U. S. Tax and Rail Problems Thrust Into Limelight by Bankers

Placid Character of Convention at New Orleans Punctuated by Pleas for Awakened America

By Merryle Stanley Rukeyser

NEW ORLEANS, November 5.

AMERICA'S investment bankers, who held their tenth annual convention here this week, recognized for the first time the full value to them of the revolutionary invention of Gutenberg in the fifteenth century.

Instead of wasting the precious opportunity created by the rubbing of elbows by the nation's principal long-term money lenders by having committee chairmen monotonously read endlessly routine reports on various academic aspects of the globe's behavior, the bankers this year threw open their meetings for free, open and spontaneous discussion and printed reports were distributed. If no epochal developments resulted, it can still be argued that the method was new and that many who had been repelled by the dryness of the previous meetings again meandered to the golf course, oblivious of the drastic change in method.

The alteration was re-enforced by the enthusiasm of Roy Osgood, Chicago banker, the retiring president. Mr. Osgood is averse to steam roller methods and used the force of his office to woo an expression of what the delegates really had on their minds. If associations can get their members to speak as candidly on the convention floor as in lobbies, the dramatic value of such congresses will be tremendously heightened, although possibly at the expense of dignity.

One reason why the clash of opinion at the sessions this week did not become more intensified is that the members of the Investment Bankers' Association have a consciousness of kind, and are more or less in agreement regarding the desirability of making politics and economics contribute to the stability of investments. Where men of the same fundamental outlook gather, the chances of differing on subjects relevant to the convention are minimized.

Suggested to Speakers

If the principle of getting all sides of a question aired is carried to a logical—or possibly an illogical—conclusion, the association would invite as speakers to the next convention such men as Eugene V. Debs, A. C. Townley, Senator Hiram Johnson and—to vary the program—George Graham Rice. These men, each from a difficult angle, indulge in philosophies and methods inconsistent with the scheme of things which investment bankers, the makers and fashioners of securities, glorify. Speakers of this extreme stamp, if invited to supplement the more customary type, would at least rouse the bankers to vigorous debate, and the intellectual exercise might have fruitful results.

However, it is well to chronicle for purposes of record that Matthew Woll, vice-president of the American Federation of Labor, was hissed last year for expressing unpopular sentiments before a body of business men whom he was invited to address.

At any rate, by the turnabout in convention technique, the investment bankers have just held their most interesting sessions, as well as the most largely attended. Eight hundred delegates and alternates were in attendance.

Honored by being the first Southern city chosen as a meeting place, New Orleans, as a corporate entity and as a body of individuals, gave new meaning and vitality to the much heralded Southern hospitality. As the country journalists say, every whim of the delegates was cared for. The badge of the banker was a signal for honor and respect. The newspaper correspondents who wore it had a guilty feeling, as naive natives looked upon them with adoration as men who caused the building of railroads, the tunneling of mountains and the construction of great cities where before had been wildernesses.

City of Contrasts

New Orleans, which is a municipality of contrasts, has a passion for holidays, and the convention days were seized upon as excuses for letdowns in the world of give and take. Delegates wandered into the old French quarter, where local color is unblurred. Shacks hundreds of years old stand there defying time, while only a few blocks away are bank buildings and other modern structures that would not feel self-conscious if thrown into the heart of New York.

Despite the picturesque setting, the convention during its business sessions succeeded in opening its vision to the broader problems of the nation as a whole as viewed by the bankers.

In pledging itself more assertively than ever before to combat aggressively the charlatan in the security world, the bankers revealed a heightened recognition of their moral obligations. The war is against unscrupulous men who play upon the avaricious impulses of the inexpert; it is against fakers who capitalize hot air, who make irredeemable promises, who tell the truth only in so far as it tends to help sales. In striking out against the swindler, the legitimate dealer perceives the need of keeping his own skirts immaculate, of imparting high standards of conduct to every cog in the machine by which he acts as intermediary between borrower and lender.

Prefer Fraud Acts

The investment bankers have come to realize the need of a more positive attitude of opposition against the deceiver. Although the convention has expressed no formal opposition to the continuance of blue sky acts in the states where they already are in force, the investment bankers by far prefer fraud acts. Modeled after the English companies' act, the latter type of law gives much freedom as to the varying types of securities that may be sold, whereas the blue sky law attempts to set up standards and limitations. Under the fraud act misrepresentation becomes a crime.

Experience has taught the delegates that in many states laws of both types often fail to protect the public because of the practical difficulty of separating the sheep from the goats. Prosecuting attorneys, however good their intentions, usually lack discrimination regarding the more subtle phases of investment finance. Speakers at the convention, therefore, urged that the bankers voluntarily organize themselves into vigilance committees, mobilizing their expert knowledge for the public good.

Publicity, it is recognized, is a withering force if directed against the unscrupulous. One of the pitfalls of the average investor is failure to discriminate between houses of integrity and counting rooms of thieves. Howard F. Beebe, of Harris, Forbes & Co., of New York, the new president of the association, suggested in conversation that it would be helpful if state bodies would publish from time to time lists of firms guilty of fraudulent practices.

New Code Set Up

In connection with market place ethics, the representatives of the money lenders set up a new code of practices for dealing among themselves. Already the association had accomplished much in this direction. The subject involves scene-shifting behind the curtain of public interest.

Despite the introduction of additional opportunities for untrammeled discussion, the point has been made that the sessions of the investment bankers are placid and unruffled. And yet emotion was not dead. Two attempts were made to ride, like Paul Revere, through the lanes of sleeping America to rouse folks to the seriousness of conditions.

First, the bankers sought to get the nation excited about taxes. There is a feeling that Congress in preparing the new revenue bill has faced a lack of general public interest, although special groups seeking special exemptions have been conspicuously articulate. The bond men feel profoundly that the revenue bill, which is scarcely more than a mitigation of the hardships caused by the 1918 measure, is wrong in principle and burdensome in practice.

The only remedy for the staggering load that the financiers here could perceive is ruthless economy. And, as long as the task of paying falls primarily on the relatively few rich, say the bankers, the populace is scarcely likely to clamor for thrift in government expenditures. And, until they do, the delegates feel Congress is unlikely seriously to take up the subject of deflation of public expenses. The way out, it was suggested, is through the sales tax, which will give all free men and women an equal opportunity to contribute to the public purse. The sales tax would tax spending and would encourage saving, its advocates point out.

And yet the multitudes are not shouting for the privilege of paying a sales tax. Although Senate sentiment was reported to be drifting to such an impost, Representative Fordney warned again that the House would not stand for it, and it was apparently defeated for the present in the Senate yesterday.

The bankers would have a system of taxation which would clear the arteries through which capital flows. They would strike out supertaxes and excess profits taxes, which, they say, chill initiative and discourage enterprise. They would instead seek to make the idle rich pay, who now escape a share of their responsibilities by purchasing tax-free securities, Federal, state and municipal.

Division Over Sales Tax

Secondly, an effort was made to get folks to envisage the question of railroad mergers as a pressing, burning issue. John E. Oldham, Boston banker, who suggested to the convention a plan for consolidating the carriers into thirteen systems instead of nineteen, as the Interstate Commerce Commission has tentatively recommended, contended that unless railroads are scientifically merged private ownership was bound to be superseded by public operation of the carriers. The railway securities commission asked that the Railroad Labor Board be coordinated with the Interstate Commerce Commission and argued that it would be dangerous to cut rates without reducing wages. It asked Congress to continue the provision of the transportation act defining 5½ per cent to 6 per cent earnings on the property investment of the carriers as a fair return. There has been agitation to repeal the clause.

The experts on industrial and public utility securities asked that investors give some attention to stocks of the highest type.

Progress Being Made In Averting Defaults

Committee on Municipal Securities Finds Prestige of Bankers' Organization Increasing

The report of the Committee on Municipal Securities says, in part:

"The annual report of the chairman of the municipal securities committee consists for the most part of a compilation of the municipal bond laws passed by legislatures this year.

"Our municipal bond laws are constantly changing; existing laws are being amended and new laws are adopted every time a Legislature meets, and it would be impossible to keep the work revised to date. The constitutional provisions for issuing municipal bonds vary so in different states that no uniform law can be framed that would meet these constitutional requirements.

"The committee's services in working out defaults, both temporary and otherwise, have been in more constant demand, and it is surprisingly gratifying to find how often we are able to be of real assistance in these matters after the efforts of the interested member have been futile. There seems to be throughout the entire country a most wholesome respect for the Investment Bankers' Association, and in many cases where the officials of the issuing community have shown a disposition to ignore requests for payments we have been able, by enlisting the aid of local bankers, commercial clubs, merchants or others who have pride in the credit of their community to enforce prompt payment. This is one of the most valuable services that the municipal committee can render, and we hope all members of the association will avail themselves of it whenever the occasion requires."

Authenticating Foreign Securities Here Urged

A. H. Wiggin, chairman, submitted the report of the Foreign Securities Committee, extracts from which follows:

"The question of the authentication of securities representing internal loans of foreign governments is perhaps the most important matter now under consideration by your committee.

"Most of these securities are written in the language of the country of their origin, and, as many of the investors in this country are unfamiliar with the different languages in which the certificates are issued, it is the opinion of your committee that it will be of benefit to the investors in this country, and also of advantage to those issuing such securities, if some official governmental agency can be established to authenticate such issues.

"Your committee has taken this subject up with the French government. If your committee receives any encouragement the same subject will be pursued with other governments. Your committee begs to report progress in this matter."

Financial Structure Important Feature In Banker's Consolidation of Railroads

Regrouping of Western Carriers Regarded as Fairer Than I. C. C.'s; Would Group Many and Have Only 14 Systems

By William E. Hooper

THE plan of railroad consolidation prepared by John E. Oldham, of Merrill, Oldham & Co., Boston, and published by the Investment Bankers' Association, rests on the assumption that the only essential difference between weak and strong railroads, in so far as the larger roads is concerned, is a difference in the capitalization of the companies.

To prove this assumption Mr. Oldham divides the larger railroads of the country as between strong and weak roads, basing his division on the payment or non-payment of dividends. In Group A he places the large roads which are paying dividends and classes them as strong roads. In Group B he puts the non-dividend paying roads and classes them as weak. In addition he deals with two other classes of weak roads, the short line railroads and the New England railroads. Under this method of division it is found that 40 per cent of pre-war traffic was handled by strong roads, 25 per cent by "weak" large roads, 10 per cent by the smaller and short line roads and 5 per cent by the New England railroads.

Same Characteristics

Mr. Oldham's basic contention is that the strong roads and weak roads handle similar traffic; that the proportion of income which is obtained from different classes of traffic is about the same; that the rates are substantially the same, and that the proportion of revenue expended for operating (transportation) expenses, maintenance charges and disbursement to security holders is about the same, and were both weak and strong large roads capitalized on the basis of their gross earnings there would be little difference in the rate of return earned on the capitalization of either. The difference between the weak and the strong roads is that with the strong roads the aggregate par value of all obligations and stock is $4.07 per dollar of gross operating income and that the par of all obligations and stock of the weak roads is $7.03.

Granting that Mr. Oldham's division of roads as between weak and strong is a correct one, and that his method of arriving at maintenance charges does not invalidate his argument, the figures bear him out. The ton mile rate and the passenger mile rate of the two groups are much the same—8.12 mills per ton mile for the strong roads, 8.19 mills for the weak roads, and 2.06 cents for both weak and strong roads per passenger per mile. The only decided difference in character of traffic is the difference in the proportion of agricultural products and of manufactures. Of the total tonnage of the strong roads 19.2 per cent is furnished by products of agriculture and 17.02 per cent for the weak roads. On the strong roads manufactures furnish 13.9 per cent of the total tonnage and on the weak roads 18.2 per cent.

On the strong roads operating expenses and taxes, excluding maintenance, consume 41.1 per cent of gross revenue and on the weak roads 43.6 per cent. Now, however, Mr. Oldham, to arrive at his rate of return on capitalization, assumes that the weak roads spend as much for maintenance per dollar of gross revenue as the strong roads. This, of course, is not in accordance with the facts, but Mr. Oldham's argument is that the facts do not invalidate the point he is trying to prove. In other words, that the weak roads could spend as much on maintenance as the strong roads, and if they could do it it is fair to assume that they do so for purpose of determining the rate of return on capitalization.

Consolidation Necessary

Mr. Oldham considers the various methods of equalizing the income of weak and strong roads and comes to the conclusion that consolidation is the only method. He does not, however, discuss the obvious alternative of permitting or forcing receivership of the weak roads and a recapitalization of these companies on a basis which according to his theories would make them strong roads. Instead he proposes a consolidation of all roads into thirteen systems, and a New England railroad system which is to be jointly controlled by four of the trunk line systems.

This handling of the New England situation is distinctly different from anything suggested by the Interstate Commerce Commission by the report of W. Z. Ripley, professor of economics at Harvard University, on which the commission's plan is based, or of any other comprehensive proposal for railroad consolidation that we know of.

Under Mr. Oldham's plan System No. 1 is to consist of the New York Central system as it did under the Interstate Commerce Commission's plan, but with this important difference: that to the New York Central system as now constituted Mr. Oldham adds the Central of New Jersey. Under the Interstate Commerce Commission's plan the Central of New Jersey was given to the Baltimore & Ohio-Reading-New Haven system. There can be little doubt that the New York Central would be much better satisfied with the Oldham lay-out than with the Interstate Commerce Commission's. The New York Central officers would probably agree heartily with Mr. Oldham that giving the New York Central the Central of New Jersey would give the New York Central "a share of the anthracite business of the country and make a better distribution of such business among the Eastern systems."

System No. 2 in the Oldham plan consists of the Erie, Wabash, Pere Marquette; New York, Chicago & St. Louis; Delaware & Hudson; Delaware, Lackawanna & Western; Buffalo, Rochester & Pittsburgh; Bessemer & Lake Erie, Pittsburgh & West Virginia; Elgin, Joliet & Eastern and Buffalo & Susquehanna. Mr. Oldham's object is to form a system which shall compete on even terms with the New York Central system and the Pennsylvania system. Purely from a banker's point of view the merging of the treasury and credit of the Delaware & Hudson; Delaware, Lackawanna & Western and Erie goes far to accomplish this purpose. From an operating point of view the Buffalo System, as Mr. Oldham calls his System No. 2, would appear to be by no means as strong as the New York Central.

System No. 3 consists of the Pennsylvania system as constituted to-day, practically.

At a Disadvantage

System No. 4 consists of the Baltimore & Ohio, Philadelphia & Reading, Ann Arbor, Lehigh Valley, Western Maryland and two or three smaller roads. The addition of the Western Maryland to the Baltimore & Ohio would give it certain operating advantages; under unified government operation the Baltimore & Ohio used certain parts of the Western Maryland advantageously. Mr. Oldham himself, however, recognizes that this system would be in a position to compete for Western business "less advantageously than the other three systems because of its less direct lines, and also because of the topography of the country through which it passes." This Buffalo system of Mr. Oldham's roughly corresponds to a combined Erie (System No. 4) and Lehigh Valley-New York, Chicago & St. Louis (System No. 5) of the Interstate Commerce Commission.

New England

The New England system, which is to be controlled by the four systems just outlined jointly, is to consist of the New York, New Haven & Hartford, Boston & Maine, Maine Central, Rutland & Bangor, Michigan & Aroostook. In his treatment of the New England situation Mr. Oldham faces the fact squarely that the New England roads cannot maintain their credit and operate under rates made for roads more favorably situated, nor can they have higher rates, but, Mr. Oldham argues, New England, with her enormous factory development, is of importance to the rest of the country, and that the New England railroad problem is a matter of concern not only to the public of New England, but to the country at large. He squarely faces the fact that the "enormous debt due the government at the present time [by the New England railroads] is a menace to private operation; their continuance will eventually lead to government ownership." Mr. Oldham, therefore, places this burden of private operation of the New England railroads jointly on the four great trunk line systems which he has formed. It is almost exactly analogous to the argument presented by the New England railroads in their request to the Interstate Commerce Commission for a higher revision of the through rates into and out of New England.

The New England system would have 6,903 miles of railroad and $21,988 gross revenue per mile. System No. 1 would have 13,678 miles and $21,932 gross per mile. System No. 2, the Buffalo system, would have 12,004 miles and $20,966 gross per mile. System No. 3, the Pennsylvania, would have 11,384 miles and $35,481 gross per mile, and System No. 4, the Baltimore & Ohio-Reading, would have 9,266 miles and $25,904 gross.

In forming System No. 5 Mr. Oldham departs radically from the principle adhered to both by the commission's plan and the Ripley suggestions, in that he boldly disregards the elimination of competition entirely. He combines the Chesapeake & Ohio with its controlled Hocking Valley, the Norfolk & Western, the Virginia and the Carolina, Clinchfield & Ohio. There would be distinct operating advantages to be gained, but the principle of preserving competition as laid down in the transportation act is entirely disregarded. The result of such elimination of competition would probably be felt primarily in the coal trade, and might or might not work out to the ecoomic advantage of consumers of bituminous coal. It may be recalled that the Interstate Commerce Commission formed two competing soft coal systems.

System No. 6 is a 12,295-mile system, consisting of the Atlantic Coast Line, Louisville & Nashville, Nashville, Chattanooga & St. Louis, some other smaller roads and half control of the Chicago, Indianapolis & Louisville. Giving this system half control of the Monon would perpetuate an arrangement which is now in existence, and which, in the opinion of a good many railroad men, has never worked satisfactorily. The joint control of the Monon by the Southern and the Louisville & Nashville never resulted in the Louisville & Nashville using that entrance into Chicago.

A Weak System

System No. 7 is the Southern Railway, its affiliated lines, the Florida East Coast and the Seaboard Air Line, which form a system of 14,512 miles, with average gross earnings of $10,145 a mile. Without recapitalization of both the Southern and the Seaboard it is difficult to see where Mr. Oldham is to get the credit which he deems essential for each of his systems.

The Transcontinentals

System No. 8 combines the Great Northern, the Chicago, Milwaukee & St. Paul, St. Louis & San Francisco and a half interest in the Chicago & Alton. Mr. Oldham is in agreement with the Interstate Commerce Commission in giving the St. Paul to the Great Northern to perform the function now performed by the Great Northern's Chicago, Burlington & Quincy, but goes one step further in that he combines a transcontinental and a Southwestern system (the Frisco).

Like the Interstate Commerce Commission, the Oldham plan gives the Northern Pacific the Chicago, Burlington & Quincy, but adds also to it, to form the System No. 9, the Chicago Great Western, Denver & Rio Grande, Western Pacific and Kansas City Southern. Whereas, therefore, the Interstate Commerce Commission's plan made the chief competitor of the Union Pacific the newly created Atchison system (the commission plan gave the Atchison the Denver & Rio Grande, the Western Pacific and Colorado & Southern) the Oldham plan makes the Burlington and Rio Grande the newly set-up strong competitor of the Union Pacific.

As in the Interstate Commerce Commission plan the Chicago Northwestern and the Union Pacific are combined, and this combination, together with a half interest in the Chicago & Alton and a full interest in the Missouri, Kansas & Texas, forms System No. 10 under the Oldham plan. This plan, however, recognizes the fact that is conceded by nearly every railroad man who knows the transcontinental situation and gives to the Union Pacific the Central Pacific.

System No. 11 is the Atchison, Topeka & Sante Fe, Texas & Pacific, half interest in the Chicago & Eastern Illinois, full interest in the International & Great Northern and the Missouri Pacific. It would appear that in forming Systems 9, 10, 11 and 12—12 being the Southern Pacific, Chicago, Rock Island & Pacific, El Paso & Southwestern, St. Louis Southwestern and half interest in the Chicago & Eastern Illinois—the Oldham plan divides up the southwestern and transcontinental road among systems far more equitably than did the Interstate Commerce Commission's plan.

The Last System

The thirteenth system consists of the Illinois Central, Minneapolis & St. Louis, Minneapolis, St. Paul and Sault Ste. Marie, the Duluth, South Shore & Atlantic, and the Mineral Range. By giving the Soo, which is now a subsidiary of the Canadian Pacific, to the Illinois Central, it is possible that the Oldham plan strengthens American railroads as against their Canadian competitors.

Mr. Oldham comes to the conclusion based on combined figures for each system for three years, June 30, 1915, to June 30, 1917, that his grouping has created systems "of about the same size and earning power; that the several systems competing in the same district obtain their earnings from passenger, freight and miscellaneous traffic in similar proportions to the total; that the character of the tonnage was much the same; that the average rate per ton mile and per passenger mile was substantially uniform, and that under these conditions similar results from operation were obtained by all systems which competed with each other."

How a Banker Would Consolidate Roads

The proposal made by John E. Oldham for the consolidation of American railroads contemplates the forming of thirteen primary systems and one subsidiary as follows:

New York Central and Central of New Jersey.

Buffalo System, including Erie, Wabash Lines East, Pere Marquette, New York, Chicago & St. Louis, Delaware & Hudson and Lackawanna, Buffalo, Rochester & Pittsburgh.

Pennsylvania System.

Baltimore & Ohio, Reading and Lehigh Valley.

New England System, including New Haven and other principal New England roads (the subsidiary system).

Norfolk & Western, Chesapeake & Ohio and Virginian.

Atlantic Coast Line and Louisville & Nashville.

Southern, Seaboard Air Line and Florida East Coast.

Great Northern, Chicago, Milwaukee & St. Paul and St. Louis & San Francisco.

Northern Pacific, Burlington, Denver & Rio Grande and Kansas City Southern.

Union Pacific, Chicago & Northwestern and Missouri, Kansas & Texas.

Atchison, Topeka & Santa Fe, Texas & Pacific, International & Great Northern and Missouri Pacific.

Southern Pacific, Rock Island and St. Louis Southwestern.

Illinois Central, Minneapolis, St. Paul & Saulte Ste. Marie and Minneapolis & St. Louis.

Oldham Divides Lines on Basis of Strong and Weak Capitalization; Not Particular About Retaining Competition

More Intensive Action Against Fraud Schemes

Government and State Co-operation to Curb Stock Promotions, Especially in Misleading "Ads"

Julian H. Harris, of Harris, Small & Lawson, Detroit, read the report of the Committee on Taxation, extracts of which follow:

"Our association was one of the first publicly to recognize the need of eliminating the excess profits tax as a peacetime measure. Your committee is thoroughly in accord with this. We feel that the provisions of the present law in that regard, while they may not bear as heavily at this time in money payment as the new proposed 15 per cent tax because of our depressed business condition, do, nevertheless, in normal times tax almost to the point of destruction that element of profits which is and should be the insurance against risk without which capital cannot be induced to promote legitimate business.

"We do not think it necessary to go further into the evils of the present methods of corporate taxation, since we believe that the country has reason to feel assured that this method of taxation will be abandoned.

"Your committee feels that the question of refunding is sufficiently germane to the question of taxation to require some attention in this report. Consideration of the question of refunding the early maturing obligations of the government has led us to the following conclusion: We believe that the policy of refunding is economically sound and humanely just to the extent that it spreads over the present and immediately succeeding generations the necessary burdens of the war which was fought for them, as well as for ourselves, and that the economic soundness of the same is further emphasized by the desirability of removing a part of the strain from the present already overburdened period of reconstruction. Nevertheless, we feel that it is neither sound economy nor elemental justice to pass on to future generations any present unnecessary extravagence, and we are of the opinion that the whole question of refunding should await the actual effecting of economies, promised by the present Administration. The outstanding Treasury certificates are at present largely absorbed by what may be called investment money. The country is to be congratulated upon the way this has been handled, and the hope may be reasonably indulged that the present liquidation is sufficiently advanced so that there may be no danger of these certificates being thrown back on the hands of the banks. If this is so, there is no pressing need for refunding.

"Your committee is heartily in accord with the position already taken by the association in regard to doing away with tax exemptions on the income from municipal bonds thereafter issued. We understand the position of the association in that regard to include the provision that the same should be done in an orderly manner by constitutional amendment, which should include a reciprocal right to the states to tax the income from Federal securities, with proper safeguards on both sides against the power to destroy which is always inherent in the power to tax.

"Nothing illustrates the evils of the present system of taxation better than the abnormal flow of capital to municipal securities. They should be absorbed by institutional buying and by the investment of trust funds, while business enterprise should be able to draw upon large accumulations of capital which should be encouraged to take the risks incident to business progress.

"In the absence of a sales tax, which seems to your committee a very remote possibility at this time, the next revenue law will be merely a revision of the revenue act of 1918, and will leave the country committed to a tax on profits and incomes for approximately 80 per cent of its revenue. The expenditures for the fiscal year ending June 30, 1922, are estimated by the Treasury at $4,034,000,000. Customs and miscellaneous non-tax receipts will yield, it is estimated, $762,000,000, leaving $3,272,000,000 to be raised by internal taxes."

Turn in Business Here, Bankers Think

The investment bankers, though predicting no immediate leaps into easy prosperity, were of the opinion that nationally the turn upward in business had come, and that the curve would be steadily upward. Since July the selling of bonds has been in a rising, active market and investment brokers are complaining only of an inadequacy of supplies.

Eliminate Tax Exempt Bonds To Aid Revenue

Abnormal Flow of Capital to Municipal Securities Illustrates Evil of System, Says the Committee

The Fraudulent Advertising Committee in its report to the convention, said in part:

"During the year there has been a much greater realization on the part of both investors and investment bankers of the sums of money lost through fraudulent promotion. Various efforts, from those of individuals to those of national legislation, have been made to cope with this increasingly difficult problem.

"Your committee has been in receipt of complaints of members located in various parts of the country that certain promotions spread broadcast were fraudulent in their nature and misrepresented the facts. Efforts have been made to check these back to their source and the results have demonstrated to your committee that the best results can be obtained by local groups.

"As an effort to co-ordinate all of the various agencies now working for the betterment of financial advertising, Richard H. Lee, special counsel of the vigilance committee of the Associated Advertising Clubs of the World, has been doing splendid work, such as securing a number of convictions of fraudulent promoters, and has been the means of stopping newspaper advertising of many others who have been about to engage in such fraudulent advertising.

"As already indicated, the large amounts obtained from innocent investors by fraudulent promotions have brought the attention of Congress to the subject, and national legislation is now pending in the House of Representatives. While this subject will be treated by the legislative committee, who have spent much time and effort in the matter, it seems only proper to record the opinion of your committee that national legislation should be along the lines of a 'fraud act' rather than along the lines of the so-called Denison bill as introduced in Congress, which simply perpetuates and puts the national government behind the blue sky laws of various states. Many of these laws and regulations do not coordinate, and the passage of this bill would bring about an almost impossible situation in handling legitimate investment business."

Propose Anglo-Chinese Bank

The conclusion of an agreement between the Acting Minister of Finance of China and a group of British merchants for the establishment of an Anglo-Chinese bank is announced in "The London and China Telegraph." The capital is reported to have been fixed at £3,000,000, and it has been provided that the British merchants shall advance loans to the Chinese at an annual interest rate of 8 per cent. The bank is to have the right to issue bank notes and to act as an agent for government bonds and loans, for which the Chinese group shall be responsible.

South to Benefit By Bankers' Visit

As a result of the visit of the investment bankers to New Orleans the South will at least sentimentally play a more important part in the counting-room calculations of Northern bankers. Actual first-hand observation gave the delegates an interest and confidence in the district which the reading of cold balance sheets could never stimulate.

Security Fashioners Try To Make Wares Attractive

Committee Reports on Several Classes of Issues Contain Many Interesting Discussions

REPORTS of several committees on different classes of securities formed one of the more practical features of the convention. These dealt with industrial, railroad, foreign, municipal and public service securities. Development of protective measures for the benefit of holders was stressed in pointing out the tremendous volume of such financing done during the year.

The New York transit commission's plan was discussed briefly in the public utility group, and the service-at-cost idea, with rewards for efficiency in operation, was commended as the fairest to all concerned. The inherent stability of this class of securities, the committee said, was demonstrated during the recent business depression.

Safeguarding Security Holder Being Stressed

Progress in Development of Protective Measures During Year, Industrial Group Finds

Harold Stanley, chairman of the Industrial Securities Committee, submitted a report, extracts from which follow:

"Judging from available figures, the year 1920 broke even the 1919 record for volume of industrial financing, and the comparison is still more impressive if confined to fixed obligations—bonds and notes. According to estimates, industrial companies furnished less than 20 per cent of the amount of new bond and note issues sold during 1915. The percentages in succeeding years have been roughly 30, 39, 37, 40 and 55 in 1920.

"Even though commodity prices should retrace their course to "normal," meaning vaguely the pre-war level, it does not necessarily follow that the volume of industrial financing will correspondingly decline. In this connection it is noteworthy that more than one-half of the 1920 financing came in the second six months, after the change in price trend. This apparent paradox is explained by the fact that the decline in sales and consequent backing up of inventory more than offset the effect of falling prices, and outside assistance was therefore needed.

"The report of this committee for 1920 referred to the covenants which have been evolved for the protection of the security holder. From this standpoint the current period of reaction has a very special interest as affording the first real test these covenants have received. It should be remembered that industrial financing as we know it is the result of evolution, and the note issues and protected stocks with their technical provisions are a comparatively late development.

"However, certain difficulties and inadequacies have come to light. As mentioned in our report of 1920, the lack of satisfactory enforcement clauses—especially in preferred stock issues—has tended to nullify the protective provisions. In some cases the responsibility of the trustee sits much too lightly. In certain issues the actual ratio was at fault—either so high as to hamper the company unduly in its normal seasonal swings, or so low as to afford no real factor of safety. There have also been errors in definition of current assets, for example, the inclusion of advances to subsidiaries or stocks of subsidiary or affiliated companies when such items are not really liquid. In many cases there has been no proper safeguard against contingent liabilities. Too frequently the covenants have been so complicated and ambiguous as to tax the patience of the borowing company and the trustee.

"An outstanding weakness has appeared in the inventory account, and it is now more generally realized that this vital part of an industrial balance sheet requires more careful study. For example, it has been customary to provide that inventory be valued "at cost or market, whichever is lower" and prices have been carefully scrutinized, but the same consideration has not always been given to the fact that inventory should be fairly balanced and bear a proper relation to the volume of sales."

Railroads' Securities Still Reflect Anxiety

Amendments to Transportation Act Needed to Improve Credit and Remove Uncertainties

Pierpont V. Davis, chairman, submitted the report of the Committee on Railroad Securities, extracts from which follow:

"The railroad problem is still with us, but not because the transportation act is a failure. The first year's test, however, demonstrates the need of amendment.

"The railways' troubles in the last twelve months were brought to a head by a shrinkage of earnings caused by a decline in traffic so rapid that expenses could not be reduced proportionately. The result has been that instead of earning a 6 per cent return on the value of their property the carriers of the country earned only 2½ per cent since the termination of the guaranty period. And this scanty return was obtained only by a curtailment of maintenance so drastic that the physical condition of roadbed and equipment, generally speaking, has deteriorated.

"In 1914 and 1915, when the percentage of return on the investment dropped to about 4.20 per cent, approximately 35,000 miles of railway were forced into receivership. That no such calamity occurred in the last twelve months is due, in considerable measure, to the fact that the Interstate Commerce Commission has made wise and effective use of the $300,000,000 revolving fund which the transportation act created.

"Recent railway earnings have shown considerable improvement. But if the carriers are to hold their place in the investment markets the betterment in earnings must run considerably further, and there must be definite deflation in the costs of operation.

"These costs are comprised chiefly of fuel, which absorbed 11 cents out of each dollar of gross in 1920; materials and supplies, which took a further 17 cents, and labor, which received 60 cents, a total of 88 cents. Contrast these figures with the ratios in 1916, when fuel took 7 cents, materials and supplies 12½ cents and labor 41 cents, a total of 60½ cents.

"The next step toward a return to normal operating conditions should be the abolition of the improvident national agreements, which compel the employment of unnecessary men and are responsible for extravagances in pay.

Most Important Item

"As wages are the most important item in operating expenses they become the determining factor in the level of rates; the division of authority, therefore, between the Labor Board and the Interstate Commerce Commission constitutes the fundamental weakness in the transportation act. The best efforts of the commission to stabilize credit and encourage economic management can be and have been nullified by the decisions of this totally unrelated board. An amendment to the act to coordinate the work of the Labor Board with that of the Commerce Commission is recommended.

"We believe that the whole railway industry will be on a much sounder basis when it is possible to reduce rates, and it is probable that reductions when made will contribute in some degree to improvement of general business; but substantial and effective decreases in railway operating costs are the conditions precedent to any rate reductions.

"As we have pointed out, the fundamental importance of the transportation act to the investor lies in its mandate to the Interstate Commerce Commission to adjust rate schedules that will yield a fair return on the aggregate value of railway property. After March 1, 1922, the statutory definition of what constitutes a fair return expires, and the determination of the rate is left to the discretion of the commission. Amendments to the transportation act have been introduced in the Senate to reduce the statutory rate of return below 6 per cent. Your committee wishes to go on record as opposing a return of less than 6 per cent, believing it would be unfair and certain to undermine railway credit.

Aid From Consolidations

"Railway consolidations, which have been proposed as the ultimate solution of the problem of the weak roads, cannot afford relief for some time to come, in any event. The Interstate Commerce Commission's plan, recently published, is purely tentative and will not be made final until protracted hearings have been held. If the plan is adopted, no consolidations are possible until the final physical valuations have been completed, in view of the stipulation of the law that the aggregate capitalization of merged properties shall not exceed their physical values.

"So we are a good many months, perhaps years, from the beginning of the operation of this section of the act. Granted that a material reduction in the number of railway systems is in the public interest, we regard with decided apprehension an amendment to the transportation act which would make consolidations compulsory even if legally possible. The effect of such forced consolidations would be far more likely to destroy the credit of the strong road than build up the credit of the weak. On the other hand, consolidations which flow from the motive of self-interest will not jeopardize credit and will, in our judgment, produce the more vigorous systems.

"The Interstate Commerce Commission now has full authority over the issuance and sale of securities. During the last year sometimes six weeks and longer have elapsed between the time the railroad company made its application to sell bonds and the date the authority was officially given. Such delays are dangerous. If the securities are sold by the bankers subject to the approval of the Commission, the investor is annoyed at not receiving delivery of his securities, and if the quoted price goes down he may attempt to cancel his purchase. If the sale by the bankers is deferred until the Commission has granted authority, the market may have disappeared. In a year of rising prices there might be no injury by delay, but in a falling market the railroads, the bankers and their customers may be seriously embarrassed. Doubtless, a part of the delay has been due to the immense amount of work the Interstate Commerce Commission has been doing. The question deserves the prompt attention of the Commission to devise a means of relief.

"A summary of the conclusions of your committee follows:

"The persistence of the railway problem is due to the acute business depression and the ensuing maladjustment of prices and labor, and is no reflection on the value and importance of the transportation act, which we regard as a most constructive legislative achievement.

"The labor costs on the railways are beyond the ability of the industry to meet, and we believe the Labor Board erred in not abrogating unconditionally the so-called national agreements.

"As wages are the important factor in the determination of the rate structure, the functions of the Labor Board should be co-ordinated with those of the Interstate Commerce Commission, and we suggest an amendment to the transportation act looking to this end.

"Railway rates are still on a war basis and should be reduced just as soon as operating costs have been reduced. But a too drastic premature reduction, in view of the weakened condition of railway treasuries, would be likely to invite disaster.

"When railway earnings fell close to 4 per cent in 1914 and 1915, receiverships multiplied. When earnings advanced to the neighborhood of 6 per cent in 1916 and 1917, reorganizations were carried out and credit was expanding. The lesson of railway history is clear that the Interstate Commerce Commission should continue to adjust rates with the view of permitting a net return of 6 per cent, when the determination of such return rests in their uncontrolled discretion, that is, after March 1, 1922.

"Consolidations are desirable so long as they result from the voluntary action of the interested parties. Compulsory consolidations might in many cases injure instead of restoring the credit of the railroads concerned.

"The overwhelming part of the railways' activities is now interstate—a fact recognized by the Transportation Act. Any restoration of regulating authority to the state commissions would be a retrograde step.

"Railroads, having already suffered from the competition of motor trucks using highways provided at the expense of the public, should not in addition be subjected to competition

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