six months for each of three auditors. This is a conservative estimate.

Many journal entries were made without any explanatory reference; this feature consumed considerable time in order to determine the true nature of such entries; working papers showing detail were evidently destroyed; in fact Bethlehem relied on memory to give an explanation of these entries. Other entries purporting a description were entirely misleading.

Even if there had been active cooperation on the part of all the company officials, an effective audit would have been extremely difficult. A current audit was carried on while the ships were being built but, according to a report by the construction auditor of the Shipping Board, it was necessarily a superficial job.² In the first place, the Emergency Fleet Corporation was short-handed. Whereas the Navy Department had about 70 auditors at Bethlehem's Alameda plant and 100 at Fore River, it had only seven men at Alameda and about twelve at Fore River. From seventy to a hundred men are required at a single plant of one company for a thorough current audit. Furthermore, the different Government auditors at the five plants failed to agree as to what should constitute cost.³

¹ Report of C. C. Colliflower, traveling auditor of U. S. Shipping Board Emergency Fleet Corporation, on Audit of Operating Expenses of Harlan Plant, Beth. Ship. Corp., January 1916 to December 1920, inclusive, p. 1 ff.

² Report of J. A. Housick, General Scope of the Audit of Bethlehem Shipbuilding Corporation Records U. S. S. E. E. F. C. Nov. 24, 1934.

³ Ibid.

Because of the ineffective character of the current audit, it was decided in the early part of 1920 that a reaudit was necessary. This work was first entrusted to a private accounting firm. After this firm had been at work for over a year and had been paid about \$600,000, they were ordered to stop, on the ground that the results of their audit were of no use to the Government.⁴ The Emergency Fleet Corporation auditors then undertook to finish the job and did so about two years after it had been begun.

The Lukens Steel Co. case offers another instance of cost padding by means of which it was possible for industry to maintain high prices.

Mr. Baruch testified before the Graham committee that as to the prices of plates: "There was a concern, the Lukens Iron & Steel Co., which made it impossible for us to give the price for steel plates lower than we did."⁵ According to his testimony, this company was a high-cost producer:

The Lukens production was made at a loss, but we held the price down with the understanding that they would get pig iron at a price that would enable them to get out with a profit. They were not an integrated plant. For instance, like the steel corporation or others, they had no blast furnaces and no coal.⁶

On December 22, 1917, at a meeting of the War Industries Board, proposal was made for a study of Lukens and other high-cost producers to determine whether special arrangements should be made to continue them in operation because of the claim that they could not produce at a profit under the existing level of prices:

The case of the Lukens Steel Co. was discussed and the point brought out that in accordance with data submitted that company could not produce plates at the price fixed at a profit. Accordingly it was moved, seconded, and unanimously carried that investigation be made of the actual price the Lukens Co. and other companies who claim that they are unable to produce at a profit at the prices fixed are receiving for the purpose of determining from actual prices received and the profits so disclosed whether these companies can continue at the present prices or whether some other arrangement covering their specific cases should be made.⁷

The committee has found, however, that in the same year the Lukens Steel Co. made a profit of 90 percent. Its net taxable income for 1917 was finally determined by the Bureau of Internal Revenue to be \$8,639,477, a 90.1 percentage of its invested capital before taxes. After taxes were paid, the percentage was 60.5. In 1918 its net taxable income was \$6,181,250, which was 22.2 percent of its invested capital. The effect of taxes in that year was to leave a net income after taxes of 19.7 percent:⁸ moreover, in 1918 conditions for the Lukens Co. were apparently good enough to warrant the retirement in cash of more than \$6,000,000 of preferred stock.⁹

The devices used by this company in its attempt to frustrate the accurate ascertainment of its costs has been described in a Federal Trade Commission report, which is reproduced in part:

The data obtained by Mr. Hoover at his first visit showed merely the combined cost of all sheared plate mills of the Lukens Co. and subsequent information obtained from the company has also shown the costs in the same way. This

⁴ Ibid.

⁵ Bernard M. Baruch, Mar. 29, 1935 (galley 91 BBQ).

⁶ Ibid.

⁷ Bernard M. Baruch, Mar. 29, 1935 (galley 91 BBQ).

⁸ Exhibit No. 1738.

⁹ Ibid.

has a misleading effect, as the total cost so shown is compared, when under consideration, with the selling price fixed by the Government, namely, \$3.25 per 100 pounds for sheared plate, and the fact that extras are allowed for sizes, gages, etc. It, therefore, becomes necessary to find the cost of plates, rolled on the different mills, so that a fair comparison may be made between the selling price of the particular products and the cost price, the selling price, of course, being \$3.25, plus extras.

Whilst the company is, of course, making no false returns, the impression created is that it is not above allowing incorrect conclusions to be drawn and that it would not object to assisting to the formation of such incorrect conclusions, provided they were in its favor. As supporting this idea, whilst Mr. Hoover knew of the existence of the iron-ore concern and also of the blast furnaces, when we sent the company a letter on November 20 telling it to make returns of all its costs, it was specifically stated that if any subsidiary companies were controlled, those companies were also to make their returns. We had no returns from the subsidiary companies until we rediscovered the existence of them. Furthermore, the company's action in compounding the costs of three different-sized mills appears to be for the purpose of showing a high cost; and when its representatives appeared before Commissioner Davies they continued to claim loudly that their cost was above the Government price of \$3.25, which, whilst being perfectly true, has no bearing on the matter, as they are not getting \$3.25, but \$3.25, plus extras. They have also said nothing about the profit on pig iron or iron ore at the Government price, rather giving the impression that they are a no. 3 classed company, which has to buy its pig iron in the open market; whereas, in point of fact, a considerable proportion of their pig iron could, no doubt, be purchased from their subsidiary company, whether, in fact, such is done or not.

The company reorganized about October 1916 from the Lukens Iron & Steel Co. to the Lukens Steel Co., and at this time increased its capital from \$500,000 to \$2,500,000. No doubt, in the past its operations have been so profitable that this was merely issuing stock for surplus. When we were making inquiry to determine the costs of investment in various iron and steel operations, we sent a request to the Lukens Co. to give us particulars concerning their investment. The information which they supplied was of the most meager description, consisting merely of two figures: Plant and property, approximately \$9,000,000; and working funds, \$5,000,000. If Mr. Basset is the accountant which Mr. Hoover believes him to be, it seems absurd to suppose that the information which we requested in our communication could not have been furnished in detail.

With regard to the profitableness of the company's operations, it is worthy of note that the profits reported for the months of July, August, September, and October, before providing for Federal taxes and writing off \$300,000 for bad debts in October, amounted to considerably over a million dollars in the remaining months.

In response to the Commission's request for information concerning the investment particulars and profit and loss figures, the Lukens Co. desired to know the authority under which the Commission was acting.

The personal attitude of Mr. Gordon, who has represented this company in various interviews, is that of a very injured party, and it may be that this is assumed in order to make Mr. Basset justified in making the statements which he does about the unprofitableness of the company's operations.

The company has definitely refused to make plates for the Government at \$3.25. The Steel Corporation appears to be able to make plates profitably at this price, and there seems to be no reason why the Lukens Co. should not do so, when they have very large equipment both in open-hearth capacity and plate-mill capacity. The company now has the largest plate mill in the world, namely, 204 inches, and as they have, at any rate, pig-iron capacity which, even if not used for their own operations, can be sold at a profit, so that the effect is that the company for part of its requirements, at any rate, is as well integrated, with the exception of coke, as some of the bigger steel companies, only inefficient operations can run their costs up to the point where their operations are unprofitable.¹⁰

Other supposedly high-cost steel companies made excessive profits at the same time that their cost position was being used as a justification for fixing high prices. The Otis Steel Co., which is cited in a Federal Trade Commission Report¹⁰ as being in the same class of integration as the Lukens Steel Co., made a profit of 139 percent in

¹⁰ Exhibit No. 1739.

1917, according to the final determination of the Bureau of Internal Revenue.¹¹ In that year, on an invested capital of \$7,154,632, this company made \$9,989,355 before taxes, the function of which had been described by Judge Gary as equalizing the profits of the low-cost companies with the "reasonable profit" that the high-cost company would obtain from the fixed price. Even after taxes were paid, the income of the Otis Steel Co. amounted to 74 percent of its invested capital.

Another company in this cost class, the Allegheny Steel Co., according to its own tax return, made \$6,832,100 in 1917, amounting to 112 percent of its capital of \$6,060,999.¹² After taxes were paid, its net income still amounted to 60 percent of its capital.

The effectiveness of auditing cost records, like the effectiveness of the Bureau of Internal Revenue's settlement of tax returns, is limited by the judgment nature of many items of cost. Especially is this true of depreciation and depletion where valuation, with all its attendant difficulties, is involved. Here also we find that it was a matter for agreement and adjustment between the Government and the producer. At a meeting of the Price-Fixing Committee, Mr. Brookings stated:

We have here before us the production of all these properties. To show you the amount of detail when we gather eight or nine hundred producers that are producing fifty million, it won't look as queer. We have found difficulty in some of these costs. We have had cost sheets presented to us of twenty-three, twenty-four, twenty-five, or twenty-six cents, whatever the case may be, and when we have analyzed them, we have reduced them to nineteen cents or something like that. They have put in other things that are their views as to depletion. My own experience teaches me that the average man is as honest as I am; I try to be honest; that is all I say. There are different methods of accounting, different methods of arriving at these things. When we change a cost, we generally do it with the consent or acknowledgment of the party; that is fair.¹³

An important factor decreasing cost that was not taken account of was the intercompany profits of well-integrated companies which appeared on the books as costs.

Usual sources of such profits were the payments to subsidiary companies of regular market prices by the parent organizations for raw materials or transportation. Prices fixed on this basis omitted to account for the profit which the parent company was gaining by doing business with itself. This also meant that the full advantages of integration were not being passed on to purchasers, of whom the largest was the Government.

The extent of the disparity between actual cost to the subsidiary and sale price to the parent company appears in the following discussion in the Price Fixing Committee regarding the provision of bauxite for the Aluminum Co. of America:

Mr. TAUSSIG. What is the reportion [proportion?] of your consumption of bauxite as compared with the others?

Mr. DAVIS. I suppose we use perhaps 66% of the total consumption of the country; we produce practically all there is produced in this country.

Mr. WOOSTER. You fixed the price on it? Do you say it is selling at \$10.00 a pound [ton?] that is your price, and you practically make the price on bauxite throughout the United States?

Mr. DAVIS. That never has been the case, because the French people have always fixed the price on bauxite.

¹¹ Exhibit No. 1740-C. The succeeding data is from the same source.

¹² Exhibit No. 1740-B.

¹³ Exhibit No. 1406.

Mr. WOOSTER. What is the duty?

Mr. TAUSSIG. It is free.

Mr. BROOKINGS. That same question came up before and we simply sidetracked it and said, we are treating your investment and capital as one, and your return on your capital, and to be consistent, inasmuch as you had fixed the price under which bauxite is sold, we must take the cost to you, and the cost to you is what we have given you credit for.

Mr. DAVIS. Our contention in that is a little different, I think, from what you put it. As a matter of fact, 25 or 30 years ago, we having practically invented the use of bauxite for aluminum, bauxite was nothing but dust with no value, but we went to our concern, and of course we did not realize how large this industry was going to grow and we bought for two or three hundred thousand dollars some bauxite land. We have spent nearly \$2,000,000 for bauxite, within the last two years, in cash. My point, is Mr. Brookings, that because we were fortunate enough to buy this bauxite 30 years ago at a cheap price that anybody should say that aluminum can be made with bauxite at 25 cents a ton, for it could not, unless somebody should take our place.

Mr. WOOSTER. The fact is that it is made for that. It costs you \$0.50, I think.¹⁴

It was not until less than a month prior to the armistice, that the Chairman of the Price Fixing Committee stated he had discovered the United States Steel Corporation to have been making an inter-company profit on the cost of rails:

The chairman announced that contrary to his previous understanding, he had discovered that the United States Steel Corporation's cost figures on rails are not strictly integrated, and that there is about a \$5 per ton intercompany profit, a part of which might possibly be charged to transportation.¹⁵

(c) *The ratio method of price determination.*—It has been suggested that many of the difficulties of the cost method of price determination can be avoided by simply revising prices according to a ratio method:

The beauty of the price ceiling is that adjustment upward of depressed segments where increased production is required is a matter of calculating ratios and not of intricate studies. Also, with a ceiling put over even a dislocated structure, segments that are too high or too low can be adjusted downward or upward in the same manner. In neither case is there necessarily a question of computing costs.¹⁶

There are limitations on the use of this device. As Mr. Baruch has stated in his testimony before the War Policies Commission, downward price revision requires cost studies:

It is a much more difficult thing to revise maximum prices downward than to revise them upward. It requires exhaustive cost studies and long and difficult negotiations.¹⁷

It can readily be seen that in time of war, when production is a vital consideration, no action will be taken to lower prices until it is definitely ascertained that necessary production will not be lost. This requires information as to the costs at which the various proportions of output are being brought in.

The World War experience was that lack of cost information delayed downward price revision.

The efforts of the War Industries Board to fix the prices of cotton textiles are in point. The Board met and fixed a price but, "there was a decided absence of cost data. Several requests had been made

¹⁴ Minutes of the Price-Fixing Committee, May 9, 1918.

¹⁵ *Ibid.* Oct. 21, 1918.

¹⁶ Supplementary statement of Bernard M. Baruch, Apr. 12, 1935.

¹⁷ War Policies Commission Hearings, op. cit., p. 807.

for such data, but the representatives of the industry claimed that the time required for their collection and compilation would be too long to make them available for immediate use."¹⁸ When price revision was considered, "the same lack of cost information held up negotiations. Indeed, 'the failure of a large number of cotton mills to submit their cost sheets' resulted in the postponing of any revision until November 16."¹⁹ When cost data finally were obtained, the Government found that under the original price a profit considerably larger than 25 percent on plant investment was being made.²⁰

Again, in the case of sole and belting leather: "It was not until the middle of July 1918 that the question of sole leather prices was taken into consideration by the Price-Fixing Committee and even then, because of lack of sufficient cost data, no definite action was taken."²¹

Upward price revision requires cost information if any attempt is to be made at profits limitation. Readjustment upward cannot be confined to the pre-war price; it will, in the usual case, be set above that level. The very fact that high-cost producers were unable to operate at normal pre-war prices indicates the necessity for this. It should be remembered that although the August 1914 price for wheat was \$1.07 a bushel, the war-time minimum price was fixed at \$2.26 per bushel to stimulate production. Cost determinations, no matter how difficult, are necessary to keep some check on the impulse to raise prices.

If profits are to be limited, costs must also be determined in situations analogous to Mr. Baruch's illustration of the cost decrease resulting from increased production (*supra*, p. 68). He has stated the process as follows:

Mechanical mass production brings low costs, but only when the machines are operating close to capacity * * *.

These machines represent enormous aggregations of capital, on which fixed charges are very great * * * when they are speeded the results in reduced cost per unit are sometimes almost fabulous.²²

Failure to take this into account means that "even with a fixed price structure and a high excess-profits tax there will be huge profits."²³

(4) NONENFORCEABILITY OF PRICE REGULATIONS

In addition, there are the profits which accrue to sellers, who by wholesale nonobservance can easily render ineffective price schedules which they do not consider satisfactory.

In the field of price enforcement, as in that of taxation, it is necessary to distinguish between avoidance and evasion. The former method of defeating governmental rules works itself out legally by following the rules and taking advantage of the loopholes therein. For example, in the World War, millers defeated the regulation limiting them to a profit of 25 cents per barrel of flour by creating jobbing departments in order to get the additional jobbers profit of 50 to 75 cents a barrel.

¹⁸ Garrett, *op. cit.*, p. 298.

¹⁹ *Ibid.*, p. 301.

²⁰ *Ibid.*, p. 302.

²¹ *Ibid.*, p. 322.

²² War Policies Commission hearings, *op. cit.*, p. 799.

²³ *Ibid.*

According to Eldred, *Wheat and Flour Trade: 1917-18* ²⁴—

Out of some 1,500 mills reporting their costs to the Food Administration under the voluntary agreement 439 had separate jobbing departments on June 18, 1918. In many cases these jobbing departments were new creations, designed to cover up profits in excess of the allowable maximum. It was an undoubted weakness in the rules which permitted and perhaps even suggested the creation of these bogus jobbing departments.

Recent experience with the N. R. A.'s attempt to enforce minimum prices has uncovered the many possibilities for noncompliance in the complicated field of price regulation. For example, Dr. Corwin Edwards, technical director of staff of the Consumer's Advisory Board of the N. R. A., stated at the N. R. A.'s hearings on price policy that producers in the machined waste industry took advantage of the brand method of filing prices by simply changing the name of their brand if they wanted to change their price.²⁵

The relations between buyer and seller also offered devices for avoidance. Dr. Edwards stated that some wholesalers would sell to retailers at the prescribed price but would also give them advertising allowances which were much larger than those offered by competitors.²⁶ In the event of war where the purchaser would be anxious to make concessions, the process could be easily reversed; i. e., he would forego the usual allowances granted by the seller.

The difficulties of preventing outright violation or "bootlegging" would become insuperable if prices were set at levels which business would not agree to in the first instance. In the World War, enforcement was a relatively minor problem because of the profitable nature of the fixed prices. It was the opinion of Commander John M. Hancock, the naval representative on the Price Fixing Committee, that enforcement of the price freezing plan, whose main feature has been pointed out to be the use of pre-war prices, would require machinery which would not work, unless this proposal was merely intended for psychological effect:

The only fear I have from having heard the discussion this morning is that it involves too much machinery, unless it is going to be a statute passed primarily for the effect it will have on people's minds. But if you are going to try to enforce it I am afraid it is going to involve too much machinery, and machinery that won't work.²⁷

General MACARTHUR, chief of staff of the United States Army, testified before the War Policies Commission that attempting enforcement of the price-freezing plan would meet with antagonism and that in final result it would be largely gesture:

Freezing of prices would appear to be a doubtful expedient because so many factors are involved that injustice must follow. Evasion and court appeals are inevitable. In the end the Government's efforts would probably be largely gesture. Attempts at enforcement would likely create antagonism, and the Government would lose the essential elements of good will. Without complete and unstinting popular support no nation can hope to fight to victory.²⁸

²⁴ Quarterly Journal of Economics, vol. 33, p. 48.

²⁵ C. D. Edwards, statement at N. I. R. A. price hearing, Jan. 9, 1935.

²⁶ Ibid.

²⁷ War Policies Commission Hearings op. cit. p. 155. One of the psychological situations which price freezing is designed to prevent has been described by Mr. Baruch as follows: "Destruction of domestic morale through a just and bitter resentment by soldiers, and their families (and indeed by all persons of fixed income) at the spectacle of grotesquely exaggerated profits and income to those engaged in trade or in services for sale in competitive markets and the constantly increasing burden of bare existence to all those who are not so engaged. This is the greatest source of complaint of "unequal burdens." The present demands for "equalizing burdens" and "taking the profits out of war" both go back to the single phenomenon of war inflation. There is no more important problem to solve—whether we consider it purely as a means to maintain the solidarity and morale of our people, or as the basis of our economic strength for war purposes, or to avoid war's aftermath of economic prostration, or on the broader grounds of humanity and even-handed justice." (Ibid p. 33.)

²⁸ Ibid p. 372.

These difficulties of keeping the actual level of prices coterminous with the prices announced to the public will be increased with the increase in the number of commodities and individuals regulated. Where all prices are to be regulated, as under the price-ceiling scheme, the task appears to be an administrative impossibility. Furthermore, it is necessary to remember that in addition to policing thousands of commodity prices and all the producers and sellers, whether wholesale or retail, in this country, it will also be necessary under Mr. Baruch's suggestion of a penal sanction against the buyer to supervise all buyers.

(5) THE STRIKE OF CAPITAL

The folly of relying upon any voluntary limitation of profits has been well demonstrated by the experience of the Government in the World War. This committee's investigation has developed the fact that the use by business of its power of forcing price concessions from the Government by making that a condition of continued production, which amounted simply to a "strike of capital"²⁹ was not uncommon and was not confined to the minority of industry.

Mr. Baruch in his statement to the War Policies Commission has pointed out some of the inadequacies of cooperation in the prevention of inflation:

Yet I venture to think that there is not one of those industrial leaders who would not heartily agree with me in saying, first, that it would be impossible to prevent general inflation by any Nation-wide convention as to price; second, that no one, no matter how generous, could agree to restrict his own price unless all other prices affecting him were restricted or unless his price were already so high that his profits were exorbitant, and, finally, that substantial price reductions by agreement (even from highly profitable peaks) could not be secured unless those willing to agree through high-mindedness knew that the Government body with which they were dealing had some sanctions—some control with actual teeth or some disciplinary power to apply to recalcitrant or unwilling subscribers in the event of default.³⁰

He has also indicated the lack of cooperation in the last war, especially in the important iron and steel industry:

I wish the record and my memories permitted me to agree with the picture presented by these witnesses of each commodity group gathering around to hear our price determinations and then going away "enthusiastic for doing it." I wish I could also agree that after a meeting of steel leaders with the Secretaries of War and Navy before the war "the effect of that kind of price control through leadership * * * was that the general price level of iron and steel prices went down after America went into the war." My recollection is of a long and tedious period of bickering attended at first by such public statements by the President as "those who do not respond in the spirit of those who have given their lives for us on bloody fields far away may safely be left to be dealt with by opinion and by the law, for the law must, of course, command these things." I recall a bitter controversy between the chairman of the Shipping Board and the industry in June 1917 leading to the Pomerene bill which proposed to authorize the President to fix iron and steel prices and to commandeer the plant of any producer who failed to comply. I remember also what I am free now to relate since Judge Gary himself has said—in effect—that he kept the steel industry from being nationalized. He was quite correct. Due to the inability of Government to reach agreement with the steel industry, I was compelled to—and did—secure authority from the President to commandeer certain companies in that

²⁹ Senator Nye said: "Calling the attitude of the steel industry and the copper industry a strike I would suggest that the only difference between their strike and a strike of labor was that in the case of the steel and copper people their strike was carried on behind closed doors. They won their strike, if we can call it that. They won the higher price they were seeking, they won higher profits as a result of their delay, and the Government did not get as large a slice of the profits back in the way of taxes that it thought it was going to get. Again for that reason, it seems to me that we need the stiffest kind of club to deal with a situation like that in the future". (Mar. 29, 1933, Galley 2 WC).

³⁰ War Policies Commission Hearings, op. cit., p. 815.

industry if it should become necessary. While all this was going on, the index figures of the United States Department of Labor show the following as to the prices of iron and steel:

1915.....	64.7	1917—Continued.	
1917:		July.....	230.2
April.....	170	August.....	227.6
May.....	182.7	September (price fixed)...	214.3
June.....	204	November.....	143.7

As Commander Hancock expressed it in his testimony (p. 154) relating to price control through leadership and agreement:

“* * * the President said to Mr. Brookings (chairman of the price-fixing commission), ‘Let the manufacturer see the club behind your door.’”³¹

Apparently, patriotism was in some instances confined to merely deploring the excessive profits that were being gained. Mr. Baruch stated:

I recall vividly that during the war, even after we had by price-fixing compelled a reduction of 35 percent from the peak index figure of iron and steel, and even after the 80 percent excess-profits tax was in effect, some high-minded and public-spirited steel men came to me expressing apprehension over the enormous profits they were making under our restrictive system operating at its best. The reason they were making such profits in spite of all we could do is made clear by the example I have given you. If to the enormous increase in profits shown by that example we add the profits due to a runaway market, the figures of profit become even more astonishing.³²

(a) *The Copper Industry.*—Prior to the entry of the United States into the World War, the leading copper producers of the country responded to the appeal of the preparedness campaign and sold 45,510,000 pounds of copper to the Government at a price of 16.67 cents a pound. The arrangement was proposed by Eugene Meyer, Jr., according to the Report of the War Industries Board,³³ and was finally effected by Bernard M. Baruch.

Mr. Baruch came to Washington early in 1917 to take charge of raw materials as a member of the Advisory Commission of the Council of National Defense. He commenced negotiation on the proposal and on March 13, 1917, communicated to Secretary of War Baker that the copper producers were anxious to meet the Government in a patriotic manner. High hopes were held out that a successful negotiation would serve as a precedent in the naming of prices that would result in large savings to the Government:³⁴

HON. NEWTON D. BAKER,

Secretary of War, Washington, D. C.:

MARCH 13, 1917.

Have had conference with leading copper producers, who are anxious and desirous of meeting the Government in a patriotic manner to give them whatever copper the Government may need at the right time and a proper and fair price. This will apply not alone to their needs in a crisis but also the needs arising from the expenditures in their present preparedness campaign. They desire to know the approximate amounts needed and the approximate time for delivery. I wish you would take this matter up immediately, as I believe that it would result in establishing a precedent in the naming of prices for all raw material which would result in a large savings [sic] to the Government and which perhaps might affect contracts already given out and which might be most potent in causing coordination between business and Government, which I understand was one of the underlying reasons for the President's desire in forming the council and its commission. I am sending a copy of this telegram to the Secretary of the Navy, as I deem it advisable for the Army and Navy to act jointly in this matter.

BERNARD M. BARUCH.

³¹ 72d Cong., 1st sess., H. Doc. No. 163, pp. 815 and 816.

³² War Policies Commission Hearings, op. cit., p. 799.

³³ P. 131.

³⁴ Exhibit No. 1690.

The Secretary of the Navy replied to Mr. Baruch on March 14, 1917, that a very large reduction in price could be effected because the average cost of production was about 10 cents per pound.³⁵ At this time electrolytic copper was selling at a price of approximately 36 cents per pound to large buyers³⁶ which represented on the basis of this cost estimate, an average per unit profit of more than 250 percent.

The 16½-cent price granted to the Government in aid of its war preparedness campaign was based upon a 10-year average of pre-war prices. These years included the very high prices in the 3 years preceding our entry into the war when the copper industry was selling to the Allies at the extremely large profits which have already been indicated. On the basis of the Secretary of the Navy's cost estimate the "gift" price to the Government was thus productive of an average profit of 66½ percent. Furthermore only 45,000,000 pounds of production were affected, 20,000,000 going to the Navy and 25,000,000 to the Army, in contrast with the more than 2,000,000,000 pounds of electrolytic copper which entered trade in 1917.³⁷

The price was determined March 20, 1917, after little more than a week of conferences by Mr. Baruch with the copper interests. The action of the industry was characterized in the following manner by Mr. Gifford who was then director of the Council of National Defense:

This willingness to furnish the copper supply needed by the Government at the maximum concession in price, is a very gratifying evidence of the recognition of men in large affairs of their patriotic obligation and both War and Navy Departments appreciate their generous and public-spirited attitude.³⁸

It has been indicated however in the testimony before this committee that at about this time a great deal of talk was going on concerning the possibility of commandeering, Senator La Follette and others having suggested the desirability of conscripting industry and wealth as well as man power. It is clear that the action of the copper producers was later used as an argument against commandeering. In July 1917 when the Army's representatives told Mr. Baruch that they wished to commandeer copper from one company, which would be a convenience to the Army, he wrote Secretary of War Baker suggesting that the copper be commandeered from all producers proportionately and stressed the helpfulness of the industry:

Yesterday afternoon Major Brett and Lieutenant Williams, of the Ordnance Department, called at my office and stated the needs of the Army to be 5,000,000 pounds of copper, of which 500,000 pounds was for immediate delivery.

The object of their visit was to discuss the commandeering of copper and they desired to commandeer from one company, as that would be a convenience to them. I would suggest that if you intend to commandeer copper or anything else that you commandeer it from all producers proportionately.

There may be some misunderstanding but I think it would be particularly unfortunate and unfair if we should commandeer any article without allowing the producers from which it is to be commandeered an opportunity to be heard. Also you will recall that the copper people were the first people who came forward in a helpful spirit at a time when it meant much.³⁹

The price was apparently a very reasonable one for the producers and it is a certainty that no participant in this "gift" lost any money.

³⁵ Exhibit No. 1691.

³⁶ Exhibit No. 1704.

³⁷ War Industries Board Price Bulletin No. 34, "Prices of Ferroalloys, Nonferrous and Rare Metals", p. 23.

³⁸ Exhibit No. 1692.

³⁹ Exhibit No. 1694.

Senator CLARK. Now, Mr. Baruch, there was no suggestion at that time, was there, on the part of any of these copper producers that they were in any danger of losing money at a price of 16 $\frac{2}{3}$ cents; the money was there?

Mr. BARUCH. They could not make it to me, because I would laugh at them.⁴⁰

The movement for higher prices soon began with the direction of attention to the relationship between high prices and the maintenance of production. On May 2, 1917, Mr. Eugene Meyer wrote Mr. Baruch the following letter:

Since our talk in Washington I have given careful study to the copper statistics. The refinery production in the United States in 1910 was 654,000 tons. It showed very little increase for several years. It slowly increased until in 1913 it was 731,000 tons. Even in 1915 it was 736,000 tons, but the 1916 figures jumped to 1,040,000 tons. This enormous increase in production coincided with the big rise in price, and, in my opinion, was unquestionably due to the rise in price.

To keep up the production it will be necessary to maintain a high price. There is a lot of this copper which cost very much above the prices that prevailed under normal conditions. To reduce the prices radically would, in my opinion, unquestionably reduce the production.⁴¹

In June 1917 the military need for copper became intense but apparently it could not be met at the previous price to the Government of 16 $\frac{2}{3}$ cents. A 25-cent price was arranged by the raw materials committee headed by Mr. Baruch and was recommended by the Munitions Board for acceptance. This price, which the copper producers held out for at a later time, was thought to be too high by the Secretary of War and on July 6 there was a communication from the Ordnance Department stating that he disapproved it. The minutes of the General Munitions Board at a meeting held July 13, 1917, follow:

Copper: A communication from Mr. Meyer dated July 11, attaching copy of communication from the Ordnance Department (No. 770.15/124) dated June 25, accepting the price of 25 cents per pound for 60,000 pounds of copper arranged for by the raw materials committee was presented; likewise copy of communication from the Ordnance Department dated July 6 (No. G-470.15/19) stating that the Secretary of War had disapproved of the arrangement referred to, and a communication from J. D. Ryan, chairman of the copper committee, dated July 10, relative thereto was presented and ordered made a matter of record.⁴¹

In July 1917, as can be seen from Mr. Baruch's letter on page 96, the Army was apparently intent on using the commandeering power, and on August 7, 1917, the War Industries Board decided that commandeering should be used to gain the necessary supply if the copper producers would refuse to accept a tentative price of 20 cents per pound:

Meeting of the War Industries Board, held at 10 a. m., Tuesday, August 7, 1917, in room 945, Munsey Building.

Present: Mr. F. A. Scott, chairman; Mr. Baruch; Mr. Brookings; Admiral Fletcher; Mr. Frayne; Judge Lovett; Colonel Pierce; Mr. H. P. Bingham, secretary.

Copper desired by British and French Governments: It was moved and carried that in connection with the negotiations which Mr. Baruch is to carry on with the copper interests relative to the furnishing to the British and French Governments of approximately 60,000,000 pounds desired for immediate shipment, that Mr. Baruch be requested by the War Industries Board to offer the copper producers a payment on account of 20 cents per pound for this amount of copper with the stipulation that such payment on account should be entirely disregarded in fixing the final price to be paid for this copper, which final price might be above or below 20 cents per pound, and further that if the copper producers refuse to enter

⁴⁰ Bernard M. Baruch, Mar. 27, 1935. Galley 55 BBQ.

⁴¹ Exhibit No. 1693.

into such an agreement, that then the Government will proceed to commandeer the necessary supply.⁴²

But on the next day, according to the minutes, the War Industries Board yielded to make an offer of a tentative price of 22½ cents:

Copper: Negotiations with copper producers. Mr. Brookings stated that Mr. Ryan had stated to him that when the needs of the Allies are included in the negotiations for supplying of copper for military needs, the copper interests are not willing to accept a memorandum price, but are willing to give the necessary copper at a firm price of 25 cents per pound, whereupon Mr. Baruch made the following motion:

"Resolved, That as the copper emergency required immediate action necessary to secure a supply for our Government and our Allies, that the Board endeavor to secure from the copper interests the needs of ourselves and our Allies at a price to be fixed when we receive the report of the Federal Trade Commission as to the costs and for purposes of payment on account of deliveries, a tentative price of 22½ cents be fixed with the understanding that this price shall in no way be taken into consideration when the final price is to be determined."

This motion being duly seconded by Judge Lovett was unanimously adopted.⁴³

At this time the Secretary of War was also beginning to make concessions, the War Industries Board minutes of August 17 stating that he suggested arrangement of a price of 25 cents a pound for the Allies. Even this high price would have to be brought about by the "individual friendly act" of Mr. Baruch:

Present: Mr. Scott, chairman, Mr. Baruch, Admiral Fletcher, Mr. Frayne, Judge Lovett, Colonel Pierce, Mr. Bingham, secretary.

Copper—Allied purchases: Colonel Pierce stated that in accordance with the instructions of the Board he and Mr. Baruch called upon the Secretary of War relative to the procurement of copper for certain of the Allies, with particular reference to the instructions given the Board by the Secretary of War under date of August 14, regarding such matters. The Secretary of War referred them to the Secretary of the Treasury who was carrying on negotiations with the Allies covering this subject. The Secretary of the Treasury expressed preference for the instructions issued by the Secretary of War in that the Board at present should only offer the Allies its friendly services until its present negotiations were completed. Colonel Pierce then stated that he again saw the Secretary of War who suggested that taking all into consideration for this emergency, it might be preferable to arrange to furnish this copper at a price of 25 cents, if such an arrangement could be possibly brought about through the individual friendly act of Mr. Baruch.⁴⁴

The War Industries Board was convinced in September 1917 that 22 cents a pound would be a reasonable price. This conclusion was more than justified by Federal Trade Commission figures which showed that 97 percent of production was being brought in at a cost of less than 20 cents per pound. The 2-cent differential at this price would have given the high-cost producers of this group a profit of 10 percent and the low-cost producers a much larger margin. Many of the latter were producing at costs of less than the average of 13.6 cents which represented a profit of 57 percent for the average producer. The Federal Trade Commission reported United Verde Extension Mining Co.'s costs to be 7 cents; Kennecott Copper Co., 8 cents; and Inspiration Consolidated, 12 cents.⁴⁵

However, Mr. Ryan told the War Industries Board that the price of voluntary cooperation from the copper industry was 25 cents per pound; at the 22-cent price, he stated that it would be impossible to

⁴² Exhibit No. 1668.

⁴³ Exhibit No. 1699.

⁴⁴ Exhibit No. 1700.

⁴⁵ Exhibit No. 1712.

obtain the cooperation of the majority of mine owners. He went further, to virtually deliver an ultimatum to the Government that if a 22-cent price were fixed it would be necessary for the Board to appoint other producers to manage the distribution of copper:

MEETING OF THE WAR INDUSTRIES BOARD, HELD SEPTEMBER 10, 1917, AT 12 A. M. IN ROOM 945, MUNSEY BUILDING

Present: Judge Lovett, acting chairman, Mr. Baruch, Mr. Brookings, Admiral Fletcher, Mr. Frayne, Mr. Bingham, secretary, and representatives of copper interests: Mr. J. D. Ryan, Mr. Joseph Clendenin, Mr. T. Wolfson, Mr. R. L. Agassiz.

Copper price-fixing.—Mr. Ryan stated that if 22 cents per pound were fixed as a price for copper that it would be impossible to obtain the voluntary cooperation of the majority of mine owners. If 25 cents were fixed he assured the War Industries Board that he and the other copper producers present would obtain all the copper of the country voluntarily from all producers, and that he would see to it that the copper was properly distributed and the price controlled. This would likewise cover the 300,000,000 pounds produced outside of the United States. Should 22 cents be fixed, this 300,000,000 pounds could not be controlled. The breaking of the sliding scale of wages now in force which the War Industries Board stated they would insist upon when fixing a 22-cent price would, Mr. Ryan said, be disastrous and would eventually curtail production of copper. He said that the copper producers present would do all they could to help the Government no matter what price was fixed, but that they were convinced that at a 22-cent price they could not control the entire copper output, and that being convinced of this fact they would suggest that other copper producers be appointed to manage the distribution of copper should the low rate be fixed. The copper producers at this point retired from the meeting.⁴⁶

On September 21, 1917, the War Industries Board yielded from its price of 22 cents which had been a concession from the original price of 20 cents offered on August 6, 1917.⁴⁷ The final figure was 23½ cents, representing a splitting of the difference in the final opposing prices of the Government and the copper producers. Even at this price with, its consequent opportunities for excessive war profits, it was necessary for Government to utter a threat of commandeering in contemplation of noncooperation. The statement of the Board as accepted by the President stated that—

The proper departments of the Government will be asked to take over the mines and plants of any producers who fail to conform to the arrangement and price, if any there should be.⁴⁸

The nature of the control over distribution which the copper producers could now guarantee was indicated in the final statement prepared by the War Industries Board for the signature of the President. One of the considerations imposed by the Board in consideration of the granting of the 23½-cent price was that:

the operators shall sell to the Allies and the public, copper at the same price paid by the Government, and will take the necessary measures, under the direction of the War Industries Board for the distribution of the copper and to prevent it from falling into the hands of speculators, who would increase the price to the public.⁴⁸

In his testimony before the committee Mr. Baruch said "Do not for a moment let me be put in the position of defending their patriotism, and all that kind of thing, because I realize that we had to use a club."⁴⁹

⁴⁶ Exhibit no. 1702.

⁴⁷ Exhibit No. 1697.

⁴⁸ Exhibit No. 1703.

⁴⁹ Bernard M. Baruch, Mar. 28, 1935 (galley 59 BBQ).

In response to Senator Clark's statement that "when they were offered by the Government 22 cents a pound, it seems to me that the demands of the copper producers were, to say the least, exorbitant,"⁵⁰ Mr. Baruch said "All that you say is correct, sir. I am not seeking to defend their actions."⁵¹

In May 1918, when the copper producers returned to demand a further price increase from the War Industries Board, there is recorded in the minutes of the Price Fixing Committee the refusal of the Anaconda Copper Co. and the Calumet & Hecla Co. to agree to furnish copper at 23½ cents per pound. Mr. Kelley, of the Anaconda, said "We have always agreed for a definite time to furnish copper at a definite price; I could not agree to furnish copper for the Anaconda at 23½ cents."⁵² Mr. Agassiz, of the Calumet & Hecla, then said "I cannot agree for our company."⁵³ There should be set against this last statement the fact that the Calumet & Hecla made a profit of 34.9 percent in 1917, according to the final determination of the Bureau of Internal Revenue.⁵⁴ According to the Federal Trade Commission's study, the Anaconda's costs amounted to \$0.16546 a pound in the year 1917 and decreased to \$0.16484 in March 1918.⁵⁵

Differences between companies also had their effect in adding to the pressure on the Government to make price concessions. In the May meeting Mr. Brookings characterized the controversy between the American Smelting & Refining Co. and certain low cost producers over the adjustment of long term contracts entered into prior to the commencement of the war and unfavorable to the smelting company, as an attempt to delay adjustment in order to force up prices:

Mr. BROOKINGS. We haven't considered your question at all; we said we wouldn't. What you are doing is to try to put over the settlement of your trouble upon the Government. The Government declines to do it. You can shut down tomorrow, that is your business.

Mr. BROWNELL. That is our business?

Mr. BROOKINGS. We don't propose you shall put it over on the Government.

Mr. BROWNELL. And we are not regarded as unpatriotic?

Mr. BROOKINGS. You can take that as you will.

* * * * *

Mr. BROOKINGS. We point to the evidence now that we made our case absolutely. There was no rebuttal of any kind. It was entirely a question of advance in the cost of wages and the advance in the cost of material; it was an advance as the result of the war and the Government wasn't responsible for that. We went so far as to tell you to present your bill to the Kaiser if you attempted to locate the responsibility on anybody. You gentlemen didn't do the right thing. We said, "Come into court with clean hands to adjust an unfair difference." There isn't a court in the United States but would say, "Gentlemen, you have no standing in this court at all."

Mr. BROWNELL. I think you are charging us with something of which we are not guilty. You are assuming a conspiracy—

Mr. BROOKINGS. Not a conspiracy but a delaying of the adjustment between yourselves, hoping that the pressure upon the Government would facilitate—⁵⁶

(b) *The steel industry.*—Between April and July 1917, a speculative increase was recorded in the War Industries Board iron and steel price index which rose almost 100 points from 274 to 370.⁵⁷ As a re-

⁵⁰ Ibid. (galley 60 BBQ).

⁵¹ Ibid.

⁵² Exhibit no. 1711.

⁵³ Ibid.

⁵⁴ Exhibit no. 1705.

⁵⁵ Exhibit no. 1712.

⁵⁶ Minutes of the Price Fixing Committee, May 22, 1918.

⁵⁷ War Industries Board Price Bulletin No. 3, Garrett, Government Control over Prices, p. 246.

See also the price index charts of steel plates and steel sheets facing p. 128 and of the metal and metal products group facing p. 126.

sult, the different branches of the Government began to make vigorous protests. On July 12, 1917, the President delivered a strong warning with special reference to the steel industry that those "who do not respond in the spirit of those who have gone to give their lives for us on bloody fields far away may safely be left to be dealt with by opinion and the law, for the law must, of course, command these things".⁵⁸ The Secretary of the Navy said:

There is no justification for a tremendous increase in the cost of basic materials. The Almighty put these things in the ground and the only additional cost over normal times is in getting them out. Under the law, the President is authorized to fix a reasonable price for what is needed for the Navy. There is no disposition whatever to cause any hardship to the producers. We are perfectly willing and intend to pay them a fair, even a liberal, profit, but we will not pay exorbitant prices, such as are being quoted in some instances.⁵⁹

The Chairman of the Shipping Board was reported as favoring the commandeering of all steel plants in the event of their refusal to accept the prices to be fixed on the basis of the cost of production study of the Federal Trade Commission, and in Congress a bill was debated which provided for commandeering any producer or dealer who failed to conform with its requirements.⁶⁰

Dissatisfaction with the high prices of steel was evident even before the entry of the United States into the war. As part of the preparedness campaign, Mr. Baruch approached the steel interests in the matter of getting lower prices.⁶¹ A contemporary memorandum which is committee exhibit no. 1728 indicates that a \$2.90 price for steel plate was considered to be the very most that should be asked of the Government:

We do not feel that an analysis of the situation would justify a price greater than \$2.90.

Judge Gary, however, felt that the steel industry could not deliver at this price. In another war-time memorandum appears the following report:

Conferred with Judge Gary at his house at 9:15 in the morning, at which time he outlined the difficulty of arranging a fixed price for plates and bars. I thought the price should be about \$2.90 for plates and \$2.50 for bars, but he stated that the many independents could not deliver at that price and make profit.

I communicated from his house with Secretary Daniels, who said he would fix a price later.⁶²

In a letter of March 31, 1917, Secretary of the Navy Daniels wrote Judge Gary that the steel industry's price of \$3.50 could hardly be considered a reduction in price since the highest price hitherto quoted was \$2.90. However, the Secretary was "glad to note that the spirit manifested by the members of the committee was loyal and liberal:"

I am in receipt of your favor of the 30th, enclosing copy of the letter which you have sent to Mr. Bernard M. Baruch, chairman of the raw materials committee of the Advisory Commission of the Council of National Defense, and also a letter to Mr. Baruch giving the names of the committee selected by you as president of the American Iron & Steel Institute, on steel and steel products. I am very glad to note that the spirit manifested by the members of the committee was loyal and liberal.

⁵⁸ Report of the War Industries Board, p. 115.

⁵⁹ War Industries Board Price Bulletin, No. 33, p. 20.

⁶⁰ War Industries Board Price Bulletin No. 3, p. 249. According to this proposal, price fixing and control were to be under the supervision of the Federal Trade Commission rather than the Council of the National Defense.

⁶¹ Report of the War Industries Board, p. 111.

⁶² Exhibit No. 1727.

The prices you name, f. o. b. Pittsburgh, are in excess of what I had hoped and expected would be made. While I appreciate the fact that everyone wants to be helpful, at the same time I wish to draw your attention to the fact that the highest prices which the United States Government has paid have been on the basis of \$2.90 for plates and that was the price named by the Carnegie Co. to the Government and which has not been raised.

While I appreciate the increased cost of production and that the market at present is continuing to rise, the country would not feel that the steel manufacturers had made a reduction in their price when the Government was charged \$3.50 as against the last price of \$2.90.⁶³

In May of that year the Secretary of the Navy turned over to Mr. Baruch a letter which he thought pertinent to the reduction of steel prices. The Secretary's correspondent referred to the fact that arguments against the Government price were being sent to country newspapers and queried the justification for the steel industry's demand when the cost of common labor had risen only \$1 a day. The costs of materials which were controlled by the large steel manufacturers and which were the main grounds offered for a higher price however had gone up out of all proportion to this 50-percent labor increase. Ferromanganese, for instance, had advanced more than 1,000 percent:

MAY 24, 1917.

MY DEAR MR. BARUCH:

I received a letter today from a gentleman in Illinois, as follows:

Copies of the Wall Street Journal are being sent out to country papers complaining about the price the Government is demanding steel for. As an excuse they quote the increased price of the products as follows: Collinsville [Connelsville?] coke, in 1914, \$1.75, now \$8; Bessemer iron, \$14.90, now, \$44.95; basic iron, \$13, now \$42; ferromanganese, \$37.70, now \$425; common labor, \$2, now \$3.

Now, if these prices are correct, why the great raise? Does it cost much more for labor to produce these things, except labor itself, than it did in 1914? To an outsider it looks as if there was a great rake-off on the products above-quoted, and there is a suspicion that the steel manufacturers are interested in the other products.

I thought this would interest you.

Sincerely yours,

JOSEPHUS DANIELS.⁶⁴

While price negotiations were going on, the Government was feeling the pressure of the armed forces for production. In a memorandum of June 21, 1917, a conference of Army and Navy officers stressed the necessity of gaining maximum steel production and indicated their willingness for the adoption of prices sufficiently high to attain that end. Reliance was placed on the excess profits tax to collect back exorbitant profits:

Memorandum adopted by the Joint Conference of Army and Navy Officers with James A. Farrell, representing the Iron and Steel Institute, June 21, 1917.

It is absolutely essential to fix a price for steel which will meet the requirements of the three great agencies of the Government (War Department, Navy Department, and Shipping Board) that are to use the product and which will also meet the requirements of the manufacturing interests of the country at large, * * * but, above all, the necessary thing is to fix the price at a point that will assure the maximum steel production throughout the country; * * * exorbitant profits if any, to be taken back by means of an excess profits tax.⁶⁵

The consequent pressure on the Government for a final decision appears in the memorandum of General Purchasing Officer R. E. Wood

⁶³ Exhibit No. 1726.

⁶⁴ Exhibit No. 1729.

⁶⁵ Exhibit No. 1730.

to General Goethals dated June 28, 1917. The construction of wooden and steel ships was virtually at a standstill because of the purchasing officer's inability to settle on the price of steel:

The situation that has arisen with regard to the price of steel is handicapping the work of the Purchasing Department very seriously.

The orders for the Moore and Scott ships have not been accepted as no price is stipulated, and the steel companies will not accept an order without a price. An early delivery is stipulated on these Moore and Scott ships. Their orders for steel have already been held up 10 days and completion of the ships will be delayed accordingly, besides giving rise to a great many possible claims.

We will be obliged to furnish the parties who make our boilers with steel. We cannot get a price on boiler steel, or get steel to our boilermakers until the general question has been settled. The same will apply to marine engines.

It is possibly not realized that 30 percent of the material that goes into a wooden hull, and over 50 percent of the material, including propelling machinery, that goes into a wooden ship, is steel or steel products, and that the wooden ships, as well as the steel ships, will be held up seriously unless this matter is decided in the very near future. Until it is decided, our work will be practically at a standstill, for I cannot close any contracts on propelling machinery or on fastenings, forgings, shafting, etc., until this matter is decided.⁶⁶

Other departments of the Government were also finding that war preparations were being seriously hampered by the delay in fixing prices for the steel industry. The Navy Department, Shipping Board, Ordnance Department, and the Panama Canal Commission reported that the unsettled condition was holding up almost all their activities. The Munitions Board decided on July 24, 1917, that the necessity for prompt action in fixing some price should be communicated to the Secretary of War:

Steel—Necessity for fixing some price.—Mr. Howe brought up the question of the present steel situation as to the holding up of necessary orders due to the lack of a price. It was reported by the various representatives that practically everything is held up because of the unsettled condition. The Departments reporting are the Navy, Shipping Board, Ordnance Department (ammunition steel and rifle-barrel steel), and the Panama Canal Commission.

After considerable argument, Mr. Scott and Mr. Rosenwald were asked to interview the Secretary of War and lay the facts before him, registering with the Secretary the opinion of the Board that something must be done promptly as the delay was seriously hampering the preparations for war.⁶⁷

Four months after the entrance of the United States into the war the Bureau of Supplies and Accounts in the Navy Department submitted a memorandum to the Secretary of the Navy stating that almost no steel sheets had been ordered since the declaration of war. Also that it was only at this late date, August 6, 1917, that the last of the stock plate and shape order was being allotted. This was due to the unintegrated finished steel producer's inability to operate on the basis of the inflated raw material prices:

The last of the stock plate and shape order (agreement between the Steel Corporation and the Navy dated April 20) is only now being allotted, although a large portion was ready for allotment in May. One cause of the delay arises from the fact that the small mills cannot produce plates and shapes at \$2.90 and \$2.50, respectively, until the Government controls the essential raw materials.

Practically no steel sheets have been ordered since the entrance of the United States into the war.⁶⁸

On the same day the minutes of the General Munitions Board contain other instances of the strong bargaining position of the steel industry. When attention was called to a plan of having the Midvale

⁶⁶ Exhibit No. 1732.

⁶⁷ Bernard M. Baruch, Mar. 29, 1935 (galley 89 BBQ).

⁶⁸ Exhibit No. 1734.

Steel Co. furnish the Navy forgings and Bethlehem the Army forgings, Mr. Scott, chairman of the Board, referred to an understanding with the companies that the condition of the determination of a fixed price was the equal division of the Navy forgings business between them. He stated that he "did not believe Bethlehem would agree to accept only Army forgings at the prices agreed upon."⁶⁹ Another instance is to be found in Colonel Blunt's remark that the United Engineering & Foundry Co. refused to bid on artillery forgings and that they gave as an excuse the existence of the Government's 8-hour law.⁷⁰

According to a letter read into the record by Mr. Baruch, the industry was holding out for prices which he thought to be "high and unfair." The possibility of noncooperation by the steel industry moved the War Industries Board to invoke the threat of commandeering. Mr. Baruch's letter in part states as follows:

Almost immediately after the declaration of war, at the request of the President, I met representatives of the steel companies in the office of Elbert H. Gary, 71 Broadway, New York City, more particularly in reference to the price of ship plates which they fixed at 4½ cents a pound, assuring me they knew that would be satisfactory to the Government. I urged them not to insist upon that price because it was too high and unfair in the circumstances. They could not see my point, although later in the evening I again met Judge Gary and made the same request, to which I got the same reply. I laid this information before the President and Mr. Denman, then Chairman of the Shipping Board. At this period I was chairman of the raw materials section of the Council of National Defense, and was acting in that capacity.

Following a conference at Washington in July, which both Judge Gary and I attended, it was decided to await the conclusion of an inquiry into prices of steel which the Federal Trade Commission was making. This brought about a meeting on September 21 on the subject. Previously the War Industries Board had passed a resolution declaring that "if the steel interests should not be willing to give their full cooperation because of the prices fixed, the War Industries Board would take the necessary steps to take over the steel plants."⁷¹

The prices that were finally fixed on September 24, 1917, follow, together with the August 1914 prices:

Commodity	Basis	Fixed price ¹	August 1914 price ²
Iron ore.....	Lower lake ports.....	\$5.05 per gross ton.....	\$2.85
Coke.....	Connellsville.....	\$6 per net ton.....	1.80
Pig iron.....		\$33 per gross ton.....	13.00
Steel bars.....	Pittsburgh-Chicago.....	\$2.90 per 100 pounds.....	1.18
Shapes.....	do.....	\$3 per 100 pounds.....	1.37
Plates.....	do.....	\$3.25 per 100 pounds.....	1.18

¹ Garrett op. cit., p. 261.

² War Industries Board, Price Bulletin No. 33, Prices of Iron, Steel, and Their Products.

The success of the steelmakers' tactics of delay and noncooperation may be seen in the vast profits obtainable from these prices at the existing costs of the majority of the producers in the steel industry which have already been alluded to on page 58 of this report. In viewing these prices from the angle of reduction of inflation it is apparent that regardless of the extent of the decrease from transitory speculative prices prevailing immediately before price stabilization, the basic price structure of the steel industry still remained at fabulously high levels over pre-war prices. War Industries Board Price

⁶⁹ Exhibit No. 1733.

⁷⁰ Ibid.

⁷¹ Bernard M. Baruch, Mar. 29, 1935 (galley S1 BBQ).

Bulletin No. 3 has stated that "the prices fixed by the War Industries Board did not represent reductions as enormous as many people believed the elaborate Federal Trade Commission inquiries into costs justified."⁷² The price index charts facing p. 128 show that the prices of steel sheets and steel plates were fixed at levels above the highly inflated all commodities index and that it was not until after the coming of peace and the discontinuance of price control that these prices fell through the all commodities level.

It has also been pointed out that the price reductions were in fact not as much as they appeared to be since the exorbitant market prices of July represented only a small volume of sales:

It should, of course, be remembered that the very high quotations of July 1917 were never realized in the majority of contract placements. They represented simply the exorbitant prices which certain sales could command because the bulk of steel was booked up under contract. The real scaling down of prices from the high point of July 1917, therefore, was actually much less than one might suppose on examining the above figures.⁷³

Furthermore, it should be recognized that since it had been decided not to apply the fixed prices to past contracts a large number of steel transactions were removed from any regulation.⁷⁴

The steel industry's journal stated that the fixed prices were really not far from the contract prices which had been prevailing for the past six months and at which levels profits were "quite satisfactory:"

While the new prices on plates, shapes, and bars are lower than some of the steel conferees were prepared to accept, particularly in view of the Steel Corporation's last advance of 10 percent in wages, which other producers have followed without question, it is to be considered that they are not far from the average prices on contract shipments in the past six months, on which the profits of integrated companies as well as of some that are but partly integrated have been quite satisfactory. With the readjustments on coke and pig iron, some companies of the latter class will do fairly well. There will be certain hardships to a number of plants that must buy pig iron, even at the new \$33 price.⁷⁵

In addition to the unreliability of using spot prices as a basis of computing the size of the reduction, it should be noted that the conservative Iron Age magazine had to correct the War Industries Board's statement of the market prices which had prevailed prior to stabilization:

The extent of the reductions from existing market prices was exaggerated in the official statement given out at Washington. Spot coke was \$12.50 last week, rather than \$16, and in putting pig iron at \$58 the statement went to an extreme, since \$50 or less has been the recent level.⁷⁶

The method of quoting prices also had the effect of exaggerating the extent of the price reduction. The Federal Trade Commission has stated:

In order however to prevent possible misunderstanding, attention should be called to the fact that the prices fixed for steel products were generally what are known as base prices; that is, generally, a price per ton, or per hundredweight, for a certain standard grade and "base" size. For special quality as well as for the numerous sizes other than the "base" size, the trade custom had established "extras" or additions to the base prices, and these customary extras were continued apparently on approximately the same scale, in most cases, according to the recommendations made to the price-fixing committee by its own advisers.

⁷² Page 261.

⁷³ W. I. B. Price Bulletin No. 3, p. 261. See Committee Print No. 3, p. 129: "An adequate analysis of cost, however, can be made only by the use of contract prices, for it is probable that only small quantities of coke were purchased at the high market prices."

⁷⁴ Report of the War Industries Board, p. 117.

⁷⁵ The Iron Age, Sept. 27, 1917.

⁷⁶ Ibid.

It is important to understand this situation, because the average costs of some companies might be above the base price and yet the products could be sold at profitable prices due to the fact that most of the tonnage carried large "extras." The use of "basing points" in quoting prices was also allowed, and this practice materially affected the prices received by many of the companies. At first both Chicago and Pittsburgh were allowed as price basing points for certain steel products but later Pittsburgh only.⁷⁷

The differentials for the various types of products were determined by a committee of the American Iron and Steel Institute which represented the steel industry. In the Report of the War Industries Board⁷⁸ it is said that—

In order to control fully the prices in this industry, a very large schedule of differentials, or prices for products which vary from the basic types had to be worked out. The problem of calculating this was assigned to the industry itself, and the work was accomplished by a committee of the American Iron and Steel Institute. These differentials were promulgated by the committee directly to the industry, but when once announced they were given the same application in all policies as those prices fixed specifically by the President through the War Industries Board or later through the price-fixing committee.

Even Judge Gary agreed that in some cases the prices fixed by the industry itself for finished products were too high.⁷⁹

The effect of the prices set was to strengthen steel stocks, an important factor in the upward movement being the expectation of a revival of new business resulting from stabilization of the market.⁸⁰ The New York Times of September 25, 1917, the day after the prices were fixed, reported:

Steel common gained 2 points; Lackawanna, 2¼; Republic Iron & Steel, 2¾; Crucible, 1; Bethlehem Steel, class B, 2¾; Great Northern Ore, 2¼; Midvale Steel and Superior Steel, 2 points. New York Central rose 1½; Union Pacific, 1¼; and Baldwin Locomotive, 4¼; with many other issues rising from 1 to nearly 3 points. An improvement of sentiment toward securities was generally evident in the Street, which supplemented the increase of optimism that followed the fixing of the price for copper last week. * * *

The lower prices will have one effect, it was said, that will be an aid to the industry. This will be the new business that will result. Since the beginning of the European war, building operations have been almost at a standstill, and now the lower steel prices have been fixed, the builders will get busy and the country can expect to experience a boom in the building business, provided the steel mills can take care of the new orders thus drawn out. * * *

So satisfactory are the prices fixed for iron and steel products that western steel makers are convinced the announcement will be followed almost immediately by a marked revival in business, writes the financial editor of the Chicago Herald. * * *

L. E. Block, vice president of the Inland Steel Co., said:

"The steel and iron prices fixed by the Government are considerably below those prevailing, but I imagine that under all the circumstances the steel manufacturers will be fairly well satisfied with them. All steel manufacturers have on their books a very large number of unfilled orders taken at the higher prices. These contracts will stand.

"Buyers who have contracted for iron or steel at the higher prices must accept delivery at those prices, but I do not believe this will be productive of any serious inconvenience."

In speaking of the price fixing, however, a report of the War Industries Board thought that the steel interests were to be commended:

* * * in view of the fact that there was no legal authority for enforcing these requirements, we considered it a great achievement and a wonderful monument to the patriotism of the steel manufacturers in the country.⁸¹

⁷⁷ Federal Trade Commission Report on War Time Profits and Costs of Steel Industry, p. 20.

⁷⁸ Page 121.

⁷⁹ Minutes of the Price Fixing Committee, Mar. 20, 1918.

⁸⁰ See discussion, *infra*, pp. 128-130, regarding the stabilizing effects of price control in the steel industry.

⁸¹ Committee Print No. 3, p. 130.

At a later point there appears the following statement:

The Division wishes to make an opportunity of recording the great assistance rendered by the American Iron and Steel Institute. Hon. E. H. Gary, as chairman, appointed a committee on steel distribution, through whom the Director of Steel Supply distributed to the various mills in the country the orders for war materials received from the various departments of our own Government and from the Allies. Commercialism was entirely dropped from their calculation, and they entered patriotically into their work with no thought of personal gain, but entirely for the interest of our common cause.⁸²

(c) *The building and operation of the Old Hickory Powder Plant.*—With the foresight bred from over a century's experience as the Nation's chief source of military powder,⁸³ the du Pont Co. directed its engineers to seek a suitable location for the construction of a new powder plant as soon as diplomatic relations were severed with Germany—2 months before we declared war.⁸⁴ From the outbreak of the war this company, which one of its officials characterized as "almost a subdivision" of the Ordnance Department,⁸⁵ strove to convince the military authorities of the need for increased powder capacity.⁸⁶ Not until October 1917 was the Government convinced.⁸⁷

Four days after the War Department had agreed to the urgent necessity of additional manufacturing capacity of approximately 1,000,000 pounds of powder a day⁸⁸ the du Pont Co. submitted a draft contract to build and operate plants of that capacity.⁸⁹ This contract estimated the total cost of construction at \$90,000,000 including a fee to the du Pont Co. of 15 percent of cost. The company was to receive in addition an operating fee of 5 cents a pound for each pound of powder produced, plus one-half of any reduction in cost below a fixed amount per pound, the Government to pay all costs of operation.

Substantially this agreement was signed by General Crozier, Chief of Ordnance, on October 25, 1917.⁹⁰ On November 7, Robert S. Brookings, then chairman of the War Industries Board, estimated that in addition to \$13,500,000 to be received as compensation for the construction of the plant, it was quite probable that under this contract the du Pont Co. would receive approximately \$30,000,000 in profits for operating the plant the first year. This Mr. Brookings felt was "utterly out of scale for any possible service they can render."⁹¹

On October 31, Secretary of War Baker had wired the du Pont Co. to do nothing about the contract until they heard further from him.⁹²

On November 14, Mr. Brookings reported to the Secretary of War that the War Industries Board had had a long conference with officials of the Ordnance Department and with representatives of the du Pont Co., but that in spite of certain changes agreed to by the du Pont Co. he, Judge Lovett, and Mr. Baruch still declined to approve it.⁹³

⁸² Committee Print No. 3, p. 135.

⁸³ "Since 1805 the du Pont Co. has provided the United States with most of the explosives that the country's fighting forces used in our wars." A History of the du Pont Co.'s Relations with the United States Government, Smokeless Powder Dept., E. I. du Pont de Nemours & Co., Inc., p. 10.

⁸⁴ Exhibit no. 1117.

⁸⁵ Part 15, p. 3696.

⁸⁶ Exhibits nos. 1117, 1123, 1124.

⁸⁷ Exhibits nos. 1117, 1125.

⁸⁸ Exhibit no. 1125, dated Oct. 4, 1917.

⁸⁹ Exhibit no. 1126, dated Oct. 5, 1917.

⁹⁰ Exhibit no. 1130; See Exhibit 1129.

⁹¹ Exhibit no. 1139.

⁹² Part 13, p. 2959.

⁹³ Exhibit no. 1142.

But although the Government officials thought that the du Pont demand for profits was exorbitant, it appeared that only the du Pont Co. could supply the services needed.

The company, by its own admission, controlled "about 90 percent of the smokeless powder producing capacity of the United States"⁹⁴ and so had a practical monopoly on operating experience. The company had been producing 1,300,000 pounds of military powder a day since 1914 for a total of nearly 750,000,000 pounds, and believed their capacity equaled that of Great Britain and France combined.⁹⁵ The du Pont Co. also had in effect a monopoly as to experience in the construction of powder factories. Within 3 years they had built factories of capacity equal to the contemplated plant and so were indeed, as they said, "in possession of all information necessary for the carrying out of this project."⁹⁶ The blueprints used for their factories would cover some 60 acres of ground.⁹⁷ A great many of these drawings were standard,⁹⁸ and so did not need to be duplicated.

Daniel Willard, as chairman of the War Industries Board, told the Secretary of War on November 26, 1917, that upon the evidence of "demonstration" it was the opinion of the Board "that the du Pont people are in every way the best fitted" for constructing the plant in the least possible time and operating it with the greatest efficiency.⁹⁹ Pierre S. du Pont on December 10, 1917, wrote that:

General Crozier has assured us that he believes it necessary to call upon us for assistance and that there is no doubt in any mind that our company should undertake the work if proper compensation can be determined.¹

The du Pont Co. recognized the strength of its own bargaining position:

* * * our willingness to negotiate has been based entirely upon the necessities of the Government and the belief that our company is not only the best equipped for executing the work promptly, but practically the only organization capable of so doing.²

Mr. Pierre du Pont wrote to Mr. E. G. Buckner, a vice president:

Our commanding position in the explosive industry has been won only by incessant work and expenditures of money by the company. The situation is an asset of the stockholders which cannot be dissipated lightly.³

It must be remembered that these negotiations occurred in the midst of war. The military forces urged speed at all costs. Mr. Brookings wrote to the Secretary of War after the November 14, 1917, conference:

On leaving the conference, General Crozier announced that he felt that, regardless of price the Government must have immediate action on this, and immediate action could only be had through the du Ponts, and therefore he would urge upon you the emergency necessity which, in his judgment, overshadowed all question of cost.⁴

Lieutenant Colonel Harris, when asked by the chairman whether there was a more critical time during the war than the period of these negotiations, testified:

⁹⁴ Exhibit no. 1151, at p. 3277.

⁹⁵ *Ibid.*

⁹⁶ Exhibit no. 1143, at p. 3272.

⁹⁷ Exhibit no. 1132, at p. 3145.

⁹⁸ Testimony of Irénée du Pont, p. 3170.

⁹⁹ Exhibit no. 1148.

¹ Exhibit no. 1154.

² Exhibit no. 1151, at p. 3279.

³ Exhibit no. 1132.

⁴ Exhibit no. 1142.

It is hard to say which was the most critical time of the War, but that was a very critical time.⁵

For 3 months the building of the Old Hickory powder factory was delayed because of the refusal of the du Pont Co. to accept the liberal terms offered to them.

At the November 14 conference the War Industries Board—

suggested to the du Ponts that they go ahead and construct this plant and operate it after construction, charging all cost of every kind and character to the Government, and, after they had demonstrated the great service rendered the Government, to leave to the Secretary of War the question of their compensation, assuring them that the Secretary of War could not do other than treat them fairly—in fact liberally—if he assumed the responsibility of paying them a fair price for their service.⁶

On November 26 the War Industries Board recommended a more liberal offer, having “so far been unable to agree with the du Ponts as to what would be fair compensation for the erection and operation of the plant.”⁷ This offer provided that the Government would pay “every dollar of expense”, would advance \$1,000,000 on account of profit and that pending the completion of the contract—

the Government, through the Secretary of War, will endeavor to negotiate with them from time to time as to what, if any, additional compensation they should fairly receive for their services, and on the completion of the contract if the du Pont Company and the Secretary of War have not been able to agree upon such sum, then the matter shall be left to the usual form of arbitration—that is each party to select one arbitrator, and the two so selected to agree upon a third, the findings of the two of these three to be binding upon both interested parties.⁸

This recommendation was adopted by the Secretary of War the following day.⁹ On the recommendation of Pierre S. du Pont,¹⁰ the president of the company, it was rejected by the company’s board of directors on November 28.¹¹

On December 12 the Secretary of War notified the company that the War Department had “proceeded to work out a plan for the direct creation of this capacity by the Government itself.”¹² Mr. Pierre du Pont testified that the Secretary of War said to him in substance: “I think it is time for the American people to show they can do things for themselves.”¹³

But the Government had no real alternative to accepting the terms of the du Ponts.

On December 15, 1918, D. C. Jackling was appointed by the Secretary of War “to build and operate the proposed new Government powder plant.”¹⁴ Just 2 days later Mr. Jackling, who apparently had had no prior experience in the manufacture of powder or explosives,¹⁵ suggested to Mr. Pierre du Pont that the building and operation of part of the projected factory be undertaken by the du Pont Co., but Mr. Jackling’s terms were refused.¹⁶

⁵ Part 14, p. 3193.

⁶ Exhibit no. 1142, at p. 3270.

⁷ Exhibit no. 1148.

⁸ *Ibid.*

⁹ Exhibit no. 1149.

¹⁰ *Ibid.*

¹¹ Exhibit no. 1150.

¹² Exhibit no. 1157.

¹³ Part 14, p. 3188.

¹⁴ Exhibit no. 1158, p. 3211.

¹⁵ Testimony of P. S. du Pont, pt. 14, p. 3211. Testimony of Irénée du Pont, part XVII, p. 4200.

¹⁶ Exhibit No. 1224 at p. 3788 and at p. 3789, letter of Jan. 9, 1918.

Under the decision of the War Department that the "direct creation" of the plant should be done by the Government itself, Mr. du Pont felt that:

Our company believes it unnecessary to reveal our practices with respect to such lines of manufacture that are now commercially developed in the United States, such as those of sulphuric acid, nitric acid, cotton purification, diphenylamine and ether, as sufficient information is obtainable elsewhere. * * * In general, this company will not attempt to criticize or approve the plans of the War Department as the close interrelation of the parts of the proposed factories makes piecemeal criticism useless and our services as directors of the whole project are deemed by the Government as unnecessary.

We pointed out to Mr. Jackling that the proposed work involved no problems that cannot be solved by capable engineers of industrial training but that economy and speed of reaching maximum output with a properly balanced plant are out of the question unless the work is in charge of an organization of experience. On that account we will not delegate any of our men as suitable to assist the War Department in its work, knowing full well that the withdrawal of even large numbers of them cannot win satisfactory results for the Government without the backing of our entire organization. Since suspension of General Crozier's order we have taken on important work for the Government which, together with that heretofore on hand, will call for the use of all our forces. On this account we should not be called upon for men. If the War Department decides to set aside this recommendation, we request that negotiations be made with our men direct, though we would appreciate the courtesy of being informed as to what is intended in this respect.¹⁷

Mr. Irénée du Pont testified that:

When Mr. Jackling came, he tried to take our chief engineer away from the du Pont Co., upsetting their work, and the chief engineer said, "I cannot do anything. I cannot help you. This is the organization that does the thing. You will have to take the organization."¹⁸

On January 29, 1918, Mr. Jackling signed a contract with the du Pont Engineering Co., a wholly owned subsidiary of the du Pont Co. having an invested capital of only \$5,000,¹⁹ for the construction of a plant with a capacity of 500,000 pounds of powder a day.²⁰ The contract provided for construction fees of \$500,000 plus 3 percent of cost, the total not to exceed \$2,000,000²¹ and for operation fees of 3½ cents per pound of powder delivered, plus half of all reductions in cost below base costs.²²

On March 23, 1918, a substituted contract was executed under which the du Pont Co. was relieved of any financial strain inasmuch as the Government was to advance \$18,750,000 for construction and reimburse this fund for current outlays until 75 percent of the total estimated cost, over and above the \$18,750,000, had been paid.²³ No fee was to be charged for construction but the 3½ cents per pound operating fee plus one-half of any savings below base costs remained,²⁴ and the capacity on which this fee was to be paid was increased from 500,000 to 900,000 pounds a day.²⁵ Furthermore the du Pont Co. could sublet any part of the construction work and charge fees paid in connection therewith to costs.²⁶

¹⁷ Ibid, at pp. 3788-89.

¹⁸ Pt. 14, p. 3178.

¹⁹ Pt. 13, p. 2948; testimony of P. S. Du Pont, pt. 14, p. 3218.

²⁰ Exhibit no. 1163, see art. II, p. 3290.

²¹ Ibid, art. VI.

²² Ibid, art. X.

²³ Exhibit no. 1168, art. II, p. 3290.

²⁴ Ibid, art. IV, par. (e), p. 3300.

²⁵ Ibid, art. I, p. 3298.

²⁶ Ibid, art. II, p. 3298 (italics added). Whenever it is inexpedient for any portion of the construction work to be performed by the contractor, it may *in its discretion*, sublet such portion of the work, upon the most advantageous terms obtainable consistent with the best interests of the United States.

In fact, a fee of \$1,078,000 was paid to the Mason & Hangar Co. for construction work costing \$21,511,000.²⁷

In addition a further advance of \$18,954,000 was to be made in three equal installments to finance production costs.²⁸

The January 29, 1918, contract authorized Mr. Jackling to order changes in specifications and otherwise to direct the work and required this approval for purchases and the like.²⁹ The primary reason for the March 23 contract was the du Pont Engineering Co.'s desire to be free "to proceed in its own way in the construction of the plant, without all these delays in getting approval of plans and specifications."³⁰

Under this final draft of the contract the company received a net profit of \$1,961,560 for the operation of the plant³¹ which never reached full capacity because of the termination of the war.³² The \$1,961,560 profit represents over 5 cents a pound on the 35,538,345 pounds³³ produced. Had the war continued the Old Hickory contract would, at that rate of profit, have yielded a return of \$15,000,000 a year (assuming a production of 300,000,000 pounds a year), on the \$5,000 capital invested in the Engineering Co.

For 3 months during the World War the du Pont Co. refused to use its knowledge to make powder for the Government at the Government's cost plus the liberal reward offered. It demanded its own terms.

Mr. Pierre du Pont called his company's position a refusal "to work without proper compensation" and felt it "necessary because the directors of our company, acting for our stockholders, have no authority to do otherwise."³⁴ He referred to the "duties of our officers and directors to endeavor to win reasonable profits for the stockholders. That is not only part of our duty, but we cannot assent to allowing our own patriotism to interfere with our duties as trustees."³⁵ It is significant that Mr. Pierre du Pont was one of the 10 largest holders of the common stock of the du Pont Co. at the time he felt that his patriotism must not interfere with his duties as a trustee for the du Pont stockholders.³⁶

(6) IMPOTENCE OF GOVERNMENTAL CLUBS

(a) *The power to requisition and commandeer.*—It has been claimed that during the World War an effective club existed in the form of the Government's power to requisition and commandeer goods and plants. Both these powers involve the actual physical seizure of property without going through any bargaining process such as accompanies its usual acquisition by payment of a contract price.

It is necessary to recognize, however, that the matter did not end with the physical taking of the property. The statutes under which this power was exercised provided for the payment of just compensation.³⁷ If they had not done so, they would have been invalid under

²⁷ Pt. 14, p. 3226.

²⁸ Exhibit no. 1168, art. V, par. (a), p. 3501.

²⁹ Exhibit no. 1165, arts. II, III, and V, pp. 3290-91.

³⁰ Testimony of W. S. Gregg, pt. 14, pp. 3220-21.

³¹ Exhibit no. 1170.

³² Testimony of W. S. Gregg and W. B. Banker, pt. 15, pp. 3599-3600; ex. 1224, p. 3784.

³³ Testimony of W. S. Gregg, pt. 14, p. 3181.

³⁴ Exhibit 1146, p. 3273.

³⁵ Exhibit 1132, p. 3145.

³⁶ Pt. 14, p. 3164. See also testimony of Irénée du Pont, p. 2963.

³⁷ A typical provision of the war-time legislation appears in sec. 10 of the Food and Fuel Control Act: " * * * the President is authorized from time to time, to requisition foods, feeds, fuel and other supplies necessary to the support of the Army or the maintenance of the Navy, or any other public use connected with the common defense, and to requisition, or otherwise provide, storage facilities for such supplies, and he shall ascertain and pay a just compensation therefor."

the Fifth Amendment to the Constitution.³⁸ It has been well settled doctrine since the case of *Ex parte Milligan* that the emergency of war does not create new powers; the actions of the Government are still subject to the limitations imposed by the Constitution.³⁹

Obviously the effectiveness of this device in compelling cooperation is dependent in large measure upon the fear which it inspires of detrimental consequences of its invocation. The executive authority, however, does not have sole power to determine what is the proper measure of compensation. After its determination has been made, the company whose property has been commandeered may appeal to the courts, inasmuch as it has been decided that under the Constitution the determination of just compensation is a question reviewable by the judiciary.⁴⁰

The measure of compensation to be used where property has been requisitioned has been stated by the Supreme Court in the case of *Phelps v. U. S.*:⁴¹

The Government's obligation is to put the owners in as good position pecuniarily as if the use of their property had not been taken.

This rule obviously leaves very little of a coercive nature to the commandeering power and judicial application of the rule has been sufficiently literal to ease whatever harshness and arbitrariness there may be in commandeering.

It has been held that where a stable market price exists, determination of compensation on the basis of cost of production plus a reasonable profit is not the proper method of restoring the producer to a position similar to that he would have been in had his property not been commandeered. In *U. S. v. New River Collieries*,⁴² the Supreme Court applied the rule to give a company the highest prevailing market price as compensation for coal which had been requisitioned by the Government. It permitted the use of export prices rather than domestic contract prices because the former were higher.

The court, in *L. Vogelstein v. U. S.*,⁴³ decided that the company's copper stock could be requisitioned at the liberal copper price fixed by the War Industries Board. By refusing to come along, the company in this case was in no worse position than if it had been cooperative and, in addition, had the possibility of gaining a larger amount from the court.

As a matter of fact the War Industries Board entertained a good deal of concern about keeping the commandeering price at the same level as the fixed price. The following excerpt from its minutes of May 28, 1918,⁴⁴ contains the discussion on that point:

Present: Mr. B. M. Baruch, chairman; Mr. R. S. Brookings, Brig. Gen. Hugh S. Johnson, Mr. Hugh Frayne, Mr. Alex Legge, Judge E. B. Parker, Mr. G. N. Peek, Mr. J. L. Replogle, Mr. L. L. Summers, Mr. H. P. Ingels, secretary.

Price fixing.—Attention of the board was called to the probable difference in rulings of the price-fixing committee and the board of appraisers of the War Department now operating under the direction of the surveyor general of pur-

³⁸ *U. S. v. L. Cohen Grocery Co.*, 255 U. S. 81. *U. S. v. New River Collieries*, 262 U. S. 34.

³⁹ 4 Wall 2. But see the *Selective Service cases*, 245 U. S. 366.

⁴⁰ *U. S. v. New River Collieries*, 262 U. S. 341.

⁴¹ 274 U. S. 340.

⁴² 262 U. S. 341.

⁴³ 262 U. S. 337.

⁴⁴ Exhibit No. 1249.

chases. If a manufacturer or producer refuses to deliver his product to the Government at prices fixed by the price-fixing committee and the product is commandeered, under the present arrangements, it is the function of the board of appraisers to determine a fair and just compensation. Considering the demoralizing effect that would result from having the board of appraisers fix prices different from those fixed by the price-fixing committee, Mr. Brookings was requested to discuss with General Johnson the advisability of

1. Having the board of appraisers work with the price-fixing committee, or
2. To have the price-fixing committee take over the work now being done by the board of appraisers.

Meeting adjourned at 12:55 p. m.

(Signed) H. P. INGELS, *Secretary*.

One of the functions of the Price-Fixing Committee was declared to be "when materials are commandeered prices of the same will be fixed by this committee."⁴⁵ It is clear that however ineffective a threat to commandeer at the same level as the fixed price with reservation of right to appeal to the courts, there would be further impairment of its function in the possibility that the administrative determination of compensation might itself result in the award of a larger sum than the price fixed.

Another defect in the commandeering power was its limited coverage. Goods could be commandeered only for the Army and Navy. Mr. Baruch testified that it was felt that:

There was nothing in the commandeering situation that we could use to commandeer from one civilian producer so that another civilian consumer or producer could get this man's products.⁴⁶

The consequence of this weakness of power on the height of prices has been stated by him as follows:

And that is one of the very reasons that these prices were not fixed quicker and why we did not hammer harder than we did, and why we had to pay more than justified for the Army and Navy.⁴⁶

The efficacy of the commandeering power to induce cooperation was further reduced by the belief of the responsible governmental authorities that there were insurmountable practical obstacles to its actual exercise. These were apparently of sufficient strength to dissuade the Government from its application, even where there was an admitted need for it.

As we have seen, the steel industry was extremely noneoperative in the price negotiations which were undertaken to lower the speculative high prices that prevailed even after the United States entered the war. It will be remembered that the War Industries Board had passed a resolution declaring that "if the steel interests should not be willing to give their full cooperation because of the prices fixed, the War Industries Board would take the necessary steps to take over the steel plants."⁴⁷ Yet this threat was not backed up by any definite plan for concrete action. Mr. Baruch has testified before this committee that in the case of the steel industry threat he did not know how the commandeering power would have been put into execution:

Mr. HISS. Let us talk about the United States Steel Corporation.

Mr. BARUCH. Yes, sir.

Mr. HISS. If your bluff had been called, what would you have been able to do?

Mr. BARUCH. I would have been in a devil of a fix.

Mr. HISS. Would not production have fallen off?

⁴⁵ Exhibit No. 1274.

⁴⁶ Bernard M. Baruch, Mar. 29, 1935.

⁴⁷ Bernard M. Baruch, Mar. 29, 1935 (galley 51 BBQ).

Mr. BARUCH. If I could not have gotten Judge Gary, I would have gotten some other fellow down the line.

Mr. HISS. But that would not have been operation by a Federal bureau, would it?

Mr. BARUCH. No, sir. We might have had to put it in charge of some officer. I do not know how we would have worked it. It was not very clear in my own mind.⁴⁸

Mr. Baruch has also testified before the War Policies Commission that he could not recall a single instance of an important industrial enterprise being commandeered during the entire course of the World War:

* * * During the World War, Government had power to commandeer factories and to operate them under bureaucratic direction. I do not recall a single important industrial enterprise that was thus taken over. This does not mean that the use of the power was never advocated. On the contrary, it was seriously urged in respect of a great industrial plant which was thought by some not to be giving full cooperation to its Government. The proposal split on the rock of this argument:

Who will run it? Do you know another manufacturer fit to take over its administration? Would you replace a proved expert manager by a problematical mediocrity? After you had taken it over and installed your Government employee as manager, what greater control would you have then than now? Now, you can choke it to death, deprive it of transportation, fuel, and power, divert its business, strengthen its rivals. Could any disciplinary means be more effective? If you take it over, you can only give orders to an employee backed by threat of dismissal, and with far less effect than you can give them now. Let the management run the plant and you run the management.

Nobody with any familiarity with industry could seriously urge a wholesale assumption by any Federal bureau of the responsibility for management of any or all of the vast congeries of manufacturing establishments upon which we must rely for extraordinary effort in event of war. Even if such bureau management could prove adequate to the task (which it could never do) the mere process of change would destroy efficiency at the outset.⁴⁹

The practical difficulties were made especially obvious in the case of industries composed of large numbers of producers. Business men who were cognizant of the actual working of industry could readily realize how improbable it was that the War Industries Board would attempt to displace existing management which knew how to run its business and place new men in many different plants spread over large areas and set up a vast central supervising agency—all at short notice and at a time when the demand was for greatly increased production. In fact when the War Industries Board was talking of commandeering the copper industry they were bluntly told by its representative, Mr. Ryan, that “it would be impossible to commandeer all of the small high cost mines as there are such a great number.”⁵⁰

The compulsory orders issued by the Army and Navy could have been of no greater effect than the commanding power. They did not impose a penal sanction on the manufacturer who refused to produce the required commodities. In the event of such refusal, the National Defense Act simply rendered him subject to the commanding power. Requiring the manufacturer to produce goods for the Government under penalty of going to jail would undoubtedly have raised the constitutional question of involuntary servitude.

⁴⁸ Ibid. (galley 82 BBQ)

⁴⁹ 72d Cong., 1st sess., H. Doc. No. 163, p. 53.

⁵⁰ Exhibit No. 1701.

Actually, it has been found that the compulsory orders issued by the Army and Navy had uses which were quite different from the functions of cutting short negotiations and inducing cooperation to get production at lower prices.

For example, the Judge Advocate General's Office ruled that a compulsory order could be used to place orders without competition:

Under this section the mere placing of an order for the supplies and materials required is sufficient without the execution of a formal contract. Therefore no advertising for bids in any form whatever or filing of bids is necessary.⁵¹

Furthermore they could be used by the Government to gain priority. Section 120 of the National Defense Act provided in part that:

Compliance with all such orders for products or material * * * shall take precedence over all other orders and contracts theretofore placed with such individual * * * corporation or organized manufacturing industry * * *

One of the consequences of the receipt of such an order would be, of course, to relieve the producer of civil liability to his private customers because of any impairment of performance due to the Government work. Lieutenant Colonel Harris, stated in his testimony before this committee, that in his opinion priority was the principal reason for the use of compulsory orders by the Navy.⁵² Lieutenant Brannon of the Judge Advocate General's Office was of the same opinion as to the purpose of issuance of the War Department orders.⁵³

(b) *The priorities system.*—In addition to the commandeering power, it has been said that the Government was able to exert coercion by means of its control of priorities.⁵⁴

But it must be recognized that the paramount purpose of the priority system was to deal with the problem of shortages. By granting certificates of preference, essential war industries could be better assured of gaining the raw materials necessary for production of the goods required by the military forces of the Nation. An effect of their denial to an industry or plant was the retardation of the flow of raw materials and the consequent curtailment of its output.

In the case of iron and steel it is necessary to recognize that the consequence of cutting off the industry's supply of fuel would have meant a diminution in the flow of shells, tanks, and other implements of war to the Army and Navy. Even the less essential industries, such as automobiles, were concerned about increasing the supply of this commodity. At a meeting of the War Industries Board with the representatives of the automobile industry, the following discussion ensued:

Mr. DURANT. Can we increase the supply of pig iron and what would it be necessary for us to do to obtain the increase?

Mr. BARUCH. Those suggestions are referred to us daily; we have made every move possible to increase pig-iron capacity. It has been a matter of fuel and transportation.⁵⁵

⁵¹ Vol. 1 of Opinions of the Judge Advocate General, p. 141 (1917).

⁵² Lieutenant Colonel Harris, Dec. 20, 1934.

⁵³ Lieutenant Brannon, Dec. 20, 1934.

⁵⁴ Mr. Baruch, in his supplementary statement to the committee dated Apr. 12, 1935, gave his estimate of the priority system:

"May I add that commandeering was by no means our only weapon. Public opinion was our real weapon. If you haven't got it, a democracy can't fight a war. If you have got it you need little else. But we did have much more than that. We had the allocation of priority based upon transportation control authorized by statute. That alone was enough. That could have choked to death and ruined any corporation, and, except for fines, that is the only effective penal sentence you can apply to an artificial person."

⁵⁵ Exhibit No. 1274.

Invocation of the priority power against a particular plant in an essential industry would be limited by the extent of the unused capacity in other similar plants. Where the company itself furnished a great proportion of the capacity, as is the case in the steel industry with such companies as United States Steel and Bethlehem, there would be relatively little opportunity for the diversion of business to other companies. The use of priorities as penalties to enforce governmental orders would thus work against the primary need of wartime, increased production.

(7) CONSTITUTIONAL DIFFICULTIES OF PRICE FIXING

Any price-fixing statute attempting to severely limit profits would raise constitutional problems. The price-ceiling scheme which attempts to fix all prices throughout the entire economic structure would be questionable on that very ground. It was the opinion of the legal section of the War Policies Commission that to uphold such a position might involve an innovation by the courts in the existing law:

The question arises whether or not to uphold universal price fixing in wartime it will be necessary for the courts to go one step further than they have so far gone, namely, to hold that because the modern methods of warfare, which involve the Nation as a whole rather than merely its armed forces, the emergency is so wide-spread and the regulative force of competition so universally restricted as to cloth with public interest all dealings in commodities and services, whether for public or private consumption, whether at wholesale or retail. Whether or not that proposition can be sustained, is, in its ultimate analysis, the question to be answered.⁵⁶

The case of *Nebbia v. New York*⁵⁷ although liberalizing the public-interest doctrine leaves open the question of whether universal price regulation would be considered to be a reasonable exercise of the war power.

And regardless of the decision as to what types of prices may be regulated, the problem of the necessity for a fair price will remain. If the cases on commandeering, such as *U. S. v. New River Collieries*, are followed, it would seem that there would be a substantial legal obstacle to the prevention of profiteering and inflation in time of war. It will be remembered that there the court decided that payment of a price which merely represented cost of production plus a reasonable profit was not sufficient and that the high market price for exports was the proper test.

⁵⁶ War Policies Commission Hearings, op. cit., p. 841.

⁵⁷ 291 U. S. 502

II. PRICE CONTROL AS A MEANS OF PREVENTING INFLATION

It is clear that the probability of price decline is remote in time of war.

The published practice of the price-fixing agencies in the World War was to set maximum prices instead of prices which did not admit of any fluctuation. Mr. Baruch, in his supplementary statement to this committee, has stated that the price-ceiling proposal also contemplates this type of price regulation:

* * * In simplest terms, I propose—

To make it unlawful to raise prices in any war from the day of declaration (or thereabouts) except as may be permitted by the President and to penalize both seller and buyer for infractions. Individual prices or whole groups of prices may be adjusted up or down by a price-adjusting committee as occasion requires. This puts a ceiling over the price structure but permits fluctuations downward as freely as before. It also offers sufficient flexibility to meet all exigencies. No price is fixed. Nothing is frozen.⁵⁸

However, it has been authoritatively stated in a War Industries Board publication that the distinction between maximum and minimum prices was really a theoretical one and that it was only in a very few cases that prices sank of their own accord:

It was characteristic of the prices fixed by the Price-Fixing Committee, if, indeed, not of all prices fixed in this country during the war, save those for wheat, pork, and hemp, that no more rigid control was attempted than the fixing of a maximum price. *The committee really set limits above which the so-called "fixed prices" might not rise, but left them to play freely below those points. This distinction, though precisely accurate, is of more importance in theory than in practice, because usually the maximum prices became the actual prices and operated, in the main, as fixed prices.* The various Government departments (the Department of War, the Department of Navy, the United States Shipping Board Emergency Fleet Corporation, and the Railroad Administration) were usually guided in their purchases by the fixed maximum prices and paid them without more ado.

The instances in which the market sank below the fixed prices, as it did with zinc and lumber, are relatively few. The committee, when such a circumstance occurred, simply reduced the fixed maximum price to a lower level.⁵⁹

When it became known to the Price Fixing Committee that there would be an increase in the copper price it asked the Government to refrain from placing orders until the higher maximum price was in effect.⁶⁰

Numerous economic forces existed to insure the continuation of the inflationary price levels which prevailed prior to the entry of the United States into the war. These arose from the state of war itself and will accompany any future conflict, regardless of the type of price control adopted.

(1) INTRODUCTION OF MARGINAL PRODUCERS

The examination of Mr. Baruch by this committee developed the fact that the necessity for increased war production requires that marginal producers be brought into operation who could not have

⁵⁸ Supplementary statement of Bernard M. Baruch, Apr. 12, 1935.

⁵⁹ Garrett, *op. cit.*, p. 240. (Italics added.)

⁶⁰ *Supra*, p. 63.

existed at pre-war price levels because of their high costs. Because of the impracticability of the individual price proposal, prices for entire industries must be raised to guarantee this marginal production. As we have seen, this inflationary influence on prices in the World War operated on the many industries whose production had to be stimulated for war purposes, and the price rise for any particular commodity was as high as war fears could make it. These considerations will be operative to carve a deep and wide exception to the price-ceiling plan.⁶¹

(2) INCREASING PLANT FACILITIES

When war comes, the economic structure must be readjusted to meet the changed character of demand. Guns, ammunition, submarines, and other implements of war are the commodities upon which production forces must be concentrated. A similar necessity exists for more of the usual peace-time commodities, such as clothing, shoes, and food. By means of the interrelationship of commodities, this shift in demand communicates itself throughout the country's price structure.

At many points where the novel demand asserts itself, it becomes necessary to either provide new plant facilities or to convert the existing plant to the new purposes. To accomplish either of these ends, large sums of money are required. War industries, it should be noted, are usually heavy industries, where investment must be extensive.

If private industry is to be induced to expend its money for new construction or for conversion of existing plants, it will be necessary to make attractive the transfer of capital, especially where it is already being profitably employed. The alternative is reliance upon a voluntary spirit of cooperation to drop profitable investment or, in the case of idle capital, to enter an uncertain and different field of business. With the coming of peace and the termination of extraordinary war demand, many facilities built for the purpose of the war suffer a loss in value from the curtailment of their profitable use. To insure investment, business requires that it be guaranteed against this future loss as well as assured of a return on the investment.

Both these purposes were effected under the high price structure existing prior to the entry of the United States into the war. Many of the price advances have been explained solely on this ground.⁶²

The institution of price control did not eliminate the upward influence of amortization on prices. It was now urged by producers as an element of cost justifying price increase. When the question of continuing the aluminum prices was before the Price Fixing Committee, the producers contended for an increase because they had enlarged their plants. This consideration was apparently strong enough to warrant an advance of 1 cent over the existing high price of 32 cents a pound.⁶³

To the extent that price increases are used to induce this new construction, there will be another gap in the price ceiling which will impair the effectiveness of that proposal.

The use of Government financing has its limitations. Unless the Government is to make a gift of the new plant to the manufacturer,

⁶¹ See *supra*, p. 56-62.

⁶² See War Industries Board Price Bulletin No. 56. Prices of Explosives, for a statement of the importance of this factor in the prices paid by the Allies for military explosives.

⁶³ Garrett, *op. cit.*, p. 286.

it must be repaid. The manufacturer will therefore have to earn during the war sufficient to recompense for the future loss in value, and that can only be accomplished by a price set at a level which is high enough to take this into account.

Where reliance is placed on a tax provision for amortization as a deduction from gross income, it should be recognized that the manufacturer utilizing it is enabled to gain profits from a facility the expense of which constitutes a subtraction from the Government's revenue. To the extent that this has to be made up by borrowing there is a tendency toward inflation. Moreover, there are many possibilities for profit in manipulation of the inexact determination of loss in value.⁶⁴

The allowance of amortization as an element of cost in the last war permitted gains that were not readily visible. For example, on May 9, 1918, the Price Fixing Committee allowed an increase in the price of aluminum from 32 to 33 cents a pound because of the manufacturer's plea that plants were enlarged to meet war production needs.⁶⁵ The Aluminum Co. of America subsequently gained amortization in the amount of \$10,650,059 under section 234 (8) of the Revenue Act of 1918, as a deduction from its gross taxable income on the theory that much of the war construction represented excess capacity in time of peace.⁶⁶ However, this company's production increased after the termination of the war. As has been noted in the taxation section of this report, production was 124,724,924 pounds in 1918; 128,476,872 pounds in 1919; 138,042,272 pounds in 1920, and from 1923 to 1931 it varied from a low of 128,658,222 pounds in 1923 to a high of 229,036,636 pounds in 1930.⁶⁷ In a word, this company was able to gain two amortization allowances, one in the form of additional price and another in decreased tax, for a loss in value of capital facilities which never materialized. The Government suffered doubly, both in its loss of revenue and in the increased cost of its purchases.

(3) ENCOURAGING FARM PRODUCTION

Another situation in which prices will be adjusted above the ceiling of the pre-war price norm is that of farm products. It was the experience of the World War that not even existing high market prices could induce a sufficiently increased production of wheat. The possibility of a future decline when the crop would be ready for market made necessary the guarantee of a minimum fixed price which would be paid at that time. The Lever Act, approved in August 1917, set a statutory minimum price of \$2 per bushel of wheat, which was increased at later times until it reached the figure of \$2.26:

The scarcity of available wheat had precipitated a panic. While fear was an element in the situation, the problem of scant supply was real. Increased world production was the effective remedy, and under existing conditions America was the country which must do most in increasing the world supply. Wildly fluctuating prices are not attractive to the American farmer, however, especially if they reach unusual heights at a season of the year when his crop is not ready for the market. A high price in May does not insure a high price at harvest time, later on. Moreover, the problem of world supply of wheat, which became acute in the spring and summer of 1917, could not be alleviated except by sowing more

⁶⁴ See *supra*, p. 32-34.

⁶⁵ Garrett, *op. cit.*, p. 286.

⁶⁶ *Supra*, p. 33.

⁶⁷ *Ibid.*

wheat to be harvested 1 year later, or in the summer of 1918. Making wheat culture attractive to the farmer, therefore, became the task of the Government officials.

Congress completed the Food Control Act (Lever Act) 4 months after the United States had declared war against Germany, and it was approved by the President on August 10, 1917. This law not only made possible the organization and program of the Food Administration, but section 14 named a minimum price of \$2 per bushel for the 1918 wheat harvest under the act. Differentials were to be set up for the several standard grades of wheat, based upon No. 1 Northern spring wheat at Chicago, or its equivalent at the principal interior primary markets. The President was authorized, whenever he should find an emergency to exist requiring stimulation of production of wheat, and whenever it seemed essential that the producers should have the benefit of the guaranty, to determine and fix what, under specified conditions, he considered a reasonable guaranteed price for wheat, in order to assure producers a reasonable profit.

It is quite evident that the authors of section 14 were concerned entirely with the producer. Production of wheat was the world's prime need and the purpose of this guaranty was to serve notice upon the farmer one year in advance of his harvest that he might expect at least \$2 a bushel for his wheat crop, and as much more as the market should justify and the President provide.⁶⁸

It has been claimed that the effect of the price may be seen in the figures of crop acreage sown. According to the Bureau of Crop Estimates, Department of Agriculture, the acreage sown in the fall of 1916 was 40,534,000; in 1917 it was 42,301,000; and the preliminary estimate for 1918 was 49,261,000.⁶⁹ The importance of this particular farm product exception is indicated by the figures of production. In 1916, 636,318,000 bushels; in 1917, 636,655,000; and in 1918, 921,438,000.⁷⁰

A somewhat similar treatment was accorded the problem of pork scarcity. For the purpose of stimulating production in 1918, the head of the Food Administration's Meat Division, declared in October 1917 that the price for hogs would not "go below \$15.50 per hundred-weight for the average of the pack's droves on the Chicago market."⁷¹ He further stated that the Food Administration would attempt to stabilize the price so that the farmer would be assured of getting 13 times the average cost per bushel of the corn fed into the hogs. In this case there was no statutory enactment but the Government used its control over the buying of the Allies, the Army and Navy, the Red Cross, the Belgian relief and the neutrals, all of which had been centralized in its hands to keep prices at the stated price level.

Mr. Baruch testified before the committee that prices of some farm products would certainly have to be increased in war time:

Mr. HISS. Mr. Baruch, it is true, is it not, that we will be forced, in any future war, to increase the prices of some farm products, as the most effective way of getting immediate and sudden increase of production?

Mr. BARUCH. Yes, sir.

Mr. HISS. And that will affect the price schedules?

Mr. BARUCH. I also think you have got to do it in peace times, but in war times certainly.⁷²

(4) INEVITABLE COST INCREASES

(a) *Insurance rates.*—Among the costs which cannot be held down to peace-time levels are ship and freight insurance rates. With the natural increase in risk of international shipping, insurance companies must provide larger reserves to meet the increased burden.

⁶⁸ Garrett, *op. cit.*, p. 60.

⁶⁹ *Ibid.*, p. 68.

⁷⁰ Statistical Abstract of the U. S., 1934, p. 599.

⁷¹ Garrett, *op. cit.*, p. 89.

⁷² Bernard M. Baruch, Mar. 29, 1935 (galley 78 BBQ).

The only way of accomplishing this end is by raising the premiums paid by the insurers. How large a risk existed in the last war may be realized from the fact that between August 1, 1914, and November 11, 1918, a period of a little more than 4 years, the United States lost 587 seagoing documented vessels, exclusive of seized enemy and requisitioned Dutch ships. The total tonnage involved was 1,146,236.⁷³ Domestic rates must also be increased to take care of the added strain that is put on the internal system of communication.

This item appears in the price of many commodities as a cost increase which warrants further advances in price. Moreover, prices must increase even where the manufacturer cannot get insurance. In such cases, to continue in existence, he must act as his own insurer by advancing the price sufficiently to cover the increased probability of loss.

(b) *Labor costs.*—It should be noted that labor costs will increase in time of war even though the rates of wage remain stationary. Less skilled labor must be used in the many industries which lose their trained men who are replaced by persons who because of their lack of skill will produce less both in quantity and quality of goods. There will therefore be an increased cost per unit of the commodity produced which must be allowed for in the final price set.

(c) *Transportation costs.*—The necessity for moving large quantities of goods and men means that there is imposed upon the railroads of the country a great physical burden of work. Older equipment is used, more repairs are needed for track maintenance, and in general it costs more to move the same per unit amount of traffic. This results in a tendency toward the imposition of higher rates if there is any attempt to avoid incurring large deficits.

In the World War the Government raised railroad freight rates 25 percent, effective June 25, 1918, in order to gain sufficient revenue to offset the threatening deficit. Even with this large advance, the net railroad revenue did not increase according to expectations, and it is reported that the Director General of the Railroads stated as reasons:

—the necessity of moving war freight expeditiously regardless of expense, the loss of men to the draft and to railroad service abroad, and the substitution of inexperienced labor and the rapid increase in cost of labor and materials. Moreover, while wage increases were largely effective from January 1, the railroads received the benefit of rate increases for only the last 6 months of the war.⁷⁴

Furthermore, it was pointed out by Mr. Baruch in his appearance before this committee, that there was in the World War a tendency toward decentralization of plants. The net effect of spreading industries like munitions over the country is, of course, to increase the cost and consequently the price of the article which is being shipped for longer distances:

Mr. HISS. Is it not also true that in the history of production in war, that in the tie-up of transportation which inevitably results from new demands on transportation, goods are accumulated at unusual places, and so forth, and the costs actually go up?

Mr. BARUCH. Yes, sir; unquestionably.

Mr. HISS. Is it not true that many manufacturers have to enter a line of production with which they are not familiar, in unfamiliar lines, and consequently, because of unfamiliarity, their costs increase?

⁷³ Garrett *op. cit.*, p. 34.

⁷⁴ Dixon, Federal Operation of the Railroads During the War, *Quarterly Journal of Economics*, vol. 33, p. 608.

Mr. BARUCH. Yes; and another matter, if you will permit me to interject here, is that because of transportation difficulties and because of the fact that many parts of our country have no business at all, and for the fact that we must scatter our munitions manufacturing so as not to have a blow-up or a falling down in some place, we were at the end of the war placing orders, as I said, in Denver, and in far away places, without reference entirely to the question of price. So that that is an important factor.

Mr. HISS. And all that means increased cost in war times over peace times?

Mr. BARUCH. Yes, sir.

Mr. HISS. And that is one of the causes of increased prices usually in war time, is it not?

Mr. BARUCH. Yes, sir.

Mr. HISS. And that tendency would be present in any war?

Mr. BARUCH. Yes, sir.

Mr. HISS. And would furnish various lines of industry with plausible, reasonable arguments as to why their particular prices should be increased?

Mr. BARUCH. They will find more than you and I can figure on now.⁷⁵

(5) THE SELLERS' ADVANTAGEOUS POSITION IN WAR MARKETS

The likelihood of a continual rise in the price ceiling is readily apparent when it is noted that war markets are sellers' markets. Buyers must procure their supply without regard to the height of prices. In the final report of the War Industries Board ⁷⁶ it is said:

A war demand differs in its essential nature from the normal demands of peace. In ordinary times a rising price carries with it its own defeat. Purchasers will buy so long as they can make a profit or reap a satisfaction by doing so. This at least is true of everything except the most extraordinary luxuries. They will stop buying when the price reaches a point outside the range where the commodity can be turned over at a profit. The inflated price drops as a result. But war is economically the greatest and most scandalous of spendthrifts. No economic profit comes from the expenditure of an instrument of war and no economic profit is considered in connection with its purchase. The demand is absolute; the price is no deterrent.⁷⁷

In the last war this consideration not only cut off the probability of downward fluctuation but furnished a major force for the advance of prices which the creation of the price-fixing body did not terminate.

For instance, on January 2, 1918, the War Industries Board approved a contract with the Hercules Powder Co. for 30,000,000 pounds of smokeless powder although they were of the opinion that the 70-cent price was too high. A reason stated in justification was the fact that it was either a matter of paying the high price or doing without the powder. The minutes read:

Under the advice of Mr. Brookings the Board approved of the amended contract with the opinion that while the Board considers 70 cents a high price and that as 7 cents per pound charged was for amortization of a new plant, that this should have been so shaped that this plant paid for by the Government in price should have been the property of the Government but that however as Captain Peters reports it was impossible to secure this and that it was either necessary to pay the 70 cents per pound or go without this powder and that having had nothing to do with the negotiations and acting only as Captain Peters' statement of the

⁷⁵ Bernard M. Baruch, Mar. 29, 1935 (galley 78 BBQ).

⁷⁶ P. 70.

⁷⁷ Compare the statement made at p. 114 of the War Industries Board Report regarding the reasons for the excessive rise of iron and steel prices prior to the inception of control.

"... the demand was absolute; there was no postponing of it. Buyers of steel in times of peace expect to realize a profit on their investment. Steel that goes into buildings and bridges must be bought at prices which will make possible satisfactory returns. Whenever these buyers believe prices are likely to decline in the near future, they will withdraw from its market. Their attitude serves as an effective check on buying when prices have reached what is considered an abnormal level.

"The attitude of the Government toward its war-time purchases, however, differed fundamentally from this. It bought with no expectation of earning a profit. The possibility of lower prices in the future did not check its buying."

case and considering its emergency nature, the Board can see no reason why the contract should not be made.⁷⁸

Similar considerations appear in the course of negotiations with the copper interests. In the September 11, 1917, meeting of the War Industries Board, Mr. John D. Ryan, President of the Anaconda Copper Co., and spokesman for the copper industry, said:

* * * if 22 cents per pound was fixed as a price for copper that it would be impossible to obtain the voluntary cooperation of the majority of mine owners. If 25 cents were fixed he assured the War Industries Board that he and the other copper producers present would obtain all of the copper voluntarily from all producers, and that he would see to it that the copper was properly distributed and the prices controlled.⁷⁹

The result of the negotiations was that the Government yielded to allow a price of 23.5 cents.

In the February 7, 1918, minutes of the War Industries Board, there is recorded the offer of the Anaconda Copper Co. to build a new manganese plant on condition that there would be no price regulation:

The Board was advised that the Anaconda Copper interests were willing to expend approximately a million and a half dollars toward developing manganese property near Butte, providing that they would receive a guaranty that the Government would not regulate the price. Mr. Baruch was requested to ask Mr. Ryan to submit a definite proposition in writing.⁸⁰

Furthermore, there was the very real pressure of the military forces for the procurement of goods regardless of price. How that operated in the determinations of the governmental price-fixing agency may be seen from Mr. Baruch's testimony that, "every time anything happened they said, 'We are going to lose the war' and I was on the spot."⁸¹

On May 22, 1918, Mr. Charles Hayden, representing the Utah Copper Co., justified a plant cost increase of more than 100 percent over normal pre-war costs by the fact that this might speed up production and aid in bringing the war to a speedier termination. He stated that the Allied Governments were demanding more goods rather than lower prices:

We have seen a plant being built at Hog Island at an estimated cost of \$42,000,000, against a normal pre-war cost of \$21,000,000. At first blush this seems extravagant, but a careful analysis shows that this excess cost of this yard, if it enables our country to get ships 6 months earlier, will, by that very fact, if it only shortens the war one-half of those 6 months or one-quarter of those 6 months, save many, many times its cost, as the daily expenses of the war are in excess of all the overcost of 1 yard. The same applied to the situation in aircraft production. And now what are we confronted with in the copper industry?

Our allies are crying for copper; representatives of foreign governments are telling me as an individual: "What do we care about a cent or more in price? What we want is the stuff." And here we are sitting and theorizing as to whether or not the Federal trade examination of costs, or a theoretical discussion of margins of profits, is meaning an undue profit to the copper industry, when there is already a shortage of over 100,000 tons of copper at the present time and when, in the interests of safety, there should be a surplus of at least that amount.⁸²

This consideration is significant for the practice in future wars and especially for the determination of the extent of adjustment that will be required for the price-ceiling plan. Lieutenant Colonel Harris, Director of the Planning Branch of the War Department, expressed doubt as to the possibility of continuing the Government contract

⁷⁸ Exhibit No. 1271.

⁷⁹ Exhibit No. 1270.

⁸⁰ Exhibit No. 1274.

⁸¹ Bernard M. Baruch Mar. 27, 1935 (galley 50 BRQ).

⁸² Minutes of the Price Fixing Committee, May 22, 1918.

provision which allows a return of 6 percent of the estimated plant value—an admittedly high figure.⁸³

Mr. HISS. Colonel Harris, we cannot be sure at the present time that the present 6 percent provision in the adjusted compensation contract can, as a matter of practical necessity, be retained in the event of war?

Lieutenant Colonel HARRIS. To be perfectly frank, I am very doubtful.⁸⁴

An increase in the percentage is apparently contemplated at the present time but it is thought advisable to defer its exact determination to the time when war is imminent. The following excerpt is from a War Department memorandum of February 20, 1934, headed, "War-Time Contracts Forms and Emergency Codes":

The question of the amount of profit to be allowed the contractor is one of the most critical in any form of cost-plus contract. The fee adopted should be fair alike to the producers and the Government. In the adjusted compensation contract the fee is based primarily upon the rental value of the facility. It is true that the contractor assumes few of the risks of an entrepreneur for which profit is paid. He does, however, have certain risks of management and certain expenses for which no compensation is made. The committee believes that some increase in the present figure might well be made, but doubts the advisability of attempting to determine the exact amount until war is imminent. It can then be decided on the basis of then-existing conditions.⁸⁵

The committee has found that a number of the owners and executives in the various ordnance districts think that the present provisions are not sufficiently liberal.

The following excerpt from a War Department memorandum dated February 6, 1934, and headed "Comments, Criticisms, and Proposals on the Adjusted Compensation Contract Form" is a comment from the St. Louis ordnance district on the present 6-percent rate:⁸⁶

It is the general consensus of opinion among owners and executives of industrial plants in this vicinity that the adjusted-compensation contract, while getting away apparently from the cost-plus contract, still retains some features highly objectionable and subject to prolonged argument. Some of the firms are frank to state it would be extremely difficult for them to voluntarily enter into such a contract in either peace or war time. * * *

There is no question but that the proposed contractors in this vicinity think the reward inadequate and unjust. This is particularly true of companies having a large bond issue and an issue of preference-accumulative stock whereby the fee and the uncertain bonus would not be sufficient to protect the company and the investors of the preference stock.

* * * * *

It is the opinion of this office, based on the discussions at the various conferences held on this subject, that the present form of adjusted-compensation contract includes a number of fundamentally objectionable features and is not satisfactory to the contractors in general.⁸⁷

The San Francisco ordnance district entered an alternative suggestion:

After careful perusal of the Bridgeport district report on the adjusted-compensation contract, it is believed that the contract is impracticable, and that its use would involve intolerable delay in the initiation of procurement.

* * * * *

⁸³ Profits of much more than 6 percent can be gained under these contracts by coming under the bonus provisions. Valuation difficulties are also pertinent. Mr. Baruch testified on Mar. 29, 1935 (galley 99 BBQ). "These figures are all too high there. They are absurd."

⁸⁴ Lieutenant Colonel Harris, Dec. 14, 1934 (galley 15 FM).

⁸⁵ Exhibit No. 1225.

⁸⁶ Exhibit No. 1227, Hearings, p. 3823. Lt. Col. Harris described the ordnance districts as skeleton organizations engaged in the field development of industrial planning. There are 14 such districts in the United States set up on a geographical basis for decentralized procurement in war.

⁸⁷ Lieutenant Colonel Harris, Dec. 14, 1934 (galley 14 FM).

It should be expected that the set price will permit of a profit of at least 10 percent on the *gross price* to the average bidders.⁸⁸

It was the opinion of the writer of the Boston district comment that the Government would not have gotten the same degree of cooperation from manufacturers during the World War if there had been no opportunity for profiteering:

The cost-plus contract offers the ideal conditions for profiteering. It seems to the writer questionable whether the Government would have received such whole-hearted cooperation from manufacturers during the World War had all opportunity for profiteering been eliminated. In other words, it seems that there are incentives to the best efforts of the manufacturers in both the fixed-price and the cost-plus contracts which are absent from the adjusted-compensation contract.⁸⁹

(6) ABNORMAL PRE-WAR PRICE LEVELS

A major reason for the proposal of a price ceiling based upon the schedule of prices existing at a pre-war date has been the impression that in this manner a normal standard for control would be created. Mr. Baruch has stated before the War Policies Commission:

To measure inflation of price and profit we must have some norm. The obvious norm is the whole price structure as it existed on some antecedent date near to the declaration of war on which the normal operation of the natural law of supply and demand can be said to have controlled prices. That determined, we need a method of freezing the whole price structure at that level. The obvious way to do this is simple, by proclamation to decree that every price in the whole national pattern as of that determined date shall be the maximum that may thenceforth be charged for anything—rents, wages, interest rates, commissions, fees—in short, the price for every item and service in commerce.⁹⁰

The studies of this committee have led to the conclusion that there is no guaranty of normality in a pre-war price level. Our experience in the World War is significant in this connection. Prices prior to our entry were at an inflated level, the Bureau of Labor Statistics index for all commodities having risen 62 percent above the 1913 level by March 1917. In fact, during the period of our participation, there was an additional rise of only 40 points. Furthermore, there was a great variation in the rates of increase of the various groups of commodities. Metals and metal products, for instance, had risen 118 percent by March 1917, while foodstuffs had gone up 48 percent and farm products 66 percent. Difference and change, rather than uniformity and stability, were the rule.⁹¹

Mr. Hurley, who was at one time Secretary of War and Chairman of the War Policies Commission, agreed that to have put the price-freezing provisions of the McSwain bill into effect on a date prior to the United States declaration of war in 1917 would have resulted in an artificially high level of prices:

Senator CLARK. Mr. Secretary, I understood you to say a moment ago that you had not read the McSwain bill. I will just read the first paragraph of it [reading]:

"That whenever Congress shall declare war or the existence of an emergency due to the imminence of war, then, from and after a date prior to such declaration which date the President is hereby authorized and directed to determine and publicly proclaim, it shall be unlawful for any person to buy, sell,

⁸⁸ *Ibid.* (Italics added.)

⁸⁹ *Ibid.*, p. 3823.

⁹⁰ 72d Cong., 1st sess., H. Doc. No. 163, p. 34.

⁹¹ See Exhibit No. 1689.

or otherwise contract for any article or thing at a higher rate, rent, price, commission, compensation, or reward than was in effect at the date so determined."

Now, taking the declaration of war in 1917, or immediately prior thereto, the effect of such a provision as that would be to freeze prices at an artificially high level, would it not?

Mr. HURLEY. Yes, sir.⁹²

When the chairman asked Mr. Hurley,

Could American industry have wanted for anything finer than a program which, upon our entry into the World War, would have found prices frozen at the point that prevailed when we entered the war?⁹³

he testified,

My own opinion is that we already had price inflation due to the war before the United States declared war. Consequently it would have been unjust, unfair, inequitable to have frozen prices at the figures that they were on our advent into the war.⁹⁴

(A chart of index numbers of wholesale prices illustrating the height to which prices had risen in April 1917 is shown facing p. 126.)

⁹² Patrick J. Hurley, Mar. 13, 1935.

⁹³ Ibid.

⁹⁴ Ibid.

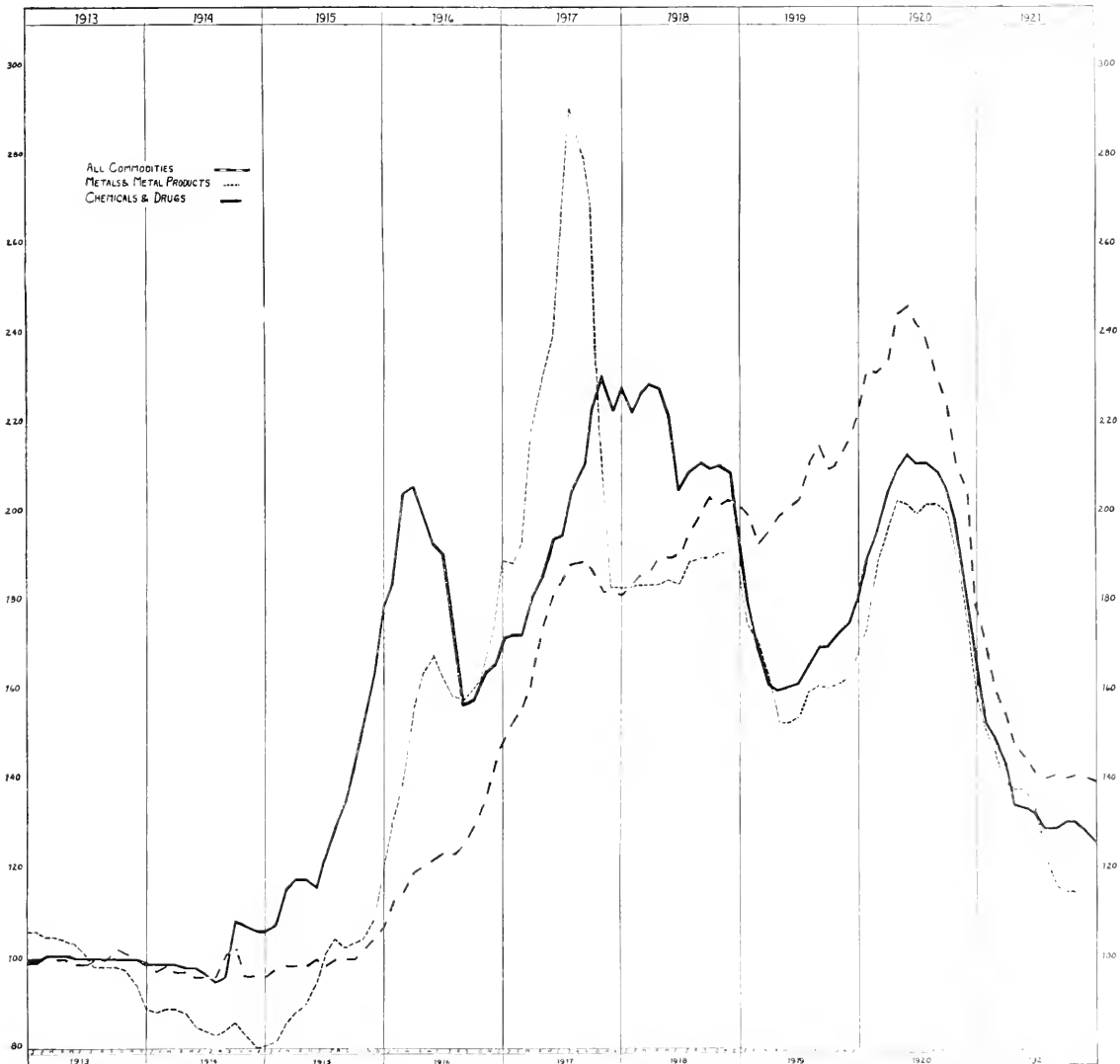
WHOLESALE PRICES

1913-1921

[Index numbers, 1913=100]

Percent

Percent



III. PRICE CONTROL AS AN AID TO INCREASED WAR PRODUCTION

(1) CURTAILMENT OF CIVILIAN CONSUMPTION

Because of the war demand for increased supply and the time new plant construction requires it becomes necessary to divert existing materials from their usual channels of distribution for the duration of the war. The Government, to produce goods for itself and to guarantee that war industries shall have an uninterrupted supply of materials, must, as a consequence, curtail direct and indirect civilian consumption. By outbidding that part of the civilian population which cannot meet increased prices, Government has an effective device for increasing its supply:

Mr. Hiss. It does mean, does it not, that in time of war the civilian needs cannot be filled as fully as in times of peace?

Mr. BARUCH. Yes, sir; they have to subordinate themselves to the war.

Mr. Hiss. Does that not mean, then, that one of the Government's problems is competition in the acquisition of necessary materials with the civilian population?

Mr. BARUCH. Yes, sir.

Mr. Hiss. In all past wars has that not been met by the Government outbidding the civilian population?

Mr. BARUCH. It was, except with us in the last war.

Mr. Hiss. Was it not one of the reasons why prices went up during the last war, because the Government had to pay?

Mr. BARUCH. With which we tried to cope. You are quite right.

Mr. Hiss. And the Government had to secure its supplies, regardless of cost, in many instances?

Mr. BARUCH. Yes.⁹⁵

Civilian consumption is automatically curtailed by the high prices set for the purpose of stimulating the production of war industries. The price-fixing practice in the World War has been described as follows:

It was the policy of the Government for the sake of maximum production, to permit the automatic raising of prices by the law of supply and demand to the point where the comfort of the civil population was endangered and then, on a scientific determination of costs, to fix a price high enough to encourage the productive contribution of even the high-cost producer, to the maximum consistent with the common good, even at the risk of undue profits to low-cost producers, relying on excess-profit taxation to equalize gain to a common level. By this expedient every possible field of production was encouraged, the danger of a runaway or speculative market was avoided, and profits were standardized.⁹⁶

The priority system was also designed to increase production. It gave the war industries a direct preference in the procurement of the limited supply of the factors of production and thus enabled them to meet one of the most important limitations on the volume of production. Indirectly, by curtailing production for civilian purposes, it released labor, supplies, and capital for use in the war industries. To avoid a vast problem of enforcement, this system, of course, had

⁹⁵ Bernard M. Baruch, Mar. 29, 1935 (galley 83 BBQ).

⁹⁶ Committee Print No. 3, op. cit., p. 23.

to operate in conjunction with the high fixed prices which had automatically cut off a large part of the force of civilian demand.

(2) MARKET STABILIZATION

Price control is useful in the stabilization of markets.⁹⁸ Where prices fluctuate at high levels, purchasers tend to curtail consumption because of the uncertainty of future price movements. The consequent irregularity of demand, together with the uncertainty of cost conditions, causes restriction of production. Price regulation eliminates this condition by fixing a price which, although at a high level, will continue without fluctuation for a period of time and upon which business men can make more accurate calculations of future costs and sales. The preference of business for stable markets has been described by Mr. Baruch:

As to the morale of industry at large in the World War, the uncertainty of the daily fluctuation of price and the inevitable rising trend on all sides was a matter for common commiseration. I am aware of no able and experienced business administrator who does not prefer operation under stable conditions to operation under price schedules in an unforeseeable state of flux.⁹⁹

Mr. Yeatman stated in a memorandum to the Price Fixing Committee that the absence of a speculative rise in the price of nickel was due not only to patriotic feeling but also "to the belief that if prices advanced too much the demand for the product would lessen."¹⁰¹

These factors were major considerations for both Government and business in the adoption of price control for the steel industry.

The report of the War Industries Board states that in the summer of 1917 "the instability of prices was in itself hampering production and driving business into confusion."² The index of iron and steel prices fell 24 points between July and August 1917.³ An additional 36 point decrease was registered in the month of September.⁴ Bessemer pig iron, Pittsburgh, declined from a high of \$57.95 in July to \$50.95 on September 19. Basic pig iron, valley furnace reached its high of \$53 on July 18 and declined steadily to \$42 on September 19.⁵

Business was reluctant to buy in this condition of the market. A letter from Mr. Crosby, a Buffalo manufacturer written on July 13, 1917, when prices were at a speculative peak, stated that the expected decline in prices would injure business because taxes would be assessed on profits computed on the basis of high value inventories:

The situation, in my judgment, is becoming extremely dangerous for the ordinary manufacturer and the ordinary merchant. A very large part of his profit is in his inventory. The Government is going to ask us to pay taxes, and very heavy taxes, on this profit. Even if the Government takes no action, prices will drop suddenly and the high figures of the inventories will melt away in a night.⁶

Expectation of future shrinkage of value also curtailed the consumption of steel for building purposes. This factor appeared in Samuel Vauclain's letter to F. A. Scott, then Chairman of the War Industries Board:

⁹⁸ Garrett states that at a meeting of the Price Fixing Committee on July 8, 1918, Mr. Brookings, the Committee's chairman, "submitted a memorandum stating that: the Price Fixing Committee was created to stabilize values and prevent extortionately high prices." See p. 64 supra.

⁹⁹ War Policies Commission hearings, op. cit., p. 813.

¹ Exhibit No. 1749.

² Page 72.

³ W. I. B. Price Bulletin, No. 3, p. 246.

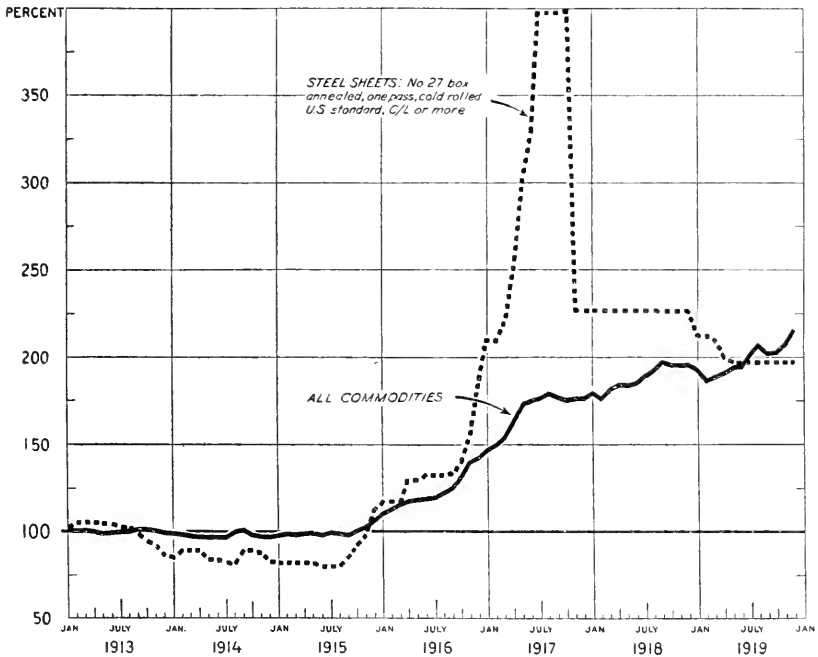
⁴ Ibid.

⁵ Bernard M. Baruch, Mar. 29, 1935.

⁶ Exhibit No. 1735.

PRICE PER POUND OF STEEL SHEETS AT PITTSBURGH DISTRICT MILLS AND PRICES OF ALL COMMODITIES

INDEX NUMBERS (1913 = 100)

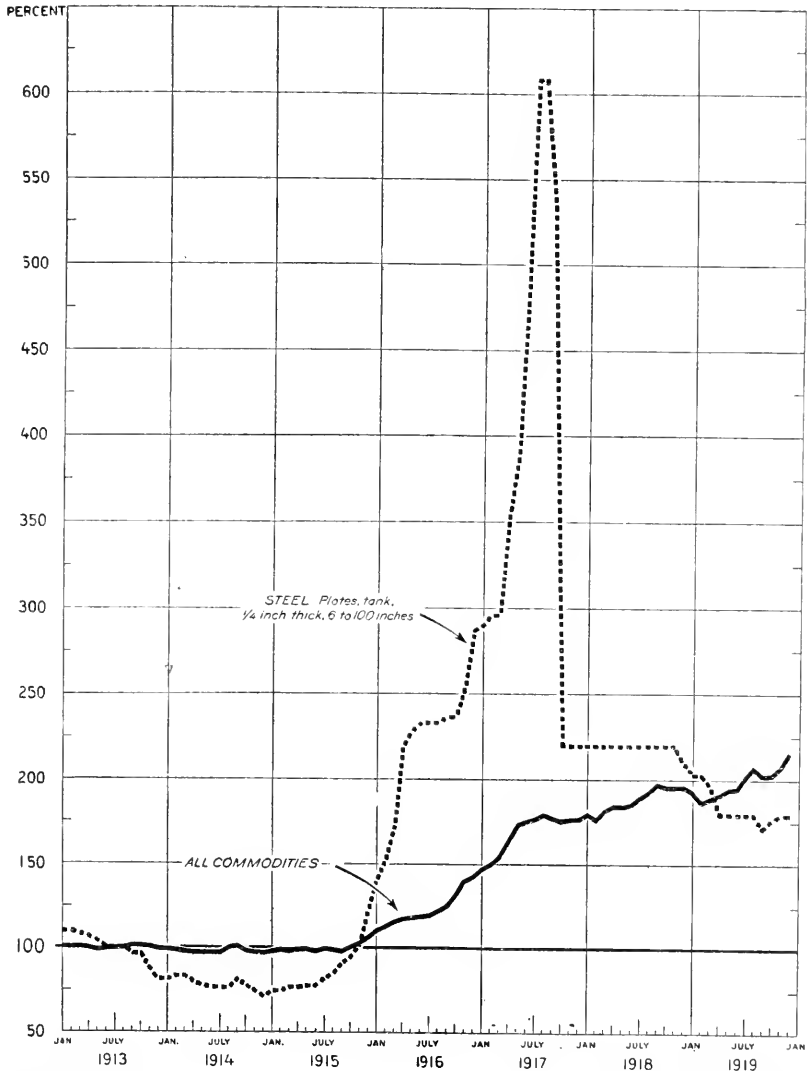


U. S. DEPARTMENT OF AGRICULTURE

NEG BUREAU OF AGRICULTURAL ECONOMICS
DATA FURNISHED BY BUREAU OF LABOR STATISTICS

PRICE PER POUND OF STEEL PLATES AT PITTSBURGH AND PRICES OF ALL COMMODITIES

INDEX NUMBERS (1913 = 100)



September 1, 1917.

Can you give me any idea how soon your Board will undertake to determine a schedule of prices for steel products?

The reason I ask is that large steel companies in which I am interested should now, without delay, place contracts for coke and other materials entering into the manufacture of open-hearth steel. The lowest price for coke today is \$11 per ton. It would be possible to pay \$6 per ton and exist, but a more reasonable price for this product would be \$5 per ton.

At one of the plants in which I am interested intend to put in a byproduct coke plant of sufficient capacity to take care of their needs, and such a plant would cost \$3,750,000 which by shrinkage in values that are to be expected in the next 2 or 3 years this plant could not be valued at more than \$2,250,000, or in other words a shrinkage of \$1,500,000 in the value of this plant is liable to take place in the very near future if contracts are taken at present prices.⁷

Another indication of consumer's resistance is to be found in the downward movement of unfilled orders of the United States Steel Co. The following figures are reported in the Iron Age:⁸

1917:	Tons
April.....	12, 183, 000
May.....	11, 887, 000
June.....	11, 383, 000
July.....	10, 844, 000
August.....	10, 407, 000
September.....	9, 833, 000
October.....	9, 010, 000

Concurrent with the decline in steel prices, the Iron Age which had previously been opposed to control began to change its opinion on the value of price regulation. In late July it reported that the steel industry was beginning to fear the effects of an unregulated market:

* * * the Government is not alone in wanting regulation of steel prices. Many producers and buyers of steel have feared the consequence of the uncontrolled upward movement of the past 6 months.⁹

And in the issue of August 30, 1917, a few weeks before prices were fixed, the magazine frankly advocated price stabilization.¹⁰

The relationship between price decline and advocacy of price fixing by the steel industry is reported as follows by the War Industries Board:

By the end of July prices began to show a sharp drop, and the more conservative factions of the steel industry saw only peril ahead unless the Government brought stabilization to the market. By late September virtually the whole industry was disposed to recommend that formal regulation begin.¹¹

The stabilizing effects of control on the price movements of steel plates and steel sheets are apparent in the charts of their index numbers facing page 128.

Apparently, the governmental authorities were as concerned with the welfare of the steel industry as they were with the high prices that were adversely affecting domestic consumers and the Allies. The Federal Trade Commission report on war-time profits and costs of the steel industry states:

Furthermore, the Government realized that it would probably be necessary to go even further and to regulate prices for the industry generally, not only in the interests of associated belligerent powers and domestic consumers but also in the interests of the industry itself. It was evident that the extravagant prices all ready prevailing would go much higher; hence, to prevent chaotic conditions and

⁷ Exhibit No. 1737.

⁸ Bernard M. Baruch, Mar. 29, 1935 (galley 90 BBQ), Iron Age, December 1917.

⁹ W. I. B. Price Bulletin No. 3, p. 250.

¹⁰ Ibid.

¹¹ Report of the War Industries Board, p. 115.

attendant disturbances in the industry, it appeared necessary to stabilize prices and to allocate the supply equitably between the Government and other consumers.¹²

In the report of the War Industries Board it is stated of the initiation of steel control that:

It was quite as much the object of the Government to stabilize the market at a point which would effect a maximum of production as to scale prices down from higher levels.¹³

Adoption of price control for the copper industry was also due in large measure to the need for stabilization.

The New York Times of January 6, 1918, wrote in its review of the effects of the Government policy upon business for the year 1917:

The past year was prosperous for the copper miners [producers]. They kept their mines operating to capacity and enjoyed the highest prices for the metal which have ruled for 50 years. * * * The United States and Great Britain fixed the price of copper at 23½ cents a pound in order to prevent a runaway market. This measure has greatly benefited copper miners. Had the price not been fixed, there would have been price fluctuations, which would have led to irregular demands for the metal. The average production cost before the war was around 8 cents a pound. Some mines produced at around 5½ cents. The cost is now about 10 cents, with many of the larger mines producing at 7½ cents.

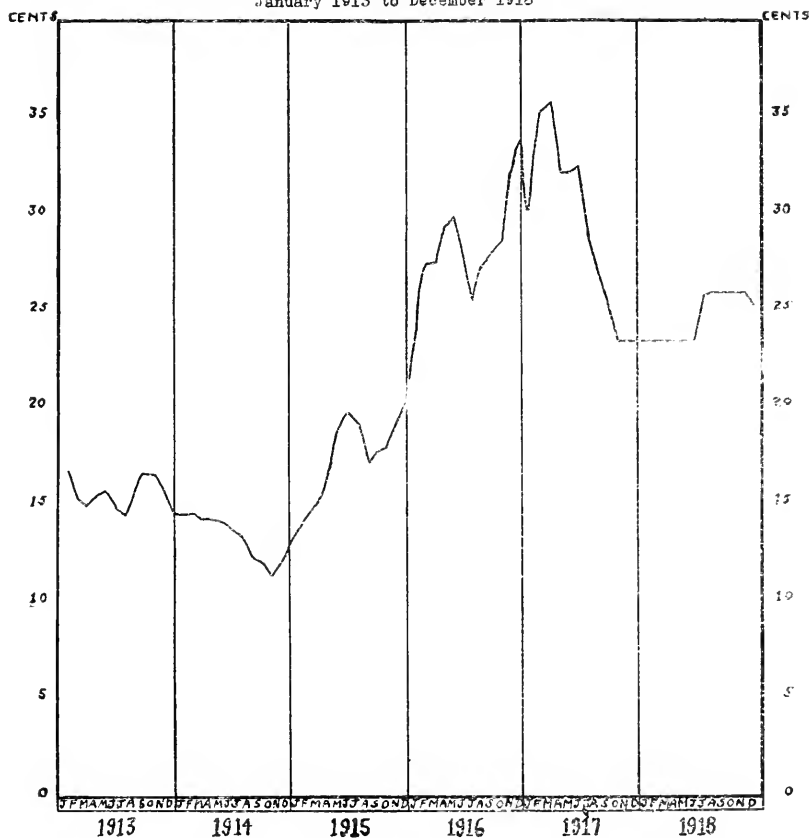
The chart of electrolytic copper prices facing page 130 indicates both the extent of fluctuation at the time of the United States entry into the war and the smooth flow of prices after the inception of price control.

¹² Ibid. p. 18.

¹³ Ibid., p. 120.

ELECTROLYTIC COPPER PRICES

January 1913 to December 1918



(SOURCE - GARRETT *op. cit.* p. 273)

11579-35. (Face p. 130.)

APPENDIX

EXHIBIT No. 1388

Submitted by Mr. Arthur Ballantine in War Policy Commission Hearings, House Document No. 163, Seventy-second Congress first session, pp. 710-711.

D.—*Corporation income and profits tax rates, exemptions, and credits under the revenue acts of 1909-1928, inclusive.*¹

[Applicable to domestic and foreign corporations]

Revenue act	Applicable to incomes for the years—	Ex-emption ¹	Income tax		Excess-profits tax ²		Rate per-cent
			Taxable income	Rate per-cent	Credit	Amount subject to tax	
1909 (excise tax)	1909 to Feb. 28, 1913.	\$5,000	All net income ⁴ in excess of exemption.	1			
1913	Mar. 1, 1913, to Dec. 31, 1915.	None	All net income.	1			
1916	1916	None	do.	2			
1917	1917	None	Dividends out of earnings from Mar. 1, 1913, to Dec. 31, 1915. Net income in excess of the sum of— The excess-profits tax for the current year and Dividends received out of earnings from Mar. 1, 1913, to Dec. 31, 1915. Net income in excess of the sum of— The excess-profits tax for the current year and Dividends received out of earnings from Mar. 1, 1913, to Dec. 31, 1917.	1	\$3,000 ⁵ plus an amount equal to the same percentage of invested capital ⁶ for the taxable year as the average annual pre-war income was of pre-war invested capital (not less than 7 nor more than 9 percent). If not established during at least one whole year of the pre-war period, 8 percent.	Net income equal to 15 percent of invested capital less credit. Net income in excess of 15 percent of invested capital but not in excess of 20 percent of invested capital. Net income in excess of 20 percent of invested capital but not in excess of 25 percent of invested capital.	20 25 35
1917	1917	None	Dividends received out of earnings from Mar. 1, 1913, to Dec. 31, 1917. Net income in excess of the sum of— The excess-profits tax for the current year and Dividends received out of earnings from Mar. 1, 1913, to Dec. 31, 1917.	2	If, during pre-war period, corporation had either no net income or a very small net income, or if invested capital cannot be determined, same percent as that of representative corporations. (See sec. 210, revenue act 1917.)	Net income in excess of 25 percent of invested capital but not in excess of 33 percent of invested capital. Net income in excess of 33 percent of invested capital.	45 60
1918	1918	2,000	Net income in excess of the sum of— The exemption, Excess profits and war profits taxes for current year and Interest on United States obligations issued after Sept. 1, 1917.	4	\$3,000 plus 8 percent of the invested capital for the taxable year. ⁵	Net income equal to 20 percent of invested capital less credit. Net income in excess of 20 percent of invested capital.	30 65

1918.....	1919 and 1920..	2,000	Net income in excess of the sum of— The exemption, Excess-profits tax for current year, Excess-profits and war-profits taxes on income from Government contracts, and Interest on United States obligations issued after Sept. 1, 1917, and War Finance Corporation bonds not exempt.	10	Same as 1918 ⁴	Net income equal to 20 percent of invested capital less credit. Net income in excess of 20 percent of invested capital.	20 40
1921.....	1921.....	\$ 2,000	Same as 1919 and 1920.....	10	do.....	Same as 1919 and 1920.....	(11)
1924.....	1922 and 1923..	\$ 2,000	Net income in excess of exemption.....	12 ¹ / ₂			
1926.....	1924.....	\$ 2,000	do.....	12 ¹ / ₂			
1928.....	1925.....	\$ 2,000	do.....	9 13			
	1926 and 1927..	\$ 2,000	do.....	9 13 ¹ / ₂			
	1928.....	\$ 3,000	do.....	12			
	1929.....	\$ 3,000	do.....	11			

See footnotes at end of table.

D.—Corporation income and profits tax rates, exemptions, and credits under the revenue acts of 1909-1928, inclusive—Continued

Revenue act	Applicable to incomes for the years—	War-profits tax ³		Tax on income from Government contracts			Tax credit for income and profits taxes paid to foreign countries or United States possessions
		Credit	Amount subject to tax	Rate percent	Exemption	Amount subject to tax	
1909 (excise tax)	1909 to Feb. 28, 1913.						
1913	Mar. 1, 1913, to Dec. 31, 1915.						
1916	1916						
1917	1917						
1918	1918	\$3,000 plus either an amount equal to the average pre-war net income plus or minus 10 percent of the increase or decrease of invested capital for the taxable year, as compared with average pre-war invested capital or 10 percent of the invested capital for the taxable year, whichever is greater.	Net income in excess of war profits credit.	80—less amount of excess profits tax.			For 1917 and prior years, taxes paid to foreign countries or United States possessions were not allowed as a tax credit, but were included in general deductions. Amount paid or accrued.
1918	1919 and 1921.				\$10,000	Amount in excess of \$10,000 derived from Government contracts made between Apr. 6, 1917, and Nov. 11, 1918.	Same as 1918.
1921	1921				10,000	Same as 1919 and 1920.	Same as 1918 act. ¹⁰ Do.
1922 and 1923.	1922 and 1923.						Do.
1924	1924						Do.
1926	1925						Do.
1926 and 1927.	1926 and 1927.						Do.
1928.	1928.						Do.
	1929						Do.

¹ All corporations are required to file returns regardless of amount of net income or loss, except those specifically exempt as mutual, cooperative, fraternal, civic, charitable, scientific, etc., not operating for profit. From Jan. 1, 1918, to Dec. 31, 1921, personal-service corporations were treated as partnerships. Prior and subsequent to said dates, such corporations were taxed as other corporations. Under the revenue act of 1909, corporations were required to file returns on a calendar-year basis; under subsequent revenue acts, corporations were permitted to file returns on a fiscal-year basis, other than the calendar year; except that, under the act of 1921 and subsequent acts, life insurance companies were required to file on a calendar-year basis in accordance with the State laws regulating insurance companies.

² For 1918 and subsequent years foreign corporations not allowed specific exemption.

³ For 1918-1921, inclusive, war-profits and excess-profits tax of foreign corporations is computed by comparison with representative corporations whose invested capital can be satisfactorily determined and which are engaged in a like or similar trade or business and similarly circumstanced. (See sec. 328, revenue acts of 1918 and 1921.)

⁴ Net income means "statutory" net income, i. e., the excess of gross income over deductions as defined in the various revenue acts. Foreign corporations report only the net income from sources within the United States. Net income has been adjusted from time to time as follows:

(a) Amortization of buildings, machinery, equipment, or other facilities constructed or acquired on or after Apr. 6, 1917, for the production of articles contributing to the prosecution of the war, are included to a reasonable amount in business deductions for 1918, 1919, 1920, and 1921.

(b) Dividends of domestic corporations were entirely tax exempt for 1918 and subsequent years.

(c) Net loss for prior year. The revenue act of 1918 provides, in the case of a net loss for any taxable year beginning after Oct. 31, 1918, and ending prior to Jan. 1, 1920, for the deduction of such loss from the net income of the *preceding year*, a redetermination of taxes for the preceding year being made. If the net loss exceeds the net income for the preceding year, the amount of such excess is to be deducted from the net income of the *succeeding taxable year*. For 1921 and subsequent years the revenue acts provide for net loss in any year beginning after Dec. 31, 1920, to be deducted from the net income of the succeeding taxable year and if such net loss exceeds the net income for the succeeding year, the amount of such excess is to be allowed in the *next succeeding year*.

(d) For insurance companies see special provisions in the various revenue acts.

⁵ Foreign corporations not allowed the \$3,000.

⁶ Invested capital within the meaning of the statute is the capital actually paid in to the corporation by the stockholders, including surplus and undivided profits (exclusive of that for the current year), stocks, bonds, and other obligations (other than obligations of the United States) the dividends or interest from which are not included in computing net income, and excluding inadmissible assets. (See art. 831 of Regulations 45.) For 1917 foreign corporations reported that proportion of invested capital which net income from sources within the United States was of the entire net income. For 1918-1921, inclusive, it was not necessary for foreign corporations to report invested capital. (See note 3.)

⁷ If corporation was not in existence during the whole of at least one calendar year during the pre-war period, the credit (with certain exceptions) shall be the sum of \$3,000 and an amount equal to the same percentage of invested capital for the taxable year as the average percentage of net income to invested capital for the pre-war period of representative corporations; but such amount shall in no case be less than 10 percent of the invested capital of the taxpayer for the taxable year. (See sec. 311, revenue act of 1918.)

⁸ Allowed domestic corporations with net income of \$25,000 or less.

⁹ Income of insurance companies, exclusive of mutual companies other than life, taxable at 12½ percent.

¹⁰ Beginning with 1921 the credit cannot exceed the proportion of the total tax against which the credit is taken that the taxpayer's net income from sources without the United States bears to the entire net income.

¹¹ Same as 1919 and 1920.

¹² See joint resolution of Congress No. 133, approved by the President, Dec. 16, 1929, reducing rates of income tax for 1929.

NOTE.—For the year 1917, there was also a tax of 10 percent upon that portion of the total net income remaining undistributed six months after the close of the taxable year, in excess of the income actually employed in the business, or invested in obligations of the United States issued after Sept. 1, 1917.

For the years 1918 to 1920, a corporation that permitted an unreasonable accumulation of profits was not subject to the ordinary corporation income tax but the individual stockholders were taxed upon their distributive shares of its net income in the same manner as the members of a partnership or a personal-service corporation.

For the years 1921 to 1923, an additional tax of 25 percent was imposed upon the taxable net income of a corporation, where it was shown that there had been an evasion of surtax as the result of an unreasonable accumulation of profits. This additional tax was increased to 50 percent for 1924 and subsequent years, with the provision that the 50 percent additional tax shall not apply if all the shareholders of the corporation include in their gross income their entire distributive shares, whether distributed or not, of the net income of the corporation for the taxable year.

EXHIBIT No. 1756

INCOME AND EXCESS-PROFITS TAX DATA FOR 13 CORPORATIONS

Aluminum Co. of America, "Exhibit No. 1746."
 Bethlehem Steel Corporation and subsidiaries, "Exhibit No. 1740A."
 Republic Iron & Steel Co. and subsidiaries, "Exhibit No. 1740D."
 Crucible Steel Co. of America and subsidiaries, "Exhibit No. 1740E."
 Lukens Steel Co. and subsidiaries, "Exhibit No. 1738."
 Allegheny Steel Co., "Exhibit No. 1740B."
 Otis Steel Co., "Exhibit No. 1740C."
 Calumet & Hecla Co. and subsidiary, "Exhibit No. 1723."
 Inspiration Consolidated Copper Co., "Exhibit No. 1719."
 Kennecott Copper Corporation, "Exhibit No. 1716."
 Phelps Dodge Corporation and subsidiaries, "Exhibit No. 1721."
 Miami Copper Co., "Exhibit No. 1720."
 Ahmeek Mining Co., "Exhibit No. 1718."
 Union Sulphur Co. and subsidiary, "Exhibit No. 1755A."
 Freeport Texas Co. and subsidiaries, "Exhibit No. 1755B."
 Atolia Mining Co., "Exhibit No. 1748."
 Wolf Tongue Mining Co., "Exhibit No. 1748D."
 Primos Chemical Co. and subsidiaries, "Exhibit No. 1740E."
 Source: Files of the Bureau of Internal Revenue.

NOTE.—Tax liability includes both income and excess-profits taxes. Figures for individual companies appear in exhibits indicated.

Net taxable income as per corporations' returns and as determined by revenue agents

Year	Net taxable income as per corporations' returns	Net taxable income as determined by revenue agents	Percent of increase
1917, 18 companies.....	\$229,189,613.55	\$290,212,129.81	24.5
1918, 17 companies ¹	136,937,770.39	142,908,612.64	4.2

¹ Companies listed except Miami Copper Co.

Net taxable income as determined by revenue agents and as finally determined

Year	Net taxable income as determined by revenue agents	Net taxable income as finally determined by Bureau	Percent of decrease
1917, 18 companies.....	\$290,212,129.81	\$263,339,558.67	9.2
1918, 17 companies ¹	142,908,612.64	134,151,948.53	6.1

¹ Companies listed except Miami Copper Co.

Net taxable income as per corporations' returns and as finally determined

Year	Net taxable income as per corporations' returns	Net taxable income as finally determined by Bureau	Percent of increase (+) or decrease (-)
1917, 18 companies.....	\$229,189,613.55	\$263,339,558.67	+14.9
1918, 17 companies ¹	136,937,770.39	134,151,948.53	-2.0

¹ Companies listed except Miami Copper Co.

Invested capital as per corporations' returns and as determined by revenue agents

Year	Invested capital as per corporations' returns	Invested capital as determined by revenue agents	Percent of decrease
1917, 15 companies ¹	\$775,799,312.08	\$547,642,452.81	29.4
1918, 14 companies ²	878,920,120.03	746,789,162.34	15.0

¹ Companies listed except Allegheny Steel Co., Atolia Mining Co., and Freeport Texas Co.

² Companies listed except Allegheny Steel Co., Miami Copper Co., Union Sulphur Co., and Atolia Mining Co.

Invested capital as finally determined and as determined by revenue agents

Year	Invested capital as determined by revenue agents	Invested capital as finally determined by Bureau	Percent of increase
1917, 15 companies ¹	\$547,642,452.81	\$717,284,142.24	30.8
1918, 14 companies ²	746,789,162.34	770,212,390.36	3.1

¹ All companies listed except Allegheny Steel Co., Freeport Texas Co., and Atolia Mining Co.

² All companies listed except Allegheny Steel Co., Miami Copper Co., Union Sulphur Co., and Atolia Mining Co.

Invested capital as per corporations' returns and as finally determined

Year	Invested capital as per corporations' returns	Invested capital as finally determined by Bureau	Percent of decrease
1917, 15 companies ¹	\$775,799,312.08	\$717,284,142.24	7.5
1918, 14 companies ²	878,920,120.03	770,212,390.36	12.4

¹ Companies listed except Allegheny Steel Co., Atolia Mining Co., and Freeport Texas Co.

² Companies listed except Allegheny Steel Co., Miami Copper Co., Union Sulphur Co., and Atolia Mining Co.

Tax liability as per corporations' returns and as determined by revenue agents

Year	Tax liability as per corporations' returns	Tax liability as determined by revenue agents	Percent of increase
1917, 17 companies ¹	\$49,927,921.15	\$89,882,631.86	79.9
1918, 17 companies ¹	45,993,839.67	59,580,309.46	29.5

¹ Companies listed except Miami Copper Co.

Tax liability as determined by revenue agents and as finally determined

Year	Tax liability as determined by revenue agents	Tax liability as finally determined by Bureau	Percent of decrease
1917, 17 companies ¹	\$89,882,631.86	\$66,028,958.07	26.5
1918, 17 companies ¹	59,580,309.46	46,841,914.37	21.2

¹ All companies listed except Miami Copper Co.

Tax liability as per corporations' returns and as finally determined

Year	Tax liability as per corporations' returns	Tax liability as finally determined by Bureau	Percent of increase
1917, 17 companies ¹	\$49,927,931.15	\$66,028,958.07	32.2
1918, 17 companies ¹	45,993,839.67	46,841,914.37	1.8

¹ Companies listed except Miami Copper Co.

Proportion of net taxable income to invested capital, both as determined by revenue agents

Year	Invested capital as determined by revenue agents	Net taxable income as determined by revenue agents	Percent
1917, 15 companies ¹	\$547,642,452.81	\$276,560,317.07	50.5
1918, 14 companies ²	746,789,162.34	126,923,550.55	17.1

¹ Companies listed except Allegheny Steel Co., Atolia Mining Co., and Freeport Texas Co.

² Companies listed except Allegheny Steel Co., Miami Copper Co., Union Sulphur Co., and Atolia Mining Co.

Proportion of net taxable income as determined by revenue agents to invested capital as finally determined

Year	Invested capital as finally determined by Bureau	Net taxable income as determined by revenue agents	Percent
1917, 15 companies ¹	\$717,284,142.24	\$276,560,317.07	38.4
1918, 14 companies ²	770,212,390.36	126,923,550.55	16.5

¹ Companies listed except Allegheny Steel Co., Atolia Mining Co., and Freeport Texas Co.

² Companies listed except Allegheny Steel Co., Miami Copper Co., Union Sulphur Co., and Atolia Mining Co.

Proportion of net taxable income to invested capital, both as finally determined

Year	Invested capital as finally determined by Bureau	Net taxable income as finally determined by Bureau	Percent
1917, 15 companies ¹	\$717,284,142.24	\$250,048,916.08	34.8
1918, 14 companies ²	770,212,390.36	119,844,375.76	15.6

¹ Companies listed except Allegheny Steel Co., Atolia Mining Co., and Freeport Texas Co.

² Companies listed except Allegheny Steel Co., Miami Copper Co., Union Sulphur Co., and Atolia Mining Co.

Proportion of net income after taxes ¹ to invested capital, with both income and capital as determined by revenue agents

Year	Invested capital as determined by revenue agents	Net taxable income as determined by revenue agents, less taxes	Percent
1917, 15 companies ²	\$547,642,452.81	\$215,467,139.61	39.3
1918, 14 companies ²	746,789,162.34	88,136,275.47	11.8

¹ The final determination by the Bureau of tax liability has been used as representing the taxes paid.

² Companies listed except Allegheny Steel Co., Atolia Mining Co., and Freeport Texas Co.

³ Companies listed except Allegheny Steel Co., Miami Copper Co., Union Sulphur Co., and Atolia Mining Co.

Proportion of net income after taxes¹ to invested capital with both income and capital as finally determined

Year	Invested capital as finally determined by Bureau	Net income after taxes as finally determined by Bureau	Percent
1917, 15 companies ²	\$717, 284, 142. 24	\$188, 955, 738. 62	26. 3
1918, 14 companies ³	770, 212, 390. 36	81, 057, 100. 68	10. 5

¹ The final determination by the Bureau of tax liability has been used as representing the taxes paid.

² Companies listed except Allegheny Steel Co., Atolia Mining Co., and Freeport Texas Co.

³ Companies listed except Allegheny Steel Co., Miami Copper Co., Union Sulphur Co., and Atolia Mining Co.

Proportion of tax liability as finally determined to net taxable, income as determined by revenue agents

Year	Net taxable income as determined by revenue agents	Tax liability as finally determined by Bureau	Percent
1917, 17 companies ¹	\$290, 212, 129. 81	\$66, 028, 958. 07	22. 8
1918, 17 companies ¹	142, 908, 612. 64	46, 841, 914. 37	32. 8

¹ All companies listed except Miami Copper Co.

Proportion of tax liability to net taxable income, both as finally determined

Year	Net taxable income as finally determined by Bureau	Tax liability as finally determined by Bureau	Percent
1917, 18 companies.....	\$263, 339, 588. 67	\$66, 028, 958. 07	25. 1
1918, 17 companies ¹	134, 151, 948. 53	46, 841, 914. 37	34. 9

¹ All companies listed except Miami Copper Co.

TREASURY DEPARTMENT,
Washington, January 28, 1935.

HON. GERALD P. NYE,
Chairman Special Committee Investigating the Munitions Industry,
United States Senate.

MY DEAR MR. CHAIRMAN: Reference is made to the letter of the Special Committee of the United States Senate Investigating the Munitions Industry dated December 12, 1934, requesting information as to (1) the complexity from an engineering and legal standpoint of the matters involved in the determination of value; (2) the amount of time it would take to make an adequate investigation of an average-sized industrial plant; and (3) specific examples of different valuations placed on property by experts appearing for the Government, experts appearing for the taxpayer and the court, and inquiring whether your committee could be supplied with information as to the personnel which would be required to conduct an adequate investigation into the problem of valuation.

The legal difficulty and uncertainty in the determination of value of property not subject to frequent sales, and as to which market quotations are not published daily, arises because it is so largely to be determined from factual and opinion evidence, none of which is legally conclusive. Such evidence is the best available. Upon such evidence the value is determined by a judge or jury, in certain instances inexperienced in valuation procedure and with inadequate knowledge of considerations governing market value. The weight to be given to the evidence is entirely within their discretion, and short of the adoption of a fundamentally unsound principle or an erroneous theory by the court in its instructions, it is impossible to secure a reversal of their finding if there is any

evidence in support thereof in the record. It is a rare case where some evidence is not admitted which will support a most unsound finding of value.

Market value has been defined as the sum that in all probability will result from fair negotiations of an owner willing to sell and a purchaser willing to buy. *Brooks-Seanlon Corporation v. United States* (265 U. S., 106 to 123; 44 Sup. Ct. 471). The fundamental difficulty in establishing the market value of industrial plants arises because as a general rule no two of such plants are alike, and a sale of the property in question rarely occurs at or about the date for which the market value is to be determined. Even in the rare cases where a sale of the property has occurred that is practically contemporaneous with the date for which the value is to be determined, the conclusiveness of such evidence is frequently impaired by the introduction of evidence attacking the fairness of the sale, alleging misrepresentation of fact, duress, or force, as factors in the transaction. As a result, in the case of the valuation of the great majority of industrial plants, evidence of value, other than sales of the property itself, must be resorted to.

"This value of property results from the use to which it is put and varies with the profitableness of that use, present and prospective, actual and anticipated. There is no pecuniary value outside of that which results from such use. The amount and profitable character of such use determine the value." *Cleveland, Cincinnati, Chicago & St. Louis Railway Co., v. Backus* (154 U. S., 439, 447).

A determination of value based on estimates of present and future profits and an appraisal of the value of such profits, usually designated as an analytical appraisal, while theoretically sound and in many cases the only available method, opens a wide field for differences of opinion. These differences arise as to interpretation of facts existing at the date of valuation, as to what reasonable prognostications as to the future should be based on the existing facts, and finally as to what the market reasonably indicates as the proper factor to be applied to the prospective earnings to arrive at value, that is, the rate of capitalization at which the earnings are to be valued.

The elements essential to an analytical appraisal of market value are primarily estimates in the light of facts known at the date of valuation. Estimates must be made of future earnings, of the time when such earnings may be realized, and of the risk involved in the purchase of the property. When these elements have been determined, the conclusion as to value is arrived at by the application of a sound judgment based on knowledge of market transactions in measurably comparable property at the nearest available time to the date of valuation. The value sought is the price which general buyers and sellers should reasonably agree upon.

As applied to the appraisal of the going-concern value of an industrial plant, the first investigation ordinarily would be an audit of the books of the operating company to ascertain the operating costs, selling price of the product, operating profit, overhead, general expenses, and depreciation, and an analysis of the capital accounts and a descriptive analysis of the asset and liability accounts.

There is considerable room for differences of opinion as to what should be included in operating costs and in capital account, and as to whether or not the past operating costs are not unduly high or low on account of extraordinary circumstances; i. e., frequently claims are made that the plant was in the development stage or that repairs and replacements, although correctly charged will not be representative in determining future costs, or that labor was untrained or inefficient, or that exorbitant or inadequate salaries were charged by interested stockholders or owners. What adjustments should be made under the circumstances are entirely matters of opinion. Similar questions may arise as to many "non-recurrent" expense items.

Again, questions arise as to whether or not the plant was running at a representative or normal capacity during the period prior to the valuation date, considering a reasonable expectancy of future use at the date of valuation, and as to the effect on costs of use of the plant at "normal" capacity. Also, where the results of operation are erratic, differences of opinion arise as to what operating period should be taken as representative. The foregoing may be taken as illustrative, but not a complete list, of questions in which differences of opinion may arise in regard to operating costs.

As to the future selling price of the product, admittedly to be determined in the light of existing conditions, wide differences of opinion frequently arise. Where there is no established price for the product at the date of valuation, i. e., the product may be disposed of through long-term contracts or on a cost or cost-plus basis, the difficulty and consequently the differences of opinion in the estimate of present and prospective market price may be greatly increased.

Having proceeded to the point where the costs of production and market prices are determined, the operating profit is a matter of subtraction. Ordinarily, the percentage of the selling price—that is, operating profit under fluctuating costs and selling prices—is much closer to a constant than the spread between cost and selling price, and a recognition of this fact permits the fixing of the margin of profit within reasonable limits. The application of this method of determining the margin of operating profit will generally be resisted by proponents of a high value, when, by the taking of costs in years of low prices against a higher expected future price, the estimated margin of operating profit is greater. Consequently, detailed analyses of such figures are necessary to demonstrate that in the particular case under consideration costs bear a necessary relation to selling price, that is, that an increased selling price is accompanied by increased costs and a decreased price is accompanied by decreased costs. On the questions of overhead and general expenses and depreciation, the same differences of opinion as in the case of the direct costs frequently arise, that is, as to whether or not extraordinary circumstances of a nonrecurrent nature have unduly affected such costs during the period preceding the date of valuation. In addition, if the value of one plant among several or of a part of plant is in question, the proper method of allocating all indirect costs further complicates the determination of value. The difficulty of determining depreciation and obsolescence, and the allocation of such charges, give rise to the same differences of opinion already mentioned with respect to direct and indirect costs of production.

The audit and descriptive analysis of the asset and liability accounts are essential in an analytical appraisal for the purposes of checking depreciation and plant accounts and of determining the capital, other than plant investment, necessary to the conduct of the business. When this factor is determined, a portion of the profits is allocated to such capital.

The determination of each of the foregoing factors gives rise to differences of opinion. The amount of capital actually employed in the case of a single plant varies considerably from time to time, and the amount that should normally be employed is essentially a matter of opinion. The question of the market rate of return on the capital, other than plant, is again a matter of opinion. There remains after the disposal of the foregoing determinations the ultimate question as to the rate at which earnings attributable to the plant should be capitalized, another matter of opinion based on the judgment of experts.

Estimates of expected profits are not infrequently complicated by the following circumstances: The product manufactured or the machines used in the manufacturing of the product are covered by patents; the plant operates under patent licenses; the product is manufactured or disposed of under terminable life contracts; the manufacturing is carried on in leased premises at rentals other than the present or prospective fair rental value; the plant is operating for others under contract with results which are more favorable or less favorable than might be obtained under terms of a contract which might be negotiated under present or prospective conditions. These factors enhance or depress present earnings, and future earnings must be adjusted to allow for the discontinuance of the effect of such factors. The amount of such adjustments is at best a matter of judgment and opinion, and on account of the highly technical nature of the subject matter, particularly in circumstances involving the use of patents, is inherently difficult from the standpoint of administrative and judicial determination.

The question of what portion of the earnings are attributable to patent protection and what portion to the business of manufacturing may be cited as one example of these difficulties.

In the case of the valuation of one plant among several operated by a business concern, the number of determinations mentioned above are multiplied due to the necessity of allocation.

By numerous decisions of the Supreme Court of the United States it is firmly established that the cost of reproduction new less depreciation constitutes evidence properly to be considered in the ascertainment of value. *Standard Oil Co. of New Jersey v. Southern Pacific Co. et al.* (268 U. S. 146, 45 Sup. Ct. 465).

In the same case the court points out, however, that such evidence is not the measure or sole guide, and states:

"The ascertainment of value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts."

The estimation of cost of reproduction new requires a very detailed and expensive inventory of each and every item comprising the plant. The current

costs of all of these items must then be estimated. Such estimates include present costs of the land occupied by the plant, grading, excavation, foundations, building materials of every description, including freight, labor and superintendence during construction, cost of machinery including freight and installation, office and general overhead expense during the construction period, engineering and architectural fees, interest on capital during the period required for plant erection, and frequently such things as contractors' profits, overhead and general expenses, and/or cost of specialized technical supervision. With such listing of items and with such estimates of current costs and prices, the cost of reproduction new is computed. The depreciation to be deducted must then be estimated.

This type of appraisals are usually made by long established engineering firms who have maintained files containing price lists and descriptive matter from all available manufacturers of items making up the plant and equipment for all types of industrial concerns. Such estimates of depreciation are usually the personal opinions of the men taking the detailed inventory, usually the minor employees of the appraiser. Such a man looks at a structure or a machine, or at its important parts, and says that is a certain percentage of as good as new insofar as wear and tear and physical decay are concerned. The estimation of obsolescence is almost never attempted. The result frequently is that the appraisal includes estimated costs to reproduce such things as masonry buildings which are obsolete and would be more expensive to reproduce than would a strictly modern substitute structure. The appraisal may include machines which are entirely obsolete because of costs of operation greatly in excess of those of modern machines, yet such machines may exhibit little or no physical deterioration and be included at practically 100 percent of cost of reproduction new. The cost of reproduction new, less depreciation representing only physical deterioration, is the so-called "sound value" of this type of appraisal. Such appraisals, especially if made at about the time of valuation, are extremely difficult to meet or check retrospectively unless by means of their own inherent weakness or through other evidence of value. *G. C. Thompson Pottery Company v. Routzahn* (25 F. (2d) 897). On account of their lack of conclusiveness, the amount of detailed work required, the remoteness of the date of valuation, and the intervening changes in plants involved, it has been found impractical in verifying such appraisals in the Bureau of Internal Revenue, to do more than require that such appraisal show the date of acquisition and original cost, check reproduction costs with the best index factors obtainable to determine the difference between original cost and reproduction cost new, and make such allowance for depreciation and obsolescence as appears to be justified by the circumstances of the particular case.

In the trial of valuation questions the dollar and cents figure shown as reproduction cost new, less depreciation and obsolescence, even under proper instructions because of its simplicity, may be given undue weight as evidence of market value rather than proper consideration with the other evidence in the case.

In the case of plants under corporate ownership, the sale price of shares of stock in the market may be admissible as evidence of the value of the assets. However, the shares of stock and the net assets of a corporation are entirely different things, and the value of one bears no fixed nor necessary relation to the value of the other. *Ray Consolidated Copper Co. v. United States* (268 U. S. 373). This type of evidence is therefore never conclusive. Unless the value in issue is the entire going-concern value of the corporation, such evidence is not a measure of the value of the property (*Pullman Palace Car Co. v. Central Transportation Co.* (171 U. S. 138)), although it may be a part of the foundation for expert opinion on value and a fact to be considered by the judge or jury with other evidence in reaching their finding of value.

Value in the case of industrial plants generally must be a conclusion based on facts and the expert opinions contributed from four distinct technical fields, that is, accounting, engineering (construction and operating), legal, and financial. The conclusion requires a correlation of these contributions since the factors contributed from each source are interdependent and modify the effects of contributions from the others.

The professions or avocations from which the contributions are made are technical and have developed experience, language, and methods of procedure peculiar to themselves. As a result, the presentation of evidence in valuation cases, in such a manner that technical complexities are minimized and the technical conclusions appeal to the common sense of parties having to deal with the determination of value, is a difficult matter and requires intensive preparation. Technicians are generally prideful or unconscious of the technical manner in

which their contributions are made, and reluctant or unable to reduce their contributions of fact or reason to simple fundamentals, intelligible to technicians in other fields and to the nontechnical man.

A further difficulty in the administration and judicial determination of market value is due to a loose popular conception or definition of value. This difficulty attends the whole process of determining value. It particularly affects expert opinion. Some fallacy, or a combination of fallacies, may be interwoven in or form the basis of the opinion. In many cases the incompetency of such opinion is not or cannot be shown on direct or cross examination with the result that such opinions may support a most unsound finding of value.

A few examples of persistent fallacies of this nature which have arisen in such a manner as to permit their rejection by the courts are:

(1) The theory that more or less uncertain estimates involved in the determination of value at the date of valuation may be corrected by the later ascertained facts. *Ithaca Trust Co. v. United States* (279 U. S. 151).

(2) That the value of property is measured by the subsequently ascertained ultimate return therefrom, or that latent occult intrinsic value controls rather than the considerations that affect market value and have their influence upon men of affairs. *Stratton's Independence, Limited, v. F. W. Howbert, Collector* (231 U. S. 399). *Reinecke v. Spalding* (280 U. S. 227).

(3) That value is to be determined under an assumption of nonexistent conditions, or on some speculative assumption as to what the value would have been if something which did not occur had occurred. *National Bank of Commerce v. City of New Bedford* (29 N. E. 532). *Bingham's Administrator et al. v. Commonwealth* (244 S. W. 781). *Rice v. Eisner* (C. C. A. 2, 16 F. (2d) 358).

(4) That value is to be determined by some morally just or normal standard divorced from the conditions existing at the date of valuation and the standard established by the market which is the gage of the considerations which influence general buyers or sellers, and of the intensity of the social desire for the property at the time. *Ithaca Trust Co. v. United States* (279 U. S. 151). *Boyd v. Wiley* (124 U. S. 105). *United States v. New River Collieries Co.* (262 U. S. 341-345). *719 Fifth Avenue v. United States* (5 F. Supp. 909). *United States v. Cole et al.* (T. D. 4165, C. B. VII-1268, C. C. H. 1927, p. 7720).

(5) Misconceptions of the nature and character of the property to be valued. *Reinecke v. Spalding* (280 U. S. 227). *Kaufmann & Bauer Co. v. Heiner* (34 F. (2d) 698).

(6) A failure to properly weigh the reasonably assured and the remote or more or less speculative elements which contribute to value. *Johnson v. United States* (44 F. (2d) 244, 70 Ct. Cl. 534). *719 Fifth Avenue v. United States* (5 F. Supp. 909). *Driscoll et al. v. Inhabitants of Northbridge* (210 Mass. 151, 96 N. E. 59). *United States v. Cole et al.* (T. D. 4165, C. B. VII-1268, C. C. H. 1927, p. 7720). *Commissioner v. Swenson* (C. C. A. 5, 45 F. (2d) 61).

(7) Attributing value to a particular property based on earnings derived in great part from many other elements or properties contributing to the production of such earnings. *Perfect Window Regulator Co. v. United States* (66 Ct. Cl. 147). *Keystone Wood Products Co. v. Commissioner* (19 B. T. A. 1116).

Another further weakness from a governmental standpoint in establishing market value is due not infrequently to the unwillingness of experts in specialized lines to accept employment as opinion witnesses for the Government. This is largely due to the fact that in many cases there is a common interest extending throughout all industries under a given set of circumstances to secure the advantage of high or low values. Competent witnesses are either directly connected with or dependent on the industry for their regular income. Witnesses of the highest qualifications are, therefore, frequently unable or unwilling to accept governmental employment.

The Bureau of Internal Revenue has had to determine the value of physical plants as distinguished from going-concern value at March 1, 1913, in the cases of taxpayers owning plants on, and operating them after, that date. Such determinations were made for the purpose of establishing a base for depreciation allowances. In the great majority of such cases the taxpayers and the Bureau have been able to agree upon a value equal to cost less sustained depreciation. Difficulty in these cases was confined generally to questions of correct accounting. The stable nature of such property and the relatively stable price level for a considerable period prior to and at March 1, 1913, eliminated, to a large extent, questions of appreciation in value and were in a large measure responsible for the comparative ease with which such questions were settled.

On account of the instability of the market standards, valuation of physical property in periods of depression or unusual prosperity furnishes the opportunity to present opinion evidence out of line with the general market conditions existing at the time, and in line with the exigencies of the case and the idiosyncracies of the witnesses. The uncertainty of litigation involving value questions to be determined in such periods is thereby increased.

On account of their peculiar and individual characteristics in every case and the confusion of their qualitative characteristics as distinguished from their quantitative contribution to value, intangible elements which may contribute to the value of industrial property generally, such as goodwill, trade marks, trade brands, etc., are the frequent sources of irreconcilable differences of opinion and litigation. However, in determining going-concern value as a whole, available market records of prices of securities of comparable corporations furnish a yardstick or market standard which permits, but does not insure, some check on the reasonableness of opinions as to value.

When patents are to be valued separate and apart from goodwill, trade marks, trade brands, or other intangible elements contributing to the value of property operated or to be operated as a whole, the values of each are inherently matters of opinions. The motive of interest results in the production of unreasonable opinions in such cases. Opinions of this nature are of frequent occurrence in which earnings in excess of a fair return of the tangible property are attributed almost entirely to patents, although it is patent that extensive advertising and good management have built up a large element of goodwill. Such opinions are the source of increased uncertainty as to outcome in litigated cases of this nature.

The foregoing recital of the complexities and uncertainties in the determination of fair market value from commercial and legal standpoints, since it attempts to cover the entire field in a general way, probably overemphasizes the difficulties that may be encountered in the great majority of cases. If the foundational facts are fully developed, the field for reasonable differences of opinion is greatly narrowed. Given competent representation on both sides, assurance that the valuation will be competently litigated if necessary and applying the standard of a common-sense reaction by a court or jury to the evidence which may be adduced by both sides rather than the standard of decisions in exceptional and extreme cases, the great bulk of valuation issues should be satisfactorily disposed of administratively.

Your question as to the amount of time it would take to make an adequate investigation of an average sized industrial plant is difficult to answer on account of the varying circumstances under which such an investigation may have to be conducted. A few of the circumstances which may greatly vary the time required in such an investigation are: The elapsed time between the date of the investigation and the date of valuation; the condition of the books of account, plant records, and operating records of the plant under investigation, and the question as to what portion of the work of the investigation may be thrown upon the owners of plants.

The answer to your question which follows is not based on the statistical analysis and should be taken as subject to wide variation in individual cases even under the assumed conditions which are suggested. The assumptions made are as follows: (1) That the original records, minute books, stock registers, stock transfer books, books of account, operating records and plant accounts are well kept and available; (2) that the burden of appraising the plant to be valued is placed upon the owner of the plant, the appraisal to show as to each item making up the inventory of plant, the date of purchase, the cost, the facts relied on to support present reconstruction cost equal to cost or departures from cost either up or down, and the facts relied upon to demonstrate the amount of depreciation and obsolescence accrued; (3) that all evidence of value either supporting a high or a low value within the knowledge of the owner of the plant is submitted by the owner of the property; (4) that the owner of the plant is restricted on any appeal from the original determination of value to the foundational facts, as distinguished from conclusions or opinions, submitted before the original determination of value, and (5) that an average sized industrial plant is one having a value of about \$3,000,000.

Under the conditions assumed, it is estimated that a competent auditor, with 1 assistant, and a competent engineer, with 1 assistant, would require about 3 months to check the history of the plant, factual evidence as to transactions in interests in the plant or in the securities of corporate owners, operating records, capital accounts, and assemble the foundational facts upon which an analytical appraisal valuation must be based, including reasonable conclusions as to recon-

struction costs new less depreciation and obsolescence, and as to the earnings and capital accounts. A competent valuation expert either having commercial experience or a knowledge of commercial transactions and of market conditions, and with some legal advice, should be able to arrive at a defensible value based on the standard of the market within 1 month. In cases which are litigated there should be added to the above time to prepare for trial the time of 1 lawyer for a 30-day period, 1 auditor for an additional 30 days, 1 engineer and 1 valuation expert for at least the same period and probably 10 days for 3 expert witnesses. If the principal foundational facts are stipulated the trial time may be a week or less. If agreement on the foundational facts cannot be reached, the trial time is impossible to estimate as is demonstrated by the widely varying length of the proceedings in hearings of public-utility commissions with which you are no doubt familiar.

Your additional inquiry as to whether information could be furnished as to the personnel which would be required to conduct an adequate investigation of the problems of valuation must be answered in the negative on account of inadequacy of the information as to the scope of the inquiry contemplated.

The table attached hereto* shows specific examples of different valuations placed on property by experts appearing for the Government, by experts appearing for the taxpayer and the courts, as well as a few cases in which the Government relied on sales of the property in question and/or the sale price of the owner corporation's securities.

The Bureau of Internal Revenue has settled administratively, or through litigation, the cost or fair-market value as of March 1, 1913, whichever is greater, of practically all property operated in the United States which is subject to depreciation, exhaustion, or depletion allowances under the income tax statutes.

The remaining costs (of Mar. 1, 1913) are kept up to date in connection with the preparation and audit of each year's income-tax returns. It therefore suggests itself, that adopting the value remaining after deducting allowances recognized as sustained under the income tax statutes as a basis for contractual compensation for the use of such property, may be worthy of your consideration. Such a basis has the merit of avoiding the burden of a large volume of revaluations. It has the further merit that a large percentage of the original value determined on other than a cash-cost basis has been eliminated through the allowances for exhaustion, depletion, and depreciation. The necessity for valuing land and possibly other nonwasting assets, as well as natural resource deposits discovered and patent developed after March 1, 1913, if such a basis were adopted would still remain.

Very truly yours,

-----, *Acting Secretary.*

* See p. 146 for table attached to above letter.

Table attached to letter of Jan. 8, 1935 from Acting Secretary of Treasury

Title of case	Kind of property valued	Evidence of value		Value found by court, jury, or the Board of Tax Appeals
		Government	Taxpayer	
Syracuse Food Products Corp. (21 B. T. A. 804).	Patents at Mar. 1, 1913.	Opinion evidence, \$200,000 to \$250,000.	Opinion evidence, \$3,500,000 to \$4,000,000.	\$1,750,000.00
<i>U. S. v. Cole et al.</i> (T. D. 1165, C. B. VII-258, C. C. H. 1927, p. 7729).	Undeveloped mining property at Mar. 1, 1913.	Opinion evidence, \$1,500,000.	Opinion evidence, \$2,500,000 to \$9,000,000.	1,875,000.00
Newaygo Portland Cement Co. (27 B. T. A. 1067).	Hydroelectric power plant.	Opinion evidence, \$295,000.	Opinion evidence, \$650,000.	375,000.00
American Metal Co. (30 B. T. A.)	Value developed mine, Dec. 1, 1927.	Opinion evidence, \$1,428,570.	Opinion evidence, \$4,250,000.	1,500,000.00
<i>719 Fifth Avenue v. U. S.</i> (5 F. Supp. 909)	Value leasehold Mar. 1, 1913.	Opinion evidence, 0.	Opinion evidence, \$300,000 to \$370,000.	0
<i>Harc v. Heiner</i> (113 F. 907 (94).	Value undeveloped coal land	Opinion evidence, \$400 per acre.	Opinion evidence, \$1,200 per acre.	1,600.00
Tex-Penn Oil Co. (28 B. T. A. 917).	Value of 1,007,834 shares of stock in newly organized oil company.	Opinion evidence value \$10,079,340.	Opinion evidence, value, 0.	7,054,838.00
J. G. Robertson (2. B. T. A. 53)	Value shares common stock Firestone Tire & Rubber Co. at Mar. 1, 1913.	Opinion evidence, \$300 per share; sale price in the market \$300.	Opinion evidence, \$670-\$800 per share; cross examination 1 witness: "Any one would be a sucker to pay more than \$300."	550.00
J. G. Robertson, Rouzahn (1 F. Supp. 355)	(2) Goodwill—distillery business.	Opinion evidence, 0.	Opinion evidence, \$1,500,000.	(3)
<i>Guckenheimer & Fos. Co. v. Heiner</i> , (unreported).	Assets of steel company.	Evidence of a contemporaneous sale for cost at \$1,115,632; subsequent sale price of petitioner's stock evidencing value less than \$2,000,000.	Opinion evidence, \$2,941,030.89 to \$3,411,030.89.	2,673,548.06
<i>Atlantic Steel Co. v. Rose</i> (unreported).	Entire assets of a brick company.	Sales of 63 percent of the stock of predecessor corporation supporting value less than \$30,000.	Opinion evidence, \$111,617.23.	63,967.23

1 Per acre.

2 The issue was the same and the evidence substantially the same as in case above.

3 Net in excess of \$431.85 per share.

EXCERPTS FROM EXHIBIT No. 1343

MEMORANDUM RE VALUATION

1. VALUATION WORK OF THE INTERSTATE COMMERCE COMMISSION

The difficulties attendant upon valuation are perhaps illustrated most graphically by the work of the Interstate Commerce Commission in connection with its valuation of the railroads of the country up to 1926.

* * * the Interstate Commerce Commission in valuing only the properties of the railroads of the country has spent more than 13 years on the task and more than \$27,000,000, and the carriers themselves in working on these same valuations have spent the same period of time and more than \$85,000,000. (Mr. Ernst's Report, 69th Cong., 1st sess., S. Rept. 27, pt. 3, p. 4.)

This statement is all the more significant in view of the fact that railroads have for a long time had their rate of profit regulated in the public interest by both State and Federal Governments.

For years past railroads, pipe lines, and express companies have been obliged to keep their books in accordance with accounting methods prescribed by the Interstate Commerce Commission. * * * There are also State and municipal regulations prescribing the form of accounting to be followed by various public utilities, banks, insurance companies, and other forms of business closely connected with the public interest. (69th Cong., 1st sess., S. Rept. 27, pt. 2, pp. 130-131.)

Since the rate of profit which has been allowed public utilities has characteristically been based on a fixed return on "value", it is apparent that a considerable store of information must have been present on the subject of valuation and on the techniques of attacking the problem. Such are the difficulties that have been encountered in connection with a business which was the first to be subject to supervision in the public interest; it is impossible to set forth the extent of the difficulties which will be encountered in connection with the valuation of industries not subject to similar prior scrutiny.

Expenditures in connection with valuation work of the Interstate Commerce Commission have continued to be on a large scale since the time of the Couzens' Report. In the account of the appropriation and expenditures of the Interstate Commerce Commission for each fiscal year there appears an item:

Valuation of property of carriers: To enable the Interstate Commerce Commission to carry out the objects of the act entitled "An act to amend an act entitled 'An act to regulate commerce', approved Feb. 4, 1887, and all acts amendatory thereof", by providing for a valuation of the several classes of property of carriers subject thereto and securing information concerning their stock, bonds, and other securities, approved Mar. 1, 1913.

For the respective years 1926-29, the amounts listed under this item were as follows:

Year:	Amount
1926-----	\$1, 883, 232. 97
1927-----	1, 715, 140. 97
1928-----	2, 563, 214. 00
1929-----	2, 336, 670. 00

(See 40th-43rd Annual Report, Interstate Commerce Comm., 1926-29.)

The size of the appropriation in these years is all the more significant in view of the note of optimism present in the 1922 report of the Interstate Commerce Commission to the effect that the valuation job had been practically completed:

We have reached the state in valuation of the steam railroads of the country where, except for rechecking, the inventorying of roads recently constructed, and a few minor details, the original field work has been completed. Underlying reports are being issued in large numbers, and hearings and final arguments on protested tentative valuations are in progress. Of 287 tentative valuations served, 101 have become final through absence of protest, which under the act any interested party may file within 30 days after service of the tentative valuation. Full hearings upon protests have been had in 39 cases. Six cases have been partly heard and 33 cases are

assigned for hearing before December 31, 1922. Final arguments have been had in three cases and 12 were set for argument in November. Issues raised by protestants in 19 cases have been submitted without argument.

* * * * *

We have completed the transfer of all forces and records of the Bureau to the central office in Washington, and have closed the San Francisco, Kansas City, Chicago, Chattanooga, and Washington district offices. This has been accompanied by reorganization and closer coordination. The number of employees has been reduced to approximately 550, or about one-third of the maximum reached in 1918. Expenditures have been reduced from approximately \$3,000,000 per annum during the first few years, \$2,735,911 for the fiscal year 1920-21, and \$1,597,572 for the fiscal year 1921-22, to approximately \$1,300,000. This reduction has, in large part, been made possible by the termination of original field work (36th Annual Report of Interstate Commerce Commission, 1922, p. 70).

The report of the Commission two years later is much less hopeful in outlook.

Based on our experience thus far, we estimate that the hearings to be held on protests to tentative valuations will exceed 500 in number. We cannot estimate their length. It is apparent that satisfactory completion of the work, already over 10 years in progress, is seriously menaced by delay in completing these primary valuations. Most of them are already from 6 to 10 years old. In administering the act present-day valuations are needed, but before they can be had primary valuations must have been completed to serve as bases for carrying the valuations forward. There is serious disadvantage in the lapse of so many years between the primary and the present-day valuations. With the passage of time come cumulative changes in the property by reason of additions, betterments, and retirements, thus rendering the original inventories increasingly unrepresentative of present conditions (38th Annual Report of Interstate Commerce Commission, 1924, p. 14).

The above-cited passage supplies clear indication that it is much more than a mere routine matter to keep a valuation, once arrived at, up-to-date. To the same effect, see the 39th Annual Report of the Interstate Commerce Commission (1925):

* * * Our valuation order no. 3 requires carriers to keep a record of additions, betterments, and retirements made subsequent to date of the primary valuation: to render annual reports to us showing, by primary accounts, the cost of such property; and to report the units of property installed and retired at such times and for such periods as we may request.

During the year the force assigned to the administration of this order averaged 54 persons. Of this number an average of 29 were assigned to policing and checking the carriers' records in the field. * * * (39th Annual Report of the Interstate Commerce Commission, 1925, p. 16.)

The same report also contains a significant statement as to the difficulties of securing sufficient competent personnel at salaries that the Government can afford to pay.

Explanation of the difficulty of keeping a valuation current may also be found in the 1930 report of the Commission, which describes the extent to which property values in the railroad industry fluctuate in the course of a year:

Changes in the property of the carriers, consisting of additions, betterments, and retirements, varying in amounts from more than one-quarter billion to more than one billion dollars, occur annually. Price levels, likewise, fluctuate continually. Therefore, unless, as provided by paragraph Fifth (f) of section 19a, we keep informed of such changes, both in the property and its value, the valuations quickly become obsolete. The United States Supreme Court has held that substantial fluctuations in price levels affect values, and it is the settled rule of that Court that the lawful rate base is present value. It follows, therefore, that if valuations are to be of practical use they must not become obsolete (46th Annual Report of the Interstate Commerce Commission, 1932, p. 89).

It was not until 1932 that the Interstate Commerce Commission completed the valuation process which it had so hopefully described in 1922 as practically complete as far as field work was concerned, and which had been entrusted to it by Congress in 1913.

During the year we have completed the last of the primary valuations of the 1,685 steam railroads listed for valuation as existing on March 1, 1913, the date of the enactment of the valuation act. These valuations are incorporated in 1,035 final valuation reports, although a few have not yet been published (46th Annual Report of the Interstate Commerce Commission, 1932, p. 86).

The recapture provision of the Transportation Act of 1920 added very measurably to the work of the Bureau of Valuation of the Interstate Commerce Commission:

RECAPTURE VALUATIONS

* * * By increased appropriation we have been enabled to assign a somewhat increased force to the administration of this order. This has averaged 64 employees, 40 of whom have been engaged in the field work of policing and checking the carriers' records. Up to the present time preliminary examinations have been made in the offices of 460 carriers. Complete field examinations, covering an average period of seven years subsequent to the various dates of valuation, have been made of the records of 205 carriers, aggregate mileage 68,000. Field examinations covering an average period of eight years are now in progress on 30 carriers, aggregate mileage 48,000. The present force available for this work still falls short of the requisite number. (40th Annual Report of Interstate Commerce Commission, 1926, p. 15.)

In fact, in one year, 1930, the Interstate Commerce Commission reported that its Valuation Bureau was compelled to restrict itself in large measure to recapture cases:

The activities of the Bureau of Valuation have in a large measure been restricted during the year for which this report is made to valuation work in recapture cases. This is in conformity with instructions issued July 18, 1929, that the "Bureau give precedence in its valuation work to recapture cases." (44th Annual Report of Interstate Commerce Commission, 1930, p. 59.)

It should be noted that the general valuation work commenced in 1913 was, in comparison with the recapture valuations, a more or less disinterested scientific inquiry. Valuation in connection with recapture was specifically linked up with the enforcement of a policy designed to limit the profits of the more favorably situated carriers. Anticipation of the resultant legal difficulty in the courts which it was feared the recapture provision would run into necessitated an even more elaborate personnel and much fuller investigation than valuation carried on from a purely scientific basis:

* * * It soon became manifest that the protests were to test with meticulous detail the inventories, prices, methods, theories, and conclusions, and even administrative procedure, and that as to any and all of these there would probably be appeal to the courts. Consequently the work had to be done with the greatest care, not only for the sake of the undertaking itself but also to withstand attack in the courts. This in turn required an army of experts consisting of engineers, land appraisers, auditors, accountants, and attorneys. Protests were filed in 748 cases and hearings held in 503 cases. Under the broad latitude afforded by the law, which gave to every protestant his right fully to be heard, hearings on individual properties ran many months. In addition there have been suits attacking our decisions. To these long-drawn-out proceedings during the later years is attributable much of the delay in the completion of the primary valuations.

It is obvious that this act requires the most extensive, detailed, and exhaustive investigation, culminating in a valuation of the complex property of the railroads extending over 250,000 miles of main track and 400,000 miles of all tracks, together with equipment, terminals, and all other holdings. The result was a much greater undertaking than those

who wrote the many detailed requirements into the law could realize at the time of its enactment (46th Annual Report of the Interstate Commerce Commission, 1932, p. 88).

That a provision such as the recapture provision demands heavy policing is apparent when the amount of excess income which the carriers reported is compared with the Interstate Commerce Commission's estimate of the recapturable excess which they had actually earned:

Recovery of excess net railway operating income, general railroad contingent fund

Period	Number of reports	Number of reports in which excess income is reported	Total amount of excess income reported
Applicable period, 1920.....	993	34	\$2,505,006.03
Calendar year:			
1921.....	975	27	458,535.72
1922.....	931	50	1,867,239.33
1923.....	902	53	6,909,296.66
1924.....	902	23	1,196,261.90
1925.....	897	32	2,402,198.71
1926.....	882	24	1,090,490.78
1927.....	870	10	177,566.32
1928.....	851	19	1,115,087.16
1929.....	843	27	5,378,101.20
1930.....	810	9	381,266.47
1931.....	753	2	67,821.48
Total excess.....			23,548,871.76

While the carriers reported a total excess income of only \$23,548,871.76, one-half of which is subject to recapture, for the period 1920 to 1931, inclusive, our estimates of recapturable excess income for the period 1920 to 1930, inclusive, amount to considerably over \$300,000,000. * * * (46th Annual Report of Interstate Commerce Commission, 1932, p. 93.)

And, finally, despite all of the Commission's wrestling with the problem of valuation for recapture purposes, the Supreme Court, in the O'Fallon case, 279 U. S. 461 (1929), by insisting that the Commission had not paid sufficient attention to the factor of reproduction cost in its valuation, necessitated a wholesale revision of the Commission's work:

The amount due from the carriers, according to preliminary computations made in the manner outlined above, is approximately \$300,000,000 for the years 1920-28. As a result of the Supreme Court's decision in the St. Louis & O'Fallon case, this estimate must be changed. It is estimated that under the present system of quasi-judicial hearing procedure a minimum of six years would be required to dispose of the present arrearage, and even at the end of that period the work would hardly be current, owing to accumulations during the interval (43rd Annual Report of Interstate Commerce Commission, 1929, p. 87).

Even with the recapture provision repealed, the appropriation for valuation available to the Interstate Commerce Commission was \$1,000,000 for the year 1933-34, and its active personnel included 381 employees:

The amendment above referred to, together with repeal of provisions of section 15a relating to excess net railway operating income, greatly simplify the valuation work. Together with the completion of the primary valuations it has enabled us to reduce materially the personnel and expenditures in the Bureau. The reduction was possible, also, because of the progress made in correcting and revising the original inventories and underlying records and data. For the last fiscal year (1932-33) the appropriation for the Bureau was \$2,750,000. Its personnel on June 1, 1933, consisted of 910 employees. The appropriation for the current fiscal year (1933-34) is \$1,000,000, and its active personnel on July 1, 1933, consisted of 381 employees (47th Annual Report of the Interstate Commerce Commission, 1933, p. 74).

This appropriation is insufficient to allow the Commission to make any considerable progress in connection with the valuations of carriers other than railroads:

Section 19a is applicable to all carriers subject to the provisions of the act. Insufficient appropriations have prevented us from proceeding with the valuations of carriers other than railroads with the exception of the Pullman and telegraph companies. The valuation of these latter companies is being prosecuted as far as appropriations permit. Requests for additional appropriations to value other carriers such as pipe-line and telephone companies have been made from time to time (47th Annual Report of the Interstate Commerce Commission, 1933, p. 76).

This situation exists in an industry with a well-established tradition of regulation in the public interest, and an industry whose books and records were consequently in much better shape than the mass of American industry. Furthermore, the statute (37 Stat. 701; 48 Stat. 221) was liberal in its provisions in aid of investigation; and to a certain extent, comparative checks could be made with data which had been acquired by the State public utility commissions which had preceded the Interstate Commerce Commission in the field.

2. GENERAL DIFFICULTIES OF PUBLIC UTILITY VALUATION

The difficulties which have only sketchingly been brought out in connection with the valuation of interstate carriers are paralleled throughout the public utility field. Frequently, of course, the issues which are raised in specific controversies do not directly concern themselves with the problems of valuation. If there be an incentive on the part of the utility to provoke delay, obstacles or confusion, resort is often had to legal technicalities and to statutory issues. The real motive underlying the attempt to thus confuse and becloud the issue will, in the usual instance, be the utility's contention that it is being unconstitutionally deprived of a fair return on its investment. The two major considerations which are germane to such a contention are the value of the utility's investment, and the rate of return on its investment to be accorded the utility. The complexity, volume, delay, and the other features which characterize rate regulation can in the usual instance be referred to the problem of valuation.

Voluminous records are the rule in public-utility rate controversies. Thus:

An illustration of the experience of the commissioner is found in the case of *The Pacific Northwest Public Service Company v. Oregon Public Utilities Commissioner* in the district Federal court at Portland, Oreg.

* * * * *

The commissioner's hearing developed a transcript record of 500 pages and 43 exhibits. Among these exhibits was a voluminous study and analysis prepared by the engineers of the commission. (Hearings before the Committee on the Judiciary, House of Rep., 73d Cong., 2d session, S. 752, serial 4, p. 18.)

Mr. Minton, of the Public Utilities Commission of Indiana, testified before the House Committee on the Judiciary as to one case involving his commission:

Mr. MINTON (Public Utilities Commission of Indiana). If we are taken into the Federal court, as we are threatened with in the *Electric case*, as we have just heard, we will be confronted, of course, with the great array of volumes of exhibits as to the inventory and appraisal of that property, some sixty-odd volumes of it, and perhaps another array of engineers. (Hearings before the Committee on the Judiciary, House of Rep., 73d Cong., 2d session, S. 752, serial 4, p. 49.)

He had an even better illustration in his testimony, that of the *Indianapolis Water case* which reopened a controversial situation which the Supreme Court had at one time passed on:

The *Indianapolis Water case* was before the Supreme Court of the United States in 1926; its title was *McArdle v. Indianapolis Water company*. The higher rates were sustained by the Supreme Court of the United States. During the time of the depression out there, they instituted a proceeding against this water company to reduce their rates again. And the case was again taken into the Federal court.

Now, that the case started early in the fall of 1931. The commission wrote its order in April 1932. They were promptly enjoined in the Federal

court, and in May 1933, we appeared before the special master in the Federal court to start to take testimony in that case. The special master in that case is a distinguished ex-judge in our State, a former United States attorney, and he was master in chancery, who has heard a number of utility cases before. We started on the 1st of May to take testimony, took the testimony all summer long, and finished about the middle of August; and we had compiled the largest record of testimony that had ever been taken in the Federal court in Indianapolis, according to the statement of the reporter who reports in that court, and has been reporting there for 30 years; a record of 15,000 typewritten pages, with hundreds of pounds of exhibits—books of exhibits, running from 200 to 400 pages each.

Now, that utility had been before the commission, with its engineers and its experts, and had gone into this thing rather thoroughly before the Commission. They brought this firm of engineers from New York, a distinguished firm; and when they came into the Federal court, the record which was made before the Commission was utterly ignored, and there was no attention paid to it at all. They started *de novo*. And they used not only the engineers used before the Commission, but they employed in the meantime an additional firm of engineers in the city of New York, a very distinguished firm, I understand the outstanding firm in New York—and they brought both firms out there.

And so we had two great firms of engineers out there in that water case. And in addition to that they brought a very noted utility expert from New York to testify about the rate of return. They brought New York counsel out there.

So we spent the whole summer there taking the testimony in that case. The briefs have just been filed on behalf of the attorney general, who represents the commission in that matter and he just last week filed his brief before the master. The brief is a document of some 200 or 300 pages, and the brief filed by the utility is some 300 pages, I suppose. (Hearings before the Committee on the Judiciary, House of Rep. 73d. Cong., 2nd session on S. 752, Serial 4, pp. 48-49, February 27, 1934.)

The expenses entailed by such a procedure are considerable.

in the *Indianapolis Water Co. case*, they were still amortizing the expenses of the 1926 rate case at the time we heard the last case out there in the Federal court; and they were still amortizing in Indianapolis, to the tune of \$30,000 per annum in expenses of that case.

THE CHAIRMAN. What were the expenses in the case?

MR. MINTON. Some \$200,000. I do not recall the exact figure. In preparing this case to present to the master last summer, the Public Service Commission, through its attorney general and legal representative, employed additional engineering help, when we were confronted with their engineers on behalf of the utilities; and we spent \$25,000 of the people's money trying to prepare that case to present it again in the Federal court. And so we are spending thousands and thousands of dollars in that one case. (Hearings before the Committee on the Judiciary, House of Rep., 73d Cong., 2nd session, on S. 752, serial 4, Feb. 27, 1934, p. 49.)

Other illustrations may be adduced of investigations which not only cost the State considerable money, but also involved delays in effective administrative action as a result of court litigation. Thus, the State of Kansas spent almost \$100,000 upon an investigation of gas rates charged by a company serving a hundred or more towns. Yet, by virtue of an injunction in the Federal district court, this case was delayed one year. (Hearings before the Committee on the Judiciary, House of Representatives, 73rd Congress, 2nd session, S. 752, serial 4, Feb. 27, 28, March 1, 1934, p. 258.) In New Jersey a valuation of public utility property took two years and cost more than \$100,000. (Hearings before the Committee on the Judiciary, House of Representatives, 73rd Congress, 2nd session S. 752, serial 4, Feb. 27, 28, March 1, 1934, p. 214.) In the Pacific Telephone and Telegraph Company and Home Telephone Company cases, after three years of proceedings within the State, new evidence was taken before a special master in Federal court; the State of Washington and its municipalities were subjected to more than \$100,000 in the way of expenditures. (Hearings before the Committee on the Judiciary, House of Representatives, 73rd Congress, second session on S. 752, serial 4, Feb. 27, 28, March 1, 1934, p. 262.)

A classic instance of delay caused by litigation is supplied by the Chicago Telephone case, referred to four times in the hearings before the House Judiciary Committee on the Johnson bill. (Hearings before the Committee on the Judiciary, House of Rep., 73rd Cong., 2d session on S. 752, serial 4, pp. 23, 70-71, 138, 224, Feb. 27-Mar. 1, 1934.) The mere printing of the record in this case for the United States Supreme Court cost \$25,000:

What the 10 years of litigation has cost we can only guess; but we know from the opinion of the United States district court that the city of Chicago was obliged to seek delays because it lacked funds to meet the costs which fell upon it, all of which might have been avoided had the company been willing to accept the method of review provided by Illinois law, under which the record before the Commission would have been transferred to the Court, without the calling of additional witnesses, and upon which an expeditious decision might have been had. (Hearings before the Committee on the Judiciary, House of Representatives, 73d Congress, 2d sess., on S. 752, serial 4, March 1, 1934, p. 224.)

The history of this case illustrates the potentialities for delay present in our commission-court system of rate regulation:

Mr. BENTON (continuing). Some reference has been made here to the Illinois Bell Telephone case. I will be glad to spend a little time pointing out what occurred with respect to that case.

On August 16, 1923, the Illinois commission, after investigation and hearing, made an order reducing the charges for certain classes of coin-box telephone service of the Illinois Bell Telephone Co. in the city of Chicago. The company applied to the United States district court for an injunction on the ground of alleged confiscation.

On December 21, 1923, upon a showing by affidavits, the district court granted an interlocutory injunction.

October 19, 1925, the United States Supreme Court affirmed the interlocutory injunction in a per curiam opinion. *Smith v. Illinois Bell Telephone Company* (269 U. S. 531).

January 30, 1930, after a hearing in which 3,000 pages of evidence was taken and 281 exhibits were introduced, the court granted a permanent injunction. *Bell Telephone Company v. Moynihan* (38 F. (2d) 77).

On December 1, 1930, the United States Supreme Court reversed the lower court, and sent the case back for further finding of facts, the injunction continuing in force in the meantime. *Smith v. Illinois Bell Telephone Company* (262 U. S. 133).

On April 29, 1933, upon consideration of evidence taken in a hearing which extended over 5 months, the district court handed down another opinion again finding the rates confiscatory, and ordering the same permanently enjoined.

Illinois Bell Telephone Company v. Gilbert (3 F. Supp. 595). From this decision the Commission prosecuted an appeal, which is now pending before the United States Supreme Court.

This case has been in the Federal court for more than 10 years. It has been before the United States Supreme Court four times during that time and is now there the fifth time. Whether this is the end nobody knows. (Hearings before the Committee on the Judiciary, House of Representatives, 73d Cong., 2d sess., on S. 752, serial 4, Feb. 27, 28, Mar. 1, 1934, pp. 70-71.)

Another illustration of the opportunities for delay which litigation affords, one which can only be adequately gauged by a lawyer, is presented by the following summary of proceedings in the case of *Great Northern Utilities Co. v. Public Service Commission of Montana* (88 Mont. 180, 293 Pac. 294; 52 F. (2d) 802; 1 F. Supp. 328, 289 U. S. 130):

September 21, 1927: Commission, on its own motion, instituted inquiry into reasonableness of rates charged by Great Northern Utilities Co. for natural gas at Shelby, Mont.

November 29, 1927: Public hearing at Shelby, Mont., on issues involved.

October 1, 1928: Further public hearing at Shelby, Mont., on issues involved.

December 20, 1928: Public hearing upon reasonableness of new schedule of rates proposed by Great Northern Utilities Co. for competitive purposes.

January 22, 1929: Order of commission rejecting proposed schedule of utility and requiring utility to establish a specific schedule of rates effective February 1, 1929 (P. U. R. 1929-B, 176).

February 8, 1929: Action instituted by utility in State court to have order declared null and void and enforcement thereof enjoined.

November 15, 1929: Second amended complaint of utility filed.

November 22, 1929: Answer of commission filed.

November 30, 1929: Motion for judgment on pleadings filed by utility.

February 4, 1930: Motion for judgment on pleadings granted.

February 4, 1930: Judgment rendered against commission declaring order null and void and permanently enjoining its enforcement.

February 8, 1930: Commission files appeal to Supreme Court of Montana.

April 3, 1930: Commission files motion to advance appeal on docket. Granted. Argument on appeal set for June 9, 1930.

June 9, 1930: Appeal argued and submitted.

July 29, 1930: Supreme Court reverses lower court and remands cause for proceedings not inconsistent with views expressed (88 Mont. 180; 293 Pac. 294).

September 2, 1930: Utility petitions for rehearing.

September 9, 1930: Commission files objections to petition for rehearing.

November 25, 1930: Petition for rehearing denied (88 Mont. 232).

December 22, 1930: Utility files action in Federal court (U. S. Dist. for Montana) alleging same identical facts as in State case and requests injunctive relief on theory order violates fourteenth amendment to Constitution of the United States. (Same grounds urged, inter alia, in State courts.)

December 22, 1930: Utility moves for injunction pendente lite.

January 2, 1931: Commission moves State court for setting of State case for trial. Granted and case set for trial for January 23, 1931.

January 15, 1931: Commission files motion to dismiss in Federal court case.

January 21, 1931: Utility files praecipe for dismissal of case in State court.

June 29, 1931: Application of utility for interlocutory injunction comes on for hearing before Sawtelle, circuit judge, and Bourquin and Pray, district judges, at Helena, Mont.

June 29, 1931: At suggestion of court cause is submitted on final hearing with the right of Commission to file its answer to bill of complaint on same date.

June 29, 1931: Answer of Commission filed raising the same identical issues of fact as were raised in the State case.

July 22, 1931: Stipulation between parties agreeing that the case is submitted on application for interlocutory injunction only and not on final hearing.

August 18, 1931: Decision of three-judge court filed (Bourquin and Pray award interlocutory injunction to plaintiff—Sawtelle dissents) (52 F. (2d) 802).

August 19, 1931: Interlocutory injunction issued against Commission.

September 15, 1931: Petition for appeal filed and order of allowance made.

September 28, 1931: Sawtelle, C. J., files special concurring opinion (52 F. (2d) 805).

February 24, 1932: Appeal argued in Supreme Court of United States.

February 29, 1932: Per curiam order affirming action of special court issuing interlocutory injunction "without prejudice to the consideration and determination at final hearing of all questions of law and fact * * *" (United States Daily, issue of Mar. 1, 1932, p. 5, col. 1).

September 19, 1932: Final hearing before a three-judge Federal Court.

October 5, 1932: Three-judge Federal court issued permanent injunction against the Commission's order (1 F. Supp. 328).

November 26, 1932: Commission filed appeal to the Supreme Court.

March 23 and 24, 1933: Argument on appeal before United States Supreme Court.

April 10, 1933: Decision of United States Supreme Court upholding Commission's order (289 U. S. 130; 77 L. Ed. 1080).

May 15, 1933: Mandate from the United States Supreme Court was filed with the clerk of the lower court.

June 7, 1933: The Commission moved for a decree in accordance with the mandate. The utility countered with a motion to file a supplemental bill on the ground of changed conditions. Before decision thereon the utility submitted a new tariff to the Commission and upon receiving the

approval of a majority of the members of the Commission it secured an order of dismissal of its action in the Federal court.

June 26, 1933: Order of dismissal entered. (Hearings before the Committee on the Judiciary, House of Representatives, 73d Congress, second session on S. 752, serial 4, Feb. 27, 28, March 1, 1934, p. 267.)

Further examples of procrastination are furnished by *Smith v. Illinois Bell Telephone Company* (hearings before the Committee on the Judiciary, House of Representatives, 73d Congress, 2d session, S. 752, serial 4, Feb. 27, 28, March 1, 1934, p. 308); the *Worcester Light Rate case* (hearings before the Committee on the Judiciary, House of Representatives, 73d Congress, 2d session, S. 752, serial 4, Feb. 27, 28, March 1, 1934, p. 225); the *Los Angeles Gas case* and the *Pacific Gas and Electric case* (hearings before the Committee on the Judiciary, House of Representatives, 73d Congress, 2d session, S. 752, serial 4, p. 215, March 1, 1934); the *Central Kentucky Gas Company v. Kentucky Railroad Commission* (hearings before the Committee on the Judiciary, House of Representatives, 73d Congress, 2d session, S. 752, serial 4, Feb. 27, 28, March 1, 1934, p. 69); and the case of *The St. Louis and O'Fallon Railway Company and Manufacturers' Railway Company v. United States of America and Interstate Commerce Commission*, 279 U. S. 461, which finally upset, in the year 1927, the valuation, for recapture purposes for the recapture periods of the years 1920, 1921, 1922, and 1923, respectively.

An estimate of average delay was supplied by the Alabama Public Service Commission, with respect to injunction suits generally, in the following:

(1) Such an injunction suit is attended with great delay. After the suit is filed and the preliminary orders of the court are made, under the rules of the Federal courts, a master is appointed to take testimony. The taking of testimony is rarely completed in less than a year, and in our opinion, the average time so employed will be found to exceed 12 months. Upon the conclusion of the taking of testimony, there is then a submission before the master. Upon this submission, the master usually takes several months in considering the testimony and in preparing and writing his report. The case then goes to the trial court. It requires, as a rule, several months to get the case submitted to the trial court and after the submission, as a rule, several other months before there is a decision by the trial court. In this way it requires, ordinarily, 2 years to get the case to a decision by the trial court. It will require in most cases most of another year to get the cause submitted, heard, and determined by the Supreme Court of the United States.

Certainly, it is safe to say that it is rare if any such injunction proceeding can be heard and determined both by trial court and the Supreme Court of the United States within less than 2 years. The records will show that many of such cases have consumed from 3 to 5 years in the final determination thereof. (Hearings before the Committee on the Judiciary, House of Representatives, 73d Congress, 2d session, S. 752, serial 4, Feb. 27, 28, March 1, 1934, p. 262.)

Compare also the *Consolidated Gas case*. (Hearings before the Committee on the Judiciary, House of Representatives, 73d Cong., 2d session, on S. 752, serial 4, pp. 14-15, February 27, 1934.)

In addition to the customary cost and volume indicia of the difficulty of utility inquiries, Mr. Reis, general counsel of the Wisconsin Public Service Commission, supplies useful data in connection with the problem, often overlooked, of the staff required to administer a utility investigation:

Mr. Reis (general counsel, Wis. Public Service Comm.).

We cited you in our memorandum to the *Wisconsin Telephone case*, which is the most stupendous utility inquiry ever undertaken in Wisconsin. Over 20 accountants, 45 engineers, rate specialists, and others of the commission's staff will have worked for almost 3 years on this investigation, compiling a record to date of 7,500 pages of testimony and 361 exhibits, at a total cost, before it is all over, of roughly a quarter of a million dollars.

Paraphrasing, I may say that a substantial portion of this quarter of a million is charged back to the utility (and doubtless ultimately as an operating expense to the ratepayer). This charge is made under a law of Wisconsin, which allows the commission to assess against the utility, for regulation, up to four-fifths of 1 percent of the gross annual revenue, together with a remainder assessment of one-fifth of 1 percent of gross

against all utilities. This gives us a budget of approximately \$1,000,000, one of the largest in the country (Hearings before the Committee on the Judiciary, House of Representatives, 73d Cong., 2d session, S. 752, serial 4, Feb. 27, 1934, pp. 22-23.)

The *New York Telephone case* is almost staggering in the voluminousness of its records and the number of stages at which comprehensive preparation and revision was required, plus the delay consequent upon the taking of the various possible steps in commission-court procedure:

Reference has been made by Senator Johnson and by the President of the United States to the *New York Telephone case*. I just want to give you a few of the dates regarding that case—just a few of them. The President said that it had taken 7 years. Well, that was true at the time when he had last heard of it, at a certain stage that they had reached. But it has taken nearly 10 years to get it through, from the time the case was started until the last decision in the United States Supreme Court.

Now, what happened? Going back to 1923, before the Public Service Commission of the State of New York, there were proceedings; over 18,000 pages of testimony were taken in those proceedings. There were 728 exhibits and 129 hearings had been held.

Then some time later, in 1924, there were further proceedings, nearly 8,000 pages of testimony were taken, and 307 exhibits were received.

But on January 23, 1924, when the company applied to the Commission for increases in rates, which were not promptly granted, they proceeded very shortly thereafter, on April 26, 1924, to seek to obtain an order from the Federal court restraining the enforcement of rates by the Commission. On May 1 they received an order for the enforcement of rates, allowing a surcharge of 10 percent, that is, allow those rates, plus 10 percent, in the city of New York, but no increase outside of New York. A master was appointed, and 710 hearings were held in that case, after all of the hearings that had been held before the Commission; 710 hearings were held before the master. That is, they started *de novo*. They did not take any of the record made before the Commission. They started to make a new record entirely. Over 36,000 pages of testimony were taken before the master in that case and 3,800 exhibits were received.

Mr. OLIVER. And most of those were duplicates, were they not, of those that had been received in the State court?

Mr. MALTBIE. I would say so, or substantially so. You see, this was started in 1924, and they did not finish the taking of testimony until 1928. So they were 4 years in there, after starting in 1924; and you have always to take additional testimony for additional years; and proceedings lasted 4 years before the master.

Mr. Maltbie speaking, Mr. Condon (Rep.):

The taking of testimony was finished on September 10, 1928. That was over 4 years later than his appointment. Briefs were submitted and on March 11, 1929, the master made his report to the court. Then there was oral argument, and the statutory court made its decision November 7, 1929, about 6 months later. Of course, it was a very elaborate record and the findings were elaborate, and about 6 months were taken. (Hearings before the Committee on the Judiciary, House of Representatives, 73rd Congress, Second Session, S. 752, serial 4, Feb. 27, 28, March 1, 1934, pp. 10-11).

Despite his extensive investigation, the court found the master's valuation erroneous:

The statutory court refused the master's valuation over \$120,000,000, but found that the rates did not allow a fair return and, consequently, that the order of the Commission was confiscatory.

Now, that was in the fall of 1929. Then, of course, the Commission had to take testimony to fix rates in accordance with that order, and the Commission proceeded to do so. But the company was not satisfied with the decision, and filed an appeal to the United States Supreme Court. That was done in the early part of 1930; and here we are in the early part of 1934, and there has just been a decision made dismissing the appeal. (Hearings before the Committee on the Judiciary, House of Representatives, 73rd Congress, Second Session, on S. 752, serial 4, Feb. 27, 28, March 1, 1934, p. 11.)

Compare also the *New York Telephone case*, Hearings before the Committee on the Judiciary, House of Representatives, 73d Congress, Second Session, on S. 752, serial 4, Feb. 27, 28, March 1, 1934, pp. 12, 13, 14, 23-24, 138, 141. The complexity of this particular valuation proceeding is all the more significant when taken in conjunction with the frequency with which the New York Telephone Company has been involved in litigation:

there have been cases affecting the New York Telephone Co. beginning a long time ago—well, I will not go back before the war; but there was one in 1915, and there were some before that. But there were other cases affecting the New York Telephone Co., beginning in 1919 and 1920, and they had been before the Commission constantly from 1919 and 1920 until 1930, and we have had two or three since. He may be entirely right. I am not positive. (Hearings before the Committee on the Judiciary, House of Representatives, 73rd Congress, Second Session, S. 752, serial 4, Feb. 27, 28, March 1, 1934, p. 16.)

3. VALUATION DIFFERENCES IN CONNECTION WITH TAXATION

The practical administrative difficulties which valuation for rate-fixing purposes has encountered is well matched in valuation procedure as related to taxation. The number of taxpayers with valuation difficulties is much larger than that of the public utilities, and the pressure caused by mere numbers has produced a tendency to settle most of these controversies outside of the courts. For that reason, instances of delay in connection with taxation valuations are characteristically found to be cases of administrative delay. Some indication of the complex and involved procedure that may be undergone in connection with valuation for tax purposes, and the amount of time that this consumes, is given by the following summary of proceedings in the case of the Union Natural Gas Co., of Pittsburgh, Pa.:

A review of the files of this case shows that there is still pending an additional tax of approximately \$200,000 for the year 1917. There have been apparent delays on the part of the taxpayer and the Department has not been able to close this case for any year.

The following chronology best illustrates the conditions prevailing in this case:

May 29, 1918: Schedules filed answering questions in the 1917 tax returns.

March 19, 1919: Taxpayer requested to file valuation data.

April 3, 1919: Second request asking for valuation data.

April 4, 1919: Taxpayer desires to comply with request for valuation data and asks extension of time and conference.

April 8, 1919: Conference granted for April 16.

April 16, 1919: No conference memorandum.

January 26, 1920: Taxpayer asks for ruling regarding drilling expenses.

April 19, 1920: Taxpayer asked to file affiliated questionnaire.

May 26, 1920: Second request for affiliated corporation questionnaire.

July 21, 1920: Third request for affiliated corporation questionnaire; given to August 16 to reply.

December 4, 1920: Taxpayer refers to letter of January 26, 1920, asking for ruling on method of handling labor and drilling costs for gas wells.

January 4, 1921: Taxpayer reminds Department in answer received in reply to letters of January 26, 1920, and December 4, 1920.

December 9, 1920: Affiliated corporation questionnaire received by Department.

January 13, 1921: Coal-valuation section asks for data to substantiate coal-land values.

January 22, 1921: Taxpayer asked to file consolidated income- and profits-tax return for 1919.

February 4, 1921: Coal-valuation reports mailed by taxpayer.

February 12, 1921: Taxpayer advised regarding drilling costs per request of December 4, 1920.

August 1921: Form O, oil and gas valuation data for 1917, 1918, and 1919 received.

October 10, 1921: Taxpayer asks for conference. Conference arranged for October 18.

December 13, 1921: Taxpayer preparing amended returns for 1917 to 1920, asks status of case.

December 27, 1921: Valuation oil and gas properties in progress by oil and gas section.

January 3, 1922: Taxpayer asks for extension of time for filing amended returns.

January 10, 1922: Extension granted to February 15, 1922.

February 18, 1922: Taxpayer asks for 90 days' extension to file amended returns.

February 28, 1922: No extension granted.

March 1, 1922: Taxpayer asks further extension.

March 18, 1922: No extension granted.

November 7, 1922: Letter to taxpayer explaining valuation methods.

January 29, 1923: Revenue agent's report filed showing additional tax for 1917, \$232,440.70.

February 1, 1923: Conference, oil and gas section.

April 30, 1923: Taxpayer asks for conference.

May 2, 1923: Conference granted May 10.

May 11, 1923: Conference, oil and gas section, discoveries disallowed.

January 10, 1924: Assessment letter showing additional tax for 1917, \$198,190.75; for 1918, \$2,719.30. This letter shows that taxpayer paid for 1917, \$446,676.13, and for 1918, \$289,400.58. The consolidated net income for 1917 was \$3,330,798.48, while the aggregate net income for 1917 was \$4,553,827.21. The consolidated invested capital for 1917 was \$13,448,957.62.

February 8, 1924: Protest filed regarding A-2 letter January 10, 1924.

May 2, 1924: Taxpayer asks for conference May 13, 1924.

May 13, 1924: No conference memorandum.

July 22, 1924: Conference held in oil and gas section.

August 21, 1924: Conference held in consolidated audit section with request that another conference be held September 12.

September 12, 1924: Conference, consolidated audit section; certain balance sheets requested.

September 23, 1924: Balance sheets received by Department.

October 21, 1924: Conference, consolidated audit section.

December 1, 1924: A 300-page revenue agent's report received covering the years 1918 to 1921, inclusive, showing additional tax due of \$29,865.01.

March 14, 1925: Department refers to taxpayer's appeal and asks for additional information.

April 2, 1925: Taxpayer granted extension to April 24, 1925, to file additional information. (Senate Report No. 27, 69th Cong., 1st sess., January 7, 1926, pp. 96-97.)

This might be compared with the long and involved court procedure in the Great Northern Utilities Co. case described on pp. —.

The delay involved in this connection has important consequences, inasmuch as frequently the statute of limitations bars assessments and controversial issues cannot be raised because the statute has run. For example:

In the Kennedy and Springer case (2981), the Government lost a tax of about \$200,000, on \$2,903,353 of profits from the sale on an oil lease, because of delay until the statute of limitations barred an assessment. Senate Report No. 27, 69th Cong. 1st sess., January 7, 1926, p. 97.)

The valuation section of the Bureau of Internal Revenue are even more helplessly unable to keep up with their work than the similar units in the Interstate Commerce Commission, see pp. 6, 10. Thus, in connection with the work in the oil and gas valuation section:

The work of this section is so far behind that up to March 1, 1925, practically all effort was concentrated on valuations for 1919 and preceding years.

In March 1925, the engineering division had 1,318 more 5-year-old cases undisposed of than in March 1923, a loss of progress of 207 percent in two years. (69th Cong., 1st sess., Senate Report No. 27, January 7, 1926, p. 96.)

Chart from pages 176 to 183 from the report of the investigation of the Bureau of Internal Revenue, Senate Report No. 27, Sixty-ninth Congress, first session.

Summary of amortization allowances of \$500,000 or over, as allowed by appraisal section up to Apr. 30, 1925

[*S. E. P., Sound engineering principles. **Solicitor's ruling. ***Solicitor's ruling, published November 1924 in the J. I. Case Threshing Machine Co. case]

Name of taxpayer	Classification of business	Original amount claimed	Final amount claimed	Amount finally allowed	Amortization allowed on property discarded or sold	Amortization allowed on reduced replacement cost
Air Reduction Co.	Miscellaneous	\$541, 839.96	\$1, 126, 658.95	\$887, 008.95	\$439, 543.28	\$533, 623.18
Alabama Dry Dock & Shipbuilding Co.	Shipbuilding	560, 185.50	540, 616.67	508, 943.41	30, 905.11	
Allan Wood Iron & Steel Co.	Iron and steel	291, 375.94	2, 717, 232.05	2, 091, 893.63	242, 323.80	
Allegheny Steel Co.	do	598, 908.61	1, 718, 701.10	1, 519, 970.57	141, 641.09	
Allis-Chalmers Manufacturing Co.	Manufacturers of machinery	6, 852, 697.36	18, 298, 431.82	15, 580, 614.39		
Aluminum Co. of America	Munitions	6, 670, 953.65	2, 565, 039.14	1, 365, 335.65		
American Clay Machinery Co.	Machinery manufacturers	816, 488.86	2, 834, 866.14	1, 714, 403.18		
American Locomotive Co.	Miscellaneous	521, 491.58	1, 448, 734.94	1, 751, 092.71		
American Manufacturing Co.	Iron and steel	201, 751.13	2, 597, 982.94	1, 537, 318.18		
American Rolling Mills Co.	Shipbuilding	1, 202, 267.67	864, 721.77	864, 721.77		
American Shipbuilding Co.	Shipbuilding	8, 004, 114.60	8, 737, 047.98	3, 567, 509.60		
Ames Shipbuilding & Dry Dock Co.	Munitions	1, 703, 728.07	1, 474, 778.65	1, 018, 642.72		160, 670.61
Anaconda Copper Mining Co.	do	538, 949.26	6, 207, 932.31	2, 744, 410.77		62, 890.34
Acheson Graphite Co.	Miscellaneous	2, 182, 674.65	699, 065.89	577, 282.88		
Atlantic Coast Co.	do	1, 206, 487.36	2, 182, 674.65	1, 136, 330.80		1, 136, 330.80
Atlantic & Pacific Steamship Co.	Shipping	1, 206, 487.36	1, 206, 487.36	1, 029, 223.36		1, 029, 223.36
Atlas Foundry Steel Co.	Iron and steel	251, 803.20	778, 440.74	710, 793.23		119, 631.84
Atlas Powder Co. and subsidiary (Richard & Co.)	Munitions	1, 748, 080.30	1, 954, 275.45	1, 882, 054.67		
Atlantic Refining Co.	Oil	4, 220, 547.23	6, 542, 743.50	3, 165, 001.67		1, 022, 138.07
Babcock & Wilcox	Machinery manufacturers	2, 874, 215.89	4, 274, 215.89	2, 145, 625.28		
Baldwin Locomotive Works	do	Not stated	4, 070, 630.53	2, 990, 806.64		96, 553.14
Baltimore Dry Dock & Shipbuilding Co.	Shipbuilding	Not stated	3, 812, 306.36	3, 384, 965.86		3, 384, 965.86
Barlett Haywood Co.	Machinery manufacturers	1, 508, 819.03	1, 459, 368.34	1, 442, 056.43		*697, 515.27
Bauer & Black	Miscellaneous	176, 822.57	537, 726.07	537, 726.07		379, 331.73
Bausch & Lomb Optical Co.	Scientific instruments	2, 493, 094.31	2, 682, 539.41	2, 107, 789.21		1, 092, 588.48
Bethlehem Steel Co.	Iron and steel	1, 731, 746.97	48, 008, 536.73	22, 103, 942.43		9, 822, 588.56
Bliss, E. W., Co.	Machinery manufacturers	3, 498, 676.88	1, 730, 746.97	1, 243, 571.09		96, 930.69
Brier Hill Steel Co.	Iron and steel	Not stated	900, 788.51	6, 217, 973.95		6, 217, 973.95
Brill, J. G., Co.	Machinery manufacturers	1, 119, 357.32	949, 858.82	603, 182.63		132, 631.75
Brown & Sharpe Manufacturing Co.	Machine tools	280, 721.77	955, 554.50	606, 763.27		
Buda Co.	Machinery manufacturers					

Summary of amortization allowances of \$500,000 or over, as allowed by appraisal section up to Apr. 30, 1925—Continued

Name of taxpayer	Classification of business	Original amount claimed	Final amount claimed	Amount finally allowed	Amortization allowed on property discarded or sold	Amortization allowed on reduced replacement cost
Caunden Forge Co.	Iron and steel	\$816,536.09	\$1,434,334.74	\$1,336,829.27	\$1,268,507.95	
Carbon Steel Co.	do.	Not stated	1,834,389.74	1,191,806.24	1,191,806.24	
Carib Steamship Co.	Shipping	663,211.05	669,211.05	694,211.05	664,211.05	
Central Steel Co.	Iron and steel	419,284.00	2,121,673.23	1,371,391.35	1,371,391.35	
Chile Copper Co.	Mining	4,313,223.24	4,313,223.24	2,844,603.07	2,844,603.07	\$2,844,603.07
China Mail Steamship Co. (Ltd.)	Shipping	Not stated	1,530,592.50	1,312,861.25	1,312,861.25	1,312,861.25
China Copper Co.	Mining	282,165.64	1,628,702.34	1,107,086.14	433,416.82	
Cleveland Cliffs Iron Co.	do.	900,180.44	4,156,210.27	1,860,791.06	506,582.80	303,623.21
Colorado Fuel & Iron Co.	Iron and steel	4,653,560.21	4,653,560.21	3,960,432.75	2,405,406.01	
Colts Patent Fire Arms Co.	Munitions	2,871,036.92	6,734,144.25	2,960,109.96	938,692.92	
Columbia River Shipbuilding Corporation	Shipbuilding	1,101,717.99	1,101,717.99	938,692.92	938,692.92	
Crumbley Steel Co.	Iron and steel	659,000.00	10,924,025.52	8,912,879.00	113,701.29	
Cuban-American Sugar Co.	Foodstuffs	Not stated	2,742,612.86	1,675,703.39	500,360.13	
Cudahy Packing Co.	Food products	215,705.99	504,625.71	1,529,574.63	1,529,574.63	
Diamond Alkali Co.	Chemicals	586,537.71	1,756,453.64	1,344,465.15	713,080.38	713,080.38
Dollar Steamship Co.	Shipping	536,999.69	721,958.44	1,713,080.38	1,241,720.53	
Donlutz & Williams Shipbuilding Co. (Inc.)	Shipbuilding	1,425,948.90	1,371,747.67	1,241,720.53	1,241,720.53	
Downey Shipbuilding Co.	do.	Not stated	1,425,948.90	1,270,991.78	357,967.91	
E. J. Du Pont de Nemours & Co.	Munitions	Not stated	17,246,224.45	15,369,123.55	15,204,780.49	
E. F. Duthie & Co.	do.	Not stated	1,142,615.61	707,972.78	707,972.78	
Edgewater Steel Co.	Shipbuilding	148,304.71	951,848.98	700,817.37	36,525.45	435,759.42
Eddystone Munitions Co.	Iron and steel	1,757,350.21	1,595,179.37	1,595,179.37	1,595,179.37	
Erie Forge Co.	Munitions	1,265,306.08	1,265,306.08	1,152,354.33	300,140.13	
Evans Engineering Corporation	Iron and steel	812,863.73	812,863.73	512,401.85	512,401.85	
Federal Shipbuilding Co.	Munitions	6,887,854.14	12,084,492.34	10,849,786.04	1,958,379.78	(f)
W. & A. Fletcher Co.	do.	4,456,245.56	1,456,245.56	529,574.63	371,264.65	297,640.82
Ford Motor Co.	Auto manufacturers	4,464,277.67	1,863,845.88	1,089,072.11	551,210.57	
Firestone Tire Co.	Tires and rubber	1,815,598.60	3,950,679.61	2,016,194.30	1,713,926.01	
General Chemical Co.	Chemicals	9,076,180.89	4,092,895.45	3,110,102.92	1,391,706.58	670,304.39
General Electric Co.	Machinery manufacturers	125,945.05	6,508,432.85	3,249,367.49	567,238.89	
Globe Shipbuilding Co.	Shipbuilding	521,700.60	800,705.50	646,850.43	505,018.31	
Gorham Manufacturing Co.	Munitions	437,715.00	614,498.40	594,636.72	594,636.72	
Grace, W. R. & Co.	Shipping	Not stated	3,890,539.68	2,158,500.60	1,886,140.02	
Great Lakes Engineering Co.	Shipbuilding	Not stated	2,142,277.21	1,700,712.16	1,700,712.16	
The Hamilton Furnace Co.	Iron and steel	1,128,181.16	1,128,181.16	769,904.65	885,999.10	
Hanlon Dry Dock and S. Co.	Shipbuilding	678,833.41	961,382.20	914,634.39	899,387.44	
Heppenstall Forge & Knife Co.	Shipbuilding	409,230.68	955,678.23	1,854,630.05	1,461,894.65	
Hydraulic Press Steel Co.	Machinery manufacturers	Not stated	3,582,924.83	1,829,320.33	260,192.25	
Ingersoll Rand Co.	Iron and steel	254,494.50	2,324,323.44	3,716,284.20	1,586,068.92	
International Harvester Co.	Machinery manufacturers	1,567,811.42	4,300,597.99			

Interstate Iron & Steel Co.	110, 977.42	610, 919.93	534, 878.44	50, 643.11	181, 017.62
Jones & Laughlin Steel Co.	10, 902, 880.84	16, 479, 478.12	7, 258, 490.17	1, 501, 332.84	4, 408.32
Kerr National Co.	Not stated	5, 498, 063.12	4, 300, 115.49	4, 300, 115.49	
The Koppers Co.	4, 104, 338.34	4, 104, 338.34	2, 505, 923.16	251, 790.00	
Iron and steel	6, 600, 000.00	2, 517, 143.76	1, 088, 062.52	77, 947.83	
do.	6, 292, 014.77	5, 207, 810.04	3, 400, 579.66	3, 400, 579.66	
Machine tools.	4, 413, 858.45	6, 778, 693.51	6, 629, 514.75	47, 789.27	39, 605.54
Auto manufacturers.	4, 819, 645.81	4, 819, 645.81	6, 048, 915.69	6, 048, 915.69	
Lincoln Motor Co.	1, 636, 958.57	1, 596, 958.57	1, 465, 334.87	1, 465, 334.87	
do.	1, 203, 718.50	4, 646, 295.54	2, 913, 922.70	2, 913, 922.70	
Shipping.	1, 012, 425.35	4, 194, 627.16	2, 017, 000.62	2, 017, 000.62	
Iron and steel.	Not stated	3, 385, 273.37	2, 418, 142.54		
do.	811, 121.12	2, 875, 920.80	2, 703, 880.44	2, 763, 880.44	
Machinery manufacturers.	1, 102, 858.78	1, 134, 865.33	1, 185, 859.15	14, 427.93	
Mackinaw Steel Co.	1, 289, 896.74	1, 200, 286.08	1, 014, 558.99	1, 014, 558.99	
Mantowoc Shipbuilding Co.	287, 081.48	1, 023, 695.99	832, 355.37	687, 082.16	47, 823.61
Mathieson & Hezler	Not stated	969, 159.73	1, 422, 770.58	1, 422, 770.58	
Merchants Shipbuilding Co.	5, 018, 661.00	4, 493, 535.49	854, 845.86	230, 539.00	
Mesta Machine Co.	157, 466.42	1, 296, 930.30	930, 440.16	930, 440.16	
Midvale Steel & Ordnance Co.	407, 710.86	10, 289, 538.18	9, 330, 440.16	56, 804.31	493, 336.01
Moore Shipbuilding Co.	2, 253, 327.64	934, 905.42	928, 816.58	2, 104, 112.54	
Moore Engr. & Canton Co. (steel foundry)	310, 279.02	7, 226, 243.15	4, 412, 653.94	97, 263.05	
Morse Dry Dock & Repair Co.	546, 965.90	1, 118, 109.12	1, 684, 024.06	532, 007.23	927, 068.08
Munson Steamship Line	1, 211, 000.00	2, 675, 250.20	1, 927, 668.08	102, 000.00	
National Acme Co.	1, 885, 436.83	1, 289, 231.05	1, 003, 751.71	8, 258, 989.43	1, 653, 750.65
National Malleable Casting Co.	1, 211, 000.00	10, 788, 867.06	9, 912, 740.08		
Newport Mining Co.	732, 077.34	1, 111, 764.59	988, 235.19	521, 517.69	
New York Air Brake Co.	1, 885, 436.83	3, 452, 013.41	1, 185, 270.33	1, 065, 083.90	
New York Shipbuilding Corporation.	815, 762.46	1, 705, 115.01	4, 462, 237.64	1, 968, 539.39	
Nicholson File Co.	831, 747.90	4, 262, 336.69	3, 584, 295.80		
Niles Bennett Steel Co.	Not stated.	678, 281.26	678, 281.26		
Norfolk Co.	815, 762.46	1, 388, 833.84	1, 113, 465.38	615, 762.46	
Ohio Fire Register Co.	349, 286.25	1, 815, 762.46	1, 615, 762.46	33, 500.51	190, 182.65
Ore Steamship Corporation.	1, 299, 884.34	1, 290, 133.69	1, 022, 977.30	580, 708.90	
Oriental Navigation Co.	1, 153, 351.81	1, 597, 942.08	1, 539, 313.83		
Pacific Coast Shipbuilding Co.	440, 000.00	1, 534, 932.74	1, 466, 389.33	710, 883.00	
Pacific Steamship Co.	5, 663, 360.21	827, 443.77	1, 710, 883.00		
Pan American Petroleum Transportation Co.	2, 000, 000.00	2, 233, 879.53	1, 097, 950.50	561, 988.07	
Pierce Oil Corporation.	1, 985, 422.08	1, 153, 351.81	1, 015, 275.24	604, 526.82	
Pittsburgh Steel Products.	1, 270, 248.86	4, 423, 917.12	645, 264.07		
Pocomontas Fuel Co.	492, 627.27	5, 663, 360.21	1, 892, 624.98	848, 625.83	1, 892, 624.98
Potters & Johnson Machine Co.	460, 911.70	3, 922, 719.19	1, 393, 368.21	142, 577.91	482, 275.51
The Pressed Steel Car Co.	809, 792.50	4, 671, 276.48	2, 696, 858.86	246, 922.70	19, 113.52
Procter & Gamble.		1, 539, 763.33	854, 218.02		
Pure Oil Co.		502, 156.33	502, 156.33		
Oil.		1, 175, 453.88	572, 167.06		
		5, 333, 254.49	3, 787, 848.67		
		809, 792.50	788, 559.59		

Summary of amortization allowances of \$500,000 or over, as allowed by appraisal section up to Apr. 30, 1925—Continued

Name of taxpayer	Classification of business	Original amount claimed	Final amount claimed	Amount finally allowed	Amortization allowed on property discarded or sold	Amortization allowed on reduced replacement cost
Pusey & Jones Co.	Shipbuilding	\$6,732,796.67	\$6,530,173.15	\$4,007,964.81		\$175,436.09
Quaker Oats Co.	Food products	1,285,463.73	4,145,518.13	2,583,048.00		
Ray Consolidated Copper Co.	Mining	259,219.07	1,283,341.78	3,919,310.77		390,472.49
Republic Iron & Steel Co.	Iron and steel	5,453,302.49	5,148,798.61	3,341,998.73		
Roebling Sons Co.	Iron and steel	1,435,611.09	1,435,611.09	1,828,725.60		
Seattle Northern Pacific Shipbuilding Corporation	Shipbuilding	1,828,664.65	1,828,664.65	1,828,664.65		
Sharon Steel Hoop Co.	Iron and steel	3,630,932.24	3,629,134.55	736,999.72		29,313.65
Sherwin-Williams Co.	Chemicals and dyes	802,081.85	3,752,869.71	691,244.37		218,645.05
Sinclair Oil & Refining Co.	Oil	2,014,403.74	4,752,108.62	4,236,512.20		750,331.16
Skinner & Eddy Corporation	Shipbuilding	4,752,088.62	4,752,108.62	4,442,978.09		1,486,181.04
Solvay Process Co.	Miscellaneous	1,797,114.00	2,551,495.87	909,869.24		
South Porto Rico Sugar Co.	Foodstuffs	447,997.84	2,004,215.40	1,009,170.57		
Southwestern Shipbuilding Co.	Shipbuilding	195,840.71	1,563,262.62	1,027,023.81		
Sperry Flour Co.	Foodstuffs	3,952,000.00	2,757,636.80	2,876,318.24		
Standard Oil Co. of Indiana	Oil	1,015,788.79	2,365,117.13	2,365,117.13		
Standard Shipbuilding Corporation	Shipbuilding	1,430,060.95	745,641.53	574,213.29		1,009,170.57
Standard Steel Works	Iron and steel	790,440.10	790,440.10	715,305.01		
The Stanley Works	Machine tools	2,114,151.37	5,889,013.06	5,232,176.46		
Steel & Tube Co. of America	Iron and steel	3,230,442.59	10,332,259.87	2,756,094.86		1,380,385.91
Sun Oil Co. and allied companies	Oil	894,083.23	894,083.23	555,304.45		
Swift & Co. (Libby, McNeil & Libby)	Foodstuffs	894,083.23	1,464,006.41	809,353.65		
Syrington Machine Corporation	Munitions	696,578.25	696,578.25	696,578.25		
Standard Steel Car Co.	Machine tools	3,071,451.14	3,071,451.14	3,039,763.34		
Saginaw Shipbuilding Co.	Machinery manufacturers	1,239,757.72	1,239,757.72	1,234,763.13		
Standler, G. M., Construction Co.	Shipbuilding	2,900,397.46	2,900,397.46	2,665,215.13		
Terry Shipbuilding Co.	do	1,447,939.89	1,447,939.89	1,340,531.49		
Timken Roller Bearing Co.	Machine tool	984,568.52	852,414.98	772,813.89		73,868.96
Todd Shipyards	Shipbuilding	2,014,081.53	3,609,625.82	2,943,103.46		81,790.87
Toledo Shipbuilding Co.	do	669,525.92	669,525.92	863,192.62		
Union Carbide & Carbon Corporation	Carbon and carbide	3,628,598.67	8,947,339.74	6,561,752.09		244,796.08
Union Construction Co.	Shipbuilding	861,900.00	1,844,980.44	1,411,561.26		1,411,561.26
Union Shipbuilding Co.	do	1,581,731.26	1,581,731.26	1,333,163.96		691,493.15
United Verde Extension Mining Co.	Mining	4,127,142.40	4,072,303.08	3,222,648.92		
U. S. Steel Co.	Iron and steel	83,065,169.21	86,411,952.61	55,063,312.60		16,608,264.87
Utah Copper Co.	Iron and steel	4,855,691.69	5,232,820.69	2,783,636.89		13,490.36
Vacuum Oil Co.	Mining	1,798,360.24	3,473,779.60	2,267,928.69		1,650,239.29
Weirton Steel Co.	Oil	1,433,399.34	2,974,033.76	1,988,553.50		1,372,426.74
Western Pipe & Steel Co.	Iron and steel	1,433,399.34	1,474,599.71	1,440,174.61		

Westinghouse Air Brake Co.....	702,820.81	2,403,968.71	1,471,369.24	83,669.27	-----
Westmoreland Coal Co.....	422,526.00	787,254.62	508,093.12	508,093.12	-----
Wheeling Steel & Iron Co.....	813,475.36	1,135,184.09	718,406.16	-----	-----
Whittaker Glessner Co.....	3,268,709.65	3,268,709.65	2,171,888.65	-----	-----
Winnett Operating Co.....	705,886.54	705,886.54	576,835.27	10,954.99	-----
Worthington Pump & Machinery Corporation.....	-----	2,127,929.64	1,900,293.78	576,835.27	-----
Youngstown Steel & Tube Co.....	3,942,848.82	9,965,145.57	6,611,647.86	3,204,511.88	-----
The Texas Co.....	2,727,561.95	2,727,561.93	2,431,720.43	271,298.23	-----
Total.....	331,527,046.18	635,934,923.16	425,921,945.92	172,625,445.74	65,712,505.79

EXHIBIT 1402

Refunds, credits, and abatements exceeding \$250,000 through special assessment allowed from July 1, 1921, to Apr. 30, 1925

[Sec. 210 of 1917 act; sec. 328 of 1918 act]

[From S. Rept. 27, 69th Cong., 1st sess., p. 221 (1926)]

Name and address of taxpayer	Section	Total refunds, credits, and abatements
W. Beckers Aniline & Chemical Works (Inc.), New York, N. Y.	210	\$446, 625. 19
Shoellkopf Aniline & Chemical Works (Inc.), Buffalo, N. Y.	210	1, 829, 141. 16
Jos. Joseph & Bros., Cincinnati, Ohio.	210	348, 757. 02
T. A. Gillespie Co., 7 Dey Street, New York, N. Y.	328	600, 629. 74
Runyon Corporation, 7 Dey Street, New York, N. Y.	328	526, 091. 69
International Shell & Ordnance Co., New York, N. Y.	328	1, 819, 009. 54
International Loading Co., 7 Dey Street, New York, N. Y.	328	1, 010, 919. 33
American Shell Co., 7 Dey Street, New York, N. Y.	328	1, 943, 170. 25
Pickands Brown & Co., Chicago, Ill.	328	456, 256. 39
Coca Cola Co., Plum Street and North Avenue, Atlanta, Ga.	210	316, 453. 36
Rockford Mitten & Holsery Co., Rockford, Ill.	328	279, 713. 97
Mass & Waldstein Co., 92 William Street, New York, N. Y.	210	462, 038. 34
J. F. Duthie & Co., Seattle, Wash.	328	330, 385. 15
Atlas Crucible Steel Co., Dunkirk, N. Y.	328	788, 334. 88
R. J. Reynolds Tobacco Co., Winston-Salem, N. C.	328	1, 698, 265. 47
Four Wheel Drive Auto Co., Clintonville, Wis.	210	348, 913. 57
Theta Oil Co., 76 West Monroe Street, Chicago, Ill.	328	427, 615. 57
Hecla Mining Co., Wallace, Idaho.	210	492, 915. 80
Allegheny Steel Co., Pittsburgh, Pa.	328	556, 553. 59
United States Branch of Employers' Liability Assurance Corporation, Boston, Mass.	328	325, 270. 72
H. W. Johns-Manville Co., Madison Avenue and Forty-first Street, New York.	328	519, 000. 87
Neuss Hesselein & Co., New York, N. Y.	210	421, 378. 13
Fulton Bag & Cotton Mills, Atlanta, Ga.	210	352, 506. 86
Fellows Medical Manufacturing Co., New York, N. Y.	210	280, 446. 88
Bessemer Coal & Coke Co., Pittsburgh, Pa.	210	261, 153. 57
The Centaur Co., 250 Broadway, New York, N. Y.	328	368, 063. 26
Whitaker-Glessner Co., Wheeling, W. Va.	210	353, 033. 07
Four Wheel Drive Auto Co., Clintonville, Wis.	328	241, 334. 31
Globe & Rutgers Fire Insurance Co., New York, N. Y.	210	450, 011. 32
Atolia Mining Co., San Francisco, Calif.	210	256, 018. 46
Latrobe Electric Steel Co., Latrobe, Pa.	328	426, 047. 32
Curtis & Co., Manufacturing Co., St. Louis, Mo.	328	278, 336. 38
E. J. Lavine & Co., Philadelphia, Pa.	210	521, 825. 00
American Car & Foundry Co., 165 Broadway, New York, N. Y.	328	5, 209, 204. 74
Cleveland & Western Coal Co., Cleveland, Ohio.	210	457, 324. 44
Lindsay Light Co., 116 East Grand Avenue, Chicago, Ill. (fiscal year)	328	316, 890. 33
	210	
Youngstown Sheet & Tube Co., Youngstown, Ohio.	210	3, 482, 610. 51
Northwest Steel Co., Portland, Oreg.	210	923, 235. 81
Select Pictures Corporation, New York, N. Y.	328	384, 475. 17
Carbon Steel Co., foot Thirty-second Street, Pittsburgh, Pa.	328	559, 039. 14
New Jersey Worsted Spinning Co., Garfield, N. J. (fiscal year)	328	401, 577. 98
	210	
The Otis Steel Co., 1140 Leader News Building, Cleveland, Ohio.	210	398, 629. 35
Jobbers Overall Co., Lynchburg, Va.	328	331, 981. 62
J. B. Inderrieden Co., 332 River Street, Chicago, Ill.	328	265, 373. 04
Bartlett-Hayward Corporation, Baltimore, Md.	328	1, 443, 735. 21
Gans Steamship Lines, 12 Broadway, New York, N. Y.	328	508, 285. 10
West Virginia Coal Co. of Missouri, St. Louis, Mo.	328	402, 458. 00
Whitney Blake Co., New Haven, Conn.	328	337, 332. 02
Electric Storage Battery Co., care of J. M. Haynes, attorney, Investment Building, Washington, D. C.	328	640, 188. 12
Kokomo Steel & Wire Co., Kokomo, Ind.	210	282, 426. 05
W. and A. Fletcher Co., Hoboken, N. J.	328	388, 526. 84
J. C. Penney Co., 354 Fourth Avenue, New York, N. Y.	210	469, 246. 88
Pittsburgh Steel Products Co., Pittsburgh, Pa.	328	1, 530, 227. 55
Hartford Machine Screw Co., Hartford, Conn.	210	914, 497. 97
Total		39, 686, 500. 00

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