Government in Big Brother Role to Help Guide Industry

Department of Commerce, Through Newly Organized Service, Aims to Perpetuate the Spirit of Co-operation Engendered by the War

By Merryle Stanley Rukeyser

AS THE flare of war is dying down, the government at Washington is thrusting out a hand of friendship to industry and asking how it can serve. It is professing a new attitude toward commerce, and American business may soon find that it can look upon the government as something more than a policeman's club.

No longer, it would seem, is the government in its relations with men of business to restrict its commands to "Thou shalt not." As the makeshift organizations born of war needs are being reconstructed out of existence, friends of trade within the government are quietly building up a structure capable of giving the command "Thou shalt"—and of helping business to achieve constructive ends.

In the days when Teutonic armies were driving on toward what looked uncomfortably like world conquest American business came to the aid of the state, and without reservation inquired what it could do. It discarded the old phrases about its rights and became oblivious of the days when government had been the persistent enemy of "big business." Business and government in those epic days discovered new secrets about their own nature and about each other. They found a rich asset in the touchstone of cooperation.

Business Gets Free Hand in Readjustment

From the standpoint of free initiative in business, two dangers loomed up when the armistice was signed. The first was that a bureaucracy built on the foundation stones of taboos might fail to unshackle industry after the emergency ended. The second—and quite the other extreme—was that lack of vision might compel government and industry to return entirely to the old ways and reject the benefits that came from working together. Before leaving for Europe, President Wilson, in an address before Congress, relieved business of the fear that it might not be set free again. Members of the Cabinet, following the lead of the Chief Executive, then began to inform the country in a phrase here and a sentence there that the genius of the American business man would be relied upon to pilot the country through the shoals incident to the readjustment of industry to a peace basis, and that the government as a serviceable friend would stimulate, promote, and actively assist in the development of new economic processes.

It soon became apparent, despite the chaos that exists in after-the-war Washington, than the main contact between government and industry would be the Department of Commerce, which had been overshadowed during the war by such emergency bodies as the War Industries Board and the War Trade Board. On the repressive side other agencies of government may be expected to continue to function, but to Secretary Redfield's department chiefly the job of becoming a Big Brother to business is delegated.

To Widen Usefulness In Fertile Field

On a larger scale than ever before, with appropriations twice as big as in any previous year, the Commerce Department is setting about, according to its chief, to place government at the disposal of legitimate industry. It has no aspirations to aid by offering patent medicine remedies for the ills of production, nor does it aim to suggest easy formulas for capturing the trade of the world. Its main purpose is to give industrial and commercial men more precise information about things related to their own occupations than was ever before available. The department expects vastly to widen its service of gathering and disseminating economic facts through the Bureau of Foreign and Domestic Commerce. It hopes to ascertain more completely the nature of the science of industry through the Bureau of Standards, which has been called upon to facilitate the movement of wedding science to industry in the United States.

But the programme of the department does contemplate making it a thing apart from business—austere, academic and theoretic. A new bureau, known as the Industrial Cooperation Service, has just been established to break down any barriers that might arise.

In describing the functions of the new bureau John Cutter, its acting chief, said: "The Industrial Coöperation Service, as its name indicates, is here to serve industry in any capacity in which it can serve, be it standardization of product or functioning in some manner as a selling agency for the other bureaus of the department. Our success depends entirely upon our ability to convince industry that we are here to help and in no way to hinder; to promote, not to restrict.

"The great value of this service lies in the fact that we are able to carry over to the Department of Commerce the intangible contact between government and industry, which was the foundation of the War Industries Board's unchallenged success."

Reversal of War Industrial Programme

Mr. Cutter, formerly a member of the textile division of the War Industries Board, left the employ of Harris, Forbes & Co. early in the war to make his pilgrimage to the capital. Besides forging the new bureau into an instrument for getting men in industry to work together and with the government, Mr. Cutter will carry over some of the War Industries Board's programme for conserving labor and materials by the elimination of unnecessary styles. But, whereas the War Board took the initiative in bringing its ideas to industry, conditions are now reversed, and the Industrial Cooperation Service will act only when called upon by the industries themselves.

In Mr. Cutter's words: "Practically, the war is over; theoretically, of course, a state of war still exists, but the fact is clearly recognized that the necessity for conservation of war purposes is ended. In other words, the time has come absolutely to reverse the policy which was the basis of the general functions of the War Industries Board, that of mobilizing industry to aid the government."

Now government bureaus are mobilizing to aid industry.

No Compulsion in New Service

The government is recognizing the fundamental importance to the nation of production and commerce. And at the expense of all the people it is preparing on a more comprehensive scale than ever before to promote business, only asking in return that trade be developed for social purposes.

So far as the industrial conservation programme, which is the most stressed of the specific functions of the new bureau, is concerned, its adoption by industries is to be entirely voluntary, but is to be done under the encouragement and with the specific approval of the government. In recently announcing the launching of the new service Secretary Redfield said: "The functions which have hitherto been exercised by the conservation division of the War Industries Board will be continued by the Department of Commerce, which has established for that purpose the Industrial Coöperation Service. The work of the new service will be voluntary so far as the industries are concerned, without any element of compulsion, depending on consent to methods approved by common council and trade experience."

Mr. Cutter revealed the plan of the new service for working out the conservation principle.

"The functions referred to in the Secretary's announcement," he said, "are the conservation of labor, material and capital through studies of individual industries themselves. The War Industries Board was a war-making institution. The conservation division as part of that organization had for its duty the saving of material so that material could be used to destroy German armies; the saving of labor so that the labor released could serve in the military forces or in the actual industries making munitions of war; the saving of capital so that the money so released could be directly or indirectly devoted to the prosecution of the war.

Attempt to Retain Industry Consciousness

"In so far as industry can suggest to this service plans for conservation in industry itself which will benefit the industry in question without detriment to the public interest these plans will be indorsed by the service. It should be clearly understood, however, that the service is promotive purely; in no sense is it restrictive, and in no sense is it a police body."

The Industrial Coöperation Service in its inception represents an attempt to retain industry consciousness, which proved a great stimulus to efficient production during the war. In league with the United States Chamber of Commerce, it is encouraging industries to form completely representative committees to handle matters of common interest.

Coöperation in industry, even government officials are now whispering, may not be entirely consonant with the spirit of the Sherman anti-trust law and its amplifications in the Clayton acts, but the awareness is growing that perhaps those acts are not the last word in economic legislation. Incidentally, because of its intimate relations with both industry and government, the Industrial Coöperation Service expects eventually to be able to make constructive recommendations to Congress regarding necessary legislation.

Data Must Be Related To Real Problems

Because of its informal character and its freedom from rigidity, the new service of the department stands in close relation to all the formal bureaus, which are charged with accumulating solid knowledge of practical import. Secretary Redfield, when asked what common purpose ran through all the bureaus, said he insists that the data gathering be scientific and have a definite, practical relation to the real problems of commerce.

"The department," the Secretary of Commerce proudly explained, "is prepared, if it shall receive the support of Congress, to sustain our commerce and industry both in the domestic and foreign field, providing both a scientific and a commercial service at home cooperating with the great commercial service abroad. It is, we venture to think, a unique governmental organization, better equipped with men and apparatus than anything of its kind in the world. Its future depends upon whether the vision of Congress shall be such as will measure it at its true value."

Would Standardize Money

Reduction in Variety of U. S. Bills Is Urged

WASHINGTON, Jan. 18.—Gradual reduction of the great variety of designs of United States currency to minimize the danger of counterfeiting and "bill raising" is under discussion between Treasury officials and members of Congress. The United States now has fifty-four different designs for bills of various denominations, and officials believe the resulting unfamiliarity of the public with the designs enables counterfeiters to operate more easily than if the designs were standardized.

There are now in circulation five different kinds of $1 notes, five kinds of $2 bills, six $5's, seven $10's, seven $20's, six $50's, six $100's, four $500's, five $1,000's, one $5,000 and two $10,000's.

Canadian Victory Bonds Are Strong In Open Markets

Widespread Buying Power Revealed After War Issues Are Released From Control of Loan Committee

Special Correspondence

TORONTO, Jan. 18.—Canadian Victory loans have enjoyed conspicuous strength in recent weeks. At the beginning of the month the Victory loans of 1917 were released from the jurisdiction of the Victory Loan Committee and listed on the Toronto and Montreal stock exchanges. The experience of the last two weeks has proved that this step was taken advisedly.

The Victory Loan of 1918 still remains under the control of the committee, but it is not unlikely that this also will be released in the near future. The Victory Loan of 1917 has three maturities, 1922, 1927 and 1937. A preference has been shown for the bonds of more distant maturity, as the investor recognizes that before they come due new issues of gilt-edged bonds will yield much less than the Victories, and that, therefore, they should advance to a proportional premium. The Victory Loan of 1917, maturing in 1937, which was issued at par, is selling in the open market now at 102½ to 103, whereas the 1927 group is being bought at 101½ to 102 and the 1922 bonds at 99¾ to 100. The old war loan of 1937 maturity is selling above the issue price, at 97½ to 97¾.

The Victory Loan Committee is finding a ready sale for Victory loans of 1918. Often buying orders have to wait for days before they are filled. These bonds were listed slightly above the issued price when the committee placed them on the market. The 1923 and 1933 maturities were both advanced in price early in the trading, and recently a further advance was authorized in the 1933 maturity, the present price being 102 and interest to buyers and 101 to sellers, as against an issue price of par and interest.

Victory Bonds Strong

The strength of the Victory bonds is due ultimately to their high yield, which is close to 5.39 per cent at the present price. The fact, however, that they are readily absorbed is a good index of the current prosperous conditions in Canada. The people have money to invest. Before the war the percentage of Canadians who invested in securities was very small. The experience in buying war bonds has taught the people a lesson. Those who purchased war loans when they were floated are for the most part holding them, for, considering the fact that some $1,300,000,000 is now outstanding, liquidation has been small.

Canadian Issues Popular

For a number of years past Canadian bonds have been favored by United States investors. The sale of government and municipal bonds in the United States was heavy previous to the time that the United States entered the war. Now that fighting has ceased the American market is again opened to Canadian securities, and the interest of Americans in new Canadian issues apparently has not diminished.

It is noteworthy that when important Canadian issues are being floated they are now being made payable in Canadian cities and New York. This is due to the fact that whether successful tenders are in Canada or the United States a large proportion of the bonds will be absorbed by United States investors.

The province of British Columbia announces that it will make a bond issue of $2,000,000, for which tenders will be called shortly. Many bonds have been delayed because of government requirements, and it is anticipated that new important flotations will appear from time to time during the winter and spring.

Spanish Credit Drawn On

Government Utilizes Pesetas Fund to Pay for Supplies

The United States government, it was learned yesterday, has begun to draw against the second instalment of 50,000,000 pesetas of the 250,000,000 peseta credit arranged last fall with a group of Spanish banks.

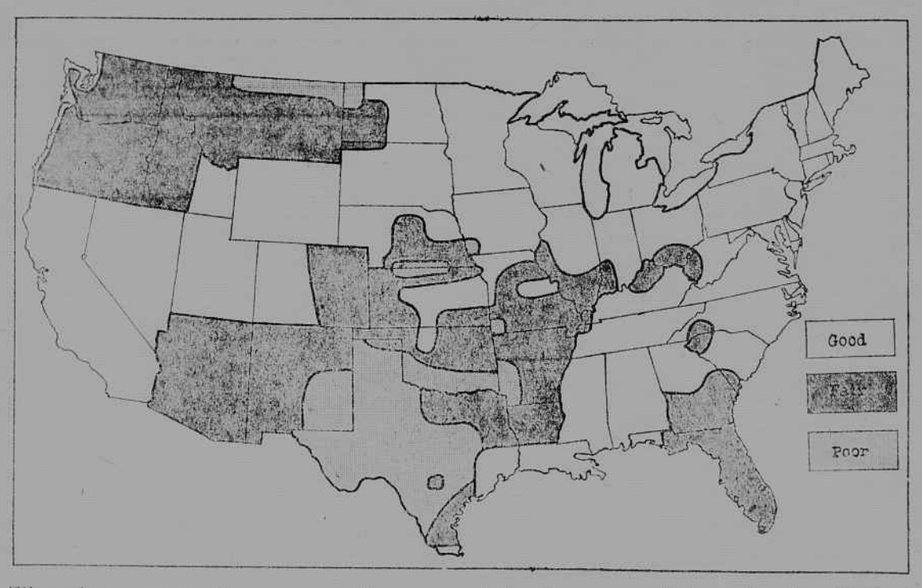
The funds obtained are being used to liquidate debts incurred in Spain in the purchase of supplies for the American forces in France. Under the terms of the credit arrangement New York banks are enabled to draw upon the Spanish banks in the syndicate through ninety-day acceptances which the Spanish banks discount at 4½ per cent.

Waiting in the Wool Trade

BOSTON, Jan. 18.—In a statement for The Tribune, the editor of "The American Wool and Cotton Reporter" said:

"Many manufacturers of woollen goods have been delaying the execution of their programme for fall business on account of lack of confidence in the prices paid at the auction of government-owned wool. They have been hoping for lower prices and unless they see them will continue to wait. Some, however, between the devil and the deep sea, or between paying the prices asked and extreme curtailment in production, or possibly stopping operation of all their machinery, will prefer to pay the price and take a chance. The feeling is general that the minimum bid policy is entirely inadvisable. Real market values will be established only by selling the wool at whatever price it will bring."

Shades in the State of Business



The above map shows general crop and business conditions in the United States on December 14, 1918, as disclosed by a survey of the Committee on Statistics of the Chamber of Commerce of the United States

Reconstruction—and Beyond

Earnings of War Bride Enterprises, Economist Says, Will Fall, but Ultimate Decline of Stocks Generally Should Be Small and Gradual, While Bonds Should Rise Slowly—Public Utility Corporations, Without Higher Rates, May Soon Be Expected to Go Into Bankruptcy

Article V—Interest and Security Values

[Note.—This is the fifth of a series of articles in which Professor Davenport outlines his views of the future of security values, interest, international trade, gold movements, wages, immigration, shipping, taxation, real estate, etc. The sixth article will be presented next Sunday.—Financial Editor.]

By H. J. Davenport

Professor of Economics in Cornell University

WERE there no remaining surplus of banking reserves and were there no practically unlimited ability in the reserve associations to create new reserves, the probability of further credit inflation would not exist. The possibility also of an ultimate contraction of credit and a speculative reaction with a resulting financial and industrial crisis would be reassuringly small.

But any crisis must be several years removed, even though the inflation continues. These three possibilities, then, are open and must receive discussion:

(1) stable prices,
(2) falling—deflated—prices,
(3) rising—inflated—prices.

The easiest way of understanding what future conditions will mean is through understanding what past conditions have meant. Supplies of "capital" during the last two years, the rates of interest and the movements of prices in the stock exchanges have brusted with surprises. The prices of securities respond rapidly to interest rates. Actual earnings and dividends fluctuate, to be sure, as also the prospects of continued earnings and of continued maintenance of interest payments. But changes in interest rates and in the forecasts of interest rates are the most potent influence for general changes in exchange quotations. Neither earnings nor prospects of earnings need a change in order to produce an active market. If a tract of land will rent for $100 it is worth $1,000 in a 10 per cent country. With interest rates ruling half as high it would change to a $2,000 property.

Values Depend on Earning Power and Interest

It is then not quite true that values depend on earning powers, but they depend on earning powers as one variable and on interest as the other. When one can buy a security that promises 6 per cent on the cost and can borrow time funds at 4 or 5 per cent, or call money at 1 or 2 per cent, it is safe to look for advances in security prices: Values are merely the capitalized present worth of forecasted returns. Original costs do not matter except in so far as they may promise new competitions and lower earnings. Good will and monopoly are dividend markers, and therefore support present market values. And business men regard either as capital.

Most economists incline, however, to regard capital as primarily or exclusively made up of industrial items like tools, appliances, machines, power plants, raw materials, and explain interest as due to the earning power of these specific kinds of capital. Capital has its origin, the economist says, in savings. But to the business man, for most of his purposes, capital means merely funds. These funds he calls money. This is what he borrows and pays interest on. And commonly he borrows the capital from a bank. To the typical economist of the established tradition high interest points to a scant supply of the means of production, or to an especially large demand for the production forms of wealth. But to the business man high interest means merely the scarcity of banking accommodations. Almost exclusively he borrows or lends what he calls cash—the circulating medium—either actual money or bank deposits, banking credit affording the same service as money.

For all practical purposes of the supply of capital or the fixation of interest rates, I side with the business man. An inflow of gold to the country—the so-called favorable balance of trade—does not bring more raw materials or make machinery cheap, or reduce the rents of machinery or of land, but only makes bank reserves plenty. But this inflow enables the banks to discount paper more freely and so to expand their deposit liabilities. Your note is neither money nor currency, but when the bank discounts it, giving you deposit credit for its proceeds, there comes about a net increase in the circulating medium.

Increasing bank reserves support a several-fold increase in the media of exchange. Under our present laws, indeed, and with the establishment of the reserve associations, $40 of new deposit currency can be issued for every dollar of increase in gold reserves.

Interest rates, therefore, are mainly and directly dependent on banking conditions and banking policies. Easy money is really easy banking credit. Easy banking credit depends, in turn, on easy reserve conditions and requirements. For all business purposes capital is plenty when borrowing is easy. Borrowing is easy when bank reserves are easy. Capital, as made up exclusively of items of machine wealth, available in the industrial processes of concrete production, the business man practically never borrows. He may or may not employ the borrowed funds in buying or making new equipment. Equally well he may be going in for wide advertising, or putting more salesmen on the road, or purchasing franchises, or patents, or financing a flotation of securities. He needs operating funds. These are capital for him. Equipment goods are capital, but they are not the capital handled in the financial markets under the ordinary interest contract.

It was through this ambiguous meaning of the term capital, and in obliviousness of the main sources of the current supply of business capital, and in the lack of understanding of the forces fixing banking charges for banking loans that the economists and the business world were misled into the expectation that the great war would bring a prompt and rapid rise in rates of interest.

In fact, however, interest rates ruled extraordinarily low for the following two years and have been at no time exceptionally high. Wealth was being destroyed. Current supplies of products were being rapidly used up by war. The belligerent nations were borrowing beyond anything hitherto dreamed of as possible in their stress for further funds. But interest rates, as the February, 1916, Bulletin of the National City Bank reported them, "were still dragging on the ground. . . . Call money at 1¾ to 2 per cent . . . Best names on commercial paper at 2 per cent."

Rising Prices Act As Shock Absorber

The explanation lay in banking policies. Gold redemption abroad was suspended. The banks of Europe were practically relieved from reserve requirement. The limits on the amount of deposit credit that these banks could create were removed with the suspension of gold redemption. Therewith the banks were enabled to absorb bonds in unlimited qualities, paying for them in terms of deposit credit; or they were carrying the buyers of bonds at the same time with offering financial support to whatever undertakings, domestic or foreign, appeared able to offer adequate security.

True, prices rose. This was inevitable. Prices were the buffer, the shock absorber. The effects of redundant reserves or suspended reserve requirements took themselves out in their bearing on prices. Unless the demand for accommodations is enormously increasing—as in fact it was increasing but this solely by virtue of the consumption and the destruction of war rather than because of new factories and new equipment and new raw materials—the rate of interest might have fallen even more sharply through the pressure of the banks to expand their loans.

These high prices in England and France—gold still being available and in use for foreign balances—set goods to flowing in from America and gold to flowing out to America. But still interest rates were low in London and Paris, because, under suspended resumption, gold holdings were not greatly needed; and they would buy foreign goods. Of course there came an end to the supply of gold to be released for export. But meanwhile America had imported nearly a billion dollars of gold from Europe. Its bank reserves were thus made plethoric—its possibilities of credit expansion rendered enormous, beyond any menace of suspended redemption or of hazard to the gold standard. Gold merely got cheaper—lost in purchasing power. Capital was plenty, borrowing remaining easy, interest moderate, deposits expanding, prices kiting. The banks could absorb bonds at low charges or could carry buying customers on easy terms. It was in truth—and still is—easy enough for the banks to keep interest rates low, but only on terms of pushing prices higher.

So again now, they can if they will force prices down by making interest high—imposing rates that will induce or compel the liquidating of banking paper and the cancellation of deposit credits in this process of making payments. Deflation is this banking aspect, and in its general aspects, is the precise reversal of inflation. Bank inflation makes deposits larger by the grant of larger loans—the larger deposit credits being the proceeds of the increase in discounted paper. Deflation is reduction of deposits made necessary by the calling in of paper—deposit credit cancelled in the paying off of borrowers' liabilities. But it takes high interest to make people want to pay their notes, as it took lower interest to induce them greatly to extend their borrowings.

But the expanding credit currency and the expanding prices expanded profits; costs of production, wages in particular, lagging behind prices. With the increasing earnings and high dividends, and with not greatly changing interest rates, there came a boom in stocks. Even bonds—fixed income securities—rose in price; more dollars, but poorer dollars. Wages, it is true, were also rising in terms of money. But the prices under the continuing inflation kept well in advance of wages, to the degree that corporate profits alone rose from 1914 to 1917 from four to upwards of ten billion dollars.

More Dollars, but Poorer Dollars

Our entry into the war did not profoundly affect this aspect of the situation. Interest rose somewhat. The securities boom slackened, but mainly through the menace of higher profit taxes and through a general uncertainty as to the duration of the high profits period. Securities are still easily to be had at par that report current earnings of three or four times the current rates of interest.

These facts would afford the key to the future movements of interest and of stock exchange quotations, if only the outlook were clear as to the movement of general prices. And the movement of general prices could be foretold, if the future policies of banking and credit were clear. The American situation, taken separately, would seem to promise inflation. The European prospect appears, not very securely, to be in the other direction. On the whole it seems probable that we shall proceed with our inflation until foreign influences block our further way.

If, however, prices remain stable—if, that is to say, inflation is halted, the government financing its domestic and foreign needs neither by the bank borrowing that multiplies currency nor by the ultimate borrowing that pushes up interest rates, but solely by taxes—interest rates should not greatly change from the present level.

The present degree of inflation will shortly have taken out its effect on prices and, somewhat more laggingly, on wages. Interest may harden a little as the currency loses its margin of redundancy. On the other hand, the longer time trend of interest is likely to be slightly downward, toward the rates that, in the long run, larger savings relatively to industrial demands will tend to fix.

Stock to Represent Larger Ownership Share

Thus the movements of security prices will not be general in either direction, but only special to particular securities or classes of securities. The earnings of the war-bride enterprises will fall. But the stocks need not sharply fall since contingent reserves have in general been amply provided against losses from the disappearing war demand.

Public utility enterprises will have to get relieved in higher rates for services, or go into receiverships.

Bonds will fail at any great appreciation until after a succession of peace years have brought lowering interest rates. Meanwhile the losses in the purchasing power of the invested principal will be not less real.

In the long run, common stocks should show the effects of the substantial scaling down of the bondholders' and preferred stockholders' rights of ownership. The stockholders' ownership share will be larger. On the other hand, and a larger matter, the earnings of the common stocks will get narrower as wages and other costs are catching up with prices. There must then be a scaling down of profits. But in the long run stocks need not greatly fall. The present market prices are low now through the general recognition that the high earnings are artificial and temporary.

This trend toward higher earnings of enterprise, while prices are rising—through the lag of wages and of other costs—and a later gradual elimination of these exceptional profit margins as costs approach more closely to the prices of production—was well illustrated in the years from 1898 to 1912. The rise in earnings and in exchange quotations was sharp from 1898 to 1902-'03; the peak in 1903-'05; a slowing up or a fall from 1904 to 1907; a panic in 1907.

Most stocks never reached again the earnings or prices of 1905-'06; but, during the two or three years of slightly rising prices following the panic of 1907, these stocks recovered in part from the earlier fall. In the large, costs had been for six or seven years gaining on the selling prices of goods, despite the general trend toward the high prices of finished goods.

The immediate prospect for advance with most stocks is, then, not bad—the longer time prospect not so encouraging. Public utility stocks, however, will seriously suffer in earnings, and therefore presumably in market quotations until charges are authorized that are somewhat in proportion to the inflation-advanced costs. These industries are a good illustration that nothing durable is accomplished by inflation excepting injustice, a host of new problems, and a long series of readjustments.

New Tax May Seize Part of Profits Never Realized

Probability of Drop in Value of Inventories as the Result of War's End Makes Requirement to Report Gross Income Unfair, Expert Asserts

By Morris F. Frey

Tax Consultant of the Guaranty Trust Company, of New York

WITH the exceedingly high rates effective for 1918, the proposed provisions in the revenue bill relating to losses are of especial importance in determining the net income upon which income and excess profits taxes must be paid. Changes in business conditions since the signing of the armistice have had a tendency to considerably affect the apparently large profits for 1918, and in the final summing up of the business for last year it is not improbable that heavy taxes will be assessed on large profits, which may prove to be fictitious, rather than on the actual profits of the business. This is especially true in the case of manufacturers and merchants, who have on hand large stocks of merchandise and material or who have been so situated that they have suffered by reason of cancellations of contracts entered into during the war.

Under the Federal income tax law manufacturers and merchants are required to report their gross income, taking as a basis the inventory of their merchandise and material on hand, valued at cost or at market value, whichever is lower. Ordinarily this method of taking inventory is sound. At present, however, the prices of many classes of materials and merchandise are inflated, and many manufacturers and merchants are confronted with the probability of an early drop in the values. The loss resulting may reduce materially the apparent profits for 1918.

Take for example wool on hand December 31. The value as fixed by the government auctions or the cost of the wool, whichever is lower, taken at the end of the taxable year of the business, must be used as the basis of the inventory. At the present time there is no free market for wool, the minimum prices being fixed by the government auctions, and it is believed that, should this restriction be released and importation from Argentina be permitted, the price of wool would be reduced materially. In other words, the value of the inventory of wool on hand December 31 is fictitious, because of the restrictions on importation and of the fixed minimum price. The Senate bill proposes to take care of such losses by providing that losses sustained during the preceding taxable year due to shrinkage in the value of inventories or other cause, but ascertained for the first time during the taxable year 1919 or 1920, shall be deducted from the net income of the preceding taxable year, the tax for such year redetermined, and any amount collected in excess of the amount shown due refunded.

The foregoing is only one of the classes of losses which business is facing. Other losses are reasonably sure to affect what have seemed in many instances to be large profits during the preceding year. It is well known that soon after the war many contracts which had been made on a war basis for furnishing manufactured products of different classes have been cancelled. This leaves in the hands of the manufacturer materials which have been purchased at war prices and on which, if used in the fulfilment of contracts made on an after-the-war basis, the manufacturer will be compelled to suffer a considerable loss. Cancellations of this character have extended to a number of different classes of business and without the benefit of the above provision of the law the high rate of excess profits tax in 1918 on fictitious profits would result in many manufacturers suffering a net los on their total business.

War Profits Lessened By Amortization

Loss which is seriously confronting some business concerns is the possible sudden depreciation of plant and equipment and vessels which have been constructed or acquired after April 6, 1917, for the purpose of filling contracts which were contributory to the prosecution of the war. In other words, many concerns have constructed new plants or made additions to their old plants which were used for the purpose of filling war contracts and whose value and use are reduced to a nominal amount by the discontinuance of such work. The new bill takes care of such losses by permitting a reasonable deduction for amortization of such property. The provision is so worded that the Treasury Department, any time within three years after the return is filed, may readjust any deduction which has been taken in the taxpayer's return. The law does not place any limitation upon the amount which may be taken in any one year, beyond the qualification that it shall be reasonable, which leaves the matter of the return to the judgment of the taxpayer, subject to the review of the Treasury Department.

Obsolescence Of Plant

There are certain classes of losses, however, which apparently are not taken care of by either of the above provisions. For instance, attention has been called to the manufacturer who, during the war, purchased at a very high value a building and plant which in normal times would have been considered about ready to scrap. The physical life of the property may extend over a number of years, but when the pressure of war business has ceased and new plant and equipment become available the value of the property will immediately decline, due to obsolescence. If the owner of this property had sold it in 1918 at scrap value, the loss could have been taken as actually ascertained in 1918 and his profits subject to tax for that year would corespondingly have been reduced. In this case the excessive amount invested in the business would be properly reflected as an expense of production during the war period. If this manufacturer was not engaged in war business and if the property was not actually sold in 1918, it is clear that he cannot obtain relief under the provision for amortization. It is also clear that if he is limited to depreciation based on the physical wear and tear of the property, adequate deduction cannot be made.

If he is to be relieved at all, it must be through the broad interpretation of the word "depreciation" to include loss due to obsolescence as well as loss due to use, wear and tear of the property based on the physical life of the property. Unquestionably, the taxpayer in this case has sustained a heavy loss incident to his business in 1918, and one for which he should receive proper allowance in computing his income subject to tax for that year. The substitution of the word "depreciation" for the term "use, wear and tear" in the 1916 law, would seem to permit an allowance for obsolescence of the property in 1918, which will give the necessary relief from excessive taxation in this case.

Fictitious Profits on Government Contracts

In another class of cases government contracts were taken during 1918 on the basis of the cost of material at the date of the contract. In order for the manufacturer, however, to fill the government contracts promptly material was used which had been purchased for the purpose of filling private contracts at a very much lower price than the government allotment. The private contracts were held in abeyance owing to the government contracts, and the manufacturers now have allotments of material on hand at the government prices which are far in excess of the cost of material upon which the private contracts, now about to be filled, were based. In taking their inventories on December 31, 1918, under the existing law and regulations, the material on hand being that which has been allotted by the government, must be taken at cost, or cost or market, whichever is lower. On this basis, the stock on hand December 31 is valued very much higher than the cost of the material actually used to fill government contracts, and which was purchased for the purpose of filling private contracts at a very much lower price. The result is that the profits on the government contracts for 1919 will show the difference between the cost of the material purchased for private contracts and the high price received on the government contracts, which price is based on the cost of material at the time the contract was taken.

The high profit, therefore, is thrown into the taxable year of 1918, and because the value of the inventory of material is based on the government allotment now being used to fill private contracts, losses will be reflected in 1919. In this particular class of cases, the manufacturer, in order that his tax may be equitably apportioned to the proper taxable years, should be permitted to include in his inventory the material which was obtained for the purpose of filling private contracts at the cost of such material and consider that the material purchased to fill the government contracts, although not actually received until after that time, was used in the government contracts. In this way the proper portion of the profits of the business will be attributed to the year in which actually earned. There is no specific provision in the bill, as at present worded, to permit this treatment. If this relief is accorded the manufacturer, it must be by regulations of the Treasury Department issued under the provision of the law which authorizes the commissioner to prescribe the manner in which inventories may be taken.

Under former laws the income and excess profits taxes have been based upon the income for each particular year. The new bill makes radical changes in existing law by permitting the taxpayer to take net losses in prior years.

Losses of Individuals

The Senate bill provides that net losses sustained during a taxable year beginning after December 31, 1916, and ending not later than December 31, 1918, by the taxpayer in his business or from the sale of buildings or facilities, acquired subsequently to April 6, 1917, and used in the production of articles contributory to the prosecution of the war, may be deducted from the net income in the succeeding year. A similar net loss occurring in a taxable year ending January 1, 1919, shall be deducted from the income of the preceding taxable year if sufficient, and if not the balance may be deducted in a succeeding taxable year. The equity of this change is clearly apparent.

An important change in the new bill permits the deduction of losses in transactions in stocks and securities, or other property not connected with the taxpayer's business, regardless of profits derived from similar transactions. Formerly losses of this character were limited to the extent of any profits from dealings in property not connected with the taxpayer's business. As under the former law, the basis for determining loss in such cases is the cost of the property, or, if acquired prior to March 3, 1913, the market value as of that date.