

THE EVOLUTION OF THE FUNCTIONS OF THE RECONSTRUCTION FINANCE CORPORATION:
A STUDY OF THE GROWTH AND DEATH OF A FEDERAL LENDING AGENCY

DISSERTATION

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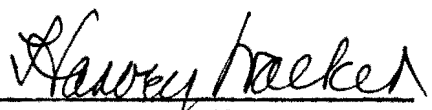
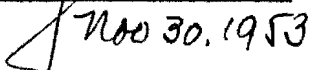

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CHAPTER I

INTRODUCTION

The Reconstruction Finance Corporation had been one of the most significant of the federal lending agencies, with broad powers in various fields of the economic and political life of the country since its inception in February 1932. This thesis is an attempt to study: (1) how and why was this organization originated; (2) how and why had it evolved to perform such a broad variety of functions as it had been performing; and (3) how and why has it been liquidated.

As the RFC had been not only one of the most gigantic agencies but also one of the most controversial government institutions in American history, this study has not become involved in "politics" although it inevitably has had to examine some of the controversial issues arising from the Congressional investigations and legislative enactments.

Throughout the thesis a historical approach has been adopted. For the study of the RFC's achievements, a statistical approach has been applied, while for the examination of the specific functions of the RFC an analytical method has been used. Under this general methodology, first the origins of the Corporation have been explored. Then, on the basis of major changes in its functions and achievements, the further study has been divided into three phases: (1) during the depression in the early 1930's and the following recovery period, (2) during the War and the related emergency period, and (3) during the post-War and re-

conversion period. Finally, in order to help summarize the functions and achievements of the RFC, a brief examination in connection with the expansion and contraction of the RFC's operating funds to meet carrying out its assigned functions, has been added.

CHAPTER II

THE ORIGIN OF THE RFC

In order to understand the reasons for the establishment of the Reconstruction Finance Corporation, it is necessary to review the crisis conditions which prevailed in the autumn of 1931. As a result of currency hoarding, recurring banking difficulties,¹ extreme deflation in prices of commodities, securities, and real estate, and a general collapse in corporate earning power in the United States, together with the suspension of the gold standard by Great Britain on

¹Statistics of bank closings indicate that the readjustment in the banking structure had been orderly until November, 1930. However, during November the public became aware of the attempts being made to save the Bank of the United States, which closed December 10, 1930, with about \$200,000,000 of deposits. It was the largest bank in the United States ever to suspend payments. See J. Franklin Ebersole, "One Year of the Reconstruction Finance Corporation," Quarterly Journal of Economics, XLVII (May, 1933), 466. Thus began the spiral. From then on, bank closings were accelerated, and domestic hoarding of currency began. The spiral approached a crescendo of severity in the last half of 1931. The decline in deposits of all banks in the last half of 1931 was almost \$6,000,000,000, or nearly five times the loss in the first half of that year. Money in circulation increased over \$800,000,000 in the last half of 1931, indicating a large conversion of bank deposits into cash. The last half of 1931 also witnessed 1,611 bank suspensions, more than twice the number in the preceding six months, and more than the total for any previous complete year. Hoarding withdrawals from banks totaled \$150,000,000 for just one week. For further detailed study of the hoarding and bank suspensions in the early 1930's, see Cyril B. Upham and Edwin Lanke, Closed and Distressed Banks (Washington: The Brookings Institution, 1948), p. 7.

September 21, followed by numerous other countries,¹ a situation developed in which sound financial institutions were being sacrificed one after the other on the altar of fear, and railroad receiverships were impending because a drastic decline in earning power and a demoralized bond market made refunding of bond maturities extremely difficult, if not impossible. During the latter part of 1931 the point was reached where even those who, as a matter of principle, felt most strongly against government intervention in business activities, thought that the time had come when little improvement in the situation could be expected without some help; and the Government appeared to be the only source of assistance.

¹The following countries officially suspended the gold standard or placed an embargo on gold export:

| | |
|--|--------------------|
| United Kingdom of Great Britain and Northern Ireland..... | September 21, 1931 |
| British India..... | " " " |
| British Malaya..... | " " " |
| Colombia..... | " " " |
| Egypt..... | September 23, 1931 |
| Irish Free State..... | September 26, 1931 |
| Denmark..... | September 29, 1931 |
| Norway..... | " " " |
| Sweden..... | " " " |
| el Salvador..... | October 8, 1931 |
| Canada..... | October 19, 1931 |
| Japan..... | December 13, 1931 |
| Portugal..... | December 31, 1931 |
| New Zealand..... | January 1, 1932 |
| Ecuador..... | February 9, 1932 |
| Chile..... | April 20, 1932 |
| Greece..... | April 26, 1932 |
| Siam..... | May 11, 1932 |
| Peru..... | May 18, 1932 |
| Union of South Africa..... | December 28, 1932 |
| United States of America..... | March 6, 1933 |

For further details, see American Institute of Banking, Banking and the New Deal (New York: American Institute of Banking, 1933), pp. 200-201, Appendix B.

Under the pressure of this economic situation, on October 6, 1931, President Hoover, following a conference with congressional leaders and Treasury and Federal Reserve officials,¹ held at the White House on October 4, 1931, issued a statement announcing that he had requested the nation's bankers to form an institution with resources of at least \$500,000,000 to rediscount bank assets not eligible for rediscount at Federal Reserve Banks, thus enabling banks to attain liquidity in case of necessity and to continue in business without restriction of credit or sacrifice of assets.² He added that "if necessity requires, I will recommend the creation of a Finance Corporation similar in character and purpose to the War Finance Corporation, with available funds suffi-

¹ President Hoover, on October 4, 1931, met Secretary of the Treasury Andrew W. Mellon, Undersecretary Ogden Mills, Governor of the Federal Reserve Board Eugene Meyer, and approximately thirty leaders of the financial world, at Mellon's apartment. Buel W. Patch, "The R.F.C. Under Hoover and Roosevelt," Editorial Research Reports, II (July 17, 1935), 71.

² "Press Statement, October 6, 1931; Outline of Program to Secure Cooperation of Bankers and Others to Relieve Financial Difficulties of the People," The State Papers and Other Public Writings of Herbert Hoover (collected and edited by William Starr Myers; New York: Doubleday, Doran & Co., 1934), vol. II, p. 5.

cient for any legitimate call in support of credit."¹

In the meantime, the National Credit Corporation was being formed. It was a private organization established early in October 1931, designed to provide a means whereby voluntary associated banks owning its stock and purchasing its debentures would provide liquidity for such of the associated banks as needed, but could not obtain, rediscounts.² The maximum amount involved was \$500,000,000. Loans were granted by the central organization only after the local association had investigated and guaranteed the proposed loan.

¹Ibid. The War Finance Corporation was set up, on May 20, 1918, by the Congress under the Woodrow Wilson Administration. It was given a capital of \$500,000,000. Its purpose was to make advances to banks and industry to aid in prosecution of World War I. See U.S., Congress, House, Hearing: before the committee on ways and means (65th Cong., 2d sess., on H.R. 9499), pp. 152-154. A year later--March, 1919,--the War Finance Corporation Act was amended to permit advances to American exporters and banking institutions to finance American exports. The deflation period which followed World War I prompted Congress to revive the Corporation in January, 1921, and in August in the same year another amendment to the Act broadened its powers, authorizing it to lend to banks and financial institutions for agricultural purposes, to livestock loan companies and to co-operative marketing associations. The War Finance Corporation Act, approved April 5, 1918, as amended, November 21, 1918, March 3, 1919, and August 24, 1921, Sections 7-13. For a scholarly study of the War Finance Corporation, see Woodbury Willoughby, The Capital Issues Committee and War Finance Corporation (a Ph.D. dissertation; Baltimore: Johns Hopkins University, 1934), pp. 40-124. The RFC, as we will examine, was patterned along somewhat similar lines. The only important innovation was the provision of larger funds and the introduction of railroad financing, which had been performed by the Treasury during World War I when the carriers were under Government control. The Corporation was terminated on April 4, 1929. U.S., War Finance Corporation, War Finance Corporation, 1929: Letter from the Secretary of the Treasury, transmitting report of the Secretary of the Treasury on the War Finance Corporation for the Year Ended November 30, 1929 (Washington: Government Printing Office, 1930), pp. 1-2.

²Patch, op. cit., p. 71

Naturally, this procedure had resulted in a cautious policy on the part of the guaranteeing banks, particularly as the basic principle involved meant a tying up of liquid banking assets in effecting a freeing of frozen banking assets. Furthermore, it soon became obvious that the stronger commercial banks were either unwilling or unable, or both, to provide enough funds to protect the weaker ones in the face of the constant withdrawal of deposits.¹

By the middle of December, 1931, Congress had already begun consideration of legislation to establish the RFC. Eugene Meyer, then Governor of the Federal Reserve Board and former managing director of the War Finance Corporation, appearing before the House Committee on Banking and Currency on December 18, 1931, advocated "some temporary emergency work by the Government to meet an extraordinary and emergency situation," and justified the need of a government lending agency by stating that "it is a sound principle of government in exceptional conditions involving the national interest to depart from the ordinary rules of governmental activity and provide exceptional and temporary institutions and measures for dealing with temporary and unusual conditions," and that "the present situation is one of those exceptional

¹The banks were never particularly enthusiastic about the scheme of a National Credit Corporation. In the course of an existence of several months, the National Credit Corporation made loans in the neighborhood of but \$10,000,000 and, furthermore, a few denials by the Corporation were decisive in discouraging applicants. United States, Congress, Senate, Subcommittee of the Committee on Banking and Currency, Hearings: Reconstruction Finance Corporation (72d Cong., 1st sess.), pp. 71, 83-90, 176, 179.

occasions where unusual action¹ is required and justified." After having given the outline of his views on the proposed RFC, Mr. Meyer concluded his statement by saying, "at this particular time the knowledge of the existence of such a corporation, with flexible powers and large sums at its disposal, would do more to reassure people who are in fear as to what might happen than any other one thing," and that conditions justified Congress "in creating, for a temporary period and for an exceptional purpose, an institution of this strength and power."²

Furthermore, in reporting the bill on January 6, 1932, the Senate Committee on Banking and Currency declared that "unless vigorous financial support can be promptly rendered, the inevitable consequences must be increased difficulties for every branch of business," and that "the country, as represented by its most eminent banking, business, and financial leaders, is eager for the prompt enactment of a measure guaranteeing Government support, such as provided by this bill."³ Again, the Committee, urging a speedy enactment of the proposed measure, endorsed it with the following statement: "There is substantial agreement among those who have been consulted that some step for the consolidation of effort and the reestablishment of confidence in the

¹U.S., Congress, House, Hearings; before the Committee on Banking and Currency, House of Representatives (72d Cong., 1st sess., on H.R. 5060; A Bill to Provide Emergency Financing Facilities for Banks and Other Financial Institutions, and for Other Purposes), Part I, p.6.

²Ibid., p. 16.

³U.S., Congress, Senate, "Creation of a Reconstruction Finance Corporation," Report, to accompany S. 1 (72d Cong., 1st sess.; Report No. 33, reported by Mr. Walcott, from the Committee on Banking and Currency), p. 2.

underlying foundations of business and finance is absolutely essential."¹

In answer to further questioning during the same debate, Senator Frederic C. Walcott² had this to say regarding the purposes and powers of the proposed corporation:

I am at liberty to quote both the governor of the Federal Reserve Board and the Undersecretary of the Treasury to this effect, that in their opinion, the strength of the corporation is so great, with the entire United States Government back of it, that enough confidence will be created by the very act itself so that the banks and the railroads probably will not call on more than the actual capital stock of the corporation, namely, \$500,000,000.³ The purpose of this bill is to lend money, not to spend money. It is believed that every dollar will come back into the Treasury, and perhaps, as was the case with the War Finance Corporation, enough more to pay the interest charges and the cost of operation.⁴

As to the reasoning behind the proposed bill to create the RFC, on January 7, 1932 Senator Walcott explained to the Senate some of the principal features and gave some of the reasons why the RFC should be created:

¹Ibid.

²Senator Frederic C. Walcott, from Connecticut, was the Chairman of the Subcommittee of the Senate Committee on Banking and Currency, as well as an original framer of the RFC Act.

³"Reconstruction Finance Corporation," Statement of Mr. Walcott, Congressional Record, 72d Cong., 1st sess., vol. 75, pt. 2 (January 7, 1932), p. 1420.

⁴Ibid., p. 1421.

It was the consensus of expert opinion that a financial relief measure must perform two principal functions: Alleviate the unmarketability for frozen condition of the securities which form the assets of the banks and other financial organizations; and, secondly, restore confidence, the unreasoning lack of which, in the face of the really solid foundations on which we stand, is the ultimate cause of our present stagnation. Of course, in the long run marketability of securities is dependent upon the restoration of confidence, directly and indirectly, in the one case by setting up an organization which will actually lend money on assets which may be frozen but are of unquestioned real value, and, in the other case, allaying popular uncertainty with the knowledge that vast resources are available for this purpose,¹ where and when needed. This may be said to be our objective.

On January 15, 1932, an RFC bill was passed by the House with a vote of 335 to 55.² A similar bill had already passed the Senate on January 11, 1932, by a vote of 63 to 8.³ Differences between the two Houses were adjusted in conference and the final result was sent to President Hoover who signed it on January 22, 1932.⁴ At the time of signing the Act, President Hoover expressed the purpose of this huge enterprise as follows:

It brings into being a powerful organization with adequate resources, able to strengthen weaknesses that may develop in our credit banking and railway structure, in order to permit business and industry to carry on normal activities free from fear of unexpected shocks and retarded influences.

Its purpose is to stop deflation in agriculture and industry and thus to increase employment by restoration of men to their normal jobs. It is not created for the aid of big industries or big banks. Such institutions are amply able to take care of

¹Congressional Record, Vol. 75, Part II (1932), pp. 1418.

²Ibid., (January 15, 1932) p. 2091.

³"Reconstruction Finance Corporation," Congressional Record, 72d Cong., 1st sess., vol. 75, pt. 2 (January 11, 1932), p. 1705.

⁴Conference Report - Reconstruction Finance Corporation," Congressional Record, 72d Cong., 1st sess., vol. 75, pt. 3 (January 22, 1932), pp. 2526-2537.

themselves. It is created for the support of smaller banks and financial institutions and, through rendering their resources liquid, to give renewed support to business, industry, and agriculture. It should give opportunity to mobilize the gigantic strength of our country for recovery.¹

In other words, the RFC, with flexible powers and large sums of money, was conceived as an organization which not only would provide additional credit resources to banks, other financial institutions, and railroads-- and indirectly through them to business, industry, and agriculture-- but would foster the return of confidence necessary to set in motion the natural forces of recovery. By providing assistance to weakened financial structures, it was hoped that the course of deflation then still in progress would be checked and a solid basis for a forward movement along the whole economic front would be laid.

Congress created the RFC as a bipartisan agency, stipulating that not more than four of the seven members of its board of directors could be of one political party, and only one appointee per Federal Reserve district was allowed.² This was done under the theory that, if partisanship should develop, the party in power would, and properly should, have the deciding vote through a majority membership. Three of the directors were ex-officio members--the Secretary of the Treasury (or Under-Secretary in case of his absence), the Governor of the Federal

¹"Press Statement, January 22, 1932; Announcement of the Signing of the Reconstruction Finance Corporation Act," The State Papers and Other Public Writings of Herbert Hoover (collected and edited by William Starr Myers; New York: Doubleday, Doran & Co., 1934), Vol. II, p. 106.

²47 U.S. Stat. at L. (1932), 5, "The Reconstruction Finance Corporation Act" Section 3.

Reserve Board, and the Farm Loan Commissioner. The other four were appointed by the President, by and with the advice and consent of the Senate.¹ The term of the presidentially-appointed directors was two years. The Board was given almost complete discretionary power as to personnel, organization, expenses, and rates of interest to be charged.

The Federal Reserve banks were "authorized and directed to act as depositories, custodians, and fiscal agents" for the RFC.² Regional loan offices were set up in each of the Federal Reserve bank and branch cities. Local operations were conducted on Federal Reserve bank premises wherever possible. Loans were made, collateral held, and collections made at these agencies; only loans to railroads, farm loan banks, and Federal intermediate credit banks were made at the main office

¹Ibid. The original board was composed of four Republicans and three Democrats. The Republicans were Andrew Mellon, Secretary of the Treasury; Eugene Meyer, Governor of the Federal Reserve Board; Paul Bestor, Farm Loan Commissioner; (all ex-officio under the law); and General Charles G. Dawes. Mr. Mellon soon was succeeded by Ogden Mills representing the Treasury. The Democrats were Jesse H. Jones, of Texas; Harvey Couch, of Arkansas; and Wilson McCarthy, of Utah. Jesse H. Jones, Fifty Billion Dollars: My Thirteen Years with the RFC (New York: Macmillan Co., 1951), pp. 512-514. The RFC started business February 2, 1932, with Eugene Meyer as Chairman of its board and General Dawes as president. In March 1933, following President Roosevelt's inauguration, the office of president of the RFC was discontinued, and Jesse H. Jones was made chairman. He served until July 1939, when he became the Federal Loan Administrator. Even later, as the Federal Loan Administrator and still later as Secretary of Commerce, Mr. Jones retained general supervision of the RFC while assuming over-all direction of other government lending agencies, including the Federal Housing Administration, Home Owners' Loan Corporation, and the Export-Import Bank of Washington, until he resigned government service in March 1945. For a further study about those who ran the RFC, see Jones, op. cit., pp. 3-13, 484-597.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 24.

¹
in Washington, D. C.

The RFC was originally organized with a capital stock of \$500,000,000 all of which was to be subscribed by the federal government.² The RFC was authorized to issue debentures, bonds, or other obligations aggregating not more than three times its subscribed capital--that is, \$1,500,000,000--outstanding at any one time. These obligations were to mature not more than five years from their respective dates of issue, and were to be fully and unconditionally guaranteed both as to principal and interest by the federal government.³

The charter was granted for a ten year period.⁴ The period of lending activity provided in the original act was one year from the date of its enactment, but the President was given authority (and used it) to extend the loaning period for two additional years.⁵ The loans of the RFC were to be made for periods of not exceeding three years, with authority to grant extensions from time to time up to a total of five years from the dates on which the loans were originally made.⁶

¹Ibid.

²47 U.S. Stat. at L. (1932), 5-12, "The Reconstruction Finance Corporation Act," Section 2.

³Ibid., Sections 2 and 9.

⁴Ibid., Section 4.

⁵Ibid., Section 5.

⁶Ibid.

Under the original Act, the functions of the RFC were principally "to provide emergency financing facilities for financial institutions" and "to aid in financing agriculture, commerce, and industry," through loans to banks, trust companies, building and loan associations, insurance companies, mortgage loan companies, and various agricultural credit agencies.¹ The RFC was also authorized to make loans secured by the assets of closed banks to aid in their reorganization or liquidation;² and, upon the approval of the Interstate Commerce Commission, to make loans directly to railroads or to receivers of railroads to provide temporary financial assistance.³ In addition, in order to facilitate the exportation of agricultural and other products, the original enactment authorized the RFC to accept drafts and bills of exchange drawn upon it arising from the sale of agricultural or other products to buyers in foreign markets.⁴

Most important was the authority to make loans to banks, insurance companies, and other financial institutions. Senator Walcott, in explaining some of the principal features of the bill to create the RFC, stated:

We are now facing a great emergency in consequence of drastic curtailment of the normal functioning of our banks. On the one hand we have those whose assets, with abnormally shrinking markets, have become frozen, and which, in order to preserve any degree of solvency, must stop doing business; on the other those

¹Ibid., Section 5.

²Ibid.

³Ibid.

⁴Ibid., Section 5a.

with adequate cash reserves which, watching those shrinkages, are in terror of impairing their assets, and voluntarily remain in a state of abnormal liquidity. In the cases of both, the business of financing is brought to a standstill,¹ and with it the wheels of activity of every sort stop running.

On the other hand, as has been pointed out, the main cause of the credit strain existing at that time was the fears of bank depositors. The RFC was to endeavor to provide for solvent banks a bulwark against demands that might force their suspension, such assistance being calculated to convince depositors that their money was safe, and to draw back into the banking system the hoarded currency then obstructing the flow of credit and impairing the ability of banks to assist and encourage business.

Loans to closed banks and those in process of liquidation were specifically authorized, but not more than \$200,000,000 could be used for this purpose.² No limitation was placed on the amount that could be loaned to banks, insurance companies, and other financial institutions as a group. The only restriction was the total lending power of the RFC less the allocation for agricultural loans.

Under the original act, agriculture was given preferential allotment. In addition to the provision to aid agriculture through financial institutions just like other industries, the original act

¹"Reconstruction Finance Corporation," Statement of Mr. Walcott, Congressional Record, 72d Cong., 1st sess., vol. 75, pt. 2 (January 7, 1932), p. 1418.

²Ibid., Sec. 5. This limitation was removed by an act of Congress approved on June 14, 1933 (48 U.S. Stat. at L., 141), see p. 28.

provided that one tenth of all funds available to the RFC through the sale of its capital stock and debt obligations be allocated to the Secretary of Agriculture for crop-production loans in 1932.¹ This was the only preferential allotment under the original act. Such loans were to be limited to farmers for the purpose of continuing crop production in the year 1932, preference being given to farmers who suffered from crop failures in 1931.² Under the provisions in the original act, the Secretary of Agriculture could at his discretion accept as "sufficient security" first liens on crops growing, or to be planted and grown.³

The railroads were in an extremely embarrassing predicament, owing to the abnormal falling off of traffic which had affected their revenues so seriously during the period of 1929-1931, and to their difficulties in borrowing.⁴ The railroads also made the same error

¹47 U.S. Stat. at L. (1932), 5, "RFC Act," sec. 2

²Ibid.

³Ibid.

⁴According to the report made by the Interstate Commerce Commission, dated December 22, 1931, to the Senate Committee on Banking and Currency, the earnings of the Class I railways dropped as shown in the following figures:

| Calendar year | Gross railway operating revenues | Net railway operating income (after taxes but before fixed charges) |
|---------------|----------------------------------|---|
| 1928 | \$6,189,917,189 | \$1,194,487,806 |
| 1929 | 6,360,303,775 | 1,274,595,403 |
| 1930 | 5,342,957,046 | 885,011,325 |
| 1931* | 4,225,000,000 | 535,800,000 |

*Estimation

Source: U.S., Congress, Senate, Report, to accompany S. 1 (72d Cong., 1st sess.; Report No. 33; January 6, 1932, reported by Mr. Walcott, from the Committee on Banking and Currency), p. 4.

that was committed by many other large borrowers, supposing before the collapse of 1929 that they could, with safety, borrow on short term and without much doubt obtain renewals from the banks when maturities occurred; or, failing in that, could fund their obligations into long-term bonds.¹ In this they had been disappointed owing to the over-anxiety of many banks to keep liquid, and owing also to the lack of general confidence which had kept many institutions from buying even the most gilt-edge securities at bargain prices.² Several class "I" railroads, which had had a continuous dividend record for generations, were compelled to suspend their dividends. Consequently, the bonds of some of these roads were disqualified as investments for savings banks. It was becoming increasingly difficult to market the bonds of even the best roads and the market price of railroad bonds in general was becoming so depressed that the financial institutions holding this class of paper were unable to realize on them.

On the other hand, it was estimated that at the end of 1931 the banking and financial institutions held more than 70 per cent of all railroad bonds and notes outstanding. Thus, it was realized that a breakdown in transportation would not only prove costly to American industry but would also work serious harm upon banking and other

¹Ibid., p. 3. The above Commission reported that loans and bills payable by the railroads on October 31, 1931, amounted to \$224,145,827, and equipment obligations for 1932 would amount to \$110,782,506. The President of the Pennsylvania Railroad also asserted that the railroads would need to borrow \$400,000,000 to meet their 1932 obligations.

²Ibid.

financial institutions. There was reason to believe that if the RFC, through aiding intrinsically sound roads, were able to restore price stability among carrier issues, considerable improvement would follow in the bond market as a whole, which would indubitably prove helpful in restoring confidence in our banking situation.

Under these circumstances, the railroads were the only industries to which the original act permitted the RFC to make loans directly and independently of the medium of financial institutions. Section 5 of the RFC Act thus authorized the RFC, "upon approval of the Interstate Commerce Commission," to make loans "to aid in . . . temporary financing of railroads and railways engaged in interstate commerce . . . in process of construction, and to receivers of such railroads and railways when . . . unable to obtain funds upon reasonable terms . . ." ¹

Senator Walcott, a member of the Senate Committee on Banking and Currency, on January 7, 1932, explained the reason to the Senate:

The reason they (the railroads) are made exceptions is because of the very wide ownership of railroads by insurance companies, savings banks, national banks, and trust companies, as well as individuals; the credit position of the railroads is a very important item at the present time in the whole national financial structure. ²

And, Senator Walcott continued:

It is not intended that this corporation shall lend to corporations other than railroads, because the proper function of the banks is to do that; but the banks having done that, if they find after they have made these loans that they are become insolvent or that their assets are

¹47 U.S. Stat. at L. (1932), 7, "RFC Act," sec. 5.

²Congressional Record, Vol. 75, Part II (1932), p. 1419

becoming too much frozen, they may come to this corporation and in turn borrow.¹

To summarize the findings of this chapter, these facts stand out as being noteworthy. Crisis conditions in the autumn of 1931 made government aid imperative and justified the creation of a Federal lending agency, the RFC, for a temporary period of time. The main objective of the agency was to combat the depression by providing emergency financing facilities for financial institutions, to aid in financing agriculture, commerce, and industry through banks and other financial institutions, to make loans directly to railroads, and to facilitate the exportation of agricultural and other products. In order to achieve these objectives the RFC was conceived as a powerful organization with adequate resources---\$2,000,000,000---backed entirely by the Federal government.

The following two chapters will be devoted to showing how and why this agency, created to meet an extraordinary and emergency situation for a temporary period of time, evolved to perform such a broad variety of functions as it actually performed.

¹Congressional Record, Vol. 75, Part II (1932), p. 1419.

²Ibid., p. 1421.

CHAPTER III

THE FUNCTIONS OF THE RFC DURING THE DEPRESSION AND RECOVERY PERIOD

Section 1

Functions of the RFC During Period 1932-1940

The Reconstruction Finance Corporation had scarcely begun operations when moves to broaden its functions were initiated in Congress. These efforts, linked with the drive for participation of the Federal government in the burden of direct unemployment relief and for expansion of public works, led to an involved legislative situation which was finally resolved by passage of the Emergency Relief and Construction Act on July 21, 1932.¹

Prior to the passage of this act, early in June 1932, Representative Henry Rainey of Illinois, Democratic leader of the House and later Speaker, introduced a bill entitled "National Emergency Relief Act of 1932,"² intended to broaden the power of the RFC. With some amendments this bill was passed by both houses, but was vetoed by President Hoover, mainly because of a provision which would authorize the RFC to make loans to "individuals, to trusts, estates, partnerships,

¹47 U.S. Stat. at L. (1932), 709-725. The official title of the act is "An Act To relieve destitution, to broaden the lending powers of the Reconstruction Finance Corporation, and to create employment by providing for and expediting a public-works program."

²"General Relief Bill," Congressional Record, 72d Cong., 1st sess., vol. 75, pt. 11 (June 6, 1932), p. 12090.

corporations (public, quasi-public, or private), to associations, joint-stock companies, States, political subdivisions thereof."¹

In his veto message,² President Hoover stated that he objected to certain features of the bill, including provisions for public works and loans to individuals. The reasons given in the veto message can be analyzed as follows; (1) the above provision of the bill would place the government in private business; (2) the bill would dump the financial liabilities and problems of those municipalities and states that have failed through their own wrong-doings upon the federal government; (3) the task of organization and operation would be insuperable, and the bill would give the RFC too much power to deal favor and disaster; (4) the bill would throw upon the RFC all the doubtful loans in the United States; (5) the bill failed to provide the funds necessary for the carrying out of its provisions; and (6) the bill constituted a misuse of the credit of the federal government.³ Then the President concluded that "This proposal violates every sound principle of public finance and of government. Never before has so dangerous a suggestion been seriously made to our country . . ."⁴

President Hoover then recommended that a compromise should be reached on terms suggested by members of both houses and both parties, and that Congress should not adjourn until this could be accomplished.⁵

¹U.S., Congress, "Disapproval of H.R. 12445," Message from the President of the United States (House Doc. No. 360; 72d Cong., 1st sess.), p. 3.

²Ibid., pp. 1-16.

³Ibid., pp. 3-4.

⁴Ibid., p. 4.

⁵Ibid., p. 5.

Accordingly Congress immediately reconsidered and passed the "Emergency Relief and Construction Act of 1932," in order "To relieve destitution, to broaden the lending powers of the Reconstruction Finance Corporation, and to create employment by providing for and expediting a public-works program."¹ It was signed by President Hoover on July 21, 1932. In addition to enlarging the RFC's powers, it increased the borrowing authority by \$1,800,000,000² and provided for replacing two of the three ex-officio board members--the Governor of the Federal Reserve Board and the Farm Loan Commissioner--with appointive members.³ With this provision, separation of the RFC from the Federal Reserve system was made complete.

The Emergency Relief and Construction Act of 1932 authorized the RFC to make five new forms of lending. First of all, the RFC was authorized to make available out of the funds of the Corporation the sum of \$300,000,000 to be allocated to states and territories, or to municipalities or political subdivisions thereof for "furnishing relief and work relief to needy and distressed people and in relieving the hardship resulting from unemployment."⁴ All \$300,000,000 under this provi-

¹Quoted from the title of the act. See 47 U.S. Stat. at L. (1932), 709 "Emergency Relief and Construction Act of 1932."

²Ibid., sec. 205.

³Ibid., sec. 208.

⁴Ibid., sec. 1.

sion was made available to 42 states and 2 territories by the end of June, 1940.¹

Secondly, \$1,500,000,000 of the RFC's loans was made available for "Self-Liquidating" projects to states, territories, political subdivisions, public corporations, boards and commissions, corporations providing cheaper housing or reconstructing slum areas and operating under state or municipal regulation, private corporations interested in bridges, tunnels, docks, viaducts, waterworks, canals, and markets, devoted to public use, and private, limited-dividend corporations, interested in developing forests and other renewable natural resources under governmental regulation.² The act defined a "self-liquidating" project as follows: "A project shall be deemed to be self-liquidating if such a project will be made self-supporting and financially solvent and if the construction cost thereof will be returned within a reasonable period by means of tolls, fees, rents, or other charges, or by such means (other than by taxation) as may be prescribed by the statute which provides for the project."³

Under this provision, the RFC made loans and contracts for numerous

¹U.S., R.F.C., Quarterly Report (ending June 30, 1940), p. 3.

²47 U.S. Stat. at L. (1932), 711-712, "Emergency Relief and Construction Act," title II, sec. 201. Under the National Industry Recovery Act of 1933, 48 U.S. Stat. at L. (1933), 210, sec. 302, the power to loan to states and municipalities for public construction was taken away from the RFC and lodged with the Public Works Administration. See p. 302.

³Ibid.

public agency projects such as the Pennsylvania Turnpike in the amount of \$37,400,000; the Knickerbocker Village, New York, amounting to \$8,000,000; the 240-mile aqueduct to carry water from the Colorado River in Arizona to Southern California, costing \$208,500,000; the San Francisco-Oakland Bay Bridge, representing an investment of \$73,000,000; and many others.¹ Most of these were advanced during the period 1937 to 1942. By June 30, 1940, the RFC authorized loans and contracts for self-liquidating projects to 176 applicants which amounted to over \$400,000,000.

Thirdly, loans were authorized to finance sales of agricultural surpluses in foreign markets, to be made when "such sales cannot be financed in the normal course of commerce" and would not "affect adversely the world markets for such products."² Under this provision, authorizations aggregating \$98,445,000 were made to six applicants for the purpose of financing sales in foreign markets of agricultural surpluses by the end of June, 1940.³

Fourthly, loans were authorized to bona fide institutions financing the carrying or orderly marketing of agricultural commodities or live-

¹U.S., R.F.C., Annual Report and Financial Statements, June 30, 1947 (Washington: GPO, 1947), p. 6.

²47 U.S. Stat. at L. (1932), 711-712, "Emergency Relief and Construction Act," title II, sec. 201.

³U.S., R.F.C., Quarterly Report (ending June 30, 1940), p. 3.

stock produced in the United States.¹ Under this provision, loans aggregating \$1,690,000,000 were authorized to 106 applicants by the end of June 1940 (including authorizations of \$1,600,000,000 to the Commodity Credit Corporation.²

Fifthly, the RFC was further authorized to "create in any of the twelve Federal land-bank districts where it may deem . . . desirable a regional agricultural credit corporation with a paid-up capital of not less than \$3,000,000, to be subscribed for by the RFC and paid for out of the unexpended balance of the amounts allocated to the Secretary of Agriculture."³ They were to be managed by officers and agents appointed by the RFC. These regional units were authorized to: (1) make loans or advances to farmers and stockmen, the proceeds of which were to be used for agricultural purposes (including crop production) or for the raising, breeding, fattening, or marketing of live stock; (2) charge rates approved by the RFC; and (3) re-discount with the RFC and Federal intermediate credit banks.⁴

In addition, two new requirements were imposed for "the protection of the public interest." First, loans were forbidden "to any financial institutions, any officer or director of which is a member of the board of directors of the . . . Corporation or has been such a member within

¹47 U.S. Stat. at L. (1932), 711-712, "Emergency Relief and Construction Act," title II, sec. 201.

²U.S., R.F.C., Quarterly Report (ending June 30, 1940), p. 3. For the Commodity Credit Corporation, see Ch. III, pp. 49-50.

³47 U.S. Stat. at L. (1932), 711-712, "Emergency Relief and Construction Act," title II, sec. 201.

⁴Ibid.

the twelve months preceding the approval of the loan or advance."¹

This provision was a direct result of the so-called "Dawes Loan."²

¹ Ibid., sec. 207.

² As to the "Dawes Loan," it can be explained as follows. On June 6, 1932, Charles G. Dawes, then Chairman of the RFC, resigned saying that he wished to return to the banking business in Chicago. There was considerable speculation in Washington as to why he should resign for no apparent reason. The reason soon became apparent. In the spring and early summer of 1932, an extraordinary pressure had developed on the Chicago banks. Runs had brought about the closing of many small independent banks in the outlying areas of Chicago. These banks, in many cases, had been overloaded with real estate mortgage loans. Most of the large Chicago banks were strong enough to hold out. The Central Republic Bank and Trust Company, an institution with which Dawes had long been associated, was very vulnerable. Its deposits had dwindled to around \$120,000,000 from the \$240,000,000 of less than a year previously. Dawes had withdrawn from the management of this bank when he was elected Vice President of the United States in 1924. After his term as Vice President he had gone to London as ambassador. Upon his return to the United States, he became President of the RFC, and later Chairman of the Board of Directors of the same organization. When he learned of the dangerous position of his old bank, he resigned from the RFC and went to Chicago to meet what he considered his most urgent responsibility. (See Benjamin Anderson, Economics and the Public Welfare (New York: D. Van Nostrand Co., 1949), pp. 274-75. Dawes himself asked for no money from the RFC, but other bankers in Chicago, realizing that if the Central Republic closed their own position would become precarious, contacted the RFC. The Central Republic had notified the other bankers on Sunday, June 26, 1932, that it could cover every depositor if given time, but that it refused to open on next Monday and let money be withdrawn at the expense of those who left theirs in the bank--unless it could obtain a loan giving full coverage to its depositors. An RFC loan of \$90,000,000 was speedily authorized--\$16,000,000 on June 25, and \$74,000,000 on June 26. This loan, together with a \$5,000,000 loan from other Chicago banks, provided the full depositor coverage demanded and averted the crisis. Be that as it may, the loan provoked a storm of criticism. It was stated in Congress that the loan was made for political purposes and that it was a glaring example of RFC favoritism to large banks. The RFC was held to favor the large banks to the extent that it permitted the small banks to fail. Congressional agitation for more direct aid to employment was intensified, and the clamor for complete publicity of all RFC activities increased. Largely overlooked was the fact that the Central Republic was as much entitled to a loan as any other bank. It was true that the collateral could not justify a loan of that size, but as President Hoover stated, the fate of the large Chicago banks, through them the fate of 725 country banks, and through them the fate of many thousands of other banks were at stake. John T. Flynn, "Inside the R.F.C." Harper's Monthly Magazine, 166 (January 1933), 164.

Second, the RFC was required to "submit monthly reports to the President and to the Senate and the House of Representatives (or the Secretary of the Senate and the Clerk of the House, if those bodies are not in session) a report of its activities and expenditures . . . , together with a statement showing the names of the borrowers . . . and the amount and rate of interest involved in each case."¹ The original RFC Act provided that the RFC should "make and publish a report quarterly of its operations to the Congress" stating "the aggregate loans made to each of the classes of borrowers" and by states in each class.² It did not provide for reporting the names of the borrowers or the amount loaned to each borrower, or for making them public.

This provision was based on the reasoning that if it became known that a bank or financial institution needed an RFC loan, such knowledge might precipitate heavy withdrawals and force the bank to close. Such a belief undoubtedly had some validity.³ Indeed it was the probable

¹47 U.S. Stat. at L. (1932), 712, "Emergency Relief and Construction Act," Title II, sec. 201.

²47 U.S. Stat. at L. (1932), 11, "RFC Act," sec. 15.

³In the confidential letter which President Hoover wrote to President-elect Roosevelt on February 17, 1933, urging that the latter make a public statement on the monetary policies of the new administration, publication of RFC loans was credited with having caused bank runs, hoarding, and bank failures. See W. S. Meyers and W. H. Newton, "The Origins of the Banking Panic of March 4, 1933," Saturday Evening Post, June 8, 1935, p. 98. A student of the question, while admitting that the RFC reports probably directed the public's attention to some of the weaker spots, contended that it was "rather far-fetched to assume that complete deferment of publicity would have restored insolvent banks to solvency. The banking situation in general was too desperate to stand or fall upon the mere issue of publicity." J. Franklin Ebersole, "One Year of the R.F.C.," The Quarterly Journal of Economics, XLVII (May 1933), 479.

intention of the original act, since it made no provision for detailed and complete publicity. On the other hand, it is desirable in the long run that the actions of a public corporation be subjected to close and constant scrutiny. For this purpose, the publicity policy was the proper course to follow in matters which affected public money. This new policy of publicizing the RFC activities was inaugurated on August 22, 1932, when the RFC sent its monthly reports to Congress and to the President.¹

During the thirty-day period ending March 3, 1933, twenty-three states had declared bank holidays or restricted the withdrawal of deposits, and on March 4, 1933, the inaugural day of President Roosevelt, governors of the remaining states took similar action, temporarily completing the suspension of the banking activities of the entire country. Following the inauguration, at 1 A.M., March 6, 1933, President Roosevelt by proclamation declared the nationwide banking holiday.² Three days later, on March 9, 1933, Congress passed the

¹The amendment did not specifically provide that the loans should be publicized, but the RFC sent its first report to Congress and the President, in August. Mr. Garner, then the Speaker, instructed the Clerk of the House to make it public. Jesse H. Jones, Fifty Billion Dollars: My Thirteen Years with the RFC. (New York: Macmillan Co., 1951), p. 32.

²"The President Proclaims a Bank Holiday: Proclamation No. 2039," The Public Papers and Addresses of Franklin D. Roosevelt, (New York: Random House, 1938), vol. 2, pp. 24-26. The purpose of closing all the banks at this time was fourfold. First, to prevent continued runs on banks which would enable one depositor to obtain an unfair advantage over another. Second, to permit the re-opening of all sound banks in an orderly manner. Third, to keep closed the many banks which were insolvent and to permit their liquidation in a just and orderly fashion. Fourth, to permit a resumption of banking under circumstances which would instill confidence in the people as to the solvency of their banking system. Ibid., p. 26, explanatory note made by President Roosevelt.

Bank Conservation Act,¹ giving significant power to the RFC. It was the power for the RFC to purchase preferred stock of any national bank or trust company, with the approval of the Secretary of the Treasury.² No stock so acquired was to bear the double-liability provision.³ In cases where state banks were not permitted by law to issue preferred stock exempt from double-liability, the RFC was empowered, by an amendment of March 24, 1933, to purchase capital notes or debentures.⁴ Similar authority to purchase the preferred stock of insurance companies was granted to the RFC by an act of June 6, 1933.⁵ If the state laws prohibited or restricted the issuance of such stock, the RFC could purchase capital notes or debentures of banks, with the approval of the Secretary of the Treasury.⁶

¹48 U.S. Stat. at L. (1933), 1-7, "Bank Conservation Act of 1933."

²Ibid., sec. 304. It reads: "If in the opinion of the Secretary of the Treasury any national banking association or any State bank or trust company is in need of funds for capital purposes either in connection with the organization or the reorganization of such a association, State bank or trust company or otherwise, he may, with the approval of the President, request the Reconstruction Finance Corporation to subscribe for preferred stock in such association, State bank or trust company."

³48 U.S. Stat. at L. (1933), 1148.

⁴48 U.S. Stat. at L. (1933), 21.

⁵48 U.S. Stat. at L. (1933), 119-122.

⁶48 U.S. Stat. at L. (1933), 21.

Purchases of preferred stock by the RFC in banks throughout the nation had important implications for the banking system of the country, as the stock-purchasing program was of assistance in restoring the impaired capital of banks that had not been permitted to re-open immediately after the banking holiday, and helped reorganize banking institutions which were found to be insolvent at the termination of the bank holiday. Furthermore, an act of Congress approved on June 14, 1933,¹ removed the previous limitation of \$200,000,000 on loans to closed banks and those in process of liquidation.²

The preferred stock bought under these provisions of law was to pay cumulative dividends of not over 6 per cent and was to bear voting and conversion rights approved by the Comptroller of the Currency.³ No dividends were to be paid on common stock unless all preferred dividends had been paid.⁴ It was also announced that the voting rights must be enjoyed by the RFC in all matters concerning the issuing institution, that the common stock dividends must be limited to an amount agreed upon by the RFC and the bank, and that there must be semi-annual payments into a preferred-stock retirement fund, under the provisions of the Bank Conservation Act of 1933.⁵

¹48 U.S. Stat. at L. (1933), 141.

²47 U.S. Stat. at L. (1932), 7, "RFC Act," sec. 5. See p. 15.

³48 U.S. Stat. at L. (1933), 7, "Bank Conservation Act," sec. 302(a).

⁴Ibid., sec. 302(b).

⁵Ibid., sec. 302(a).

These provisions gave new powers to the RFC over individual banks. Through voting power on the preferred stock holdings, the RFC was often in a position to influence the selection of officers and thus to exercise control over policies. While such control was apparently exercised sparingly, and while it was denied that the RFC desired to obtain additional power over banks, the RFC did vote its preferred stock. For instance, the Administration denied that it was control which it was seeking. A letter from President Roosevelt to Chairman Jones of the RFC dated September 26, 1933, reads in part as follows:

I understand the question has been raised in some quarters that the government wants to control the banks through the ownership of preferred stock. Nothing could be further from the truth. The government only wants to help provide banking capital adequate to meet the credit needs of the country, and through buying, and lending upon preferred stock and capital debentures, it accomplishes this without undue demand upon present stockholders.¹

Mr. Jones frequently made similar statements. Upon one occasion he said flatly:

. . . the government has, and has had, only two objectives in view in its preferred stock program. One to strengthen the banks in the interests of depositors, and the other to place banks in such a strong capital position as to enable them to assist in the recovery program by providing legal credit for agriculture, business and industry.

There is no thought of dictating management nor of coercion as to bank policies or bank investment.²

¹"President's Letter on Banks," (dated September 26, 1933, to the Chairman of the RFC), The New York Times, October 2, 1933, p. 3.

²"RFC Chairman Tells New York Bankers That President Expects Banks Assume Full Share of Recovery," The American Banker, XCIX (February 6, 1934), p. 5. See also address by Harvey C. Couch, RFC Director, over a NBC network on November 21, 1933, at Atlanta, Ga., in "Couch Says Fears of Control Illegal," The American Banker, XCVIII (November 22, 1933), p.3.

However, authors on the question point out that:

There are some indications that the RFC may have made considerable use of its potential control. At least there are numerous cases in which banks that have sold preferred stock to the RFC have elected new executive officers who were formerly employees of the RFC or the Comptroller.¹

In examining further, it was found that the RFC did vote the preferred stock the RFC held, and Mr. Jones admitted that the responsibility which stock ownership entailed could not be evaded, indicating that when questions arose the RFC would, and should, be expected to exercise its rights as an owner of the bank's stocks.²

For instance, in early 1934, at the time of the election of Mr. Walter Cummings as chairman of the Continental-Illinois National Bank and Trust Company,³ an RFC statement admitted that the Corporation "felt that some new faces and ideas in the Continental would be helpful," and that it would "insist upon changes where the best interests of the stock-holders and the depositors are involved."⁴ The statement further indicated that in general the voting power would be used to cooperate with the present management, but that in situations where the

¹Cyril Upham and Edwin Lanke, Closed and Distressed Banks (Washington: The Brookings Institution, 1934), p. 238.

²"R.F.C. Will Vote Capital Stock Owned in Banks," American Banker, XCVII (December 16, 1933), p. 1 and p. 5.

³The Continental Illinois Bank of Chicago, then one of the largest banks in the United States, had become deeply involved in the Insull enterprises, and, with their collapse, had been badly in need of new capital. In December, 1933, the bank sold \$50,000,000 in preferred stock to the RFC and wrote down its common stock from \$75,000,000 to \$25,000,000. This recapitalization gave the RFC voting control of the bank.

⁴"RFC States Policy On Preferred Stock Voting Privileges: Will Insist on Changes in Management Where Interests of Stockholders and Depositors Require," The American Banker, XCIX (January 11, 1934), p. 2.

management was unsatisfactory it would be changed.¹

The RFC exercised no voting power through ownership of capital notes or debentures unless they were in default. But should a bank issuing these obligations default on them or become insolvent, the RFC, as the majority holder of the debentures, could assume control of the personnel of the bank and their compensation and of its ownership of real estate. In addition, banks issuing debentures were to agree not to incur other long-term indebtedness without the majority consent of the debenture holders.²

The RFC thus came to possess a large degree of control over the state and national banks which had sold it preferred stock, and a lesser degree over state banks which had issued to it capital notes or debentures. From the standpoint of control, an observation indicates that the RFC had purchased the issues of "nearly half the active banks," in the country as a whole.³ The observation stresses that most of the reorganized banks were included, and that large banks, as well as small, had subjected themselves to RFC control.⁴

The RFC's purchases of preferred stock in banks throughout the

¹Ibid.

²U.S., R.F.C., "Information Regarding Subscriptions for Preferred Stock and Purchases of Capital Notes or Debentures," Circular No. 18 (October, 1934), p. 2.

³Upham and Lanke, op. cit., p. 237.

⁴Ibid.

nation had important implications for the banking system of the country. The stock-purchasing program was of assistance in restoring the impaired capital of banks that had not been permitted to reopen immediately after the banking holiday. The great increase in the number of closed banks after the banking holiday gave rise to demands that RFC loans were to be used to free deposits frozen in such institutions. The reorganization of institutions found to be insolvent at the termination of the bank holiday was also greatly facilitated by their ability to secure capital from the RFC. Furthermore, an act of Congress approved on June 14, 1933,¹ removed the previous limitation of \$200,000,000 on loans of this character,² and on October 15 of the same year the President set up a Deposit Liquidation Board, headed by an RFC director, in order "to stimulate and encourage liquidating agents of banks closed after January 1, 1933, to borrow from the RFC in order that funds may be made available to depositors as quickly as possible."³ It was stated in the White House Statement to establish the Deposit Liquidation Board, that loans would be made up to 50 per cent of a bank's deposits, or more in certain cases, wherever justified by the value of the assets.⁴ Subsequently, after agitation for plans under which the government was asked to pay off depositors in closed banks, the RFC announced that it

¹48 U.S. Stat. at L. (1933), 141, "An Act to Amend the Reconstruction Finance Act . . ."

²See Chapter II, p. 15.

³"White House Statement on the Establishment of the Deposit Liquidation Board, October 15, 1933," The Public Papers and Addresses of Franklin Roosevelt, op. cit., p. 396.

⁴Ibid.

would reappraise assets of such institutions and make loans on a more lenient basis.¹ Later, a determined effort was initiated to extend such investments to other banks to enable them to expand their credit advances. Strengthening of capital structures to meet requirements of the Federal Deposit Insurance Corporation furnished another reason for stock purchases.²

Under these conditions which the financial field faced, the RFC by December 31, 1933, had made loans in the amount of \$17,218,000 to 127 financial institutions, secured by preferred stock of 38 banks and trust companies; made subscriptions for preferred stock of 1,031 banks and trust companies in the amount of \$259,463,000; and purchased capital notes or debentures of 1,276 banks and trust companies in the amount of \$227,119,000,³ aggregating over \$503,000,000 in total, as shown in Table 1. A year later, at the end of 1934, the total had climbed to 7,828 authorizations for loans on preferred stock, or for the purchases of preferred stock, capital notes or debentures of 6,509 banks and trust companies, aggregating \$1,156,000,000, as shown in Table I, with loans in the amount of \$27,281,000, secured by preferred stock of 244 banks and trust companies; subscriptions for preferred stock of

¹Buel W. Patch, "The R.F.C. Under Hoover and Roosevelt," Editorial Research Reports, II (July 17, 1935), 82.

²Only banks found to be solvent by the government could obtain a Federal Deposit Insurance Corporation guarantee of deposits. The fact was that many banks, to attain the required solvency, had to get new capital.

³U.S. RFC, Quarterly Report (ending December 31, 1933), p. 3.

GROWTH OF LOANS AND OTHER AUTHORIZATIONS TO BANKS AND TRUST COMPANIES
FROM FEBRUARY 2, 1932, to DECEMBER 31, 1936, INCLUSIVE¹

(Amount in thousands of dollars)

| Year | Class | Authorized | Disbursed | Outstanding at the end of year |
|------|---|------------|-----------|--------------------------------|
| 1932 | Loans to open banks ² | 949,451 | 850,822 | 594,598 |
| | Loans to closed banks ³ | | | |
| | Purchases of $\frac{1}{4}$ preferred stock, etc. ⁴ | | | |
| | Total | 949,451 | 850,822 | 594,598 |
| 1933 | Loans to open banks | 1,806,069 | 1,429,556 | 711,425 |
| | Loans to closed banks | | | |
| | Purchase of preferred stock, etc. | 503,801 | 264,347 | 264,187 |
| | Total | 2,309,870 | 1,693,903 | 975,612 |
| 1934 | Loans to open banks | 2,263,679 | 1,812,722 | 632,209 |
| | Loans to closed banks | 131 | 22 | 20 |
| | Purchases of preferred stock, etc. | 1,156,904 | 938,004 | 865,084 |
| | Total | 3,420,714 | 2,750,748 | 1,497,313 |
| 1935 | Loans to open banks | 2,394,125 | 1,919,278 | 381,206 |
| | Loans to closed banks | 12,322 | 11,797 | 1,234 |
| | Purchases of preferred stock, etc. | 1,252,019 | 1,040,973 | 899,486 |
| | Total | 3,658,466 | 2,972,048 | 1,281,826 |
| 1936 | Loans to open banks | 2,457,199 | 1,963,256 | 201,432 |
| | Loans to closed banks | 13,112 | 12,273 | 1,324 |
| | Purchases of preferred stock, etc. | 1,259,498 | 1,073,267 | 684,046 |
| | Total | 3,729,809 | 3,048,796 | 886,802 |

¹Source: U.S., R.F.C., Quarterly Report, from 1932 through 1936.

²Loans to banks and trust companies under section 5 of the RFC Act.

³Loans on the assets of closed banks and trust companies under section 5e of the RFC Act.

⁴Loans on and subscriptions for preferred stock, and purchases of capital notes or debentures of banks and trust companies under section 304, Title III, of the act approved on March 9, 1933, "Bank Conservation Act."

3,765 banks and trust companies in the amount of \$710,433,000; and purchases of capital notes or debentures of 2,766 banks and trust companies in the amount of \$419,189,000.¹ By June 30, 1935, the RFC had made authorizations for loans or subscriptions for preferred stock, or for the purchase of capital notes or debentures, to 6,699 banks and trust companies, aggregating \$1,188,461,000.² At this time, Mr. Jones was able to state that the "bank repair" program had virtually been completed.³

Again, the RFC was made an instrumentality through which the government could regulate high salaries of corporation officials. In March, 1933, the Senate included in an RFC bill a provision prohibiting loans to any applicant paying a salary in excess of \$17,500 per year.⁴ This action was modified in conference, and the act as approved June 10, 1933, stipulated that the RFC should not make, renew, or extend any loan to any applicant paying any salary "in excess of what appears reasonable" to the RFC, and unless the applicant agreed, as long as the loan was outstanding, not to increase salaries to

¹Ibid. (ending December 31, 1934), p. 4.

²Ibid. (ending June 30, 1935), p. 3.

³Jones, op. cit., p. 30.

⁴Congressional Record, 73d Cong., 1st sess., vol. 77, pt. 4 (May 24, 1933), p. 4120.

amounts considered unreasonable.¹ In other words, the RFC could prevent such practices only in the case of borrowers from the RFC, and as long as the offending institutions continued to borrow. But, the fact that a bank had to ask the RFC for aid was particular justification for requiring it to pare down exorbitant salaries.²

Thus, this statute (48 U.S. Stat. at L. 120) empowering the RFC to regulate the salaries paid by financial institutions to which it made loans, also gave the RFC a considerable degree of control over the management of banks.

Loans to railroads were the most important activity next to the loans to the financial institutions by the RFC during the earlier part of its career. Mr. Jones claims in his book that, of the 250,000 miles of railroads which interlace the United States, more than one-third went into receivership or bankruptcy during the 1930's, and that another third would have except for loans from the RFC.³

¹48 U.S. Stat. at L. (1933), 120, sec. 4. Under resolutions of the Senate, the Senate Committee on Banking and Currency conducted a series of hearings during October, November, and December 1933, and found out that salaries and bonuses in some cases were entirely out of line with services rendered. For instance, Mr. Albert H. Wiggin, chief executive officer of the Chase National Bank of the City of New York, testified that he received \$175,000 as annual salary and \$100,000 as "bonus" in 1929 from the bank; total \$218,750 in 1930; \$250,000 in 1931; and \$220,300 in 1932. Besides, he received some \$40,000 annually as salaries for additional compensation in connection with other corporations. For details, see U.S., Congress, Senate, Hearings: before the committee on banking and currency (73d Cong., 1st sess.; on S. Res. 84 and S. Res. 56), pt. 5 (October 17 to 25, 1933), pp. 2320-2323, and 2325.

²The same control by the RFC was even more vigorously exerted with regard to railroad executives. See pp. 39 and 41.

³Jones, op. cit., p. 109.

However, the amount of RFC financing to railroads was small compared to aid which was given to the railroads during and after World War I. During that War, carriers borrowed \$1,080,000,000 from the government, and of that amount approximately \$1,043,000,000 was repaid, along with \$217,000,000 interest.¹ In contrast, RFC loans to railroads aggregated \$284,311,000 by December 31, 1932; \$394,094,000 by December 31, 1933; and stood at \$447,000,000 at the end of 1934, as shown in Table 2.

In connection with the loan of \$23,200,000 to the Southern Pacific Company in May 1933, salary reductions were first ordered by the RFC, ranging from 10 per cent on \$4,800 to 60 per cent on salaries of more than \$100,000. At that time, the salaries of the officers of the Southern Pacific Company were: Hale Holden, chairman of the executive committee, \$150,000; Paul Shoup, president, \$100,000; A. D. McDonald, vice-president of the Executive Board, \$85,000.² When the Southern Pacific Company received the loan from the RFC in May 1933, the company had to accept the order of the salary cut formulated by the RFC, limiting their salaries to: Mr. Holden \$60,000; Mr. Shoup \$50,000; and Mr. McDonald \$42,500.³ The RFC successively imposed similar

¹F.R. Dick, "When Government Rules the Rails," Savings Bank Journal, (March 1934), p. 23. And also E.S. Mead, "Why R.F.C. Loans to Railroads Fail," Savings Bank Journal (May 1933), pp. 5-7.

²Jones, op. cit., p. 110.

³Ibid.

Table 2

GROWTH OF LOANS TO RAILROADS FROM FEBRUARY 2, 1932, to DECEMBER 31, 1940¹

| Year | (Amount in thousands of dollars) | | | |
|------|----------------------------------|-----------------|--------------|--------------------------------------|
| | Loans authorized | Loans disbursed | Loans repaid | Loans outstanding at the end of year |
| 1932 | 337,435 | 284,311 | 11,839 | 272,472 |
| 1933 | 411,846 | 394,094 | 57,014 | 337,080 |
| 1934 | 457,856 | 447,283 | 70,728 | 376,555 |
| 1935 | 494,376 | 487,217 | 90,967 | 396,250 |
| 1936 | 623,519 | 517,126 | 171,146 | 345,980 |
| 1937 | 643,597 | 537,126 | 181,233 | 355,893 |
| 1938 | 745,872 | 625,100 | 189,006 | 436,094 |
| 1939 | 802,021 | 665,110 | 216,318 | 448,792 |
| 1940 | 911,604 | 786,604 | 312,723 | 473,881 |

¹ Source: U.S., R.F.C., Quarterly Report (from February 2, 1932, to December 31, 1940, inclusive).

salary limitations in all loans to railroads as well as to other corporations asking RFC help.¹

In the fall of 1933, the RFC attempted to meet the credit needs of small and medium-sized business enterprises by urging the formation of community mortgage-loan companies through which loans might be made to business men unable to obtain necessary credit at the banks.² When this program failed to develop satisfactorily, agitation increased for direct loans to industry by some agency outside the banking system. Provision for such loans, both by the Federal Reserve banks and by the RFC, was finally made by amendments to both the Federal Reserve Act and the RFC Act as Section 13b and Section 5d respectively, approved on June 19, 1934.³

Under Section 5d of the RFC Act, the RFC was authorized:

. . . to purchase the securities and obligations of, and to make loans to, any business enterprise . . . either directly or in cooperation with banks or other lending institutions through agreements to participate or by the purchase of participations, or otherwise.⁴

¹Ibid., pp. 111-112.

²For the formation of community mortgage-loan companies, see Buel W. Patch, "The R.F.C. Under Hoover and Roosevelt," Editorial Research Reports, (July 17, 1935), 82-84.

³48 U.S. Stat. at L. (1934), 1105-1113.

⁴Ibid., 1108, sec. 5. This section was added to section 5 of the RFC Act as section 5d.

The section defined a number of governing conditions: (1) capital and credit at prevailing rates for the type of loan applied for must not be otherwise available at banks, (2) adequate security must be provided, (3) the applicant must be solvent, (4) continued or increased employment must be proved, (5) the amount of the loan must not exceed \$500,000 to one borrower and the aggregate amount of such loans outstanding at one time was¹not to exceed \$300,000,000, and (6) the term of the loan must not exceed five years.

Unlike Section 13b of ~~the~~ Federal Reserve Act, the RFC's authority to make business loans had been modified on several occasions. The Act of January 31, 1935, extending the RFC's lending authority for two years, sought to broaden the availability of such loans by modifying the language of the act that loans should be "so secured as reasonably to assure repayment," instead of requiring that loans should be "adequately secured."² It also lengthened the original five-year maturity requirement provided for in the amendment of June 10, 1934, by permitting them to mature not later than January 31, 1945.³ The new legislation authorized business loans to "any institution, now or hereafter established, financing principally the sale of electrical, plumbing

¹Ibid.

²Cf. 49 U.S. Stat. at L. (1935), 3, sec. 4(a) with 48 U.S. Stat. at L. (1934), 1108, sec. 5.

³Cf. 49 U.S. Stat. at L. (1935), 2, sec. 3 with 48 U.S. Stat. at L. (1934) 1108, sec. 5.

or air conditioning appliances or equipment or other household appliances both urban and rural,"¹ and "upon sufficient security" to corporations, individuals, and partnerships engaged in mining, milling, or smelting ores, or in the development of deposits of gold, silver, or tin ore.²

However, as a result of the general recovery in business and of the improved liquidity of the banks in 1936 and 1937, it was believed that direct governmental financial assistance to business was no longer needed. In view of this situation and recognizing the emergency nature of the RFC's activities, as has been examined in Chapter II of this study,³ the President, on October 18, 1937, significantly directed the RFC to discontinue taking applications for loans.⁴

A few months later, however, when the unexpected business recession of 1938 began to reach serious proportions in the nation's economy, the RFC again began to extend credit under the terms of its legislation. Under this situation, one of the most important revisions to the RFC Act was effected as of April 13, 1938, further liberalizing authority

¹49 U.S. Stat. at L. (1935), 4, sec. 10

²Ibid., sec. 14.

³See pp. 3-19.

⁴The lending authority of the RFC was terminated on October 18, 1937, by the direction of the President and was resumed on February 18, 1938, also by the direction of the President. See U.S., Congress, Senate, "Purchases and Loans by the Reconstruction Finance Corporation," Hearing: Before the Committee on Banking and Currency, 75th Cong., 3d sess., on S. 3735, p. 4.

and broadening the scope of the RFC's activities in the business loan field.¹ Whereas, formerly, loans could be made only for the purpose of maintaining or increasing employment, under the amendment of 1938 loans could be made to business enterprises if they were promoting the "economic stability of the country or encouraging the employment of labor."²

Limitations as to length of maturity were completely removed, allowing the RFC to set maturities at its own judgment; removed, too, was the limit upon the aggregate amount which could be outstanding.³ In addition, the RFC was authorized to purchase securities from business, as well as to make loans.⁴ Finally, the requirement that loans "be so secured as reasonably to assure repayment" was further liberalized; instead, a provision was inserted that all loans made and securities purchased should be "of such sound value, or so secured, as reasonably to assure retirement or repayment,"⁵ but the condition that such loans could be made only if credit was not otherwise available was retained in the amended act of April 13, 1938.⁶

¹52 U.S. Stat. at L. (1938), 212-213.

²Cf. 52 U.S. Stat. at L. (1938), 212, with section 5d of the RFC Act prior to the amendment of April 13, 1938.

³Ibid.

⁴Ibid.

⁵Ibid. See also U.S., Congress, House, "Loans to Public Agencies and business enterprises by Reconstruction Finance Corporation," Hearings: Before the Committee on Banking and Currency, 75th Cong., 3d sess., on H.R. 10055 (superseded by S. 3735), p. 25.

⁶52 U.S. Stat. at L. (1938), 212.

Congressional hearings in connection with this revision (amendment to the RFC Act approved on April 13, 1938) found the committee members uncertain as to whether this language would permit unsecured loans, but Mr. Jesse H. Jones, who was still chairman of the RFC, indicated that it would not be so construed,¹ and the instructions issued by the Corporation continued to require first mortgage or other first-lien security.² Likewise, the RFC did not construe the authority to purchase securities to include any securities other than bonds meeting the same conditions as those specified for loans.³

This amendment was followed by a flood of new loan applications which were made possible by the RFC's newpower to grant loans of whatever maturity it should judge best. Business loan authorization jumped as indicated in Table 3, from \$5,027,000 in the first quarter of 1938 to \$34,266,000 in the second quarter, and reached a peak of \$54,591,000 in the third quarter of 1938. The figures would seem to indicate that at least some business enterprises were in need of long-term loans and were unable to secure them through the regular channels.⁴

¹U.S., Congress, House, Hearings: Before the Committee on Banking Currency on H.R. 10055 (superseded by S. 3735), (75th Cong., 3d sess., March 29, 1938), pp. 29-30.

²U.S., R.F.C., "Information Regarding Loans to Business Enterprises," Circular No. 13 (Revised), p. 3.

³Ibid.

⁴For a further discussion, see Chapter V, pp. 282-287.

Table 3

GROWTH OF BUSINESS LOANS UNDER SECTION 5d OF THE RFC ACT
DURING 1937 AND 1939¹

(Amount in thousands of dollars)

| Year | Quarter | Loans authorized | Loans disbursed | Loans repaid | Loans outstanding at end of quarter |
|------|---------|------------------|-----------------|--------------|-------------------------------------|
| 1937 | First | 152,231 | 78,592 | 15,099 | 63,493 |
| | Second | 156,827 | 88,014 | 17,465 | 79,594 |
| | Third | 161,974 | 93,096 | 19,995 | 73,101 |
| | Fourth | 163,695 | 97,986 | 23,193 | 74,793 |
| 1938 | First | 168,722 | 99,390 | 26,702 | 72,688 |
| | Second | 202,978 | 106,169 | 29,798 | 76,371 |
| | Third | 257,569 | 130,746 | 34,021 | 96,725 |
| | Fourth | 291,006 | 150,438 | 42,691 | 107,747 |
| 1939 | First | 319,532 | 160,618 | 48,771 | 112,047 |
| | Second | 351,125 | 173,706 | 56,626 | 117,080 |
| | Third | 395,604 | 204,701 | 74,076 | 130,625 |
| | Fourth | 403,055 | 214,285 | 83,581 | 130,704 |

¹ Source: U.S., R.F.C., Quarterly Report (from 1937 to 1939).

Through December 31, 1940, commitments to business enterprises under all of the above-mentioned legislation had totaled \$446,596,000,¹ including \$102,884,000 in bank participations. Disbursements by the RFC came to \$219,020,000 and by banks to \$20,531,000. On the RFC's disbursements, \$112,015,000 was still outstanding as of December 31, 1940, and of the disbursements by banks, \$9,253,000.²

The Act of June 19, 1934 which authorized the RFC to make business loans further gave an authorization for the RFC "to make loans upon full and adequate security, based on mineral acreage, to recognized and established incorporated managing agencies of farmers' cooperative mineral rights pools not engaged in drilling or mining operations, said loans to be made for the purpose of defraying the cost of organizing such pools."³ In addition the RFC was "authorized and empowered to make loans upon adequate security, based on mineral acreage, to recognized and established incorporated agencies, individuals, and partnerships engaged in the business of mining, milling, or smelting of ores."⁴

Six months later Congress authorized RFC loans to corporations, individuals, and partnerships for the development of new mineral properties when there was "sufficient reason to believe that, through

¹See Table 4 on p. 71 in this chapter.

²R.F.C., Quarterly Report (for the period from February 2, 1932, to December 31, 1940, inclusive), p. 8.

³48 U.S. Stat. at L. (1934), 1112, sec. 13.

⁴Ibid., sec. 14.

the use of such loan . . . there will be developed a sufficient quantity . . . to pay a profit upon mining operations."¹ The loans were limited to not more than \$20,000 each, and the total sum for these purposes was limited to not more than \$10,000,000.²

However, because of the speculative nature of these loans, disbursements were small. From a total authorization of \$16,575,000, only \$6,490,000 was loaned by the end of 1940; and half of the loans had been repaid by this time.³

The Act of June 19, 1934, also authorized the RFC to lend to school districts to pay teachers' back salaries due prior to June 1, 1934, where the district was able to give satisfactory security.⁴ However, because of the security requirements in the act, so far there has been only one such loan (of \$22,500,000) made during RFC's entire operation.⁵

Aid to agriculture was one of the RFC's most important functions. At the very bottom of the depression, in 1932 and 1933, the RFC through the Regional Agricultural Credit Corporations made loans of nearly

¹49 U.S. Stat. at L. (1935), 5, sec. 12.

²Ibid.

³U.S., R.F.C., Quarterly Report (ending December 31, 1940) p. 10

⁴48 U.S. Stat. at L. (1934), 1113, sec. 16.

⁵The only school district which could qualify for a loan was the Chicago Board of Education. This school authority owned very valuable business property in the Loop district of Chicago. Jesse Jones, "Billions Out and Billions Back," The Saturday Evening Post (July 31, 1937), p. 66. Also R.F.C., Quarterly Report, (ending September 30, 1934), p. 2.

\$160,000,000 to farmers and stockmen in every state of the Union.¹

Mr. Jones describes the activities of the Regional Agricultural Credit Corporations during the depression as follows:

While under RFC direction, Regional Agricultural Credit Corporations paid out from five to six million dollars each week. A fifth of their loans were for less than \$250. The largest single class of loans was in the \$500 to \$1,000 category, but there were quite a few really large ones, thirty-seven being above \$100,000 each.²

However, Mr. Jones points out that the RFC's miscellaneous aids to farmers and stockmen were helpful, but "what really saved the whole country from disaster," in his view, "was the work of the Commodity Credit Corporation."³ The CCC was created by Executive Order No. 6340 on October 16, 1933, under the laws of Delaware.⁴ Its entire capital stock of \$3,000,000 was subscribed and held by the Secretary of Agriculture and the Governor of the Farm Credit Administration on behalf of the United States. Pursuant to the act of April 10, 1936,⁵ the capital

¹U.S., R.F.C., Quarterly Report, period 1932-33. See also Jones, op. cit., p. 92.

²Jones, op. cit., p. 92.

³Ibid.

⁴Formation of the Commodity Credit Corporation. Executive Order No. 6340. October 16, 1933, in The Public Papers and Addresses of Franklin D. Roosevelt, compiled and collated by Samuel I. Rosenman (New York: Random House, 1938), vol. 2 (1933), pp. 404-406.

⁵49 U.S. Stat. at L. (1936), 1191, "An Act To enable the Commodity Credit Corporation to better serve the farmers in orderly marketing, and to provide credit and facilities for carrying surpluses from season to season."

stock was increased to \$100,000,000, the RFC acquiring the additional \$97,000,000. In addition the RFC supplied the CCC with a considerable line of credit, totaling \$767,717,000 up to the time when Congress finally (in 1938) gave the CCC direct authority to borrow for its requirements with government guarantee and without going through the RFC.¹

The CCC was authorized to make loans upon such farm commodities as might from time to time be designated by the President. The object was to contribute to the support of farm prices by enabling producers to hold on to their products which might otherwise have been dumped with resulting price declines. The loans have thus made it possible for the farmers themselves to get the advantage of eventual price increase which otherwise would have been lost to them.

While technically there was no connection other than the presence of several RFC officers on the Board of the CCC, the latter was actually made an integral part of the RFC in order to avoid expense and duplication. Direct disbursements on loans to farmers were made by RFC agents, but the bookkeeping transaction recorded a loan by the RFC to the CCC and subsequently a loan by the latter corporation to the farmer. In this manner the money "borrowed" by the CCC did not pass through its hands at all, except as the RFC employees were considered its agents.²

¹U.S., R.F.C., Quarterly Report (from 1933 through 1938).

²John McDiarmid, Government Corporations and Federal Funds (Chicago: University of Chicago Press, 1938), p. 165.

In connection with the aid to agriculture in the 1930's, it should be noticed that in June and July of 1933 the RFC lent some \$15,400,000 to the Chinese government for wheat, flour, and cotton purchases, and made small loans to exporters to finance shipments of cotton to the Soviet Union.¹ This was done because one of the problems facing American agriculture during the depression was to increase its export of agricultural commodity surpluses. To help solve this problem, the Government abandoned traditional opposition to export subsidies and subsidized shipments to foreign nations, at first through the RFC.

But the large increase in loans on agricultural commodities in 1933 and later resulted from a provision of the Agricultural Adjustment Act of May 12, 1933,² making processors, producers, and others engaged in the handling of agricultural commodities eligible for RFC assistance in carrying out marketing agreements.³ It was asserted that loans to farmers under this provision, through the CCC set up for the purpose, helped to increase and maintain commodity prices.

Under the Emergency Farm Mortgage Act,⁴ which was the companion of the Agricultural Adjustment Act of 1933, approved May 12, 1933, the RFC

¹ Patch, *op. cit.*, p. 83.

² 48 U.S. Stat. at L. (1933), 31-44, "Agricultural Adjustment Act of 1933."

³ Ibid., sec. 5.

⁴ 48 U.S. Stat. at L. (1933), 45-54, "Emergency Farm Mortgage Act of 1933."

was authorized to make loans to drainage, levee, and irrigation districts to aid in refinancing outstanding indebtedness.¹ The Emergency Farm Mortgage Act of 1933 also allocated the sum of \$200,000,000 of RFC funds to the Farm Loan Commissioner for direct loans to farmers for refinancing indebtedness, providing working capital, or redeeming fore-closed property.²

A rise in prices in the spring and early summer of 1933 halted temporarily the tinkering with the currency by the government under the authority of the Bank Conservation Act and the Agricultural Adjustment Act. However, when prices declined in the early autumn simultaneously with the marketing of summer crops, agitation for inflation revived. At this point, the Administration decided to attempt inflation by reducing the gold content of the dollar.

As a means to that end President Roosevelt on October 22, 1933, announced the establishment of a government market for gold in the United States and the authorization of domestic and foreign purchases and sales of gold by the RFC.³ By executive order the RFC was authorized, "subject to such regulations as may from time to time be prescribed by the Secretary of the Treasury, to acquire gold which has been received on consignment by the United States mint or assay office, and to hold, earmark for foreign account, export, or otherwise dispose of such gold."⁴

¹Ibid., sec. 36.

²Ibid., sec. 32.

³"The Fourth 'Fireside Chat'--'We Are on Our Way, and We Are Headed in the Right Direction,' October 22, 1933," The Public Papers and Addresses of Franklin D. Roosevelt (New York: Random House, 1930), p. 426.

⁴Ibid.

The significance of this order lay in the fact that the RFC was authorized to acquire gold without any limitation, except determining price, which was subject to prior consultation with the Secretary of the Treasury.¹ At that time the statutory price for mints, assay offices, and Federal Reserve banks remained fixed at \$20.67 an ounce. The RFC, starting October 26, 1933, began buying domestic gold at the price of \$31.36 per ounce. This represented an advance over the world price of 27 cents an ounce. The next day there was a further advance of 18 cents an ounce, followed by advances of 22 cents and 6 cents on succeeding days. On October 29, 1933, the price set by the RFC stood at \$31.82, and the world price at \$30.57.²

The early phase of the gold purchases had little influence on domestic prices. The value of the dollar in the foreign market likewise did not move in harmony with the advancing gold price. Consequently, on October 29, 1933, a broadening of the gold buying policy was announced. The RFC was authorized not only to buy domestic gold but also to buy it in the open world market.³ In the period from October 26, 1933, to January 15, 1934, the RFC purchased \$108,800,000 of foreign gold and \$23,400,000 of domestic gold. During the remainder of January, the Treasury purchased \$55,600,000 of gold, making the total purchases of the government from October 26, 1933 to January 31, 1934, amount to

¹Gove Griffith Johnson, Jr., The Treasury and Monetary Policy, 1933-1938 (Cambridge, Mass.: Harvard University Press, 1939), p. 22.

²American Institute of Banking, Banking and the New Deal (New York: American Institute of Banking, 1933), p. 42.

³Ibid., p. 43.

\$187,800,000. When the dollar was revalued on January 31, 1934, the direct governmental gold-buying program came to an end.¹

In March 1935, the RFC, having come into possession of all the common stock of the Webster and Public Utilities Securities Corporation as a result of the default of the Dawes bank loan, came into the utility business whether the RFC wanted to or not.² The Webster and Public Utilities Securities Corporation had pledged among other securities for a \$2,000,000 loan from the defunct Central Republic Trust Company of Chicago, known as the Dawes bank, 80,000 shares, the entire common and voting capitalization of the Webster and Public Utilities Securities Corporation. The 80,000 shares had subsequently been turned over to the RFC among other collateral for the \$90,000,000 loan to the Dawes bank. On the other hand, the Webster and Public Utilities Securities Corporation, in turn, held voting trust certificates for 500,000 shares of the Utilities Power and Light Corporation, which controlled about two thousand public utility plants in the Middle West.³

In March 1935, the RFC took over management of the Webster and Public Utilities Securities Corporation, elected a majority of its board, ousted Harley L. Clarke, "a figure in the utility world," as its head on the ground that this was necessary to safeguard the RFC's investment.⁴

¹Ibid.

²Gilbert H. Montague, "New Deal Costs and the High Cost of Living: RFC" The Annals of the American Academy of Political and Social Science, 183, (January 1936), 251.

³The 50,000 shares of the Utilities Power & Light Corporation were an amount that was looked upon as constituting working control of the Utilities Power & Light Corporation, but which, it developed, was not.

⁴Patch, op. cit., 85.

Subsequently it undertook to form a voting trust to consolidate control of the Utilities Power & Light Corporation.

However, four months later, in July 1935, the RFC turned over the collateral of the Webster and Public Utilities Securities Corporation to the Atlas Corporation, including the entire common stock and voting interest of the Webster and Public Utilities Securities Corporation, which, in turn, meant the 500,000 shares of the Utilities Power & Light Corporation.¹

Ordinarily collateral acquired through foreclosure or by agreement with borrowers was disposed of directly by the RFC. However, a subsidiary, the Consolidated Realty Corporation, was organized in 1938 for the purpose of administering and liquidating the collateral acquired from the loan made in 1932 to the Prudence Company, Inc.²

The RFC transferred the collateral acquired in the Prudence foreclosure to the Consolidated Realty Corporation at an assigned value of \$14,595,716 and accepted the Consolidated's note for this amount, the assets transferred being pledged as collateral to the note. The acquired collateral included the entire capital stock of several real estate corporations which owned capital stock in other corporations and owned participations in real estate syndicates. Thus the Consolidated became the parent company of a number of real estate corporations. Most of the property owned by these subsidiary companies was located in New York City

¹
Ibid.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947. (House Doc. No. 468; 81st Cong., 2d sess.), p. 60.

and consisted of hotels, theaters, office buildings, and miscellaneous properties.¹

The management of the Consolidated Realty Corporation and its subsidiaries was vested in a special representative of the RFC acting as general manager and serving in the capacity of a director of the various corporations. The special representative reported directly to the RFC Board of Directors. The Board relied upon these reports, supplemented by reports from its internal auditors, to discharge its responsibility for administering the affairs of the Consolidated.²

The economic collapse of the early thirties had particularly devastated the mortgage market of the country which had been weakened by unsound financial practices. As a result, very little private capital was re-entering the mortgage market. Private capital was frightened. As time went on, government agencies such as the Home Owners Loan Corporation³ and the Federal Housing Administration⁴ were set up to cope with the problems in the residential field, while the Federal Farm Mortgage Corporation⁵ and other agencies⁶ were aiding

¹Ibid.

²Ibid. It was not until the end of June, 1950, that the liquidation of the Consolidated Realty Corporation was substantially completed.

³48 U.S. Stat. at L. (1933), 128-135, "Home Owners' Loan Act of 1933."

⁴48 U.S. Stat. at L. (1934), 1246-1265, "National Housing Act, Approved June 27, 1934."

⁵48 U.S. Stat. at L. (1933), 45-54, "Emergency Farm Mortgage Act of 1933."

⁶Such as the Commodity Credit Corporation, Federal land banks, Joint-stock land banks, Agricultural credit corporations, Livestock credit corporations, etc.

agriculture. Thus, in January 1935, the RFC requested permission from Congress to invest up to \$100,000,000 in the capital stock of mortgage companies to aid the refinancing of existing mortgages, in the hope of thus encouraging private capital.

The RFC's hope was incorporated in the Act of January 31, 1935, which authorized the RFC, with the approval of the President, to use \$100,000,000 "to assist in the reestablishment of a normal mortgage market" by purchasing the capital notes or debentures, of any national mortgage association organized under the National Housing Act or of any mortgage-loan company or similar financial institution engaged principally in the mortgage-loan business. Pursuant to this provision the RFC, on March 14, 1935, incorporated the RFC Mortgage Company with an initial paid-in capital stock of \$10,000,000.¹

The purpose of the company was to assist the reestablishment of a normal mortgage market, to make loans on income-producing real properties for construction or refinancing, and to purchase certain federally insured mortgages.² The powers conferred upon it by its charter were extremely broad, and through the RFC Mortgage Company the RFC was enabled to make loans on first mortgages on income-producing properties not eligible for financing by other government or government-sponsored credit agencies, such properties including apartment houses having more

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, the RFC Mortgage Company, and Federal National Mortgage Association for the Fiscal Year Ended June 30, 1945 (House Doc. No. 450; 80th Cong., 2d sess.), p. 3.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945, (House Doc. No. 316; 80th Cong., 1st sess.), p. 38.

than four apartments, hotels, and office buildings, etc. The Company was also able to make loans to distressed holders of first-mortgage bonds and loans for construction of new buildings.

Up to December 31, 1940, the RFC Mortgage Company had refinanced mortgages on income-producing properties totalling \$146,125,000, of which \$27,399,000 was for financing large-scale housing projects insured by the Federal Housing Administration.¹ It also dealt in insured mortgages on old residences.

More important than RFC's aid to income-producing properties and old residences, however, was its help in establishing a market for FHA-insured mortgages on new residences and rental housing projects. The National Housing Act of 1934 (48 U.S. Stat. at L., 1246-1265) provided for the organization of national mortgage associations to buy FHA-insured mortgages and to create a market for them.² As a result, the RFC Mortgage Company went into the business of buying FHA mortgages on new constructions at a discount of 0.5 to 1 per cent and selling them to investors at a slight premium sufficient to cover the administrative cost.

On February 10, 1938, the RFC again organized the Federal National Mortgage Association. This wholly owned subsidiary of the RFC acted as a bank of discount for the FHA mortgages on new construction under the provisions of the National Housing Act of 1934.

¹U.S., R.F.C., Quarterly Report (ending December 31, 1940), p. 8.

²48 U.S. Stat. at L. (1934), 1247, sec. 4.

Through these two subsidiaries--the RFC Mortgage Company, and the Federal National Mortgage Association--the RFC carried on in part its lending activities. The affairs of these subsidiaries were administered through the same organization as were the affairs of the RFC, whose directors were the majority directors of the subsidiaries. For this and other reasons, the two subsidiaries were regarded generally as operating divisions of the RFC.¹

The Export-Import Bank of Washington was incorporated in the District of Columbia under an executive order of the President dated February 2, 1934,² under the authority granted by the National Industrial Recovery Act of June 16, 1933, and the RFC Act of January 22, 1932, as well as under the Bank Conservation Act of March 9, 1933.³ It was intended to assist in the financing of trade with the Soviet Union which the United States Government had recently recognized. However, because of the breakdown in debt negotiations no credits were ever granted to the Soviet Union through this Bank. The original idea was to have different banks

¹The report of the Comptroller General of the United States has been treating these two subsidiaries with this same view. See, for instance, the reports on audit by the Comptroller General which appeared in House Doc. Nos. 316 and 450 of the 80th Congress, 1st Session; Nos. 458 and 638 of the 80th Congress, 2d Session; No. 367 of the 82d Congress, 2d Session; No. 104 of the 83d Congress, 1st Session; and others. For a further development of these subsidiaries, see Ch. IV, p. 88 and Ch. V, pp. 183-187.

²The Export-Import Bank of Washington Is Created. Executive Order No. 6581. February 2, 1934, "The Public Papers and Addresses of Franklin D. Roosevelt, op. cit., vol. 3 (1934), p. 76.

³U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, for the Fiscal Year Ended June 30, 1945. (House Doc. No. 450) 80th Cong., 2d sess.), p. 42.

for various countries, but that idea was almost immediately abandoned as too complex to be practical.¹ Thus, when in this same year financing with Cuba and other countries was needed, a second Export-Import Bank was instituted to deal with "all countries except Russia."² This second Export-Import Bank, after a brief existence, was merged with the first Bank, and its charter was terminated by Executive Order No. 7365 dated May 7, 1936.³

The total amount of preferred stock of the Export-Import Bank of Washington authorized to be issued by its charter was subscribed and paid for by the RFC. At the end of 1940, the RFC held \$74,000,000 of the preferred stock,⁴ and during first quarter of 1941, the RFC subscribed an additional \$100,000,000 of preferred stock,⁵ thus bringing the total subscription of the preferred stock to \$174,000,000.⁶

¹U.S. State Department, The Export-Import Bank of Washington: The First Ten Years (Publication 2234; Commercial Policy Series 75; ed. by Eleanor Lansing Dulles; Washington, D.C.: Government Printing Office, 1944), p. 5.

²U.S., Congress, House, "To Extend the Functions of the Reconstruction Finance Corporation," Hearings: Before the Committee on Banking and Currency, 74th Cong., 1st sess., on H.R. 4240 (S. 1175), pp. 61-62.

³Ibid. On January 31, 1935, by Public Law 1, 74th Congress, the first Export-Import Bank was given the legal form under which most of its operations had been carried on, and shortly thereafter the trustees of the two Banks voted to liquidate the second Bank. 49 U.S. Stat. at L. (1935), 4, "Joint Resolution To Extend the functions of the Reconstruction Finance Corporation for two years, and for other purposes," sec. 9.

⁴U.S., R.F.C., Quarterly Report, quarter ended December 31, 1940, p.7.

⁵Ibid., quarter ended March 31, 1941, p. 2.

⁶For a further development of the Bank see pp. 97-98.

The operations of the Bank had been small until 1940, with disbursements totaling less than \$62,000,000.¹ Prior to the amendment of 1940 the most noteworthy loans, in respect to size or the uses to which they were put, were made to Chile, China, Cuba, Brazil, Finland, and Haiti. Among the loans made, the loan of \$25,000,000 in 1939 to the Chinese-owned Universal Trading Corporation of New York was made to assist United States exports of agricultural and industrial products and the importation of tung-oil to the United States, but this transaction was generally recognized as a sign of official support of China in her war with Japan.² It was therefore not exclusively economic in significance. The Bank soon became a definite instrument of American foreign policy. An examination of this question together with a further development of the Bank will be made in the following chapter.³

After the Southern California earthquake in March 1933, Congress authorized the RFC "to make loans to non-profit corporations . . . organized for the purpose of financing the repair or construction of buildings or structures . . . damaged or destroyed by earthquake, conflagration, tornado, cyclone, or flood in the year 1933, and in the months of January and February 1934," and "deemed by the Reconstruction

¹U.S., State Department, The Export-Import Bank of Washington: The First Ten Years, op. cit., p. 10.

²U.S., State Department, "Repayment of Chinese Loan," and "American Aid to China Since 1931," Bulletin, VI and X (March 28, 1942; April 15, 1944), 260 and 350-65.

³See pp. 94-98.

Finance Corporation to be economically useful or necessary."¹ Similar directions were given to the RFC by Congress after the tornadoes in Kansas, Mississippi, and Georgia in the same year, and other damages of similar nature during years 1933 and 1936 inclusive.² These loans amounted to \$12,000,000 and by December 31, 1940, almost 90 per cent of them had been repaid.³

However, in early 1937, the Ohio-Mississippi Valley was devastated by floods. No part of the funds made available by the above authorizations could be used to aid those who sustained property loss or damage in that catastrophe, because the provisions of the authorizations limited such aid to catastrophes occurring only in the years 1933 to 1936 inclusive. It was deemed desirable, nevertheless, that financial assistance be given by the Government to ease the distress caused by the 1937 floods. Hereupon the Disaster Loan Corporation was brought into existence.

The Disaster Loan Corporation was created by an Act of Congress approved February 11, 1937.⁴ Under the provision of the act, the RFC

¹48 U.S. Stat. at L. (1934), 589, "An Act Authorizing the Reconstruction Finance Corporation to make loans to nonprofit corporations for the repair of damages caused by floods or other catastrophes, and for other purposes," approved April 13, 1934.

²U.S., R.F.C., Quarterly Report (from 1933 to 1936 inclusive).

³Ibid. (quarter ended December 31, 1940), p. 10.

⁴50 U.S. Stat. at L. (1937), 19, "An Act To provide for loans made necessary by floods or other catastrophes in the year 1937," approved February 11, 1937.

was directed to furnish the DLC with capital up to \$20,000,000 and to appoint officers and agents to manage the corporation.¹ During its first year of existence, the DLC was owned by the RFC, which subscribed and paid for a total of \$20,000,000 or the entire capital stock of the DLC.² Ownership was transferred to the Treasury Department in February 1938, and the RFC was reimbursed for its investment. However, the DLC was managed throughout its existence by the RFC, the directors of the DLC having been granted the authority to establish rules and regulations governing its operation. The RFC made a formal delegation of the management responsibility to two managing directors, but the operations of the DLC were conducted, in practical effect, as though it were a division of the RFC and not a separate corporation. Like all other RFC activities after July 1939 its operations came under the general supervision of the Federal Loan Administrator, and its affairs were conducted through the RFC organization in Washington and in 31 loan agency offices in various cities of the United States. The DLC had no employees of its own.³ Thus, the DLC was duly considered as an affiliate but not a subsidiary of the RFC.⁴

The DLC was originally given authority to make such loans as might be necessary or appropriate because of floods or other catastrophes in

¹Ibid.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, for the Fiscal Year Ended June 30, 1945: Disaster Loan Corporation (House Doc. No. 623, 80th Cong., 2d sess), p.3

³Ibid., p. 2.

⁴Ibid., p. 1.

the year 1937.¹ Subsequent legislation² increased the capital stock to not to exceed \$40,000,000 and provided for the making of loans considered necessary or appropriate because of floods or other catastrophes occurring during the period between January 1, 1936, and January 22, 1947.

The DLC had advanced \$23,600,000 to some 11,000 catastrophe victims as of June 30, 1940. Among the loans, more than \$8,600,000, representing 7,500 loans, was authorized as a result of the Ohio River flood in 1937; and following the hurricane which caused widespread damage in the New England States in September 1938, a total of 1,880 loans was authorized involving approximately \$4,062,000.³

By joint resolution approved June 30, 1945,⁴ the DLC was dissolved, effective July 1, 1945, and its functions, powers, and duties, together with its assets and liabilities, were transferred to the RFC to be

¹50 U.S. Stat. at L. (1937), 19, "An Act To provide for loans made necessary by floods or other catastrophes in the year 1937," approved February 11, 1937.

²50 U.S. Stat. at L. (1937), 211, "Joint Resolution To extend the lending authority of the Disaster Loan Corporation to apply to flood disasters in the year 1936," approved, May 28, 1937; 52 U.S. Stat. at L. (1938) 84, "An Act To extend the lending authority of the Disaster Loan Corporation to apply to disasters in the year 1938," approved, March 3, 1938; 53 U.S. Stat. at L. (1939), 510, "An Act To continue the functions of the Reconstruction Finance Corporation, and for other purposes," approved March 4, 1939; and 59 U.S. Stat. at L. (1945), 310, "Joint Resolution To transfer to the Reconstruction Finance Corporation the functions, powers, duties, and records of certain corporations," approved, June 30, 1945.

³U.S., R.F.C., Annual Report and Financial Statements (June 30, 1947), p.7.

⁴59 U.S. Stat. at L. (1945), 310, "Joint Resolution To transfer to the Reconstruction Finance Corporation the functions, powers, duties, and records of certain corporations."

exercised and administered in the same manner and to the same extent as if they had originally been vested in the RFC.¹

The Rural Electrification Administration was established by Executive Order No. 7037, issued on May 11, 1935, under authority of the Emergency Relief Appropriation Act of 1935.² The purpose of the REA, as outlined in the Order, was "to initiate, formulate, administer, and supervise a program of approved projects with respect to the generation, transmission, and distribution of electric energy in rural areas."³ A year later, by an act of Congress (Rural Electrification Act of 1936), approved May 20, 1936,⁴ the authority of the REA was made more specific, and the funds for its operation were provided. In order to implement the general ends of the REA outlined in the Executive Order No. 7037, the act authorized the REA to make loans to responsible applicants for "the construction and operation of generating plants, electric transmission and distribution lines or systems for furnishing of electric energy to persons in rural areas who are not receiving central station services."⁵ And for the wiring of the premises

¹For a further development, see p. 160.

²49 U.S. Stat. at L. (1935), 115, "Emergency Relief Appropriation Act of 1936," approved, April 8, 1935.

³Morris L. Cooke, "Municipalities and R.E.A.," National Municipal Review, XXV (May 1936), 262.

⁴49 U.S. Stat. at L. (1936), 1363-1367, "Rural Electrification Act of 1936," approved May 20, 1936.

⁵Ibid., sec. 4.

of persons living in rural areas and the purchase and installation of electrical and plumbing equipment.¹

The RFC, under the provisions of the Rural Electrification Act of 1936, was authorized and directed to make loans to the REA upon the security of the obligations of borrowers from the REA. Under the same act, the aggregate amounts of loans were not to exceed \$50,000,000, for the fiscal year 1937 by the RFC. In addition, the act authorized an appropriation to be made from the Treasury of the United States in the amount of \$40,000,000 for REA during the fiscal year 1938, and it authorized \$40,000,000 for each year thereafter for eight years.²

However, by an agricultural act passed on June 25, 1940, the RFC was authorized to supply loan funds to REA.³ Thus, \$100,000,000 of the \$140,000,000 loan fund for the fiscal year 1939 was obtained by loan from the RFC, the remainder of the fund for the fiscal year 1939 being appropriated from the Treasury. By June 30, 1940, the RFC made loans to the REA amounting to \$146,000,000.⁴

¹Ibid., sec. 5.

²Ibid., sec. 3(b). Actually this plan had not been followed from year to year; the amount appropriated or authorized in each fiscal year since 1937 had varied. Frederick William Muller, Public Rural Electrification (Washington; American Council on Public Affairs, 1944), p. 39. Also U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, for the Fiscal Year Ended June 30, 1945 (House Doc No. 450, 80th Cong., 2d Sess.), p. 41.

³54 U.S. Stat. at L. (1940), 566, "An Act Making appropriations for the Department of Agriculture for the fiscal year ending June 30, 1941, and for other purposes."

⁴U.S., R.F.C., Quarterly Report (quarter ended December 31, 1940), p.4.

Section 2

General Appraisal of RFC Activities During Depression and Recovery Period

As has been indicated, the Reconstruction Finance Corporation was designed to be a government lending agency in bringing about recovery from depression by extending financial assistance to agriculture, commerce, and industry by means of direct loans to banks and other financial institutions, insurance companies, and various agricultural credit agencies. The RFC was also authorized to make loans to closed banks to aid in their reorganization or liquidation, and, upon approval of the Interstate Commerce Commission, to make loans directly to railroads. Through amendatory and supplemental legislation, the RFC was further authorized to make loans on the assets of closed banks and trust companies, and, with the approval of the Secretary of the Treasury, to purchase preferred stock, or if the state laws prohibited or restricted the issuance of such stock, capital notes or debentures of banks. Through further amendatory and supplemental legislation, the effect of which was extensively to broaden its original powers, the RFC, for the purpose of maintaining and promoting the economic stability of the country, encouraging the employment of labor, and for other purposes, was authorized, generally, to (1) make direct loans to any business enterprise, (2) make loans to states, municipalities, political subdivisions of states, and other public authorities, (3) make loans to

various government corporations and agencies, such as the Commodity Credit Corporation, the Export-Import Bank of Washington, and the Rural Electrification Administration, (4) make "catastrophe" loans, first directly by the RFC under specific congressional enactments and later through the Disaster Loan Corporation, and (5) aid in the maintenance of a normal market for home mortgages through purchases of mortgages insured or guaranteed by the Federal Housing Administration mostly through its two subsidiaries--the RFC Mortgage Company and the Federal National Mortgage Association. In addition, the RFC was directed to perform certain miscellaneous functions from time to time through congressional enactments or Executive direction, such as regulating high salaries paid to corporate officials who borrowed money from the RFC, and establishing a government market for gold in the United States. The RFC even assumed certain miscellaneous functions which had not been specifically mentioned in any congressional legislation or Executive directive--for instance, as a result of the default of the Dawes Bank loan, the RFC came into the utility business for a short period of time; and for the purpose of administering and liquidating the collateral acquired from the loan made to a real estate business, the RFC organized the Consolidated Realty Corporation which managed hotels, theaters, office buildings, and other miscellaneous properties for over ten years.

With the examination of the RFC's ever broadening functions, from its inception in 1932 until 1940 when the national defense program began to operate, a question immediately arises as to whether or not the RFC had performed a useful function in bringing about recovery from depression, maintaining and promoting the economic stability of the

country, encouraging the employment of labor, and other assigned functions.

First of all, the magnitude of the RFC's overall operations during this period would be an aid in determining the merits of RFC operations. As indicated in Table 4, the RFC during this period authorized loans of over \$10,000,000,000. Of this amount, over \$7,669,000,000 was actually disbursed. Repayments and other reductions amounted to almost \$6,000,000,000 leaving about \$1,700,000,000 outstanding at the close of December 31, 1940. Judging by this large amount of loans and other authorizations, it may be concluded that the RFC had performed a useful function generally in bringing about recovery from depression.¹ Furthermore, the high percentage of repayments of the loans, ranging over 77 per cent of the actual disbursement, would seem to indicate that the RFC had performed a useful function in making sound loans. Furthermore, the lending activity of the RFC, to June 30, 1945, had produced an accumulated net income of slightly more than \$500,000,000.²

Secondly, in view of the fact that the loan is the medium through which the RFC affects economic conditions, changes in the volume of

¹ Professors Merle Fainsod and Lincoln Gordon, in their book, Government and the American Economy, after having discussed the operations of the RFC during this period, conclude that "Financial results (of the RFC) so far have been thoroughly satisfactory." Merle Fainsod and Lincoln Gordon, Government and the American Economy (New York: W. W. Norton, 1948), p. 720.

² U.S., R.F.C., Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, for the Fiscal Year Ended June 30, 1945, (House Doc. No. 316, 80th Cong., 1st Sess.), p. 6. For a further discussion of the net profit of RFC operations, see pp. 315-316.

GROWTH OF LOANS, INVESTMENTS, CONTRACTS, AND OTHER AUTHORIZATIONS¹
OF THE RFC, FROM FEBRUARY 2, 1932, to DECEMBER 31, 1940, INCLUSIVE¹

(Amount in thousands of dollars)

| Class | 1932 | 1933 | 1934 | 1935 | 1936 |
|--|-----------|-----------|-----------|-----------|-----------|
| Banks and trust companies | 949,858 | 2,309,870 | 3,419,874 | 3,658,466 | 3,729,809 |
| Agricultural financing institutions | 114,124 | 856,782 | 1,609,768 | 1,833,638 | 2,017,447 |
| Other financial institutions | 276,591 | 555,991 | 700,995 | 753,748 | 802,170 |
| Railroads | 337,435 | 411,845 | 457,856 | 494,375 | 623,520 |
| National Defense | | | | | |
| Business enterprises | | | 30,687 | 104,685 | 146,760 |
| Self-liquidating projects, etc. | 146,572 | 230,764 | 256,097 | 292,157 | 339,212 |
| Mining, milling, or smelting of ores | | | | 7,145 | 9,988 |
| Drainage, levee, irrigation, and similar districts | | 16,870 | 81,786 | 121,153 | 130,964 |
| Repair of damage by earthquake, flood, etc. | | | 2,150 | 2,300 | 16,104 |
| All others | 113,087 | 306,352 | 331,537 | 333,956 | 338,093 |
| Total authorizations | 1,937,667 | 4,738,654 | 6,890,750 | 7,601,623 | 8,154,067 |
| Total disbursements | 1,524,747 | 3,301,155 | 5,129,086 | 5,836,642 | 6,165,023 |
| Outstanding at end of year | 1,224,723 | 2,258,518 | 2,690,032 | 2,736,139 | 2,168,159 |

¹Source: U.S., R.F.C., Quarterly Report from 1932 through 1940.

Table 4 (continued)

| Class | 1937 | 1938 | 1939 | 1940 |
|--|-----------|-----------|-----------|------------|
| Banks and trust companies | 3,821,020 | 3,866,994 | 3,901,176 | 4,192,002 |
| Agricultural financing institutions | 2,383,632 | 2,442,170 | 2,449,778 | 2,452,071 |
| Other financial institutions | 849,539 | 973,262 | 976,875 | 985,019 |
| Railroads | 643,598 | 745,872 | 802,021 | 911,605 |
| National defense | | | | 680,578 |
| Business enterprises | 164,504 | 291,815 | 396,413 | 446,595 |
| Self-liquidating projects, etc. | 399,217 | 490,847 | 545,144 | 614,091 |
| Mining, milling, or smelting of ores | 11,300 | 12,635 | 14,913 | 16,576 |
| Drainage, levee, irrigation, and similar districts | 138,365 | 140,861 | 140,861 | 140,861 |
| Repair of damage by earthquake, flood, etc. | 16,104 | 16,184 | 16,184 | 16,184 |
| All others | 338,261 | 338,261 | 338,391 | 339,055 |
| Total authorizations | 8,765,540 | 9,318,901 | 9,581,756 | 10,794,638 |
| Total disbursements | 6,512,517 | 6,975,302 | 7,362,605 | 7,669,360 |
| Outstanding at end of year | 2,060,396 | 1,814,364 | 1,756,354 | 1,712,638 |

Table 5

AMOUNT OF AUTHORIZATIONS, DISBURSEMENTS, AND OUTSTANDING ¹
 FROM FEBRUARY 2, 1932, to DECEMBER 31, 1941, INCLUSIVE

(Amount in thousands of dollars)

| Year | Amount of authorizations | Amount of disbursements | Amount outstanding at end of period |
|-------|--------------------------|-------------------------|-------------------------------------|
| 1932 | 1,937,667 | 1,524,747 | 1,224,723 |
| 1933 | 2,800,987 | 1,776,408 | 2,258,518 |
| 1934 | 2,152,096 | 1,827,931 | 2,690,032 |
| 1935 | 710,873 | 707,556 | 2,736,139 |
| 1936 | 552,444 | 328,381 | 2,168,159 |
| 1937 | 611,473 | 347,494 | 2,060,396 |
| 1938 | 553,361 | 462,785 | 1,814,364 |
| 1939 | 262,855 | 387,303 | 1,756,354 |
| 1940 | 1,212,882 | 306,755 | 1,712,638 |
| 1941 | 3,485,653 | 1,797,594 | 2,938,283 |
| Total | 14,280,291 | 9,467,954 | ----- |

¹U.S., R.F.C., Quarterly Report, from 1932 through 1941. See and compare also Table 4 on pp. 70-71.

Table 6

LABOR FORCE, 1932-1941¹

(Thousands of persons, 14 years of age and over)

| Period | Total labor force (including armed forces) | Armed forces | Total civilian labor force | Unemployment |
|--------|--|-----------------|-------------------------------|--------------|
| 1932 | 51,250 | 250 | 51,000 | 12,060 |
| 1933 | 51,840 | 250 | 51,590 | 12,830 |
| 1934 | 52,490 | 260 | 52,230 | 11,340 |
| 1935 | 53,140 | 270 | 52,870 | 10,610 |
| 1936 | 53,740 | 300 | 53,440 | 9,030 |
| 1937 | 54,320 | 320 | 54,000 | 7,700 |
| 1938 | 54,950 | 340 | 54,610 | 10,390 |
| 1939 | 55,600 | 370 | 55,230 | 9,480 |
| 1940 | 56,030 | 390 | 55,640 | 8,120 |
| 1941 | 57,380 | 1,470 | 55,910 | 5,560 |

¹ Source: U.S. President, The Economic Reports of the President to Congress, July 21, 1947 (New York: Harcourt, Brace & Co., 1949), p. 105.

Table 7

WHOLESALE PRICE INDEX, 1932-1941¹

| Year | Index |
|------|-------|
| 1932 | 64.8 |
| 1933 | 65.9 |
| 1934 | 74.9 |
| 1935 | 80.0 |
| 1936 | 80.8 |
| 1937 | 86.3 |
| 1938 | 78.6 |
| 1939 | 77.1 |
| 1940 | 78.6 |
| 1941 | 87.3 |

¹ For the data, see Federal Reserve Bulletin, XXVIII (March 1942), 255.

loans granted per year, remittances, repayments, and amounts outstanding should permit an evaluation of the economic effects of RFC activities. That is, lending activities will be considered stabilizing if loans tend to increase when economic activity decreases and to decrease when full employment is reached.

Tables 5, 6, and 7 present the data for RFC activities, labor force, and wholesale price index during the depression and recovery period.

From these tables it is observed that when the peak of unemployment was reached in 1933 more loans were authorized in that year than in any other year until 1941, when rearmament activities began to affect the volume of RFC loans. That is, as indicated in Tables 5 and 6, in 1933 when 12.8 million men were out of work, loans of over \$2,800,987,000 were authorized. Again, disbursements were at the maximum for the first three years during the period 1932-41 while the index of wholesale prices of all commodities was kept at the lowest, as shown in Tables 5 and 7. By further observation of these three tables, it is found that prices and employment continued to rise slowly until the latter half of 1937, at which time they dropped sharply, while the annual rates of loans declined each year from 1934 through 1936, and increased slightly in 1937 and 1938. Thus, it can be concluded that the authorizations and disbursements of the RFC were conducted, in the main, in a stabilizing manner during the period 1932-38 inclusive.

Thirdly, it would be worthwhile to pay special attention to RFC loans to banks and other financial institutions. If loans to banks and other financial institutions are greater during periods of depressed

economic activity as compared to periods with higher levels of activity, this will also be considered stabilizing. Table 8 indicates that banks and other financial institutions had been the largest beneficiaries of RFC operations, receiving actual advances ranging from 55 to 72 per cent of the total RFC loans and other advancements until 1941 when the national defense program started. It should be noted that on this score the record of RFC operations had been successful in achieving the basic purpose for which the RFC was first created, that is, to save banks and other financial institutions from failing¹ and to make loans to financial institutions and thereby facilitate the granting of loans to private enterprise. Furthermore, by examining the amounts outstanding at the end of each year of the advancements made during the year, it can be determined that RFC action during the period of the depression and the recovery was stabilizing, since the largest amount of aid was concentrated in the period of the banking crisis in 1932-34 and it tapered off quickly after that period. On the basis of the evidence gathered above, it is also probably valid to conclude that RFC activities in the depression period in the 1930's resulted in raising the equilibrium levels of income, employment, and prices.

Another question in appraising the activities of the RFC during the period 1932-40 is how and why government intervention in the private financial field can be justified, since the RFC made loans to

¹Mr. Jesse H. Jones pointed out that "the bank-repair program" had been approximately completed by mid-1935. See

Table 8

GROWTH OF LOANS AND OTHER AUTHORIZATIONS TO BANKS AND OTHER FINANCIAL INSTITUTIONS FROM FEBRUARY 2, 1932, TO DECEMBER 31, 1941, INCLUSIVE¹

(Amount in thousands of dollars)

| Year | 1, Authorizations | 2, Disbursements | 3, Outstanding as of Dec. 31 | 4, Total RFC Disbursements | 5, Ratio between 2 and 4 |
|------|-------------------|------------------|------------------------------|----------------------------|--------------------------|
| 1932 | 1,226,449 | 1,101,184 | 818,338 | 1,524,747 | 72 |
| 1933 | 2,865,861 | 2,113,475 | 1,285,001 | 3,301,155 | 64 |
| 1934 | 4,120,869 | 3,243,128 | 1,702,814 | 5,129,086 | 63 |
| 1935 | 4,412,204 | 3,529,344 | 1,464,143 | 5,836,642 | 60 |
| 1936 | 4,531,979 | 3,660,069 | 1,074,101 | 6,165,023 | 59 |
| 1937 | 4,670,559 | 3,763,742 | 929,122 | 6,512,517 | 58 |
| 1938 | 4,840,256 | 3,931,570 | 923,810 | 6,975,302 | 56 |
| 1939 | 4,878,051 | 4,045,578 | 850,902 | 7,362,605 | 55 |
| 1940 | 5,177,021 | 4,232,384 | 929,981 | 7,669,360 | 55 |
| 1941 | 5,436,096 | 4,505,596 | 1,054,873 | 9,465,949 | 48 |

¹ Source: U.S., R.F.C., Quarterly Report, from 1932 through 1941.

1

business enterprises under the amendment to the RFC Act, approved June 19, 1934, and subsequent amendments, and since the field of business loans is basically under the functions of private banking institutions in the economic system in the United States.

Underlying the industrial loan program is an assumption that this agency can make loans directly to business enterprises which banks "can not, will not, or should not make."² It is obviously implied in this assumption that the loan policy of the RFC will, therefore, differ from that of banks. Then, at what points and to what extent does the loan policy of the RFC differ from that of commercial banks, if there is any difference?

A study of the RFC's policy seems to reveal that while the loan policy of the RFC does not differ fundamentally from that of the banking system looked at in the large, RFC loan policy does seem to differ from that of banks on at least two points. That is to say, while the RFC in passing on an application took into account the same factors which bear on credit risk as would a bank, RFC loan policy seemed to differ from that of banks not in kind but, so to speak, in "degree."

First, there is reason to believe that, while the RFC took into account the same credit risk factors, it was more liberal in its appraisal of credit risk. While the industrial loan program was not

¹48 U.S. Stat. at L. (1934), 1105-1113, "An Act Relating to direct loans for industrial purposes by Federal Reserve banks, and for other purposes," discussed in Section 1 of this chapter, pp. 41-48.

²John Desmond Glover, "Industrial Loan Policy of the RFC," Harvard Business Review, 17 (June 1939), 465.

designed as a subsidy to industry, it was the intent of legislators that, for the purpose of " . . . maintaining and promoting the economic stability of the country or encouraging the employment of labor . . . ,"¹ the RFC was to be more liberal.

In order to explain the greater liberality of RFC loan policy, it is quite significant to note the view contained in some of Mr. Jones's statements. For instance, he told the Senate Committee on Banking and Currency in 1938 that the RFC felt that ". . . the government, under present circumstances, can afford to take a chance that a bank cannot."² In other words, while some bankers, through unfortunate experiences of past years or some other reasons, became unduly conservative, or reluctant in granting loans to some business enterprises, the RFC supplemented banking facilities and made the loans in some measure. Again, quoting from Mr. Jones's own statement, there was an area for the RFC to make loans to private business enterprises, "if we (the RFC) could afford to take a little more than average business risk."³

¹52 U.S. Stat. at L. (1938), 212, "An Act To amend section 5d of the Reconstruction Finance Corporation Act, as amended, to authorize loans to public agencies, to provide credit facilities for business enterprises and for other purposes."

²U.S., Congress, Senate, "Purchases and Loans by the Reconstruction Finance Corporation," Hearing: Before the Committee on Banking and Currency, 75th Cong., 3d sess., on S. 3735 (March 29, 1938), p. 4.

³Mr. Jones stated before the House Committee on Banking and Currency that "We will try to administer the law the way you give it to us, that is the way we have been doing. There is a lot of borderline cases where we could help employment, if we could afford to take a little more than the average business risk." U.S., Congress, House, "To Extend the Functions of the Reconstruction Finance Corporation," Hearings: Before the Committee on Banking and Currency, 74th Cong., 1st sess., on H.R. 4240 (S. 1175), p. 5.

At this stage, it seems to be necessary to point out that the RFC loan program to private business was never conceived of as being part of a subsidy to industry. The RFC, as has been examined, was required by law to find "reasonable assurance" for the repayment of the funds when it made loans.¹

Taking these two conditions together, it seems that they defined the area in which the RFC was to operate. This area covered those loans which, for one reason or another, could not be obtained from banks but still offered reasonable assurance of repayment. In other words, it was assumed that a public interest was met in seeing that credit was made available to those in an area which lay beyond what private sources could provide.

Second, it was a fact that bankers, to a greater or a lesser degree, were reluctant to make loans with maturity up to ten years. Although it would be incorrect to say that the Federal Reserve banks and the RFC originated term lending,² yet these two government lending agencies served as a competitive spur to private banks, and also helped to educate many commercial banks in the techniques of making

¹ 52 U.S. Stat. at L. (1938), 212, "An Act To amend section 5d of the Reconstruction Finance Corporation Act, as amended, to authorize loans to public agencies, to provide credit facilities for business enterprises and for other purposes."

² Neil H. Jacoby and Raymond J. Saulnier, Term Lending to Business, (New York: National Bureau of Economic Research, 1942), p. 24.

"term loans."¹ Recently, however, "term loans" became more widely accepted by bankers, so that RFC policy with respect to maturity, as such, came to differ less and less as time passed.

In explaining further the RFC's "term loan" program, it seems to be helpful to examine some aspects of the banking structure of the country. It could be said that the banking structure was set up so as to care adequately for the needs of business when such needs consisted largely of short-term loans. Events of the 1930's had so changed conditions that the banking structure could be said to be somewhat out of touch with business needs. Many firms needed funds for periods of ten years or more in order to maintain or expand employment. Banks generally avoided loans of such duration. Here again there was an area for the RFC to make loans to business enterprises.

In summing up the question of government intervention in the private financial field, there was no clear-cut area for the RFC to operate in the field of business loans, differing from that of private banking institutions, but there was an area for which the RFC was required to meet public demand which the private banks could not meet. To make this point clear, it should be added that the business loan program of the RFC was essentially a supplementary source of credit, designed to meet a demand for inherently sound loans which, for any reason other than a question of inherent soundness, was not met by private banks.

¹ Jacoby and Saulnier define "term loan" as "a loan to a business enterprise that is repayable, according to agreement between borrowers and lender, after the lapse of more than one year." Ibid., p. 1. The "term loan" is in essence a medium-term working-capital or equipment loan to be amortized out of future profits. For further definition, see Fuller, op. cit., p. 106.

CHAPTER IV

THE FUNCTIONS OF THE RFC IN NATIONAL DEFENSE

At the time of the defense crisis in May 1940, no more pressing problem faced the government than that of bringing about the necessary expansion of the nation's industrial plants to meet defense needs. In fact, as Industrial Commissioner William S. Knudsen later asserted, industrial expansion became the nation's "Problem Number 1."¹ Industrial expansion was a problem for which the nation was at best but partially prepared.

The core of the problem was money--where to get the capital to finance expansion. This capital could come from only two sources, private financing or government financing. Private capital, while yearning for new opportunities for investment after the depression years, was yet understandably timid at the prospect of investment in defense industries because of the risk involved. During the summer and fall of 1940 the Advisory Commission to the Council of National Defense (NDAC) was partially active in seeking to create the necessary incentive for private capital.² The other source of financing was the government, but in the summer of 1940 the greatest immediate need for expansion was not in highly specialized arsenal-type facilities traditionally financed by the armed forces. Rather it was in facili-

¹Quoted in the column of Ernest Lindley, The Washington Post, January 13, 1941.

²The two important resulting NDAC contributions were tax amortization and its less successful Emergency Plant Facilities contract.

ties for the aircraft industry, normally an area for private financing. In any case, the Congressional appropriations to the armed services were far from adequate.¹

Since the armed services were without sufficient appropriations and private capital was reluctant to make investments of doubtful future value, the possibility of financing through the RFC took on special significance. The RFC had independent borrowing authority and was not dependent upon Congress for its funds.² Following the President's "50,000 planes" speech³ in May 1940, the RFC began to play a large role in defense financing.

Acceptance by the RFC of any such role, however, required a substantial amendment to the basic RFC Act. In May 1940, the RFC's

¹The War Department got its first appropriation of \$200,000,000 of "expediting funds" for new facilities on June 26, 1940. 54 U.S. Stat. at L. (1940), 602-603, "An Act Making supplemental appropriations for the national defense for the fiscal year ending June 30, 1941." An additional \$335,000,000 was made available by the National Defense Appropriation Act of September 9, 1940, and \$178,000,000 more by the National Defense Appropriation Act of October 8, 1940. 54 U.S. Stat. at L. (1940), 874, 970, "An Act Making supplemental appropriations for the national defense for the fiscal year ending June 30, 1941." The Navy got smaller amounts for extra expenditures, "including facilities," particularly in the appropriations of the Bureau of Ordnance and Bureau of Aeronautics. 54 U.S. Stat. at L. (1940), 313, "An Act Making supplemental appropriations for the national defense for the fiscal year ending June 30, 1941."

²The borrowing authority of the RFC will be discussed in Ch. VI, pp. 301-316.

³"We Stand Ready Not Only to Spend Millions for Defense, but to Give Our Service and Even Our Lives for the Maintenance of our American Liberties." Message to the Congress Asking Additional Appropriations for National Defense. May 16, 1940." The Public Papers and Addresses of Franklin D. Roosevelt (New York: Macmillan Co., 1941), pp. 198-212.

financing of industry was governed by an amendment made in 1934¹ which provided that the RFC might lend to industry only in cases where credit was not available from private sources.² And no loan could be made under this provision unless, in the opinion of the board of directors, it was "of such sound value, or so secured, as reasonably to assure retirement or repayment."³

If the RFC were to assume the larger risk of loans needed by many industries for the creation or expansion of defense facilities, obviously this provision of the RFC Act required modification. By the end of May, 1940, an amendment proposal was finally hammered out within the RFC, designed for the Corporation to assume the necessary powers to meet national defense needs. As introduced into Congress, the proposal, as the late Senator Robert Taft (Ohio) stated in the Senate, asked for "almost unlimited power to do anything,"⁴ in language which provided that the RFC might, on the request of the Federal Loan Administrator and with the approval of the President, organize a corporation or corporations "with such powers as may be necessary to aid the Government of the United States in its national defense program."⁵

The request for such unlimited authority was opposed by members of

¹48 U.S. Stat. at L. (1934), 1105-1113, "An Act Relating to direct loans for industrial purposes by Federal Reserve banks, and for other purposes." See Ch. III, pp. 41-48.

²Ibid., sec. 5.

³52 U.S. Stat. at L. (1938), 212, "An Act To amend section 5d of the Reconstruction Finance Corporation . . ." sec. 5d.

⁴Extension of Authority of Reconstruction Finance Corporation, "Congressional Record", vol. 86, pt. 8, p. 8837.

⁵Ibid., p. 8338.

both houses of Congress.¹ Senator Taft, who was its most vigorous critic among the members of the Senate Banking and Currency Committee, denounced the new amendment proposal as "the most outrageous legislative proposal that has been made to the Congress since I have been here."² It would grant powers so sweeping, he said, that the Government could "go into just any business it chooses" in competition with private enterprise, without another word from the Congress, without another appropriation."³

Opposing further the amendment bill, Senator Taft explained that if the bill were passed the Government:

. . . could go into the business of manufacturing any kind of airplanes, any kind of strategic materials; yes, go into almost any and every thing. As far as I can see the Government could go into the business of buying corn and wheat; could, in fact, go into the business of running farms. It could go into the utility business, the oil business, or any and every kind of business it might choose to go into . . .⁴

Commenting on the amendment bill, Senator Taft however clearly stated that it was a worthy purpose for the RFC to "buy" strategic and critical materials and to that he had no objection, but opposed the provision in the bill authorizing the RFC "to manufacture war

¹See "Reconstruction Finance Corporation," Congressional Record, vol. 86, pt. 8, pp. 8267-8272, and "Extension of Authority of Reconstruction Finance Corporation," ibid., pp. 8322-30, and 8336-40.

²U.S. Senate, "To Amend Reconstruction Finance Corporation Act," Hearings: Before a Subcommittee of the Committee on Banking and Currency, 76th Cong., 3d sess. on S. 3938, A bill to authorize purchase by Reconstruction Finance Corporation of stock of Federal home-loan banks, to amend Reconstruction Finance Corporation Act, as amended, and for other purposes, May 14, 1940, p. 39.

³Ibid.

⁴Ibid. Cf. the actual operation of the RFC during World War II and related period. See pp. 88-161.

supplies."¹ Because, as he stated, he preferred to give the power "to manufacture war supplies" to the War Department "in whose hands it will be subject to the control of the Appropriations Committee." He further warned against the provisions of the proposed bill that: "If we create a corporation of this kind, the corporation will be gone forever from the care of Congress. The Corporation may do anything."²

Largely as the result of Senator Taft's criticism, the bill was rephrased in order to make its language more precise and its grant of power less all-inclusive, by revising the original bill in listing the purposes under which the RFC might make defense loans, or create, organize or acquire a corporation or corporations.³

The measure finally was passed by both houses and signed by the President on June 25, 1940.⁴ By this amendment, Section 5d of the RFC Act was amended, giving the RFC unprecedented powers in their scope and size. This amendment newly authorized the RFC, "in order to aid the Government of the United States in its national-defense program," (1) to make loans to, or, when requested by the Federal Loan Administrator with the approval of the President, purchase the capital stock of, any corporation for illustrated purposes, and (2) when requested by the Federal Loan Administrator, with the approval of the President, to create or to organize a corporation or corporations with power

¹Extension of Authority of Reconstruction Finance Corporation," Congressional Record, vol. 86, pt. 8, p. 8338.

²Ibid.

³See 54 U.S. Stat. at L. (1940), 572-574, "An Act To authorize the purchase by the Reconstruction Finance Corporation of stock of Federal home-loan banks; to amend the Reconstruction Finance Corporation Act, as amended, and for other purposes," sec. 5, and The RFC Act, sec. 5d.

⁴"Enrolled Bill Signed," Congressional Record, vol. 86, pt. 8, p.8773.

illustrated.¹ This section was added to section 5d of the RFC Act, as 5d(2), and 5d(3).

A year later, in June 1941, another amendment to the RFC Act was passed, permitting the RFC to form government corporations "to take any action deemed necessary to expedite the defense program."² It was just that, without any qualification. Mr. Jones, who suggested this wording himself,³ testified that the act would give the RFC "the power to do whatever it lacked the power to undertake heretofore."⁴ The decision as to what activities were necessary "to expedite the defense program" was left in the hands of two men: the President and the Federal Loan Administrator.⁵

Under these two laws the RFC was to play, and in fact played, the unprecedented role in the national defense and war purposes as this chapter will discuss.

¹54 U.S. Stat. at L. (1940), 572-574, "An Act To authorize the purchase by the Reconstruction Finance Corporation of stock of Federal home-loan banks; to amend the Reconstruction Finance Corporation Act, as amended, and for other purposes," sec. 5. The functions of the RFC under this amendment will be discussed in Section 1 and Section 2 of this chapter, see pp. 91-94 and pp. 106-160.

²55 U.S. Stat. at L. (1941), 250, "An Act To extend the operations of the Disaster Loan Corporation and the Electric Home and Farm Authority, to provide for increasing the lending authority of the Reconstruction Finance Corporation, and for other purposes," sec. 4. This amendment was added to the RFC Act as sec. 5d(3)(g).

³Dwight Macdonald, "Jesse Jones, Reluctant Dragon," Nation, 154 (February 7, 1942), 159.

⁴Ibid.

⁵55 U.S. Stat. at L. (1941), 250, sec. 5d(3)(g).

Section 1

Lending Activities During World War II and the Related Emergency Period

The normal operations of the RFC during World War II consisted of the various phases of its lending activity undertaken pursuant to authorizations and directives contained in the RFC Act, as amended, and other acts of Congress and directives of the President. Some of its lending activities were conducted by the two subsidiaries, the RFC Mortgage Company and the Federal National Mortgage Association, as they had been before the War.

There were new developments pertaining to RFC lending activities which originated during the War. The first of these was loans to Defense Homes Corporation, under the provisions of section 5d(2) of the RFC Act, as amended,¹ to finance the construction of certain multiple-housing projects located in the vicinity of Washington, D.C. and elsewhere in the United States. When the United States embarked upon industrial expansion for defense purposes in the summer of 1940, great shiftings of populations set in which created sudden demands for shelter for people who had left their old homes to take employment in helping build or operate new plants or to find places on the expanding federal pay rolls in Washington and elsewhere. The National Capital and many "defense areas" became exceedingly congested. On October 23,

¹54 U.S. Stat. at L. (1940), 573, "An Act to authorize the purchase by the Reconstruction Finance Corporation of stock of Federal home-loan banks; to amend the Reconstruction Finance Corporation Act, as amended, and for other purposes," sec. 5.

1940, to assist in meeting the swelling needs for housing, the RFC created a subsidiary, Defense Homes Corporation, with its capital stock \$10,000,000 from President's Emergency Funds.¹

The RFC disbursed to the Defense Homes Corporation \$65,750,000. With this money it built and operated 10,964 housing units, ranging from small individual homes to dormitories, apartment houses, and a hotel.² These were scattered across the country in 13 states and the District of Columbia.

For the loans to the DHC, the RFC did not hold any mortgages on the properties of the DHC. The security to the loans arose from an agreement between the RFC and the DHC dated September 1, 1942, as amended December 31, 1942.³ Under this agreement it was provided that among other things no mortgages, pledges or liens might be made by the DHC without the consent of the RFC. The agreement also provided for quarter-annual remittances of "net proceeds"⁴ from rentals and

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, the RFC Mortgage Company, and Federal National Mortgage Association for the Fiscal Year Ended June 30, 1945, (House Doc. No. 450, 80th Cong., 2d sess.), p. 46

²Jesse H. Jones, Fifty Billion Dollars: My Thirteen Years with the RFC (New York: Macmillan Company, 1941), p. 468.

³U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, the RFC Mortgage Company, and Federal National Mortgage Association for the Fiscal Year Ended June 30, 1945, (House Doc. No. 450, 80th Cong., 2d sess.) p. 46.

⁴Ibid., p. 47. The term "net proceeds" is, in substance, defined in the agreement as "the net profit from the property after payment or provision for payment of (1) administrative and overhead expenses, (2) management expenses, operation and maintenance costs, taxes, and insurance, and (3) such reserves as may be necessary for repairs, maintenance, replacements, vacancy losses, and bad debts." Ibid.

proceeds from sales of properties. The RFC had the right of approval of property sales, including the sales prices.¹ As of June 30, 1945, the unpaid remainder of the loan to the DHC amounted to \$55,909,408.² Effective June 30, 1948, the net assets of the Defense Homes Corporation were transferred to the RFC for liquidation and settlement of the amounts due to the RFC.³

The second development involved a loan to a foreign government. Early in 1941 the dollar position of Great Britain began to get very low. The United Kingdom had been ordering vast quantities of war materials in the United States and needed dollars to pay for them. The British Government had already sold nearly \$1,500,000,000 of American securities which British subjects had been obliged to surrender to it.⁴ The sale of so many of these securities was forcing the market down, and the return to the British represented much less than true values.⁵ Thus, British selling under pressure was hurtful to the market generally and to our entire economy. If the British continued to throw on the market their American investments, market conditions would continue to get worse. Furthermore many of the British investments in this country

¹Ibid.

²Ibid., p. 48. See also Table 9 on p. 105.

³U.S., Congress, Report on the Audit of Reconstruction Finance Corporation for the Fiscal Year Ended June 30, 1951 (House Doc. No. 367, 82d Cong., 2d sess., p. 32.

⁴Jones, op. cit., p. 472.

⁵Among the British-owned investments in the United States was the American Viscose Corp., the largest producer of rayon in this country and a very profitable institution. Thrown on the market through Wall Street banking houses in March 1941, the British-owned enterprises were sold at about half of their worth, the bankers advancing \$40,000,000 for the property valued at about \$75,000,000. Ibid., p. 473.

were an important factor in their war economy and the income from them was being used to pay for war supplies.

Under this situation, as a part of the national defense program, the RFC Act was amended so as to permit the RFC to make loans to foreign governments or their central banks or agents "for the purpose of achieving the maximum dollar exchange value in the United States" for their securities or other property in this country.¹ The amendment provided that these loans were to be permitted "notwithstanding the provisions of any other law."²

Under this authority the RFC, under date of July 21, 1941, entered into an agreement with the Government of the United Kingdom of Great Britain and Northern Ireland for a loan of \$125,000,000. Of the amount agreed upon, a total of \$390,000,000 had been advanced by the RFC to June 30, 1945, and \$125,306,287 had been repaid, leaving a balance of \$264,693,713 unpaid at that date.³

The third development was the authority given the RFC under the June 25, 1940 amendment, the new Section 5d(2), to make direct national

¹55 U.S. Stat. at L. (1941), 248-250, "An Act To extend the operations of the Disaster Loan Corporation and . . . to provide for increasing the lending authority of the Reconstruction Finance Corporation," sec. 4.

²It was referring to the Johnson Act, by which loans were prohibited to foreign countries that had repudiated or defaulted on loans they had gotten from the United States Treasury during and after World War I.

³U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, the RFC Mortgage Company, and Federal National Mortgage Association for the Fiscal Year Ended June 30, 1945, (House Doc. No. 450, 80th Cong., 2d sess.) p. 53. For a further study on loans to foreign governments, see Ch. V, pp. 176-177. This British loan was paid in full September 28, 1951. U.S., Congress, Report on the Audit of Reconstruction Finance Corporation for the Fiscal Year Ended June 30, 1951 (House Doc. No. 367; 82d Cong., 2d sess.) p. 10.

defense loans to private industry.¹ Under the amendment the RFC, "in order to aid the Government of the United States in its national-defense program," was permitted to make loans to, or, when requested by the Federal Loan Administrator with the approval of the President, purchase the capital stock of, any corporation (a) "for the purpose of producing, acquiring, and carrying strategic and critical materials as defined by the President,"² and (b) "for plant construction, expansion and equipment, and working capital, to be used by the corporation in the manufacture of equipment and supplies necessary to the national defense, on such terms and conditions and with such maturities as the Corporation may determine."³

In examining the amendment, it did not specify how the RFC should

¹54 U.S. Stat. at L. (1940), 573, "An Act To authorize the purchase by the Reconstruction Finance Corporation of stock of Federal home-loan banks; to amend the Reconstruction Finance Corporation Act, as amended, and for other purposes," sec. 5.

²On June 26, 1940, in a letter to the Federal Loan Administrator, the President issues his first pronouncement relating to strategic and critical materials. It read as follows: "I hereby define, as required by Section 5d of the Reconstruction Finance Corporation Act, as amended, strategic and critical materials as those materials now contained in the list of strategic and critical materials of the Army and Navy Munitions Board, revised and approved January 30, 1940, as well as such materials as may hereafter be added to such list." U.S. Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Defense Supplies Corporation (House Doc. No. 439, 80th Cong.), p. 14. The list of strategic and critical materials approved by the Army and Navy Munitions Board as of January 30, 1940 was as follows: Strategic materials--Antimony, chromium, coconut shell char, manganese, manila fiber, mercury, mica, nickel, quartz crystal, quinine, rubber, silk, tin, tungsten. Critical materials--aluminum, asbestos, cork, graphite, hides, iodine, kapok, opium, optical glass, phenol, platinum, tanning materials, vanadium, wool. Within a week, President Roosevelt, acting under the act of Congress, approved on July 2, 1940, (54 U.S. Stat.

determine that credit would be used by an applicant "in the manufacture of equipment and supplies necessary to the national defense," and it was uncertain whether this phrase required an applicant to hold a prime contract, to be a defense subcontractor, or to be a producer of machinery and equipment necessary to the operations of either or both prime contractors or sub-contractors. The directors of the RFC, under the direction of the Federal Loan Administrator and the President, were to make final determination in each case of the extent to which the credit would aid the national defense program.¹

Furthermore, there were no requirements in the amendment that borrowers be solvent, that loans be "of such sound value, or so secured, as reasonably to assure retirement or repayment,"² or that credit be unavailable at prevailing rates for the class of loan applied for.³ The

at L., 714: "An Act to expedite the strengthening of the national defense,") issued a proclamation which prohibited the export of certain articles and materials from the United States, including arms, ammunition, and implements of war; essential machinery and machine tools; certain metals, chemicals, drugs; fertilizers and explosives; petroleum products; several non-metallic minerals; certain textiles, fibers, and manufactures; certain animal and vegetable products, and oils; and other miscellaneous articles, such as cork, aerial cameras, wood pulp, optical instruments. For the list of prohibited articles and materials from exportation from the United States, see "Export of War Materials and Strategic Raw Products Prohibited Except by License. Proclamation No. 2413. July 2, 1940," The Public Papers and Addresses of Franklin D. Roosevelt, (1940) op. cit., pp. 278-279.

³54 U.S. Stat. at L. (1940), 573, "An Act . . . to amend Reconstruction Finance Corporation Act, as amended. . . ." sec. 5.

¹U.S. R.F.C., Circular No. 23, "Information concerning Loans and Purchases to Aid in the National Defense Program," (July 1940), p. 2.

²U.S. Stat. at L. (1938), 212, "An Act To amend section 5d of the Reconstruction Finance Corporation. . . ."

³48 U.S. Stat. at L. (1934), 1108, "An Act Relating to direct loans for industrial purposes by Federal Reserve banks, and for other purposes," sec. 5.

existence of a national emergency presumably was deemed sufficient cause for relaxing credit standards applicable to concerns producing or holding materials vital to national welfare. Inferentially, the philosophy was that the RFC should assume greater risks in granting credit to that peripheral group of concerns unable to obtain credit either from private agencies or from the RFC under its regular business loan powers, in order to assure an expeditious mobilization of military production.

Loans in substantial volume were made under this authority, many of them at the request of the War or Navy Departments; and the balance of national defense loans outstanding amounted to over \$306,000,000 on June 30, 1945.¹ The authority to make national defense loans expired on June 30, 1947.²

The fourth new development during the War was the shift in emphasis of the policy and character of the Export-Import Bank of Washington during the war and related period. In 1940, the act creating the Export-Import-Bank was twice amended, first on March 2,³ and then on September 26.⁴

¹ U.S. Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, for the Fiscal Year Ended June 30, 1945 (House Doc. No. 450, 80th Cong., 2d sess.), p. 4.

² 61 U.S. Stat. at L. (1947), 202-209, "Joint Resolution To extend the succession, lending powers, and the functions of the Reconstruction Finance Corporation," sec. 1.

³ 54 U.S. Stat. at L. (1940), 38, "An Act To provide for increasing the lending authority of the Export-Import Bank of Washington, and for other purposes."

⁴ 54 U.S. Stat. at L. (1940), 961-962, "An Act To provide for increasing the lending authority of the Export-Import Bank of Washington, and for other purposes."

Meanwhile the President gave his support to the expansion of activities in a message requesting that "the Congress give prompt consideration to increasing the capital and lending power of the Export-Import Bank of Washington by \$500,000,000 and removing some of the restrictions on its operations to the end that the Bank may be of greater assistance to our neighbors south of the Rio Grande, including financing the handling and orderly marketing of some part of their surpluses."¹

The act passed on September 26, 1940, authorized the Bank to make loans "To assist in the development of the resources, the stabilization of the economies, and the orderly marketing of the products of the countries of the Western Hemisphere," with the overall limit of not to exceed \$500,000,000 outstanding at any one time."²

Mr. Jones, then Federal Loan Administrator, testified before the Committee on Banking and Currency in explaining the President's message

¹"A Recommendation for Legislation to Assist the Other American Republics to Finance the Marketing of Their Surplus Products," The Public Papers and Addresses of Franklin D. Roosevelt (1941) (New York: Macmillan Co., 1941), p. 33. See also U.S., State Department, "Export-Import Bank of Washington: Message of the President Regarding Increase in Capital and Lending Power," Bulletin, III, (July 27, 1940), 41. See also U.S. Congress, Senate, "Increasing the Lending Authority of the Export-Import Bank of Washington," Hearing: Before the Committee on Banking and Currency, 76th Cong., 3d sess., on S. 4204, p. 2.

²54 U.S. Stat. at L. (1940), 961, "An Act To provide for increasing the lending authority of the Export-Import Bank of Washington, and for other purposes," sec. 1.

that:

I think it is more to enlarge the scope of the Bank, to continue to be helpful to our exporters, and manufacturers of South America and Central America are going to have to buy in this country many things which they have heretofore bought in the European countries, and we would like to have them do that. As good neighbors we would like to help them in their predicament. We would like to help them with their economy and the marketing of some of their products to avoid cutthroat competition with our own exports.¹

The Bank became thus a definite instrument of American foreign policy. Even before the enactment of this amendment (54 U.S. Stat. at L. 961), it was made clear to Congress by Mr. Jones that the Bank was possessed of diplomatic aspects when he stated in February 1939 before the Senate Committee on Banking and Currency:

. . . The South American countries are young countries . . . they have got to trade and ally themselves, at least economically with those who give them credit and who buy things from them. . . . Undoubtedly, if we do not want the South American trade to get away from us, and also the thing that consequently goes with it, the natural intercourse between the countries, we should try to hold that trade and to get back some that we have already lost.²

By Executive Order 9361, dated July 15, 1943, the Bank was placed under the supervision of the Office of Economic Warfare (later the Foreign Economic Administration), although the RFC retained its investment of \$174,000,000 in the preferred stock of the Bank.³ Meanwhile the amounts of Export-Import Bank disbursements between January 1940

¹U.S., Congress, Senate, "Increasing the Lending Authority of the Export-Import Bank of Washington," Hearing: Before the Committee on Banking and Currency, 76th Cong., 3d sess., on S. 4204, op. cit., p. 6.

²U.S., Congress, Senate, "To Continue Functions of the Commodity Credit Corporation, Export-Import Bank of Washington, and Reconstruction Finance Corporation (to January 15, 1941)," Hearings: Before the Committee on Banking and Currency, 76th Cong., 1st sess., on S. 1084 and S. 1102, February 14 and 21, 1939, p. 57.

³"Letters and Executive Order on Controversy Between Henry A. Wallace and Jesse H. Jones over Economic Warfare. Executive Order No.

and June 1944 had been approximately \$200,000,000, while the expenditures under lend-lease to the other American republics were reported to have amounted to approximately \$172,000,000 on June 30, 1944,¹ and the purchases and commitments by the RFC through its subsidiary corporations were also substantial in amount.²

The Export-Import Bank Act of 1945, approved July 31, 1945,³ established the capital stock of the Bank at \$1,000,000,000, to be subscribed by the United States. This act directed that payment for \$1,000,000 of such capital stock be made by surrender for cancellation of the common stock heretofore issued by the Bank and purchased by the United States; that payment for \$174,000,000 of such capital stock be made by surrender for cancellation of the preferred stock heretofore issued by the Bank and purchased by the RFC; and that payment for the balance of \$825,000,000 be made by the Secretary of the Treasury.⁴ Accordingly, on October 1, 1945, the RFC surrendered the preferred stock

9361. July 15, 1943, "The Public Papers and Addresses of Franklin D. Roosevelt, (1943), op. cit., p. 298-306.

¹U.S., State Department, The Export-Import Bank of Washington: The First Ten Years (Publication 2234; Commercial Policy Series 75; ed. by Eleanor Lansing Dulles; Washington, D.C.: Government Printing Office, 1944), p. 15.

²Ibid.

³59 U.S. Stat. at L. (1945), 526-29, "An Act To provide for increasing the lending authority of the Export-Import Bank of Washington, and for other purposes."

⁴Ibid., sec. 4.

at the par value and received \$174,000,000 and accrued dividends.¹

Thus, the Bank became an agency independent from the RFC.

Furthermore by the Act of July 31, 1945, the lending authority was increased from \$700,000,000 to \$3,500,000,000 and its financing was arranged directly from the Treasury instead of through the RFC.²

In review of the relationship between the RFC and the Export-Import Bank of Washington, the RFC's investment in the Export-Import Bank of Washington constituted it the holder of the majority of the voting stock of that institution on June 30, 1945. Normally, under such conditions the relationship of parent and subsidiary prevails. However, the Bank was managed with considerable independence, although the RFC was represented on the Bank's Board of Directors.³ RFC did not perform any management or accounting functions in connection with the operations; it merely acted as a substitute for the Treasury of the United States in supplying funds to finance the operations of the Bank, and, accordingly, the Bank had not been regarded as a subsidiary of the RFC.

The fifth new development during the War was the authorization under the so-called Murray-Patman Act,⁴ approved May 11, 1942, to

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, for the Fiscal Year Ended June 30, 1945 (House Doc. No. 450, 80th Cong., 2d sess.), p. 42.

²U.S., Congress, Report on Audit of the Export-Import Bank of Washington, Fiscal Year Ended June 30, 1945 (House Doc. No. 248, 80th Cong., 1st sess.), p. 4.

³At its formation there were five trustees representing the Departments of Agriculture, Commerce, and State, and the RFC, there being two from the RFC. See Executive Order No. 6581, February 2, 1934.

prevent and relieve distress among dealers in articles and commodities which were rationed in connection with the war effort. That is, at the request of the National Automobile Dealers Association, Sen. James E. Murray and Rep. Wright Patman introduced legislation enabling the RFC to buy or make loans on rationed articles or commodities. Such loans and purchases were made on a basis which enabled dealers to secure an amount equal to the cost to the dealers of such articles or commodities, provided the cost was a reasonable one incurred in the ordinary course of business.¹ Among other advances made by the RFC under this provision, the RFC directly and through Defense Supplies Corporation arranged to assist authorized dealers, banks, and other financial institutions in the carrying and orderly marketing of approximately 125,000 automobiles and light trucks shipped on and after January 16, 1942, before the conversion of the automobile industry to war production, ~~the~~ these cars having been frozen by the Office of Price Administration until April 1, 1943, at the earliest.²

The sixth new development pertaining to the RFC lending activities

The number was increased to nine on February 14, 1934, and later to eleven. U.S., State Department, The Export-Import Bank of Washington: The First Ten Years, op. cit., p. 6.

¹56 U.S. Stat. at E. (1942), 275-76, "An Act For the relief of dealers in certain articles or commodities rationed under authority of the United States."

¹ U.S., Congress, Activities of the Reconstruction Finance Corporation and Its Subsidiaries in Connection with the War up to October 31, 1942 (House Doc. No. 905, 77th Cong., 2d sess.), p. 19.

²Ibid., p. 18.

which originated during the War was the "blanket participation" program. As War financing tapered off and reconversion began to loom as an important financial problem, the RFC, on March 1, 1945, offered to banks a "Blanket Participation Agreement" under the amendment to the RFC Act approved on April 13, 1938.¹ The amendment provided that the purchases of securities and obligations on the loans might be made or effected "either directly or in cooperation with banks or other lending institutions through agreements to participate or by the purchase of participations, or otherwise."² In effect, the program provided for practically automatic guarantee of 75 per cent of the amounts of loans made to business enterprises by approved banks.³ Under this program, banks were enabled originally to make eligible loans up to \$250,000 to any one borrower (later increased to \$350,000 in December 1945, and then, one year later, reduced to \$100,000 as of December 1, 1946) without prior approval of the RFC.⁴ Loans requiring

¹52 U.S. Stat. at L. (1938), 212-13, "An Act To amend section 5d of the Reconstruction Finance Corporation Act, as amended, to authorize loans to public agencies, to provide credit facilities for business enterprises and for other purposes."

²Ibid.

³U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, for the Fiscal Year Ended June 30, 1945 (House Doc. No. 450, 80th Cong., 2d sess.), p. 54.

⁴Ibid.

guarantee of more than 75 per cent or loans exceeding the established limit in amount could also be made, but only with the prior approval of the RFC. As a charge for the protection afforded by the plan, the RFC collected a fixed percentage varying from one-half of 1 per cent to three-fourths of 1 per cent per annum, depending upon the amount of bank participation.¹

In order to qualify for protection under this plan, a bank was required to present its application for a blanket participation agreement to the loan agency of the RFC serving the territory in which the bank was located. The application was submitted to the directors of the RFC, and, upon being advised of the board's approval, the agency manager was authorized to execute the agreement. Thereafter, loans were automatically covered by the agreement when the loan agency manager received certain information required to be furnished by the bank with respect to each loan made by it.²

Under the agreement, the RFC was obliged to purchase its agreed participation in the unpaid remainder of the loan within 10 days of written demand by the bank, but not later than 60 days after maturity of the note evidencing such loan. The loans were made upon terms and conditions satisfactory to the banks, including the RFC's basic requirement as to solvency and security, without need for filing a loan applica-

¹Ibid.

²Ibid.

tion with the RFC. Loans were limited to 10 years in length, were repayable in installments aggregating each year not less than 10 per cent of the principal, and could not bear interest in excess of 4 per cent on the RFC's share, or 6 per cent on the bank's share.¹

The announced purpose of this program was to "adequately and promptly care for the large volume of applications for loans which it is anticipated may develop during and subsequent to the period of reconversion from a war-time to a peacetime economy."² The automatic character of the arrangement was well accepted especially by many small banks which could avoid filing long application forms as well as taking the chance that guaranty might be refused. Furthermore, they by virtue of the guaranty were enabled to handle loans much larger than their legal loaning limit would otherwise permit. Thus, these banks were not only able to increase their earnings without added risk, but avoided the loss of customers, a hazard which might have been present if other banks were called in to share in setting up large credits.³

On the other hand, the larger banks with extensive correspondent relationships were generally critical of the agreements; for, with these loans, the RFC took the position that, in view of the bank participation, it was not obliged to investigate whether the entire

¹Ibid.

²Ibid.

³Douglas R. Fuller, Government Financing of Private Enterprise (Stanford: Stanford University Press, 1948), p. 110.

credit requested might be available from other sources. The American Bankers Association, at the 72nd annual convention held in Chicago on September 24-26, 1946, went on record in opposition to the program as "superfluous, and as leading toward socialization of banking by eliminating the risk-taking function that is at the basis of private banking."¹ The president of the association, Frank J. Rathje, in his address to the convention on September 25, 1946, criticized the RFC's "blanket participation plan," by saying:

"The stimulus to credit expansion given by this program is unnecessary and untimely. The banks, at the present time, have sufficient resources to meet any demand for credit required by American business of all types. An aggressive policy of credit expansion, at present price levels, by a government agency, is to invite the danger of speculation and over-expansion."²

And in the Wall Street Journal of September 26, 1946, a former American Bankers Association president, Robert M. Hanes, was quoted as having asserted that the automatic guarantee should be discontinued because "it will encourage loose lending practices and be a contributing factor to inflation," and because "it throws an additional liability upon the Government which already is overburdened with financial responsibilities and liabilities."³

¹"Hold to Private Enterprise, Cut Down Spending; A.B.A. Platform," The American Banker, CXI (September 26, 1946), pp. 1 and 5.

²"Large Credits by U.S. Agencies Held Dangerous by F. J. Rathje," The American Banker, CXI (September 25, 1946), p. 43.

³"Hanes Hit RFC Bank Loan Plan," The Wall Street Journal, September 26, 1946, p. 5. And also "Hanes Calls RFC Blanket Guaranty Dangerous," The American Banker, CXI (September 26, 1946), p. 32.

The program was terminated effective January 23, 1947.¹ In substitution the RFC offered a "Small Loan Participation" plan which, in essence, was a simplified form of application designed to expedite the processing of requests for guarantees of not over 75 per cent of loans under \$100,000.²

Despite the brief life of this program, Blanket Participation Agreements were approved with 5,253 banks, of which 2,422 actually made loans under the agreement. The total number of loans authorized was 11,057 in the aggregate amount of \$525,000,000, of which \$380,000,000 or 72.6 per cent represented the RFC's commitment for its guaranty under the Blanket Participation Agreements.³

At June 30, 1945, the RFC and its two subsidiaries had combined loans which amounted to approximately \$2,204,000,000. Of this total, \$304,000,000 represented funds advanced to United States Government corporations and agencies, and \$1,400,000,000 represented funds advanced to others. Table 9 summarizes the principal loans from the RFC's consolidated balance sheet as of June 30, 1945.

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, for the Fiscal Year Ended June 30, 1945, (House Doc. No. 450; 80th Cong., 2d sess.), p. 55.

²Ibid.

³U.S. Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 47.

Table 9

LOANS OF THE RFC AND ITS SUBSIDIARIES OUTSTANDING AT JUNE 30, 1945¹

(Amount in thousands of dollars)

| Class | Amount | |
|--|--|-----------|
| U.S. Government Agencies: Rural Electrification Administration Export-Import Bank of Washington Federal home loan banks Secretary of Agriculture Defense Homes Corporation Others | \$240,170 174,000 125,132 95,344 55,909 113,864 | \$804,419 |
| Others: Financial institutions Enterprises engaged in national defense Railroads, commercial and mining enterprises United Kingdom of Great Britain and Northern Ireland States, territories, municipalities, and public bodies Others | 318,708 305,605 271,941 264,693 122,887 116,519 | 1,400,353 |
| Total | \$2,204,772 | |

¹ Source: U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945 (House Doc. No. 316; 80th Cong., 1st sess.), pp. 106-107, Exhibit 1, Consolidated Balance Sheet--June 30, 1945.

Section 2

Non-lending Activities During World War II

As has been mentioned at the first part of this chapter, the national defense and war activities of the RFC originated with the enactments approved on June 25, 1940, and June 10, 1941, which were added to section 5d(3) to the basic RFC Act for the purpose of enabling the RFC "to aid the Government of the United States in its national-defense program." Under section 5d(3), the RFC was empowered to create corporations with authority:

1. Deal in strategic or critical materials.
2. Acquire real estate and plant facilities for the manufacture of strategic and critical materials, arms, ammunition, implements of war, and equipment necessary for their manufacture.
3. Lease, sell, or otherwise dispose of plant facilities.
4. Acquire and dispose of railroad equipment, commercial aircraft, and parts and supplies necessary in connection with them.
5. Engage in manufacturing operations.
6. Acquire and dispose of facilities for the training of aviators.
7. Take such other action as the President and the Federal Loan Administrator may deem necessary to expedite the national defense program.

In addition, the RFC itself was authorized to make loans to or

¹54 U.S. Stat. at L. (1940), 573, "An Act To authorize the purchase by the Reconstruction Finance Corporation of stock of Federal home-loan banks; to amend the Reconstruction Finance Corporation Act, as amended, and for other purposes," sec. 5 and 55 U.S. Stat. at L. (1941), 249, "An Act to extend the operations of the Disaster Loan Corporation and the Electric Home and Farm Authority, to provide for increasing the lending authority of the Reconstruction Finance Corporation, and for other purposes," sec. 4.

purchase the stock of private corporations for the purpose of acquiring strategic materials and for plant construction, expansion and equipment, and working capital to be used for the national defense program, as has been discussed in the preceding section.¹

The RFC, "in order to aid the Government of the United States in its national defense program" and war activities, created seven subsidiary corporations under the powers conferred upon it by Section 5d(3) of the RFC Act, and acquired one additional subsidiary (Rubber Development Corporation) under Section 5d(2). The names of those corporations and the dates of their creation and dissolution were:

| <u>Name of Corporation</u> | <u>Date Created</u> | <u>Date Dissolved</u> |
|--|-----------------------------|-----------------------|
| Metals Reserve Company | June 28, 1940 | July 1, 1945 |
| Rubber Reserve Company | June 28, 1940 | July 1, 1945 |
| Defense Plant Corporation | August 22, 1940 | July 1, 1945 |
| Defense Supplies Corporation | August 29, 1940 | July 1, 1945 |
| War Damage Corporation | December 13, 1941 | April 1, 1947 |
| U.S. Commercial Company | March 26, 1942 | June 30, 1949 |
| Rubber Development Corporation | February, 1942 ² | June 30, 1947 |
| Petroleum Reserves Corporation (later War Assets Corporation) | June 30, 1943 | June 30, 1946 |

1. Defense Plant Corporation

The Defense Plant Corporation was organized on August 22, 1940, as a government corporation wholly owned by the RFC, under the authority given to it in Section 5d(3) of the RFC Act, "in order to aid the Government of the United States in its national-defense program." The principal

¹See pp. 91-94.

²Acquired in February 1942, inactive until February 16, 1943.

objective of the DPC was to provide financing and supervising for the acquisition of plant sites, the construction of plants, and the purchase and installation of machinery and equipment, all in order to expand the nation's facilities for the production of war materials.¹

Theoretically the DPC built the plants or bought machinery and equipment and leased them to manufacturers. In practice, the actual job of designing, building and equipping the factories was turned over to the potential operating company, which functioned as the DPC's agent. DPC engineers confined themselves to checking on the utilitarian character of the proposed facilities and seeing the job was carried out in accord with the approved specifications. Most of the plants were subject to an option under which the operating company could purchase them at a depreciated value established in the lease. Thus, the government assumed all the entrepreneurial risk, and the private corporations would buy the plant later on if it looked profitable. In the case of synthetic rubber and the vast expansion of aluminum facilities, the lease and option arrangement was not used, and the plants automatically reverted to the DPC after the War.²

Virtually all of the DPC's war-plant facilities were acquired or constructed in compliance with the requests or directives of other

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations--Defense Plant Corporation for the Fiscal Year Ended June 30, 1945 (House Doc. No. 474, 80th Cong., 1st sess.), P. 153, Appendix E, "Defense Plant Corporation--Corporate Charter."

²The synthetic rubber plants were operated by another RFC subsidiary, the Rubber Reserve Company. See pp. 124-125 and pp. 196-201.

sponsoring agencies of the Government, such as War and Navy Departments, Maritime Commission, War Production Board, Office of Defense Transportation, and other federal agencies and RFC subsidiaries.¹ Under the arrangements of the sponsoring agencies, the DPC undertook to acquire plant facilities, and to lease them to war contractors. Generally the lease agreements with these contractors were of one of the following types:

a. Leases specifying the nominal rental of \$1 per year. This form was generally used where the entire plant output was intended to be purchased by the Federal Government under a cost-basis contract.

b. Leases for the payment of rentals based upon investment in plant costs. In these cases, the lessee generally assumed all financial risks of operation; rental rates were 5 per cent per annum on land and buildings and 12 per cent per annum on equipment.

c. Leases which specified that rentals would be based upon sales, upon net profits, or upon volume of production. These forms of leases were used where the Corporation undertook to assume some portion of the financial risk of operation.

d. Other lease arrangements called for fixed amounts² of rentals, payable monthly, quarterly, or for other periods of time.

Under this formula, the DPC owned at the time of its dissolution on June 30, 1945, between 10 and 12 per cent of the total industrial capacity of the nation.³ At that time the DPC owned approximately 96 per cent of the capacity of the synthetic-rubber industry, 90 per cent of the magnesium metal, 71 per cent of aircraft and aircraft engines,

¹For the investment in plants and facilities according to the sponsoring agencies, see U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations--Defense Plant Corporation for the Fiscal Year Ended June 30, 1945 (House Doc. No. 474; 80th Cong., 1st sess.), p. 40.

²Ibid., p. 7.

³Ibid., p. 4, and p. 36.

and 58 per cent of the aluminum metal industry. It also had sizable investments in iron and steel, aviation gasoline, ordnance, machinery and machine tool, transportation, radio, and other more miscellaneous facilities.¹ All in all, the DPC owned about 2,200 projects with a recorded cost of approximately \$6,982,000,000, which is analyzed according to industry in the following list.²

| | <u>Number of plant and facility locations</u> | <u>Cost in Millions of dollars</u> |
|---|---|--|
| Aircraft industry, and flying schools and related facilities..... | 658 | \$ 2,656 |
| Metals..... | 373 | 2,201 |
| Synthetic rubber..... | 132 | 740 |
| Oil pipelines, barges and tug boats, and other transportation facilities..... | 78 | 301 |
| Ordnance..... | 106 | 285 |
| Aviation gasoline..... | 38 | 237 |
| Shipbuilding and ship engines and parts..... | 78 | 132 |
| Chemicals..... | 174 | 116 |
| Machine tools and machinery manufacture..... | 215 | 92 |
| Radio equipment..... | 154 | 81 |
| Other, including machinery in plants owned by others..... | <u>188</u> | <u>141</u> |
| TOTAL..... | 2,194 | \$ 6,982 |

From the larger view of government the DPC mechanism was advantageous, for the lessee used his "know-how", subject to supervision by the DPC, in directing the construction and equipment of the plant which the lessee would later operate. The lessee's experience was

¹Ibid., p. 36.

²Ibid., p. 4.

thus enlisted to construct the plant efficiently and speedily. The lease mechanism was also advantageous in that it kept the cost of supplies separate from the cost of facilities. Since rentals were moderate or nominal the price of the supplies produced was not inflated by charges to amortize the new facilities. The DPC lease mechanism also had important advantages to the Armed Services and to the emergency agencies it served. During the early period to Pearl Harbor, when appropriations to the services were insufficient to meet all needs, the DPC was particularly useful. The DPC eased the budgets of the military and naval services and the Maritime Commission by requiring those agencies to provide at most a part and sometimes none of the costs of construction. Consequently, many plants were erected sooner than would otherwise have been possible. Following construction, the DPC continued to be useful in assuming the administrative burden associated with operation of the facilities. The DPC's value was further heightened by the fact that its leases were flexible and readily adaptable to the changing production needs of its sponsors.

For the lessee, too, the mechanism had advantages. As the lessee of a civilian government agency newly and specifically created to construct a defense and war plant, the lessee was able to operate the DPC plant with far greater freedom than if he were operating a service-owned plant under a management-fee contract. The plant, in fact, bore the name of the lessee. Subject to certain minimum checks by the DPC, the lessee was free to conduct his operations as if the plant were his own. The DPC lease mechanism thus largely "substituted self-policing

for control by government red tape."¹ Moreover, the DPC shouldered all risk associated with the fixed capital investment. Consequently, there was no danger that the private firm operating the plant would emerge from the war burdened with debt as a result of unwise plant investment.

Again, looking into it from the standpoint of the financial mechanism of the country, the DPC, as a subsidiary of the RFC which had independent borrowing authority, could supply funds outside the system of Congressional appropriation. Since it had funds available, it could supply immediate financing to certain areas of industry, such as aircraft, normally financed by private capital at a time when private capital was hesitant because of the risks involved in an expansion of such proportions.

Thus the DPC met better than any alternate means the needs of many defense and war programs requiring additional facilities. For industry, the DPC lease offered a simple and flexible arrangement allowing a maximum of freedom in the operation of the facilities without risk of ownership while at the same time the government was protected from windfall gains to industry through the terms of the supply contracts and through its maintenance of title to the facilities. The DPC was "an improvisation unique to World War II."² As such, it

¹Gerald T. White, "Financing Industrial Expansion For War: the Origin of the Defense Plant Corporation Leases," Journal of Economic History, IX (November, 1949), 182.

²White, op. cit., p. 183.

marks a notable development of government financing in a situation of national crisis.

After the close of the War, the DPC entered a stage of liquidation. It was dissolved effective July 1, 1945, and its activities, assets, and liabilities were merged with those of the RFC on that date in accord with a joint resolution approved on June 30, 1945.¹

2. Defense Supplies Corporation

The Defense Supplies Corporation was created by the RFC on August 29, 1940, pursuant to the authority contained in Section 5d(3) of the RFC Act. The principal functions of this agency were (a) the procurement, stock-piling, and disposal of commodities defined as strategic and critical materials by the President of the United States,² chiefly those which were not minerals or metals, and (b) the payment of subsidies to producers and on the transportation of strategic and critical materials.³

The original operating capital of the DSC consisted of its capital stock of \$5,000,000 which was all subscribed for and issued to the RFC

¹59 U.S. Stat. at L. (1945), 310, "Joint Resolution To transfer to the Reconstruction Finance Corporation the functions, powers, duties and records of certain corporations."

²For the definition and list of strategic and critical materials see pp. 92-93.

³U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Defense Supplies Corporation, (House Doc. No. 439, 80th Cong., 1st sess.), p. 161, "Defense Supplies Corporation--Corporate Charter, as amended."

for cash. The additional funds required by the DSC were obtained by loans from the RFC against notes of the DSC. Under these arrangements the DSC, as Mr. Jesse H. Jones remarks in his recent book, was "by far the most versatile member of RFC's sturdy brood of wartime offspring."¹ The DSC was "a catch-all, go-anywhere, do-anything organization."²

The greater part of the activities of the DSC was concerned with the procurement and disposal or stockpiling of commodities. In the case of some of the commodities, the volume of activity became so great as to utilize practically the entire domestic productive resources of the industries involved. This was true in the 100-octane aviation gasoline and industrial alcohol programs for supplying the Army and the Navy. This program involved a diversion of a major portion of the domestic petroleum industry into a new field. Tremendous amounts of component ingredients, such as benzol of various types and 91-octane gasoline, were acquired by the DSC and directed into channels where their use was required. The program to procure commercial alcohol by the DSC involved the procurement of large quantities of molasses from Cuba and other West Indies sources, and their sale to commercial users at arbitrary prices related to the selling price of alcohol as determined by the Office of Price Administration. Contractors for the DSC, for the period from its inception to June 30, 1945, produced more than 12,000,000,000 gallons of 100-octane aviation gas-

¹Jesse H. Jones, Fifty Billion Dollars: My Thirteen Years with the RFC (New York: Macmillan Co., 1951), p. 350.

²Ibid.

oline and more than 1,000,000,000 wine gallons of commercial high-proof alcohol.¹

One of the largest stockpiling operations required of the DSC was the procurement and storage of Australian, New Zealand, South African, and South American wool. When this program was undertaken in 1940, it was planned only that Australian wool owned by the United Kingdom would be stored in the United States to insure an adequate reserve supply should enemy action sever communications with the Antipodes.² In 1942, however, to relieve the dollar exchange shortage which then existed in Great Britain, large quantities of the stored wool were purchased by the DSC. Also, the DSC undertook to procure wool from sources other than Australia. Furthermore, in 1943 the DSC entered into another arrangement with the United Kingdom under which Australian and New Zealand wool were brought to this country and stored for the account of the United Kingdom. The DSC agreed to pay one-half of the shipping and storage charges on this wool, which eventually would all be trans-shipped to Great Britain.³

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Defense Supplies Corporation (House Doc. No. 439, 80th Cong., 1st sess.) p. 15.

²Ibid., p. 16.

³This arrangement was not considered to be a part of the DSC wool stockpiling activity. Ibid., p. 17.

The DSC's numerous other procurement programs involved strategic and critical materials or rationed commodities which were acquired by purchases, by contract for manufacture, or by arrangements involving the sponsorship of new sources of supply.

Under the authority of Section 2(e), Title I, of the Emergency Price Control Act of 1942,¹ the DSC paid cash subsidies to the producers, processors, and vendors of certain strategic and critical commodities, when a determination had been made by the Federal Loan Administrator,² with the approval of the President, that the maximum necessary production of such materials was not being obtained, or might not be obtained during the ensuing year, unless such subsidies were paid. The foodstuffs on which subsidies were paid were meat, flour, and butter. Transportation equalization subsidies were paid on petroleum and petroleum products, on sugar, and on coal. Production subsidies were paid on certain critical chemicals, aluminum rods, petroleum produced from stripper oil wells, timber and wood pulp,

¹56 U.S. Stat. at 4. (1942), 23-36 "Emergency Price Control Act of 1942."

²By Executive Order 9071, dated February 24, 1942, issued under the authority of the First War Powers Act, 1941, all of the functions, powers, and duties of the Federal Loan Administrator, including those which related to the DSC, were transferred to the Department of Commerce to be administered under the direction and supervision of the Secretary of Commerce. Insofar as the DSC was concerned, this transfer had no practical effect, since the Federal Loan Agency and the Department of Commerce were both headed by the same man, Mr. Jones. The transfer was reversed three years later when the act of February 24, 1945 (59 U.S. Stat. at L. 5), "An Act To provide for the effective administration of certain lending agencies of the Federal Government," made the Federal Loan Agency an independent agency of the Federal Government.

building bricks, and firewood.¹ Subsidies to stimulate the production and processing of commodities were made necessary by OPA price controls which had discouraged production or processing operations by rendering them unprofitable. Transportation compensatory payments were required to equalize the burden of excess transportation costs attributable to the disruption of normal transportation facilities, principally by enemy warfare.

Four pipelines,² constructed and owned by Defense Plant Corporation, were operated by the DSC. At the request of other Government agencies, the DSC acquired certain properties and leased them to others. For instance, a large multi-passenger airplane was purchased and leased to the War Production Board.³ The lease agreement provided that the rental payments might be applied to the purchase of the airplane, and, after the cumulative total of the payments equaled an agreed-upon amount--\$139,000 plus interest, title to the plane would pass to WPB. After having paid \$122,000 for rent through June 1946, WPB decided not to execute its option to purchase the airplane and returned the craft to the RFC on June 30, 1946.⁴

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Defense Supplies Corporation (House Doc. No. 439, 80th Cong., 1st sess.), p. 17.

²They were the Trans-Florida Line, the South Texas Line, the Greensboro, N.C.-Richmond, Va. Line, and the Big Inch and the Little Big Inch Lines. Ibid., p. 18.

³Ibid.

⁴Ibid.

At the request of the Director of Inter-American Affairs, the DSC became responsible for certain activities in South America. These included the so-called de-Germanization of South American airlines, the training of nationals of South American republics as aircraft technicians, and other activities relating to the improvement of technical development among the South American republics.¹

In buying, lending, and subsidizing the DSC disbursed approximately \$9,226,000,000 in the United States and forty-five foreign lands as a part of the government's preparedness and war-making activities. Of the amount disbursed, \$1,672,000,000 was recorded as cost of subsidy and other activities incurred by the DSC as agent for the Government of the United States on June 30, 1945.²

The DSC was dissolved effective July 1, 1945, and all of its functions, powers, and duties were transferred to the RFC on that date in accord with a joint resolution approved on June 30, 1945.³

3. Metals Reserve Company

Metals Reserve Company was created on June 28, 1940, pursuant to Section 5d(3) of the RFC Act. The MRC's principal functions, as set forth in its charter, were (a) the procurement, stockpiling, and disposal

¹Ibid., p. 19.

²Ibid., p. 2, p. 75.

³59 U.S. Stat. at L. (1945), 310, "Joint Resolution To transfer to the Reconstruction Finance Corporation the functions, powers, duties and records of certain corporations."

of metals and minerals defined as strategic and critical materials¹ by the President of the United States, and (b) the payment of subsidies to producers of strategic and critical materials.² The original capital of the MRC consisted of its capital stock of \$5,000,000, which was all subscribed for and issued to the RFC for cash.³ The additional funds required by the MRC were borrowed by loans from its parent, the RFC, which in turn had borrowed from the Treasury of the United States.

At first, the MRC contracted for the purchase of materials on a delivered basis, buying all such materials as would comply with requirements necessary to produce the required finished product. This program was later expanded by the execution of agreements with the governments of foreign countries, particularly in South America, whereby all ~~the~~ exportable surplus of ~~such~~ countries was to be sold to the MRC, in some cases involving payment of a part of the purchase price before the materials were shipped to the United States.⁴

Among the metals traded in were aluminum, copper, nickel, tin and tin ore, chrome ore and concentrates, platinum, antimony, mercury, lead, manganese ore, quartz crystals, zinc, asbestos, mica, tungsten ore and concentrates, silver, and gold. They totaled approximately 50

¹ For the definition and the list of the strategic and critical materials, see pp. 92-93n.

² U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Metals Reserve Company (House Doc. No. 758, 80th Cong., 2d sess.), Appendix B "Metals Reserve Company--Corporate Charter."

³ Ibid., p. 9.

⁴ Ibid., p. 11.

different minerals, and were purchased from 51 different foreign countries and the United States.¹

Under the authority of Section 2(e), Title I of the Emergency Price Control Act of 1942,² the RFC paid cash subsidies to the domestic producers of strategic and critical metals and minerals. In addition, many of the trading activities undertaken involved the making of sales at less than cost, with resulting losses which were tantamount to subsidies. Other indirect subsidies took the form of financial advances made under circumstances which were characterized by more than the ordinary risk of loss.³

The total costs incurred in the subsidy and trading programs from inception of the MRC to June 30, 1945, are summarized in the following tabulation:⁴

¹ Ibid., p. 40. Among the MRC's activities, the operation of the tin smelter at Texas City, Texas, and the import of, and trading in, refined tin and tin ores are still continued under the RFC and will be studied in the next chapter. See pp. 201-208.

² 56 U.S. Stat. at L. (1942), 23, 36, "Emergency Price Control Act of 1942."

³ U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Metals Reserve Company (House Doc. No. 758, 80th Cong., 2d sess.), p. 3.

⁴ Ibid., p. 13.

| | |
|--|-------------------|
| Direct subsidies allowed to producers of strategic and critical metals and minerals..... | \$212,500,000 |
| Net losses resulting from processing and trading activities..... | 104,500,000 |
| Interest on borrowed funds..... | 18,500,000 |
| Administrative expenses and certain other items of expense and income, net..... | <u>15,900,000</u> |
| TOTAL COST | \$351,400,000 |
| Less gains resulting from processing and trading activities..... | <u>35,500,000</u> |
| NET AMOUNT..... | \$315,900,000 |

The MRC was dissolved effective July 1, 1945, and all of its functions, powers, and duties were transferred to the RFC on that date in accord with a joint resolution, approved on June 30, 1945.¹

4. Rubber Reserve Company

This subsidiary was formed on June 28, 1940, "to aid the Government of the United States in its national-defense program," under the authority of Section 5d(3) of the RFC Act, by providing supplies of crude rubber, scrap rubber, and aiding in the establishment of synthetic rubber plants.² Its entire authorized capital stock of \$5,000,000 was subscribed and paid for in full by the RFC.³

¹ 59 U.S. Stat. at L. (1945), 310, "Joint Resolution To transfer to the Reconstruction Finance Corporation the functions, powers, duties, and records of certain corporations."

² U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Rubber Reserve Company, and Rubber Development Corporation (House Doc. No. 444, 80th Cong., 2d sess.), p. 2.

³ Ibid., p. 12.

The RFC, through the Rubber Reserve Company and another subsidiary, the Rubber Development Corporation, became the sole agent of the government concerned with the procurement, stockpiling, and distribution of natural rubber, after June 30, 1941. The RFC also became the sole importer of rubber in the United States on June 20, 1941, and continued that function until April 1, 1947,¹ when commercial imports were resumed and no new purchases of natural rubber were made by the RFC after that date.

Most of the natural rubber acquired by the RFC was procured in the Far East, the normal source of more than 97 per cent of the world supply. After the Japanese conquest of the principal rubber-producing areas in the Far East early in 1942, the Rubber Reserve Company, in conjunction with the State Department, negotiated agreements with 17 Latin American countries for the procurement of practically all the rubber produced in those countries.² The Company sent representatives and technicians into most of those countries to assist in increasing the production and availability of wild rubber. In addition to paying a very substantial price for the rubber, the Company

¹ This function was performed through the Rubber Reserve Company until June 30, 1945, and, after that date, directly by the RFC, as the Rubber Reserve Company lost its corporate autonomy on June 30, 1945.

² U.S., Congress, Activities of the Reconstruction Finance Corporation and Its Subsidiaries in Connection with the War Up to October 31, 1942, (House Doc. No. 905, 77th Cong., 2d sess.), p. 16.

was expending large sums of money to improve transportation and working conditions, increase the labor supply, and do whatever else might be necessary to get more rubber.¹ These agreements provided for the establishment of development funds to facilitate the creation or expansion of rubber production. Most of the agreements were subsequently extended to expire June 30, 1947.

Acquisition from the Far East accounted for approximately 77 per cent of all natural rubber obtained, notwithstanding the inroads of war particularly during 1942 and early 1943. Approximately 9 per cent was secured from the Latin American countries, principally Brazil. The remainder was obtained from Africa and from inventories of domestic manufacturers.²

As of June 30, 1947, sales of natural rubber by the RFC amounted to \$737,000,000 and the net loss from trading in natural rubber totaled almost \$140,000,000.³ The average cost of the rubber from the Far East closely approximated the selling prices charged by the RFC. Thus, the reported loss on natural rubber was primarily attributable to the extraordinary procurement costs (including promotion and development)

¹Ibid., p. 17.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468, 81st Cong., 2d sess.), p. 99.

³Ibid., p. 100.

incurred in the acquisition of rubber from marginal and new sources in the Western Hemisphere.¹

The synthetic rubber program of the Rubber Reserve Company was begun in 1941 with a plan to construct plants capable of producing 40,000 long tons of rubber annually.² The program was expanded rapidly after Pearl Harbor, and by June 1945 there were 18 plants in production with a rated annual capacity of 818,000 long tons and a demonstrated capacity of approximately 1,000,000 long tons.³ In addition to the rubber-producing plants, the Defense Plant Corporation constructed a number of plants for the production of raw materials required in the manufacture of rubber. All of these plants were leased by the Defense Plant Corporation to the Rubber Reserve Company for use. The expenditures by the RFC for plants used in the synthetic rubber program totaled \$707,000,000, by June 30, 1945.⁴

The synthetic rubber plant facilities were operated for the RFC by private industry, primarily rubber, petroleum, and chemical companies. The RFC usually entered into two contracts with each operator. Under one agreement the plant was leased to the operator at a nominal rental of one dollar a year. The other, an operating agreement, generally provided that the RFC would reimburse the operator for all costs of operation and maintenance of the plants, and for the payment of manage-

¹Ibid.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945—Rubber Reserve Company, and Rubber Development Corporation (House Doc. No. 444, 80th Cong., 2d sess.), p. 11.

³Ibid., p. 30.

⁴Ibid., p. 31.

ment fees, based on production quantities.¹

As of June 30, 1947, sales under the synthetic rubber program amounted to \$1,191,000,000 and the net operating loss totaled \$188,000,000.²

The Rubber Reserve Company, furthermore, in compliance with the request of the President necessitated by the critical rubber shortage, in June 1942 agreed to buy scrap tires and miscellaneous scrap rubber at \$25 per short ton in carload lots at any shipping point in the country. The first scrap-rubber collection drive was announced by President Roosevelt on June 12, 1942. Oil companies under the direction of the Petroleum Industry War Council conducted the drive which lasted until July 10, 1942.³ Then this program was carried out through the four large scrap-rubber dealers⁴ which had nation-wide organizations. The Rubber Reserve Company entered into agency agreements with the four dealers. Under the terms of the agreements, the agents were required to procure, store, and sell scrap rubber and they were to be reimbursed for their actual expenses.⁵ Thus, the scrap rubber was

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468, 81st Cong., 2d sess.), p. 101.

²Ibid., p. 154.

³Jones, op. cit., p. 432.

⁴They were Nat E. Berzen, Inc., Lowenthal Company, H. Muehlstein & Co., and A. Schulman. Ibid.

⁵U.S., Congress, Activities of the Reconstruction Finance Corporation and Its Subsidiaries in Connection with the War up to October 31, 1942, (House Doc. No. 905, 77th Cong., 2d sess.), p. 17.

obtained through commercial channels and by public collection drives.

The scrap rubber program had resulted in loss of over \$22,000,000 by June 30, 1945, mainly because of expenses for handling, transporting, and storing.¹ Even after June 30, 1945, further expenses were incurred in disposing of the scrap rubber still on hand, which, according to the Rubber Reserve Company's estimates, had no value.²

The Rubber Reserve Company was dissolved as of July 1, 1945, by the provisions of a joint resolution, approved June 30, 1945,³ and its powers and duties were merged with those of the RFC. The functions of the defunct Rubber Reserve Company have since been carried out by the RFC through its Office of Rubber Reserve.

5. War Damage Corporation

On December 13, 1941, the RFC, pursuant to the authority contained in Section 5d(3) of the RFC Act, as amended, created the War Insurance Corporation. By charter amendment dated March 30, 1942, the name was changed to War Damage Corporation to conform to the provisions of Section 2 of the Act approved on March 27, 1942,⁴ which was added to the

¹ U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Rubber Reserve Company, and Rubber Development Corporation (House Doc. No. 444, 80th Cong., 2d sess.), p. 64.

² Ibid., p. 65.

³ 59 U.S. Stat. at L. (1945), 310, "Joint Resolution To transfer to Reconstruction Finance Corporation the functions, powers, duties, and records of certain corporations."

⁴ 56 U.S. Stat. at L. (1942), 174-176, "An Act To provide for the financing of the War Damage Corporation, to amend the Reconstruction Finance Corporation Act, as amended, and for other purposes."

RFC Act as Section 5g.

Under the provisions of Section 5g of the RFC Act, the RFC was directed to continue to supply funds to the War Damage Corporation up to the aggregate amount of \$1,000,000,000, and the War Damage Corporation was empowered to use the funds to provide, "through insurance, re-insurance, or otherwise, reasonable protection against loss of or damage to property, real and personal,"¹ which might result from enemy attack, including any action taken by the military, naval, or air forces of the United States in resisting enemy attack.²

The act also provided that protection should be applicable to property situated in the United States, the Philippine Islands, the Canal Zone, the territories and possessions of the United States, and in other places determined by the President of the United States to be under the dominion and control of the United States.³

The act of March 27, 1942, provided specifically for property loss or damage which might have occurred after December 6, 1941, and before the date on which protection was to become available as determined by the Secretary of Commerce.⁴ Under the law, such losses or damage might be compensated by the War Damage Corporation without requiring a contract of insurance or the payment of a premium or other charge, and "such loss or damage may be adjusted as if a policy covering such

¹Ibid., sec. 2. It became Section 5g of the RFC Act, as amended.

²Ibid.

³Ibid.

⁴Ibid.

property was in fact in force at the time of such loss or damage."¹
This insurance program was designated by the WDC as the "pre-policy
program."²

On July 1, 1942, in conformity with the determination of the Secretary of Commerce, provided under Section 5g of the RFC Act, the WDC inaugurated the "policy program," publishing its regulations, rules, and rates effective as of July 1, 1942.³ On that date coverage was provided on property situated in the continental United States, Alaska, the Virgin Islands, Hawaii, Puerto Rico, and the Canal Zone. Because the Philippines, Guam, and Midway Island were under the control of enemy forces on July 1, 1942, coverage was not extended to those areas when the "policy program" was inaugurated.⁴

In order to avoid the necessity for creation of a nation-wide governmental organization to handle its insurance program, the WDC negotiated agreements with established private insurance companies to act as its fiduciary agents. These agents were authorized to receive applications and premium remittances, issue policies, and transact any other business in accord with the prescribed regulations. Under this arrangement the WDC mobilized the services of approximately 1,450

¹Ibid.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945-- War Damage Corporation (House Doc. No. 605, 80th Cong., 2d sess.), p. 8.

³Ibid.

⁴Ibid., p. 9.

policy-issuing offices, 1,166 of which became actively engaged in making general war-risk insurance protection available to the public.¹

The WDC also, consistent with its policy adopted in the writing of war-risk insurance, determined that the investigation and adjustment of claims for loss or damage could best be handled by private agencies already established and experienced in that field. Consequently, the WDC entered into agreements with Fire Companies' Adjustment Bureau, Inc., Western Adjustment and Inspection Company, and Underwriters' Adjusting Company, under which the personnel and facilities of those companies in approximately 400 cities in the United States could be utilized as claims service offices of the WDC.²

The issuance of policies was discontinued on March 15, 1946, because of the cessation of hostilities and the consequent decrease in demand for war damage insurance. Insurance under policies in force at that date remained in effect until the expiration dates specified in the policies and until the expiration of any duly authorized periods of extension. In any event, all policies automatically expired by April 1, 1947, while the WDC had existence only until January 22, 1947, by its charter, except for purposes of liquidation.³ In its final liquidation of the WDC, the RFC paid into the federal Treasury \$209,827,810, representing profits realized from its operations.⁴

¹Ibid., p. 4.

²Ibid., p. 5.

³Ibid., p. 9.

⁴Ibid., p. 13, See also Jones, op. cit., p. 455.

6. The U.S. Commercial Company

The U. S. Commercial Company was organized as an RFC subsidiary on March 26, 1942, pursuant to Section 5d(3) of the RFC Act.¹ The principal functions of the USCC were (1) the conduct of preclusive purchasing and other disruptive activities abroad, designed to prevent the acquisition of strategic commodities by enemy powers, and (2) the procurement abroad of commodities defined as strategic and critical materials by the President of the United States, and stockpiling of such commodities in foreign locations or their importation into the United States for delivery to other agencies of the government.²

The USCC had been regarded as one of the war subsidiaries of the RFC, but unlike the other RFC war subsidiaries, which were operated under the general supervision of the Federal Loan Administrator, the USCC was managed under the direction of the Office of Economic Warfare by the Executive Order 9361, dated July 15, 1943.³ By Executive Order 9380, dated September 25, 1943,⁴ the Office of Economic Warfare was

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--U.S. Commercial Company (House Doc. No. 713, 80th Cong., 2d sess.), p. 1.

²Ibid., p. 77, Appendix, U.S. Commercial Company, Corporate Charter."

³"Letters and Executive Order on Controversy Between Henry A. Wallace and Jesse H. Jones over Economic Warfare. Executive Order No. 9361. July 15, 1943," The Public Papers and Addresses of Franklin D. Roosevelt, (1943), op. cit., pp. 398-405. The same order was made effective for the Rubber Development Corporation, the Petroleum Reserves Corporation and the Export-Import Bank of Washington. See pp. 135, 139 and 161.

⁴"The Foreign Economic Administration Is Established. Executive Order No. 9380, September 25, 1943," The Public Papers and Addresses of Franklin D. Roosevelt, (1943), op. cit., pp. 406-412. During the defense and earlier war periods, a number of Federal Departments and agencies

transferred to the Foreign Economic Administration, together with the corporations (including the USCC), agencies and functions assigned to it by the Executive Order 9361. Thus, the question of ownership of the USCC was not satisfactorily resolved until the responsibility for management of the USCC was restored to the RFC on October 20, 1945, by Executive Order 9630¹ issued by President Truman on September 27, 1945, under which the Foreign Economic Administration was discontinued and the USCC as well as the Rubber Development Corporation and the Petroleum Reserves Corporation were transferred to the RFC,² while all of the other residual functions of the Foreign Economic Administration were assigned to other agencies of the government.

The main preclusive operations were conducted in Spain, Portugal, and Turkey under loss-sharing agreements with the United Kingdom Commercial Company and the British Ministry of Economic Warfare.³

had had a hand in the matter of economic warfare. They dealt with such vital international economic functions as relief and rehabilitation of liberated areas, lend-lease, stock-piling of critical materials, export and import control, and preclusive purchases designed to keep strategic materials out of the hands of the enemy. It eventually became apparent that a thorough consolidation of these several agencies engaged in international economic activities was necessary in order to eliminate the confusion of duplicating, and sometimes competing operations. By this Executive Order, President Roosevelt merged into the new Foreign Economic Administration the Office of Lend-Lease Administration and the Foreign economic operations of the Office of Foreign Economic Coordination of the Department of State together with the Office of Economic Warfare.

¹"Redistribution of Foreign Economic Functions and Functions with Respect to Surplus Property in Foreign Areas. Executive Order No. 9630, September 27, 1945," C.F.R. 1945 Supp., p. 119.

²Ibid.

³U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945, (House Doc. No. 316, 80th Cong., 1st sess.), p. 88.

Except for the disposal of inventories, the preclusive operations were discontinued in 1944 when Germany was no longer able to trade with the neutral countries. Early in 1943 the USCC, under the direction of the Board of Economic Warfare, undertook to obtain and ship farm machinery, vegetable seeds, fertilizer, and other supplies for the establishment of food-producing projects in New Guinea, New Caledonia, and the Solomon Islands. In addition, trade goods such as textiles, knives, sewing machines, and fishing tackle, were shipped to the islands for sale to the natives. In return, the USCC purchased some copra and native handicraft.¹ The program was undertaken at the request of the Navy Department. Its primary purposes were to raise fresh foodstuffs for the armed forces and thus conserve valuable shipping space, and to supply the natives with trade goods until normal private trade could be resumed. After the surrender of Japan, the program was extended to the other islands in the central Pacific including the Carolines, Marianas, Marshalls, and Hawaii. On December 11, 1947, these activities were transferred to the Navy Department.²

Similar activities were initiated by the USCC in the Philippines after their liberation in 1944. This program was administered in cooperation with the War Department through a branch office in Manila.

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1946 and 1947 (House Doc. No. 468, 81st Cong., 2d sess.), p. 117.

²Ibid., p. 118.

Its general purpose was to aid in the restoration of the civilian economy and trade of the islands. Consumer goods and transport equipment were purchased by the USCC from various sources and sold to civilian consumers and the Philippine government. Also the USCC purchased abaca and copra in the Philippines for shipment to the United States. The Manila office closed on December 31, 1946, when the program was largely completed.¹

During 1946 and 1947 the USCC acted as agent for the War Department in the importation of raw materials and manufactured goods from Japan, Germany, and Korea, and the sale of such commodities both in the United States and abroad. It has also acted as agent for the Commodity Credit Corporation in the export of cotton to Japan and Germany for the manufacture of textiles. These programs were begun in order to expedite the return of international trade to normal channels, assist the War Department to defray occupation costs, and provide dollar exchange for the military authorities in occupied countries.² Effective December 31, 1947, the USCC's participation in these programs was terminated, and its functions were assigned to the military governments of Japan and Germany.³

The charter of the USCC expired on June 30, 1949. By the date of its expiration, the USCC disbursed nearly \$2,000,000,000. Its balance sheet at that date showed a cumulative net loss of only \$172,000,000, which, to Mr. Jones' estimation, was less than might have been anticipated.⁴

¹Ibid.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945 (House Doc. No. 316, 80th Cong., 1st sess.), p. 89.

³Ibid.

⁴Jones, op. cit., p. 387.

7. Petroleum Reserves Corporation

The Petroleum Reserves Corporation was created on June 30, 1943, in response to the Government's wartime need for access to foreign reserves of crude petroleum.¹ The concept of the Petroleum Reserves Corporation grew out of the worries of the Joint Chiefs of Staff.² They were gravely concerned over the rapid dwindling of domestic reserves of petroleum caused by wartime demands. During June, 1943, under the auspices of the War Department, a number of meetings were held attended by representatives of departments of State, War, Navy, and Interior.³ Those in attendance on the meetings recommended, among other things, that the government make secret contracts with the presidents of the Texas Company and the Standard Oil Company of California which jointly owned the California Arabian Standard Oil Company, and negotiate for the purchase of 100 per cent of the latter's capital stock. They also recommended that a government official be dispatched to the Middle East to sound out Alexander C. Kirk, then the American Minister to Egypt and Saudi Arabia, as to what, if anything, ought to be done to arrange appointments and conferences with King ibn-Saud.⁴ All these plans and proposals were submitted to

¹ U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Petroleum Reserves Corporation (House Doc. No. 622, 80th Cong., 2d sess.), p. 1.

² Jones, op. cit., p. 483.

³ They were Herbert Feis of the Department of State; Robert P. Patterson, then Under-Secretary of War; General Boykin C. Wright and Colonel W.E.R. Covell of the War Department; William C. Bullitt and Captain W. J. Carter of the Navy Department and Abe Fortas of the Interior Department. Ibid.

⁴ Ibid.

President Roosevelt through the secretaries of the four departments and the Director of War Mobilization.¹ President Roosevelt, on June 29, 1943, directed the Federal Loan Administrator and the RFC to create the Petroleum Reserves Corporation.²

Thus, on the next day, June 30, 1943, a new war subsidiary of the RFC was formed. However, the general supervision of the PRC, as has been explained before,³ was handed over to the Office of Economic Warfare, effective July 15, 1943, and soon to the Foreign Economic Administration as of September 25, 1943, by the executive orders. As were the cases of the U. S. Commercial Company and the Rubber Development Corporation, the PRC was returned to the RFC on September 27, 1945, by an executive order.⁴ However, during this entire period the RFC continued to finance the PRC and to perform most of its accounting functions.

In addition to the main purpose of the PRC in buying or acquiring foreign reserves of crude petroleum, the disposition of the oil or of its products was also contemplated by the charter.⁵ Furthermore, the PRC was authorized to construct and operate refineries, pipelines,

¹ Secretaries of the four departments were Secretary of State Cordell Hull, Secretary of War Henry L. Stimson, Acting Secretary of the Navy James Forrestal, and Secretary of Interior Harold Ickes; and the Director of War Mobilization was James F. Byrnes. Ibid.

² Ibid.

³ See p. 131.

⁴ See pp. 131 and 141.

⁵ U.S., Congress, "Petroleum Reserves Corporation: Corporate Charter,"

storage tanks, and other facilities outside the United States.¹

The PRC, under this authority, in early February 1944, was committed to build a 1,250-mile pipe line from the Persian Gulf starting on the eastern shore of Saudi Arabia, to the eastern end of the Mediterranean. Cost of this project was estimated between \$130,000,000 to \$165,000,000 by the PRC, depending on final details of design.² The PRC soon announced the text of "agreement on principles," disclosing that the PRC would exercise complete domination in transportation of Arabian and Kuwait oil to the Mediterranean area where it would be available for transshipment to countries along the shores of that ocean, to western Europe, or to the Western Hemisphere.³

The PRC held that the pipeline would be a hedge against a long war and would be a part of the over-all United Nations' military petroleum-policy program and that it would ultimately serve to loosen the British monopoly on Persian Gulf oil.⁴ However, bitter

in Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Petroleum Reserves Corporation (House Doc. No. 622; 80th Cong., 2d sess.), p. 15.

¹Ibid.

²Henry D. Ralph, "Government Becomes Transportation Arbitor for Middle East Fields," The Oil and Gas Journal, 42 (February 10, 1944), 28.

³Ibid., 30. The "agreement on principles" was signed between the PRC on the one side and the Arabian-American Oil Co., Gulf Oil Corp., the Texas Co., and the Standard Oil Co. of California on the other side on February 7, 1944. Ibid., 30 and 36.

⁴See Secretary of the Interior Harold L. Ickes' radio address in Henry D. Ralph, "Advocates of Arabian Line Race Against Time to Beat Threatened Interferences," The Oil and Gas Journal, 42 (March 16, 1944), 52. Secretary of the Navy Frank Knox also declared that the Arabian project is "the birth of a genuine foreign-oil policy." See ibid., 56.

opposition developed, particularly from the smaller oil companies who saw no necessity for Government participation in oil affairs. They pointed out that while technically the Government was not actually engaged in the production of oil, the pipe-line-contract terms in effect gave the government control over exploration and production policies of the private companies.¹ Officially, under the proposed pipe-line contract, the Government through the PRC was to act as a banker making a loan. In return for acting as banker, the Government intended to extract a guaranteed minimum tender of oil to the line. That meant that regardless of future tanker developments, possible market eastward via the Persian Gulf and the Red Sea, and regardless of how low tanker rates might go, the pipe line was to be kept filled at a tariff high enough to guarantee the Government a return of capital plus a profit.² Furthermore, the Government in the "agreement on principles" demanded and obtained a monopoly on all pipe-line construction to the Mediterranean.

In the meantime, negotiations were begun on the first proposed

¹For the text of the "agreement on principles," see The Oil and Gas Journal, 42 (February 10, 1944), 30.

²Charles J. Deegan, "Middle East Pipe Line Proposal May Upset Entire U.S. Petroleum Industry," The Oil and Gas Journal, 42 (February 24, 1944), 58.

Anglo-American petroleum agreement.¹ Consequently the Administration, to quiet the controversy during the delicate negotiations, agreed to call off the pipeline project.²

The PRC had nothing more to do, so its name was changed to the War Assets Corporation on November 15, 1945, in order to facilitate its employment as a disposal agent for surplus property under the Surplus Property Act of 1944.³ On March 25, 1946, however, the War Assets Corporation was relieved of its responsibilities as a disposal agent, and on June 30, 1946, it was dissolved by the RFC.⁴

¹The State Department on July 12, 1944, made an announcement on the resumption of the negotiations on oil between the United States and the United Kingdom. U.S., State Department, "Petroleum Questions," Bulletin, 11 (July 16, 1944), 62.

²For the petroleum agreements between the United States and the United Kingdom, see U.S., State Department, "Petroleum Agreement Between the United States and the United Kingdom," Bulletin, 11, (August 13, 1944), 153-156; "Conversation on Anglo-American Oil Agreement," Bulletin, 13 (September 9, 1945), 385-86; and "Anglo-American Petroleum Agreement," Bulletin, 13 (September 30, 1945), 481-83.

³U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Petroleum Reserves Corporation (House Doc. No. 622; 80th Cong., 2d sess.), p. 2.

⁴Ibid.

8. Rubber Development Corporation

The Rubber Development Corporation was originally chartered, in November 1940, as the Pacific Development Company, Inc., a corporation of the State of Delaware, an enterprise organized primarily to make a survey of the Galapagos Islands with a view to the establishment of an air base there.¹ The Company operated on funds borrowed from the Export-Import Bank of Washington and from the Defense Supplies Corporation. The first loan, in the amount of \$30,000, was obtained from the Export-Import Bank of Washington as the result of a request from the President of the United States, who promised to repay the loan from his emergency appropriation. The advances, in the amount of about \$50,000, made by the Defense Supplies Corporation were not repaid; and in February 1942 the Defense Supplies Corporation came to possess the entire stock of the Pacific Development Company, Inc. In turn, the Defense Supplies Corporation sold the entire stock to the RFC. On February 16, 1943, the certificate of incorporation was amended to change its name to Rubber Development Corporation, and to alter the nature of its business so as to enable the Rubber Development Corporation to engage in rubber trading activities.²

This subsidiary then became a procurement and development agency in South America and Central America, and the Agency of the government

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Rubber Reserve Company, and Rubber Development Corporation (House Doc. No. 444, 80th Cong., 2d sess.), p. 13.

²Ibid.

responsible for the importation of plantation rubber from Far Eastern and African sources during the period beginning on February 23, 1943. The Rubber Reserve Company had had full responsibility for natural rubber operations before that date.¹ From February 23, 1943, until October 30, 1943, the Rubber Development Corporation was an agent of the Rubber Reserve Company. After that date, it became responsible on its own account for the activities assigned to it, and the Rubber Reserve Company confined its activities to the production of synthetic rubber in the United States and to the distribution of synthetic rubber and rubber scrap.²

Incidental to its principal foreign activities, the Rubber Development Corporation acquired tires and tubes in Brazil and Mexico and sold them, in part, in South American and in part, in the United States. It also conducted certain operations auxiliary to the development of wild natural rubber sources in the Western Hemisphere and to the procurement of rubber from those sources. These auxiliary operations included trading in equipment, materials, and supplies; financing of rubber products, directly and through South American financial institutions; furnishing of technical instruction and assistance in rubber-tapping and -processing operations; improvement of sanitation and health in the rubber-producing areas; financing the recruitment and transportation of labor; acquisition of river steamers and other transportation equipment and leasing of equipment to local enterprises; road and airport construction; and exploration.³

¹Ibid., p. 2.

²See p. 124.

³U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, Rubber Reserve Company, and Rubber Development Corporation, for the Fiscal Year Ended June 30, 1945 (House Doc. No. 444, 80th Cong., 2d sess.), p. 2.

Responsibility for the administration of its affairs, as in the cases of the U. S. Commercial Company and the Petroleum Reserves Corporation,¹ was transferred from the RFC, on July 15, 1943, to become vested first in the Office of Economic Warfare and then in the Foreign Economic Administration. However, the RFC continued to finance and to perform the accounting functions of the organization. The management functions were restored to the RFC on September 27, 1945, when the Foreign Economic Administration was terminated by an executive order.² Effective July 1, 1946, the assets, liabilities and functions of the Rubber Development Corporation were taken over by the RFC under an agreement between the two corporations. The Rubber Development Corporation then was allowed to expire on June 30, 1947, in accord with a provision contained in its charter.³

In summary, the functions of the RFC other than its lending activities were carried out through the above eight war subsidiaries which the RFC created or acquired under the authority provided for by Section 5d(2) and 5d(3). First of all, the RFC through its subsidiary, the Defense Plant Corporation, constructed or equipped more than 2,000 industrial plants for use in war production, 62 flying schools and 150 other facilities essential to the war effort, with a recorded cost of approximately \$6,900,000,000. These plants were leased to private industry for the

¹ See pp. 130-131 and 161.

² See p. 161.

³ U.S. Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, Rubber Reserve Company, and Rubber Development Corporation, for the Fiscal Year Ended June 30, 1945 (House Doc. No. 444, 80th Cong., 2d sess.), p. 4.

manufacture of war materiel and supplies, with the exception of the synthetic rubber plants, the tin smelter in Texas City, Texas, the magnesium and aluminum facilities and a few others, which were operated by private organizations under management arrangement for the account of the RFC. The plants under the Defense Plant Corporation included facilities to produce aircraft, engines and parts, aviation gasoline, chemicals, machine tools, guns, tanks, shells, bombs and other ordnance, ships and parts, steel and pig iron, industrial machinery, medical supplies, and numerous other facilities. It was estimated that these facilities represented from 10 to 12 per cent of the value of the entire production facilities of the country; in particular industries these facilities mounted as high as 96 per cent in synthetic rubber, 90 per cent in magnesium metal, 71 per cent in aircraft manufacture and aircraft engine industry, and 58 per cent in the aluminum metal industry.¹

Secondly, the RFC, through its subsidiaries—The Defense Supplies Corporation, the Metal Reserve Company—paid cash subsidies under the direction of the Federal Loan Administrator, with the approval of the President, under the authority of Section 2(e), Title I, of the Emergency Price Control Act of 1942, which designated the corporations created or organized pursuant to Section 5d(3) of the RFC Act as the only agencies of the government to pay subsidies to domestic producers of strategic and critical materials.²

¹ Cf. the testimony made by Senator Robert Taft before the Committee on Banking and Currency, 76th Congress, 1st session, on S. 3938. See pp. 84-85.

² Ibid.

Under the Price Control Act, the RFC subsidiaries were authorized to pay subsidies or to trade in strategic commodities in the manner and upon the terms and conditions necessary to obtain the required maximum production of such commodities. The Price Control Act read, with respect to these authorities, that whenever the Federal Loan Administrator:

. . . determines that the maximum necessary production of any commodity is not being obtained or may not be obtained during the ensuing year, he may . . . buy or sell . . . in such manner and upon such terms and conditions as he determines to be necessary to obtain the maximum necessary production thereof . . . or to make subsidy payments to domestic producers of such commodity.¹

The subsidy programs were instigated as a war measure for the purpose of stimulating production of materials and supplies essential to the national defense and war effort. From the inception of the programs on February 1, 1942, to June 30, 1947, the RFC had expended in direct subsidy payments an aggregate amount of more than \$3,000,000,000, which is summarized in Table 10.

Commenting on major items in the Table, the livestock slaughter subsidy was undertaken by the RFC in May 1943, at the direction of the Office of Economic Stabilization, in order to obtain the maximum necessary production of beef, veal, pork, lamb, and mutton, and to maintain the OPA ceiling prices on these commodities.² Pursuant to Office of

¹Ibid. Although under this Emergency Price Control Act, the Federal Loan Administrator was the only person empowered to determine the necessity for subsidy payments on strategic and critical materials, in actual practice such determinations were made by other Government agencies, principally the Office of Economic Stabilization and the War Production Board.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 85.

Table 10

DIRECT SUBSIDIES PAID BY THE RFC CUMULATIVE TO JUNE 30, 1947¹

(Amount in thousands of dollars)

| Class | Total to June 30, 1945 | Total to June 30, 1947 |
|--|---------------------------|---------------------------|
| Foodstuffs: | | |
| Livestock slaughter | \$ 937,678 | \$1,546,636 |
| Flour milling | 173,836 | 348,399 |
| Butter production | 160,036 | 181,618 |
| Coffee importation | ----- | 40,699 |
| Sugar transportation | 24,977 | 25,011 |
| Petroleum and Petroleum Products: | | |
| Petroleum and petroleum products transportation | 290,528 | 276,595 |
| Stripper oil well production | 51,028 | 121,899 |
| Metals and Minerals: | | |
| Zinc | 100,926 | 175,086 |
| Copper | 73,566 | 109,482 |
| Lead | 36,952 | 65,401 |
| Aluminum | 23,474 | 23,474 |
| Other metals and minerals | 7,637 | 9,523 |
| Others | 53,178 | 111,701 |
| Total | \$1,933,816 | \$3,035,724 |

¹ Source: U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 152.

Economic Stabilization directives, the RFC paid subsidies on flour and butter for ~~the~~ purpose of securing the maximum necessary production of these commodities and stabilizing OPA ceiling prices. The coffee subsidy was authorized by the Stabilization Administrator, Office of War Mobilization and Reconversion, in order to obtain adequate supplies of green coffee for civilian consumption ~~without~~ increasing OPA prices or resuming coffee rationing.¹ The sugar subsidy was inaugurated at the request of the WPB in order to insure a supply of sugar in all sections of ~~the~~ country sufficient to meet consumers' requirements under the rationing program. The RFC reimbursed importers, refiners, and distributors of cane and beet sugar for costs incurred in transporting and distributing sugar in excess of those normally incurred in peacetime operations.²

During the period from August 1, 1942, to October 31, 1945, the RFC made subsidy payments totaling \$276,000,000 to defray excess costs incurred in the transportation of petroleum and petroleum products to the East Coast by railroad tank cars and pipeline in substitution for ocean-going tankers. Overland transportation became a necessity as a result of the submarine warfare along the East Coast and the general shortage of tankers during the War.³

¹Ibid., p. 86.

²For the sugar subsidy, the RFC conducted ~~the~~ operations for a period from March 16 to December 16, 1942, at which date the program was transferred to the Commodity Credit Corp. See ibid.

³Ibid.

Expansion of the nation's armament production program, following the entry of the United States into the War, made it necessary to increase the output of copper, lead, and zinc. To accomplish this purpose without increasing the OPA ceiling prices, RFC at the request of WPB and OPA undertook to compensate the producers of copper, lead, and zinc ore for increased production costs, particularly in connection with the mining of low-grade and marginal ores which could not be worked at a profit under existing OPA price ceilings. The subsidy was paid on production in excess of quotas at rates established by a committee of WPB and OPA officials. The quotas also were fixed by this committee subject to the approval of the RFC.¹

Under the Veterans' Emergency Housing Act of 1946,² the RFC was authorized to advance ~~funds~~ for the construction of access roads to standing timber on Government-owned lands and to make premium payments to producers of building materials to increase the supply of materials for veterans' housing and for other construction essential to the national well-being.³

Thirdly, the RFC through its subsidiaries--the Defense Supplies Corporation, the Metals Reserve Company, the Rubber Reserve Company, the Rubber Development Corporation, and the U. S. Commercial Company--

¹ Ibid., p. 87.

² 60 U.S. Stat. at L. (1946), 207-215, "Veterans' Emergency Housing Act of 1946."

³ Ibid., sec. 1(a).

undertook the trading activities involving the procurement, stock-piling, and disposal of essential commodities and materials for national defense. On a cumulative basis, the RFC expended approximately \$9,680,000,000 for this purpose to June 30, 1947. Sales of such commodities and materials amounted to \$9,360,000,000 during the same period, resulting approximately in \$320,000,000 of loss in these trading operations.¹

The trading activities were carried on by the RFC for one or more of the following purposes, depending upon the particular economic situation with respect to each of the commodities involved:

1. To supply current needs of the government and private contractors for war production and national defense purposes.
2. To stockpile commodities in short supply.
3. To facilitate and control the distribution of certain rationed and allocated materials and to provide financial assistance to owners of frozen stocks.
4. To obtain the maximum necessary production of certain commodities.
5. To stabilize prices.²

¹ U.S., R.F.C., Annual Report and Financial Statement (June 30, 1947), p. 9, and U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468, 81st Cong., 2d sess.), p. 16 and p. 153.

² Ibid., p. 90.

The RFC procured strategic and critical materials from all available sources, domestic and foreign. Owing to the great need during the War period for these materials, the cost of procurement was of necessity deemed to be of lesser importance than it would have been had there been an adequate supply. Usually the services of experienced agents were employed to purchase, store, and sell the materials. The RFC also let production contracts for the processing and manufacturing of certain materials and in some instances made loans and advances on liberal terms to finance production facilities and operations of a high risk nature when credit could not be obtained elsewhere.¹

Many procurement contracts were terminated by the RFC on or about V-J Day; some were continued thereafter for purposes of orderly liquidation or to supply civilian deficiencies, determined by the Civilian Production Administration,² such as natural rubber, copper, tin, alcohol, molasses, burlap, lead, fibers, and zinc. New procurement contracts were also made by the RFC after V-J Day to supply civilian deficiencies.

Among the purposes of RFC trading activities, previously listed, were (1) the stabilization of prices and (2) the obtainment of maximum

¹Ibid., p. 91.

²The powers to allocate scarce materials to industry were vested in the President under Title III of the Second War Powers Act and re-delegated by the President to the War Production Board until October 4, 1945, when by Executive Order 9638, WPB's powers were transferred to the newly created Civilian Production Administration. Subsequently, by Executive Order 9809, December 12, 1946, CPA's powers were transferred to the Office of Temporary Controls, which exercised them until June 1, 1947, when the functions of the President under Title III were transferred to the Department of Commerce.

necessary production of certain commodities. It will be noted that the objectives are the same as those to be accomplished through the payment of direct subsidies. The trading losses incurred in attempting to attain these objectives are in effect indirect subsidies.

RFC's authority with respect to indirect subsidies was derived from the same sources as the authority to pay direct subsidies, namely, the Emergency Price Control Act of 1942¹ and the Price Control Extension Act of 1946.² The original Price Control Act authorized the RFC to buy and sell for the purpose of maintaining maximum necessary production. It was subsequently amended to place definitely in the category of subsidies losses sustained on commodities bought "for the purpose of selling at a loss"³ in order to maintain production.

Commencing in 1941 the RFC followed the practice of importing war materials free of duty. The privilege of making importations free of duty originates in legislation enacted on June 30, 1914,⁴ in order to enable the Secretary of the Navy to avoid the payment of duties on repair parts purchased by Navy personnel while in foreign waters, or on war materials purchased abroad to be brought to the United States for

¹56 U.S. Stat. at L. (1942), 26.

²60 U.S. Stat. at L. (1946), 664-78.

³Ibid., 664, sec. 3.

⁴38 U.S. Stat. at L. (1914), 392-415, "An Act Making appropriations for the naval service for the fiscal year ending June thirtieth, nineteen hundred and fifteen, and for other purposes."

research or testing purposes. The scope of application of the original enactment was considerably less extensive than the scope of its application during World War II by the RFC and by the other agencies of the Government¹ which made use of the enactment.

It was held by the Comptroller General of the United States that the act of June 30, 1914, was in effect at May 30, 1942, and that the privileges which it created were functions of the Navy Department² transferrable under the First War Powers Act of 1941 to other agencies. It was also held that the privilege was applicable to all importations of war materials, irrespective of end-use to which they were put; in many cases, of course, end-use could not be determined at the date of entry of the shipments. Executive Order 9177,³ which became effective May 30, 1942, vested in the RFC, and in certain other government agencies as well, the authority of the Secretary of the Navy to make emergency purchases of war materials abroad, provided, "that when such purchases are made abroad this material shall be admitted free of duty."⁴

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 93.

²55 U.S. Stat. at L. (1941), 838, "First War Powers Act, 1941," Title I, sec. 1.

³"Defining Additional Functions, Duties and Powers of the Secretary of War, the Secretary of the Treasury, the Secretary of Agriculture, and the Reconstruction Finance Corporation, Executive Order 9177. May 30, 1942," C.F.R. Cum. Supp., p. 1166.

⁴Ibid.

The RFC was actually the beneficiary of the exemption created by the 1914 act before this privilege was conferred upon it by the Executive Order No. 9177. In 1941 and early in 1942 the RFC's subsidiaries made importations of wool, aluminum, and other commodities, and avoided the payment of duty on the strength of exemption certificates issued by the Secretary of the Navy who held that privilege exclusively at that time. To justify the issuance of the certificates in these cases, it was asserted that the RFC, acting as agency, had purchased the commodities involved for the account of the Navy.¹

The principal and indeed the only practical reason advanced for exemption of the RFC's importations from duty payments was that the red tape of duty determination and collection would "bottleneck" strategic materials at the ports of entry and substantially impede the flow of commodities, to the detriment of the war effort. Included in this reason, or corollary to it, was the consideration that the importing agencies would waste the time, the administrative manpower, and the expense necessary for the proper determination of the duties and their payment.²

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947. (House Doc. No. 468; 81st Cong., 2d sess.), p. 93.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945. (House Doc. No. 316; 80th Cong., 1st sess.), p. 84.

In December 1945 the RFC reviewed its foreign purchase contracts and commitments and decided not to request duty-free entry on certain commodities imported after January 1, 1946, because such commodities were intended for civilian consumption and not for war purposes. The RFC decided to continue importing certain other commodities duty-free after V-J Day until the end of 1946 because they were deemed to be purchases of war materials and thus eligible for free entry under Executive Order 9177. The principal materials, ordinarily subject to duty, imported free after V-J Day until the end of 1946 were alcohol, molasses, copper, lead, zinc, antimony, nickel oxide, chrome, and aluminum. Justification for classifying these and other commodities as purchases of war materials after V-J Day was based on the following determinations:

1. The commodities were, or will be purchased under contract entered into prior to V-J Day, although delivery and importation will take place subsequent to that date. Thus, in effect, each such purchase is, or will be, an emergency purchase of a war material abroad.

2. The commodities are being, or will be imported under contracts with individual shippers (whether such contracts were entered into prior or subsequent to V-J Day) pursuant to obligations imposed upon the U. S. Commercial Company by agreements made directly with foreign Governments requiring the Company to make purchases of commodities. It has been determined that purchases made under these agreements with foreign Governments at the time such agreements were made, were, and in effect will be, emergency purchases of war materials abroad.¹

Duty-free entries for domestic consumption were discontinued voluntarily by the RFC on January 1, 1947. The authority of the RFC to import duty-free under Executive Order 9177 was not terminated, however, until November

¹A memorandum from the general counsel of the U. S. Commercial Company to the general counsel of the RFC, dated January 11, 1946. U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 93.

12, 1947, when Executive Order 9903¹ was issued which provided that the RFC was liable for duty on any articles entered for consumption or withdrawn from warehouses on or after December 12, 1947.

Fourthly, the RFC operated through its agents--The Defense Plant Corporation, the Metals Reserve Company, and Rubber Reserve Company-- certain plants and facilities which it had acquired or constructed upon specific recommendations of the defense and wartime policy-making and procurement agencies of the government, under the authority provided for under Section 5d(3) of the RFC Act.

To a large extent, operations of these facilities and plants had been discontinued on June 30, 1947, except operations of the synthetic rubber plants and the tin smelter at Texas City, Texas.² Generally the RFC operations were of an experimental or unusual nature or were necessary only to produce materials required to meet a wartime expanded demand. Except the operations of synthetic rubber plants, tin smelter, and fiber plantations, which continued after June 30, 1947, or are still continuing, some of the important RFC operations will be studied briefly in the following few pages, while the former operations will be examined in a more detailed manner in the next chapter.

Fishing Vessel Program: In 1945, upon the recommendation of the War Foods Administrator that the RFC finance the acquisition of certain fishing vessels, agreements were entered into with the Pacific Exploration Company, Inc., and the Bellingham Iron Works, Inc., for the conversion of

¹Termination of Duty-Free Admission of War Materials Purchased by Certain Agencies. Executive Order 9903. November 12, 1947, "C.F.R. 1947 Supp., pp. 174-75.

²For the synthetic rubber plants and the tin smelter at Texas City, Texas, see Ch. V, pp. 196-201, and pp. 201-208.

the S. S. Mormacrey (acquired by the RFC from the War Shipping Administration) into a factory ship and for the construction of four steel trawlers.¹

This fleet was acquired for the purpose of catching and processing fish and crabs, with a prime objective of increasing the nation's supply of protein food and a secondary one of establishing claims in the Bering Sea area.²

In November 1945 the War Mobilization Director advised the RFC that it would benefit the government to complete the project and suggested that the RFC arrange for the operation of the factory ship and the four trawlers. Accordingly, on July 10, 1946, the RFC and the Pacific Exploration Company, Inc., entered into a charter agreement which provided that the Pacific would operate the vessels and pay a charter fee to the RFC for their use. In addition the Pacific agreed to furnish scientific and other data to the various agencies of the government.³

The factory ship "Pacific Explorer" was completed in January 1947, and was sent to explore fishing grounds in the Bering Sea and Pacific Ocean, primarily to search for crabs, bottom fish and tuna. Incident to such exploration the Pacific engaged in the catching and packing of seafoods.⁴ However, various California fish canners protested, contending

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945-- Defense Plant Corporation (House Doc. No. 474; 80th Cong., 1st sess.), p. 122, Appendix B, Plancor 2448.

²Ibid.

³U.S., Congress, Report on Audit of Reconstruction Finance Corpora-

that these operations created a serious competitive problem to the private fish canning industry of the Pacific coast. Consequently, on June 26, 1947, the charter agreement of July 10, 1946, was terminated.¹

A new agreement was drawn up for the period to December 31, 1948. It provided for the operation of the vessels by the Pacific without fee or profit, for the account of the RFC. It was further agreed that Pacific would be reimbursed for all expenses incurred in the operations undertaken under the terminated charter agreement and that the RFC would take over the inventories of fish and supplies, receiving all proceeds. The Fish and Wild Life Service of the Department of the Interior formulated a program to be followed in operating the vessels. The expenses incurred by the Pacific under its terminated agreement, subsequently paid by the RFC, were estimated to exceed by approximately \$650,000 the ultimate recoveries from the inventories taken over.²

tion and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947,
(House Doc. No. 468; 81st Cong., 2d sess.), p. 112.

⁴U.S., R.F.C., Annual Report and Financial Statements (June 30, 1948), p. 13.

¹As a result of these complaints hearings regarding the operation of the fishing vessels were held before a Subcommittee of the Committee on Merchant Marine and Fisheries, House of Representatives. U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.) p. 12.

²Ibid., p. 112.

On March 31, 1948, two trawlers were engaged in a survey of tuna resources in the Southwest Pacific area; the other two trawlers were being prepared for operation in the unexploited fishing areas off Peru and Chile, and preparations were being made for operation of the factory ship in the Bering Sea area.¹

Operations ceased with the expiration of the agreement on December 31, 1948. Two of the trawlers were transferred to the U. S. Maritime Commission in June 1948; subsequent to June 30, 1949, the factory ship was transferred to the U. S. Maritime Commission and the remaining trawlers to the Department of the Interior.²

Aluminum and Magnesium Forgings: In September, 1944, the War Production Board recommended that the RFC enter into arrangements with Wyman-Gordon Products Corporation for the construction of a plant at Worcester, Massachusetts, and the production of large aluminum and magnesium forgings. The WPB contended that this project would be of value to the future military aircraft program.³

An agreement for the operation of the facilities by Wyman-Gordon was signed on March 11, 1946. Effective June 30, 1950, the operating

¹Ibid., p. 113.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Its Wholly Owned Subsidiary: Federal National Mortgage Association, for the Fiscal Years Ended June 30, 1948 and 1949 (House Doc. No. 638; 81st Cong., 2d sess.), p. 94.

³U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 113.

agreement between the RFC and Wyman-Gordon was terminated, and an interim permit, effective July 1, 1950, for the use of the plant was issued by the RFC to the Department of the Air Force.¹

Natural Gas Pipeline: In June 1943 the RFC through its subsidiary, the Defense Plant Corporation, negotiated a 5-year operating agreement with the Union Sulphur Company, Inc., authorizing it to construct a natural gas transmission line from gas fields near Jennings, Louisiana, to various defense plants near Lake Charles, Louisiana.²

Gas purchases were made from various petroleum companies operating oil and gas wells in the area. About one-half of the output of the pipeline was sold to the Cities Service Refining Company for use in its own refining operations.³

The facilities were declared surplus and transferred, together with the operating agreement, to the War Assets Administration on June 30, 1948.⁴

Underground Gas Reservoir: On September 8, 1942, the Petroleum Coordinator for War and War Production Board advised the RFC that a serious

¹U.S., R.F.C., Annual Report and Financial Statement (1950), p. 22.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945--Defense Plant Corporation (House Doc. No. 474; 80th Cong., 1st sess.), p. 136, Appendix B. Plancor 1118.

³Ibid.

⁴U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 113.

shortage of natural gas which would adversely affect war production was anticipated in the Los Angeles area. They recommended that the RFC take immediate action to acquire land (dry oil and gas wells) to establish a reservoir for the purpose of storing natural gas which was then being wasted. The RFC acquiesced, and engaged the Union Oil Company of California to supervise, operate, and maintain the gas storage reservoir.¹

A contract, effective October 1, 1942, was executed with the Southern California Gas Company, authorizing it to inject, store, and withdraw natural gas from the reservoir to meet the requirements for natural gas in the Los Angeles area. The gas company was required to make annual payments of \$200,000 until the RFC had recovered from this source and from incidental reservoir operations its investment in the project plus interest at 5 per cent per annum. The contract terminated March 30, 1951.²

The cost of the facilities amounted to \$1,084,156. By June 30, 1947, \$1,000,000 had been received in five yearly payments from the gas company, and profits from operations amounted to \$205,454.³

Chlorine Tank Cars: In the early part of 1942, the War Production Board recommended that the RFC arrange for the construction of 80 tank cars to be used in transporting chlorine needed in war production.⁴

¹Ibid., p. 114.

²Ibid.

³Ibid.

⁴Ibid.

The Shippers' Car Line Corporation was engaged to act as RFC's agent in arranging for the leasing of the cars to third parties, collecting mileage allowance and car rentals, and maintaining complete use and movement records. The agent received \$5.00 per month per car as compensation for its services, in addition to being reimbursed for all expenditures incurred in maintaining the cars.¹

The RFC had received \$497,000 to June 30, 1947, in net receipts from the rental of these tankcars. Later in 1947, the cars were declared surplus and transferred to the War Assets Administration for disposition.²

As has been partially explained throughout this chapter, effective July 1, 1945, the war subsidiaries managed by the RFC except the War Damage Corporation were dissolved by a joint resolution passed June 30, 1945.³ The legislation sponsored by both Houses of Congress at the request of the Federal Loan Agency, was passed without a dissenting vote in either House.⁴ It provided for the absorption by the RFC of the following subsidiaries: the Defense Plant Corporation, Metals Reserve Company, Rubber

¹ Ibid.

² Ibid.

³ 59 U.S. Stat. at L. (1945), 310, "Joint Resolution To transfer to the Reconstruction Finance Corporation the functions, powers, duties, and records of certain corporations."

⁴ U.S., Congress, Senate, Dissolution of Certain Subsidiaries of the Reconstruction Finance Corporation (Senate Report No. 285; 79th Cong., 1st sess.). For the House report, see House Report No. 815; 79th Cong., 1st sess. under identical heading.

Reserve Company, and Defense Supplies Corporation.¹ By the same enactment, the Disaster Loan Corporation, an affiliated lending enterprise the stock of which was wholly owned by the Treasury of the United States and the operations of which had been under RFC administration, was also dissolved and merged with the RFC.²

These subsidiary corporations which were dissolved by this joint resolution, with the exception of the Disaster Loan Corporation, were created to perform certain functions arising out of the War and its related emergency. The functions of these corporations were, as has been examined in this chapter, substantially ~~those~~ of procurement of strategic and critical materials and other supplies and equipment essential to the successful prosecution of the War. By mid-1945, these functions had for the most part been accomplished and, therefore, some administrative reorganization at that time was desirable. That is, the transfer to the RFC, the parent corporation, of the functions, powers, duties and authority of these corporations would simplify operations and it was reasonably expected that some economy in operation could be effected. Even after this consolidation of the subsidiaries into the RFC, the management remained where it was, in the Board of Directors of the RFC, the members of which at that time were also the directors of the subsidiary corporations, with the addition of one or two other persons.

¹59 U.S. Stat. at L. (1945), 310, sec. 1.

²Ibid. For the Disaster Loan Corporation, see Ch. III, pp. 61-64.

While the Disaster Loan Corporation was created not for national defense purposes, but to provide loans necessitated by floods or other catastrophes, nevertheless since it had been managed by the RFC officers and agents under rules and regulations prescribed by the Board of Directors of the RFC, it was felt that there was no sound basis for having these functions performed by a separate corporate entity.

The War Damage Corporation, although wholly owned and managed by the RFC, was excluded in this joint resolution, because it was created for "a highly specialized purpose" and it was believed that "it should continue as a separate corporate entity until its insurance program directly related to the war has been completed."¹ The U. S. Commercial Company, the Petroleum Reserves Corporation, and the Rubber Development Corporation, although wholly owned and managed by the RFC, were not included in this resolution for the reason that they had been transferred to and were subject to the supervision of the Foreign Economic Administration.² The Petroleum Reserves Corporation became the War Assets Corporation as of November 15, 1945, as has been pointed out previously in this chapter.³

¹U.S., Congress, House, "Dissolution of Certain Reconstruction Finance Corporation Subsidiaries," Hearing: Before the Committee on Banking and Currency, 79th Cong., 1st sess., on S. J. Res. 65 (June 25, 1945), p. 3.

²Ibid. See pp. 130-131, 135, and 141.

³See p. 138. The War Assets Corporation, too, was dissolved after the transfer of its functions to the War Assets Administration, which occurred in March 1946.

Section 3

General Appraisal of RFC Activities for National Defense

During the War and the related emergency period, a considerable change took place in the functions of the RFC, principally on the basis of authority derived, directly or indirectly, from Section 5d of the RFC Act as amended, from the First War Powers Act, and from the Emergency Price Control Act of 1942. In order to aid the Government of the United States in its national defense program and, in the war period, to further the national defense and security, the RFC was authorized to acquire and construct and to own and operate war-plant facilities, make subsidy payments, to deal in and to stockpile strategic and critical materials, and to conduct a great variety of other activities, in addition to its lending activities. Under this broad authority, the RFC during this period made authorizations and other commitments amounting to \$25,000,000,000, with actual disbursements of approximately \$23,500,000,000, counting loans, investments, advances to government agencies and wartime outlays. Table 11 presents the magnitude of RFC operations during this period.

With the expansion of the disbursements, the borrowing power of the RFC had been gradually expanded. At June 30, 1945, the RFC was empowered to issue obligations up to \$14,090,000 under its so-called "general borrowing authority." A summary of the changes in authority which produced this total at June 30, 1945, may be traced in the following

Table 11

A COMPARISON OF THE RFC'S OPERATIONS
BETWEEN DECEMBER 31, 1940, AND JUNE 30, 1947¹

(Amount in thousands of dollars)

| Class | December 31, 1940 | June 30, 1947 |
|---|----------------------|-------------------|
| Banks and other financial institutions | 5,177,021 | 5,818,723 |
| Agricultural financial institutions | 2,452,071 | 2,453,733 |
| Railroads | 911,605 | 1,048,816 |
| Business enterprises | 446,596 | 1,509,831 |
| National defense | 680,578 | 23,221,340 |
| Foreign governments | ----- | 495,000 |
| Self-liquidating projects, etc. | 614,091 | 752,498 |
| Mining, milling, or smelting of ores | 16,576 | 18,446 |
| Drainage, levee, irrigation, etc. | 140,862 | 150,057 |
| Repair of damage of earthquake, flood, etc. | 16,184 | 18,210 |
| All others | 339,054 | 339,445 |
| Total authorizations | 10,794,638 | 35,826,125 |
| Total disbursements | 7,669,360 | 31,255,115 |
| Total outstanding | 1,712,638 | 1,270,504 |

¹Source: U.S., R.F.C., Quarterly Report, ending December 31, 1940 and June 30, 1947.

tabulation:¹

| <u>Enactment</u> | <u>Borrowing authority</u> |
|--|----------------------------|
| Initial authorization, 47 Stat. at L., 5..... | \$1,500,000,000 |
| July 21, 1932, 47 Stat. at L., 714..... | 1,800,000,000 |
| June 16, 1933, 48 Stat. at L., 210..... | (400,000,000) (decrease) |
| June 20, 1934, 48 Stat. at L., 319..... | 850,000,000 |
| Feb. 24, 1938, 52 Stat. at L., 79, and National Housing Act, approved June 27, 1934, 48 Stat. at L., 1247..... | (1,660,000,000) (decrease) |
| Sept. 28, 1940, 54 Stat. at L. 962..... | 1,500,000,000 |
| June 10, 1941, 55 Stat. at L., 250..... | 1,500,000,000 |
| Oct. 23, 1941, 55 Stat. at L., 744..... | 1,500,000,000 |
| March 27, 1942, 56 Stat. at L., 176..... | 2,500,000,000 |
| June 5, 1942, 56 Stat. at L., 326..... | <u>5,000,000,000</u> |
| Balance, at June 30, 1945..... | \$14,090,000,000 |

In addition to these amounts of "general borrowing authority," the RFC under the so-called "specific borrowing powers," could issue further obligations limited by the amounts which it was authorized to expend in certain specified activities, and in other cases it was authorized to borrow for certain specific purposes without limitation on the amounts.²

At June 30, 1945, the RFC attributed its borrowing to the following:³

¹ U.S., R.F.C., Reconstruction Finance Corporation Act As Amended and Other Laws Pertaining to Reconstruction Finance Corporation (Revised, January 1946; Government Printing Office, 1946), p. 239, Appendix A.

² Details of these "specific borrowing powers" together with a further examination of the "general borrowing authority" will be discussed in Ch. VI, pp. 301-304 and pp. 312-314.

³ U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations, for the Fiscal Year Ended June 30, 1945 (House Doc. No. 450, 80th Cong., 2d sess.), p. 32.

| | |
|--|------------------|
| For general purposes..... | \$ 8,056,056,115 |
| <hr/> | |
| For specific purposes: | |
| For loans to Rural Electrification Administration..... | 153,700,000 |
| For purchase of stock of Federal home-loan banks..... | 124,509,900 |
| For loans to Secretary of Agriculture: | |
| For farm tenancy loans..... | 90,343,640 |
| For rural rehabilitation loans..... | 5,000,000 |
| For purchase of preferred stock, capital notes, and debentures, and for loans secured by preferred stock of banks and trust companies..... | 272,495,403 |
| For loans on preferred stock of insurance companies... | 31,508,439 |
| For purchase of securities from Federal Emergency Administration of Public Works..... | 74,962,084 |
| For purchase of stock of mortgage loan companies..... | 36,000,000 |
| For retirement of capital stock of the RFC..... | 175,000,000 |
| For expenditures for the account of War Damage Corporation..... | <u>371,543</u> |
| Total for specific purposes..... | 963,891,009 |
| Total borrowings..... | \$9,019,947,125 |

The net expenditures of the RFC in conducting its national defense, war, and reconversion activities from the inception of the programs in 1940 to June 30, 1947, aggregated \$9,313,736,531,¹ while the lending operations of the RFC resulted in net profit of \$551,901,483 from its inception to June 30, 1947.² The former amount of net expenditures was to a large extent not recoverable by the RFC, since the RFC performed these

¹For the details of these expenditures, see U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468, 81st Cong., 2d sess.), pp. 137-142, Exhibit 3.

²For the net profit of \$551,901,483 from the RFC's lending activities, see the comments and criticisms made by the U. S. Comptroller General's audit reports, e.g., House Doc. No. 450, 80th Congress, 2d session, pp. 8-10, and 37-39; and House Doc. No. 468, 81st Cong., 2d session, pp. 5-6, 33-35, and 136.

activities as though it were a disbursing agency of the United States Treasury in conducting the national defense program, by utilizing the RFC's borrowing authority from the Treasury as a means of avoiding the necessity for making appropriations of public monies. Here arises a question of constitutionality as to the borrowing by the RFC from the Treasury for such purposes as those expenditures amounting to \$9,313,736,531. This was the equivalent of the withdrawal of funds from the Treasury. Yet, according to Article I of the Constitution of the United States of America "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law."¹ It is further provided by law² that "No Act of Congress passed hereafter (June 30, 1906) shall be construed to make an appropriation out of the Treasury of the United States . . . unless such Act shall in specific terms declare an appropriation to be made . . ."³

However, the borrowing authority of the RFC was utilized as a means of avoiding the necessity for making appropriations of public funds through the medium of note cancellations by enactments of Congress. Thus the total amount of the net expenditures incurred by the RFC in connection with the national defense programs was restored to the RFC by legislation

¹U.S. Constitution, Article I, Section 9, Clause 7.

²34 U.S. Stat. at L. (1906), 697-768, "An Act Making Appropriations for sundry civil expenses of the Government for the fiscal year ending June thirtieth, nineteen hundred and seven, and for other purposes."

³Ibid., 764.

enacted June 30, 1948,¹ authorizing the Secretary of the Treasury to cancel notes of the RFC in an amount equivalent to the aggregate net expenditures of \$9,313,736,531.²

While statutory provisions afforded a framework guiding the detailed application of RFC lending and non-lending authority, it retained an enormous area of discretion in its operations. Indeed, in his testimony before the Senate Committee on Banking and Currency, Jesse H. Jones, then the Secretary of Commerce and the Federal Loan Administrator, once said: "We can lend anything that we think we should--any amount, any length of time, any rate of interest, and to any-body that we feel is entitled to the loan."³

But the fact of Congress delegating such authority with such discretionary powers to a single government agency was partly, yet to a large extent, explained by the personal influence of Mr. Jones. Professors Merle Fainsod and Lincoln Gordon assert that:

The confidence which the corporation has engendered in both Congress and the country at large is a function of the cautious manner in which it has administered its duties. This record has been closely associated with the personality of Jesse H. Jones, RFC Chairman for over seven years. His unusual position was

¹62 U.S. Stat. at L. (1948), 1183-1195, "The Government Corporations Appropriations Act, 1949."

²For a further discussion, see This matter was also considered by committees of both the Senate and the House of Representatives in December 1947 during hearings held in connection with the passage of the Government Corporations Appropriation Act of 1949. See U.S., Congress, Senate, "Inquiry into Operations of R.F.C. and Its Subsidiaries Under Senate Resolution 132," Hearings: Before Special Subcommittee, 80th Cong., 1st sess., on Res. 132 (December 3-12, 1947), Part I.

³U.S., Congress, Senate, "Increasing the Borrowing Authority of the R.F.C.," Hearings: Before the Committee on Banking and Currency, 77th Cong., 2d sess., on S. 2485 (May 8, 1942), p. 2.

strikingly demonstrated in 1940, when special legislation was enacted enabling him to retain his position as Federal Loan Administrator, in charge of the RFC and other credit agencies, while also becoming Secretary of Commerce.¹

The principal policy-making functions were performed by Mr. Jones as the Federal Loan Administrator, even after he resigned the chairmanship of the RFC to become the Federal Loan Administrator in 1940, since his authority transcended that of the Board of Directors; and the boards of both the parent and the subsidiary corporations assumed the principal operating and administrative responsibilities, which they discharged under his supervision, by maintaining intimate contact with the details of operation and administration.

¹Merle Fainsod and Lincoln Gordon, Government and the American Economy (Rev. ed.; New York: W. W. Norton & Co., 1948), p. 721.

CHAPTER V

THE FUNCTIONS OF THE RFC IN THE POST-WAR PERIOD

The great problems in the post-War period and during the period of reconversion and after were how to transform the nation's economic system from war to peacetime operations and yet to endeavor to preserve full employment. One of the vital problems of this transition from war to peacetime operation of business and the preservation of full employment was that of obtaining adequate financing which was needed (1) to convert machinery and other plant facilities from the production of military to civilian supplies, (2) to rehabilitate run-down and replace obsolete plants and equipment, and (3) to acquire unusual amounts of inventory and to dispose of it as surplus war property.

This chapter will first be devoted to examining what were the functions of the RFC during the transition from war to peacetime operations of business and for the preservation of full employment. Secondly it will examine some of the controversies in connection with the operations and scope of the RFC which led to a series of Congressional investigations which occupied a number of years. Finally the chapter will end with the general appraisal of the RFC activities in the post-War period and the results of the Congressional investigations.

Before we examine the functions and operations of the RFC in the post-War period, it seems at this point to be helpful for our study to

summarize the functions of the RFC around mid-1947. The period up to that time has been dealt with in the previous chapters. Since its inception in January 1932, the RFC had performed various types of functions. It had engaged in extensive lending operations; it had been used by the Congress as a ready source of funds for the financing of other Government corporations and agencies, and of projects carried on under the direction of other governmental departments; it also engaged in extensive operations in support of the war effort. Analyzing these general functions of the RFC by mid-1947 more in detail, the Corporation had been authorized:

- (1) to make loans or to purchase the capital stock of banks, insurance companies, agricultural credit corporations, and various governmental agencies;
- (2) to make loans to business enterprises, mining interests, agricultural improvement districts, public-school authorities, and various other classes of borrowers;
- (3) to assist in financing the construction of public works and various self-liquidating projects; and
- (4) to make catastrophe loans.

Further, the Corporation was authorized to subscribe for the stock of national mortgage associations organized under the National Housing Act. Pursuant to this authority, the RFC subscribed for the stock of the Federal National Mortgage Association, which made and purchased housing loans secured by mortgages on real estate. The RFC also subscribed to the stock of the RFC Mortgage Company, which was organized to assist in establishing a normal mortgage market. Subsequently, the RFC Mortgage Company provided a secondary market for Veterans' Administration guaranteed home loans. The Federal National Mortgage Association had provided a similar market for FHA mortgage loans.

Under the national defense powers the RFC had authority to create corporations for the purpose of producing, acquiring, and stockpiling strategic materials and of constructing plants to be used in the manufacture of equipment and supplies necessary to the national defense. Pursuant to this authority the RFC created or acquired the following subsidiaries: the Defense Plant Corporation to construct and acquire the industrial facilities necessary to the national defense; the Defense Supplies Corporation to buy, sell, produce, make subsidies for, or otherwise deal in strategic and critical materials; the Metals Reserve Company to aid in the procurement of strategic metals and minerals; the Rubber Reserve Company and Rubber Development Corporation for the purposes of purchasing and stockpiling natural rubber, of processing natural rubber from foreign sources, and of operating the synthetic-rubber program; the U.S. Commercial Company for the conduct of preclusive purchasing and other disruptive activities abroad, designed to prevent the acquisition of strategic commodities by enemy powers, and for the purpose of the procurement abroad of commodities defined as strategic and critical materials; the War Damage Corporation for war insurance purposes; and the Petroleum Reserves Corporation for buying or acquiring foreign reserves of crude petroleum.

By mid-1947 most of these war subsidiary corporations had been dissolved or transferred to the RFC, except the Rubber Development Corporation and the U. S. Commercial Company which were being liquidated. Thus the only important wartime activities still in operation were the tin shelter in Texas City, Texas, and the synthetic rubber plants, all of which continue even to the present time.

Furthermore, the succession of the RFC and all of its lending powers and other functions were, under the provisions of then existing law,¹ to be terminated on June 30, 1947.

¹60 U.S. Stat. at L. (1946), 901, "Joint Resolution To extend the succession, lending powers, and the functions of the Reconstruction Finance Corporation."

Section 1

Lending Activities in the Post-War Period

As we have examined, the powers and responsibilities of the RFC at mid-1947 were found scattered in the many statutes that had been enacted to meet the wide variety of problems which had emerged during the 15-year existence of the Corporation. The RFC had played an important role in helping to meet the problems of the economic depression and in the production and procurement problems of preparing for and engaging in the War. In order to simplify the provisions of the RFC Act and other legislative enactments in connection with the operations of the RFC and to extend the life of the RFC to June 30, 1948, an amendment of the RFC Act was passed by the Congress and signed by the President on June 30, 1947.¹ This amendment was so drastic a one as to be considered as a new charter for the RFC, repealing, in effect, all powers which were no longer needed, and bringing together in one act all of the general functions of the RFC which Congress felt

¹The bill reported by the House Committee on Banking and Currency (H.R. 3916, 80th Cong., 1st sess.), provided for a 2-year extension to June 30, 1949, in the life of the RFC, but this period of time was reduced to 1 year in conference with the Senate Committee on Banking and Currency, inasmuch as a special subcommittee of the Senate Committee on Banking and Currency wished to undertake an extensive inquiry into the operations of the RFC. See U.S., Congress, House, Conference Report, To accompany S. J. Res. 35 (House Report No. 722; 80th Cong., 1st sess.), p.2. For the hearings and Report of the Special Subcommittee of the Senate Committee on Banking and Currency, see "Inquiry into the Operation of the Reconstruction Finance Corporation and Its Subsidiaries Under Senate Resolution 132," pt. 1 (December 3-12, 1947), p. 2 (January 14-22, 1948), and Senate Report (Senate Report No. 974; 80th Cong., 2d sess.).

should be continued.¹ In the following pages the most important changes contained in the amendment and reasons for the amendment will be examined. (1) Under the provisions of the 1947 amendment to the RFC Act, the RFC's authority to purchase the non-assessable stock in any national banking association, state bank or trust company for the purpose of supplying funds for capital purposes was terminated. This was one of the first and most significant changes enacted in the post-War period. As has been pointed out, rescuing banks and other financial institutions was one of the primary purposes for which the RFC was created and the RFC actually had extended substantial aid to the financial institutions.² In the course of its existence, the RFC had authorized aid of over \$4,500,000,000 to banks and other financial institutions by June 30, 1947, in the form of approximately \$1,600,000,000 in loans to operating banks and financial institutions, \$1,400,000,000 in loans to receivers of closed banks and liquidating agents, and \$1,500,000 for preferred stocks of banks and other financial institutions.³ The banks of the country now have the Federal Deposit Insurance Corporation with its \$1,000,000,000 of capital funds and \$3,000,000,000 of borrowing authority from the United States Treasury. The Federal Deposit Insurance Corporation was non-existent when the RFC was called upon so heavily in the banking crisis of the early thirties. No insured bank has been placed in involuntary liquidation

¹U.S., Congress, House, "Reconstruction Finance Corporation Act," House Report (Report No. 626; 80th Cong., 1st sess.) p. 4.

²See pp. 14-15 and pp. 75-77.

³U.S., R.F.C., Report, covering the period from February 2, 1932, to June 30, 1947, inclusive, pp. 3-4.

since May 1944.¹ The amendment of 1947 removed the power of the RFC to subscribe for or to make loans upon non-assessable preferred stock in a bank, trust company, or insurance company in need of funds for capital purposes, a power which apparently was no longer needed. Yet the RFC could still make loans to financial institutions and if necessary could thus supplement the protection afforded banks by the Federal Deposit Insurance Corporation.

(2) The amendment act of 1947 terminated the power of the RFC to purchase loans guaranteed or insured under the Servicemen's Readjustment Act of 1944. By an act to extend the RFC approved August 7, 1946, it was authorized to furnish a market for veterans home loans made pursuant to the provisions of the Servicemen's Readjustment Act of 1944.² The purpose of the legislation was to assure originating mortgagees such as banks, building and loan associations, and other private lending institutions a secondary market for such investments at par and thus to encourage the extension of credit to assist veterans in financing the purchase of homes.³ As of June 30, 1947, when the RFC's authority to carry on this function expired, it had purchased 11,800 such mortgages in the gross amount of \$67,080,000 and had commitments outstanding to purchase 13,200 additional loans amounting to \$81,200,000.⁴ The

¹U.S., Congress, House, "Reconstruction Finance Corporation Act," House Report (Report No. 626; 80th Cong., 1st sess.), p. 5.

²60 U.S. Stat. at L. (1946), 902, "Joint Resolution To extend the succession, lending powers, and the functions of the Reconstruction Finance Corporation," sec. 2.

³U.S., R.F.C., Annual Report and Financial Statements (June 30, 1947), p. 7.

⁴Ibid.

Congressional committees on Banking and Currency reasoned that the RFC's function to purchase such loans had the effect of allowing the original lending institution to refinance the loan on a 100-per cent basis with the Government and that, if this authority should be continued, unlimited authority of this kind might have the potential result of consuming a large portion of the limited loaning and purchasing power which the proposed bill was intended to limit, under which limit the RFC would thereafter function.¹

(3) The act further terminated the authority of the RFC to make foreign loans. The RFC was administering two loans to foreign governments at June 30, 1947: a loan to the United Kingdom of Great Britain and Northern Ireland made in 1941, with an unpaid balance of \$187,536,031, and a loan to the Republic of the Philippines made in 1947, with an unpaid balance of \$60,000,000.² The Comptroller General of the United States in his audit report for the fiscal years ended June 30, 1946 and 1947, recommended as follows:

As RFC is primarily concerned with loans to domestic commercial enterprises, we believe that it would be desirable to transfer these loans to an agency whose facilities and personnel are engaged primarily in the administration of loans to foreign governments, such as Export-Import Bank of Washington.³

¹U.S., Congress, Senate, "Temporary Extension of Succession and Powers of the Reconstruction Finance Corporation," Senate Report (Report No. 321; 80th Cong., 1st sess.), p. 2. U.S., Congress, House, "Reconstruction Finance Corporation Act," House Report (Report No. 626; 80th Cong., 1st sess.), p. 4. And also U.S., Congress, House, "Reconstruction Finance Corporation Act," Conference Report (Report No. 722; 80th Cong., 1st sess.), p. 7.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 10.

³Ibid.

The House Committee on Banking and Currency (80th Congress, 1st Session) also recommended that "the making of foreign loans should be confined to the institutions created by the Congress for that purpose, such as the Export-Import Bank of Washington."¹ The act of 1947 followed these suggestions and removed the RFC's power to make loans for foreign governments and at the same time specifically stated that the future lending powers of the RFC would be restricted to the United States, Alaska, Hawaii, and Puerto Rico.²

(4) The act further prevented the RFC in the future from supplying the capital of other governmental agencies, or forming subsidiary corporations and capitalizing them. The House Committee on Banking and Currency reasoned that the RFC should no longer be used as a source of capital funds for other governmental agencies.³ Pursuant to this policy, the act provided for the transfer to the Treasury of the capital stock of the Federal home-loan banks owned by the RFC and the retirement of RFC notes held by the Treasury in like amount.⁴

¹ U.S., Congress, House, "Reconstruction Finance Corporation Act," House Report (Report No. 626; 80th Cong., 1st sess.), p. 4.

² 61 U.S. Stat. at L. (1947), 204, sec. 4(a) and 4(g). An amendment approved May 25, 1948, included the Virgin Islands within the area in which the RFC's lending powers were to extend. 62 U.S. Stat. at L. (1948), 265, "An Act To amend the Reconstruction Finance Corporation Act, as amended, and for other purposes," sec. 4(g).

³ U.S., Congress, House Report, To accompany H.R. 3916 (House Report No. 626; 80th Cong., 1st sess.), p. 5.

⁴ 61 U.S. Stat. at L. (1947), 208, sec. 205.

(5) Under the same act, the RFC Mortgage Company was ordered liquidated,¹ and the Federal Loan Agency and the Smaller War Plants Corporation were abolished.²

(6) The act further provided for the transfer to the Treasury of all rights and interests in loans previously made by the RFC, pursuant to the direction of the Congress, for Rural Rehabilitation, Farm Tenancy, or Rural Electrification Administration, and cancellation of Treasury-held RFC notes for such amount.³

(7) Besides the restriction and limitation of the authority of the RFC, the act limited the total lending powers of the RFC to \$2,000,000,000 outstanding at any one time.⁴ Outstanding loans and security holdings held at June 30, 1947, by the RFC were to be liquidated as soon as possible, and the proceeds of such liquidation were to be returned to the Treasury to retire RFC notes held by the Treasury.

The amendment act, however, authorized the RFC "to purchase the obligations of and to make loans to (1) business enterprises, including railroads and air carriers, (2) financial institutions, (3) specific public projects--the so-called "proprietary functions" for local government levels or those not directly essential to preservation of the government,⁵ and to make catastrophe loans up to an aggregate of \$25,000,000

¹Ibid., sec. 203.

²Ibid., sec. 204.

³61 U.S. Stat. at L. (1947), sec. 206.

⁴Ibid., sec. 4.

⁵Ibid.

outstanding at any one time.¹ The act also continued the RFC's power to buy surplus property from the War Assets Administration for small business "when, in its (RFC's) judgment, such disposition is required to preserve and strengthen the competitive position of small business." A provision was added requiring the RFC to have on file a request from a small business for the property before the purchase was made.²

On May 25, 1948, the RFC Act was further amended, effecting the following changes: (1) The life of the RFC was extended through June 30, 1956. The Senate bill (S. 2287, 80th Congress, 2d session, to amend the Reconstruction Finance Corporation Act, as amended, and for other purposes) provided for a 12-year extension of the RFC through June 30, 1960 and the House Committee on Banking and Currency amendment provided for a 4-year extension through June 30, 1952.³ But the committee of conference modified this to an 8-year extension through June 30, 1956.⁴ (2) The RFC was directed to retire all of its outstanding capital stock in excess of \$100,000,000, and to "pay to the Treasury as miscellaneous receipts the par value of the stock so retired."⁵ Thus the capital stock of the RFC was reduced from \$325,000,000 to \$100,000,000. (3) The retention of accumulated net income was limited to a maximum of \$250,000,000. The

¹Ibid.

²Ibid., sec. 208.

³U.S., Congress, Senate, "Operations of the Reconstruction Finance Corporation." Senate Report (Report No. 974; 80th Cong., 2d sess.), p. 20, and U.S., Congress, House, "Reconstruction Finance Corporation," House Report (Report No. 1836; 80th Cong., 2d sess.), p. 11.

⁴U.S., Congress, House, House Report (House Report No. 1940; 80th Cong., 2d sess.), p. 2.

⁵U.S. Stat. at L. (1948), 262, "An Act To amend the Reconstruction Finance Corporation Act, as amended, and for other purposes," sec. 1.

excess was to be paid annually to the Treasury as a dividend on the RFC's capital stock, within six months after the end of each fiscal year, beginning with the fiscal year ended June 30, 1948.¹ The Senate bill (S. 2287) provided for the payment by the RFC into the Treasury as a dividend of the amount of accumulated net income in excess of \$50,000,000.² From its inception in 1932 through June 30, 1947, the RFC had accumulated a net income or surplus of \$551,901,483 from its normal lending activities.³ The Senate proposal would therefore require the payment of approximately \$700,000,000 of capital funds of the RFC to the Treasury after June 30, 1948. To make this payment of capital funds, the RFC would have to borrow a like amount of funds from the Treasury due to the fact that the RFC used to maintain only a normal cash working balance. There would be no net effect on the budget of the Government. It would not affect the over-all lending operations of the RFC for the reason that operations of the RFC were limited not by capital funds and authorized borrowings but by a limitation placed on over-all lending authority.⁴ From the standpoint of the RFC, it would result in the replacement of approximately \$700,000,000 of funds upon which the RFC did not pay interest because the funds represented capital and surplus, with \$700,000,000 of funds upon which the RFC

¹Ibid. The initial dividend of \$307,391,555 was paid in December 1948.

²U.S., Congress, Senate, "Operations of the Reconstruction Finance Corporation," Senate Report (Report No. 974; 80th Cong., 2d sess.), p. 20.

³U.S., Congress, House, "Reconstruction Finance Corporation," House Report (Report No. 1836; 80th Cong., 2d sess.), p. 3 and p. 14.

⁴Ibid., p. 3.

would have to pay interest because it would represent borrowings from the Treasury. Under this circumstance, the House Committee on Banking and Currency made an amendment to the Senate proposal modifying it so that the RFC would retain a surplus of \$400,000,000.¹ This if accepted by the Senate and passed by the Congress, would allow the RFC a total of \$500,000,000 of interest-free capital funds, of which \$100,000,000 would represent the capital stock subscribed to by the Treasury, and \$400,000,000 would represent accumulations of past earnings and not funds originally provided by the Treasury. The House Committee on Banking and Currency explained its proposal for the retention of \$500,000,000 of interest-free capital funds by the RFC by asserting that a reasonable amount of interest-free capital funds for the RFC would permit it to absorb certain losses that it might incur in carrying out programs and policies at the direction of the Congress without the necessity of covering these costs by a specific appropriation measure.² The same committee further explained that for instance the RFC at the direction of the Congress might endeavor to supplement rather than compete with private lending institutions, or the RFC might have to incur considerable expense in investigating and setting up loan applications to see if it could not interest private lending agencies in making loans which private capital should make.³ Thus the committee recommended that the RFC be allowed to retain interest-free capital of \$500,000,000 so that the Corporation might absorb such expenses and perform the public-interest position for which

¹Ibid., p. 3 and p. 10.

²Ibid., p. 4.

³Ibid.

the Corporation was, among other functions, responsible.¹ (4) The total amount of investments, loans, purchases and commitments made subsequent to June 30, 1947, was reduced to \$1,500,000,000 from \$2,000,000,000 provided for by the previous amendment to the RFC Act, approved June 30, 1947, outstanding at any one time, including catastrophe loans to \$25,000,000, public project construction loans to \$200,000,000, and insurance company loans to \$15,000,000.² (5) In deferred participation loan agreements, participations by the RFC were limited to 70 per cent of the balance of the loans outstanding at the time of disbursement in those cases where the total amount borrowed was \$100,000 or less. Where the total amount borrowed was over \$100,000, the RFC's participation was limited to 60 per cent of the balance.³ (6) The lending powers of the RFC would terminate at the close of business on June 30, 1954.⁴ (7) The amendment act restated the primary functions of the RFC: "To aid in financing agriculture, commerce, and industry, to encourage small business, to help in maintaining the economic stability of the country,

¹Ibid.

²62 U.S. Stat. at L. (1948), 264, "An Act To amend the Reconstruction Finance Corporation Act, as amended, and for other purposes," sec. 4(c).

³Ibid., sec. 4 (b).

⁴Ibid., sec. 4 (f).

and to assist in promoting maximum employment and production." The RFC was authorized to make loans to business enterprises (including railroads and air carriers), to banking and financial institutions, and to public agencies engaged in financing or developing public works and projects, if credit from other sources could not be obtained on reasonable terms and provided each loan was so secured as to assure reasonable prospects of repayment.¹ It is very significant to point out that the amendment act of 1948 included the encouragement of "small business" as one of the purposes for which the RFC could use its lending authority.²

In 1947 and 1948, there was a critical shortage of housing. The high War- and post-War marriage rates and the favorable economic conditions following the War created a great demand for new homes. There had been very little residential construction through the War years. Toward solving this situation national and local efforts were being made to get great numbers of houses built. As part of the general effort to encourage construction, under section 102 of the National Housing Act of 1948, approved August 10, 1948, the RFC was given authority:

. . . to make loans to and purchase the obligations of any business enterprise for the purpose of providing financial assistance for the production of prefabricated houses or prefabricated housing components, or for large-scale modernized site construction.³

¹62 U.S. Stat. at L. (1948), 263, "To amend the Reconstruction Finance Corporation Act, as amended, and for other purposes," sec. 4. Cf. with sec. 5 of 47 U. S. Stat. at L. (1932), the original RFC Act.

²For the discussion of lending to small business, see p. 193 and pp. 281-284.

³62 U.S. Stat. at L., (1948), 1268, "Housing Act of 1948," Sec. 102.

Most of the loans authorized by the RFC under section 102 of the National Housing Act were for the production of prefabricated houses. Through June 30, 1950, 33 loans had been authorized to 26 borrowers under this authority; the total amount of these authorizations was \$43,214,613, including \$325,000 taken by banks in participation loans.¹ The largest single recipient of loans under this authority was the Lustron Corporation.²

Furthermore, the National Housing Act of 1948 authorized the Federal National Mortgage Association to provide a secondary market for Veterans' Administration-guaranteed as well as Federal Housing Administration-insured loans. The Federal National Mortgage Association was established in 1938 as a wholly owned subsidiary of the RFC in order to assist in the creation of a normal mortgage market and to achieve that purpose it created a secondary market for the Federal Housing Administration-insured mortgage loans. Ever since its creation, the Federal National Mortgage Association served a very useful function in connection with the insured mortgage system.³ By offering a ready market for FHA mortgages, it made it possible for lending institutions to finance a tremendous volume of needed housing, with the assurance that their long-term mortgage paper could, if the need arose, be readily converted into cash.⁴ The

¹ U.S., R.F.C., Annual Report and Financial Statements (June 30, 1950), p. 17.

² For the RFC loans to the Lustron Corporation, see pp. 236-252.

³ U.S., Congress, Senate, "Inquiry into the Operation of the Reconstruction Finance Corporation and its Subsidiaries Under Senate Resolution 32," Hearings: Before a Special Subcommittee of the Committee on Banking and Currency, 80th Cong., 2d sess. (January 14, 15, 16, and 22, 1948), pt. 2, p. 410.

⁴ ibid.

Association also performed a useful service by purchasing individual mortgages from various institutions and then selling them in blocks to large investors who were not interested in making or purchasing individually a large number of small home mortgages.¹

The FHA and VA programs were combined with the FNMA in 1948 to provide an effective combination in financing the housing boom at low interest rates. In 1947 and 1948 the rise in demand for housing credit and the increased risk arising from higher construction costs began to force interest rates in some areas above the maximum of the VA and FHA programs. Private funds became inadequate. The lending conditions were more liberal under the FHA legislation and the limited funds went into these loans. VA loans showed a decline in 1948. This shortage of loanable funds to finance the veteran's housing program was partially remedied by the government when it established the FNMA as a secondary market for VA mortgages. As lending institutions throughout the country invested in such mortgages to the maximum, housing credit sources would have been exhausted had not the FNMA supplied a secondary market for the absorption of such securities.² This freed the funds for additional investments.

The total annual mortgage purchases by the FNMA increased from \$47,000,000 in the fiscal year 1948 to \$424,000,000 in 1949, and finally

¹Ibid.

²R. W. Lindholm, "The Federal National Mortgage Association," The Journal of Finance, VI (March, 1951), 54.

up to \$946,000,000 in 1950.¹ Several factors contributed to this vast expansion in FNMA's mortgage activity, but the major cause was the magnitude of the postwar housing boom. An important contributing element in 1948 was the belief, at that time, that interest rates would increase. This prompted mortgage holders to sell their mortgages to have funds available to buy future higher-yielding obligations. The great increase of FNMA commitments to purchase mortgages in mid-1949 was sparked by a belief that FNMA funds were nearly exhausted and would not be promptly expanded.² In addition, the eligibility of mortgages for purchases was increased, through eliminating the restriction from VA Section 501 home loans that only 50 per cent of the mortgages of eligible institutions could be sold to the FNMA.³ This provision widened the range of FNMA as a market, and stimulated VA-guaranteed mortgages.

Principally as a result of increased mortgage purchases by the FNMA, the Congress at various times during 1948 and 1950 increased the lending authority of the RFC until at June 30, 1950, the total limitation was \$3,750,000,000.⁴ However, the FNMA was transferred to the Housing and

¹U.S., R.F.C., Annual Report and Financial Statement (June 30, 1949), p. 12 and *ibid.*, (June 30, 1950), p. 7.

²Lindholm, *op. cit.*, 56.

³62 U.S. Stat. at L., (1948), 1268, "Housing Act of 1948," sec. 102.

⁴See 62 U.S. Stat. at L. (1948), 268, sec. 701; 63 U.S. Stat. at L. (1949), 446, sec. 302; 63 U.S. Stat. at L., (1949), 906, sec. 3; 64 U.S. Stat. at L. (1940), 81, sec. 506.

Home Finance Agency, effective September 7, 1950, pursuant to Reorganization Plan No. 22 of 1940 in accord with the recommendations of the Commission on Organization of the Executive Branch of the Government.¹

Shortly after the outbreak of hostilities in Korea, RFC lending policies were changed to give priority, within RFC's existing authority, to loans which would contribute directly to national defense. Accordingly, while no relaxation of credit standards was allowed, every effort was made to expedite the handling of applications from firms engaged as prime or sub-contractors in the defense program, or as producers of strategic basic materials.

On September 8, 1950, Congress passed the Defense Production Act which authorized the President of the United States to make provision for loans to private business enterprises for the expansion of capacity, the development of technological processes, or the production of essential materials, if such loans were in the interest of national defense and were not otherwise available on reasonable terms.² Executive Order 10161 and Executive Order 10200, as amended by Executive Order 10281, dated

¹U.S., Congress, House, "Message from the President of the United States Transmitting Reorganization Plan No. 22 of 1950," House Document (Doc. No. 587; 81st Cong., 2d sess.), pp. 1-4. And also U.S., Congress, Senate, Hearings: Before the Committee on Expenditures in the Executive Departments, 81st Cong., on S. Res. 299 (June 28 and 29, 1950), pp. 1-5.

²64 U.S. Stat. at L. (1950) 798, "Defense Production Act of 1950," sec. 302.

August 28, 1951, delegated to the RFC the authority to make loans "upon such terms and conditions as the Corporation shall determine," if a certificate was issued certifying that the expansion or production for which the loan was requested was necessary for national defense.¹

Certificates were issued by the Secretary of Agriculture with respect to loans for food and food facilities, and by the Defense Production Administrator with respect to loans for all other materials and facilities. All functions delegated to the Corporation pursuant to the above-mentioned Executive orders were performed subject to the direction, control, and coordination of the Director of Defense Mobilization.²

The Defense Production Act of 1950 also authorized the President of the United States to make provision for purchases of or commitments to purchase metals, minerals, and other raw materials, including liquid fuels, for Government use or for resale.³ Executive Order 10281 delegated that authority to the Defense Materials Procurement Administrator to be carried out in accord with programs certified by the Defense Production

¹The agencies delegated to certify under this act were Departments of Commerce, Interior, and Agriculture, and the Defense Transportation Administration of the I.C.C. "Executive Order 10161: Declaring Certain Functions of the President Under the Defense Production Act of 1950," C.F.R., supp. 1950, p. 123. Executive Order 10200, issued January 31, 1951, terminated the authority of the Secretaries of Commerce and Interior, and Commissioner of the I.C.C. to issue certificates as mentioned in Executive Order 10161, and delegated the authority to the Defense Production Administrator. "Executive Order 10200: Establishing the Defense Production Administration," C.F.R., supp., 1951, p. 61. Later by Executive Order No. 10281 the Defense Materials Procurement Agency was designated as additional guaranteeing agency under the Defense Production Act. "Executive Order 10281: Defense Materials Procurement and Supply," C.F.R., supp., 1951, p. 463.

²"Executive Order 10200: Establishing the Defense Production Administration," C.F.R., supp., 1951, p. 61, sec. 1.

³64 U.S. Stat. at L. (1950) 298 "Defense Production Act of 1950," sec. 303.

Administrator.¹

In order to carry out the above-mentioned purposes, the RFC under the provisions of the Defense Production Act of 1950, was authorized to borrow money from the United States Treasury.² A summary of the Corporation's borrowing authority at December 31, 1952, as delegated to it under the Defense Production Act follows:

| <u>Authorized by</u> | <u>Purpose</u> | <u>Amount</u> |
|---|---|--------------------|
| <u>Lending Program</u> | | |
| The President of the United States..... | To finance working capital loans..... | \$50,000,000 |
| Secretary of Agriculture..... | To finance loans for the expansion of capacity, production of materials, etc., with respect to food and food facilities..... | 4,000,000 |
| Defense Production Administrator..... | To finance loans for the expansion of capacity, production of materials, etc., except with respect to food and food facilities..... | <u>407,000,000</u> |
| | | \$461,000,000 |

In addition, the RFC was authorized under the Federal Civil Defense Act of 1950, approved January 12, 1951, to make loans or to purchase securities to aid financing civil defense projects.³ Loans for this purpose were to be made upon the certification of Federal Civil Defense

¹"Executive Order 10281: Defense Materials Procurement and Supply," C.F.R., supp., 1951, p. 463, sec. 201.

²64 U.S. Stat. at L. (1950), 798 "Defense Production Act of 1950, sec. 304.

³64 U.S. Stat. at L. (1950-1951), 1257 "Federal Civil Defense Act of 1950," sec. 409.

Administrator, and the total amount of the lending authority was limited to \$250,000,000 outstanding at any one time.¹

Again, the RFC was authorized under the Defense Production Act Amendments of 1951, approved July 31, 1951, to make loans and advances upon the recommendation of the Small Defense Plants Administration certifying that the applicant was a qualified small business concern engaged in defense or essential civilian activities.² The aggregate amount of loans under this authority was limited to \$100,000,000 outstanding at any one time.³

These were provisions under which the RFC conducted its lending activities during the post-War period. As a summary, Table 12 presents comparative amounts of outstanding loans and investments during the same period.

In examining the operations of the RFC as shown in the figures presented in Table 12, we shall find some significant changes in the RFC's lending activities. First of all, loans outstanding to financial institutions declined from \$286,593,000 to \$54,767,000, from June 30, 1947 to June 30, 1952. The extent of this liquidation of investments in and loans to financial institutions seems to indicate the extent of the recovery of these businesses from the low point of 1933. With the approval of bank supervisory authorities, the amounts subscribed by the RFC for the

¹
Ibid.

²65, U.S. Stat. at L. (1951), "Defense Production Act Amendments of 1951," sec. 107.

³
Ibid.

preferred stock and capital notes and debentures of banks were reduced as the financial condition of the banks warranted. The progress made in the liquidation of these investments can be measured by comparing the amounts outstanding presented in Table 8 and Table 12. The outstanding balance of \$54,000,000 at June 30, 1952, was all that remained out of \$3,900,000,000 disbursed from the commencement of the program of aid to financial institutions in 1932.¹

Secondly, the gradual liquidation of railroad loans is worthy of attention. Since 1940, the nation's railroads have made notable progress in recovering from the financial ills which beset them during the depression of the 1930's. Generally speaking, railroad earnings have been good and markets for their capital securities and debentures have been favorable. In consequence, few railroads have approached the RFC for financial assistance for the past decade, and the RFC concentrated its efforts on the liquidation of its prior railroad loans and investments. On June 30, 1952, the total of railroad loans and security purchases outstanding was \$83,100,000. This amount was less than 7 per cent of the total of \$1,151,000,000 disbursed on railroad loans and security purchases during the history of the RFC.² Included in the total of \$83,100,000 held at June 30, 1952, were bonds of the Baltimore and Ohio Railroad Company in

¹ U.S., R.F.C., Annual Report and Financial Statements (from 1950-1952 inclusive).

² U.S., R.F.C., Annual Report and Financial Statements (June 30, 1952), p. 11.

Table 12

COMPARATIVE SUMMARY OF OUTSTANDING LOANS AND INVESTMENTS¹

(Amount in thousands of dollars)

| Class | June 30, 1947 | June 30, 1948 | June 30, 1949 | June 30, 1950 | June 30, 1951 | June 30, 1952 |
|---------------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Financial institutions | \$ 286,593 | \$ 137,449 | \$ 122,817 | \$ 109,969 | \$ 94,056 | \$ 54,767 |
| Industrial and commercial enterprises | 276,422 | 303,449 | 384,345 | 518,351 | 463,387 | 365,767 |
| Railroads | 146,887 | 144,277 | 117,246 | 110,426 | 94,056 | 83,143 |
| Mortgages | 80,965 | 185,664 | 591,860 | 100,862 | 81,565 | 74,894 |
| Public agencies | 891,259 | 41,339 | 30,195 | 19,456 | 24,907 | 15,950 |
| Catastrophe loans | 626 | --- | 3,998 | 4,517 | 4,401 | 16,239 |
| Foreign governments | 241,684 | 215,165 | 174,004 | 128,349 | 75,175 | 54,000 |
| Other receivables | 23,303 | 1,827 | 3,270 | 2,267 | 3,818 | 1,809 |
| Total | 1,947,739 | 1,029,139 | 1,427,735 | 994,197 | 841,365 | 666,454 |

¹ Source: U.S., R.F.C., Annual Report and Financial Statements (from 1947 through 1952).

the amount of \$69,900,000, the issue of \$80,000,000 acquired in 1947 having been paid down to this figure.¹

Thirdly, it should be noted that the volume of business loans increased during the period of mid-1949 and 1950.² For instance, the RFC received loan applications from 13,086 business enterprises during the fiscal year 1950, as compared with 8,156 during the fiscal year 1949. Loan authorizations totaled \$593,600,000 as compared to \$388,500,000 in the fiscal year 1949.³

Among other factors explaining the larger volume of loan applications to the RFC, the RFC seems to assume that the effects of the 1948-1949 business contraction and the benefits of the subsequent recovery were not equally distributed among business concerns of all sizes.⁴ To support this assumption the RFC explains that "By far the greatest number of requests for financial assistance received by the Corporation come from small and medium-sized businesses; it was these same classes of concerns which were most adversely affected by the 1948-1949 recession and they were the last to share in the benefits of the recovery."⁵

¹For the Baltimore and Ohio Railroad Co. \$80,000,000, see pp. 220-226.

²See Table 12.

³U.S., R.F.C., Annual Report and Financial Statements (June 30, 1950), p. 7.

⁴Ibid., p. 8.

⁵Ibid.

Finally the RFC's authority to make catastrophe loans is worthy of special attention in the course of studying the operations of the RFC. Included in the RFC's lending authority under the RFC Act (as amended in 1947 and 1948) was a specific provision to make such loans "as it may determine to be necessary or appropriate because of floods or other catastrophes."¹ Pursuant to this authority the RFC was ready at all times to take immediate measures for the rehabilitation of inhabitants and resources of areas stricken by floods, fires, earthquakes and storms. The usual prerequisites for other types of RFC loans, such as the non-availability of credit from other sources, and reasonable assurance of repayment, were not required for catastrophe loans. The amount of each loan was limited to the cost of replacing or repairing the damaged property. Maturity dates were limited to 20 years, and the interest rate was set at 3 per cent a year, with provision for free interest of 4 months.² With these special provisions the activity of the RFC in making catastrophe loans has proven of particular value in filling local credit needs in alleviating hardship and rehabilitating damaged properties due to floods and other catastrophes.

¹ 61 U.S. Stat. at L. (1947), 204, "Joint Resolution to Extend the Succession, lending powers, and the functions of the Reconstruction Finance Corporation," sec. 4(a). And also 62 U.S. Stat. at L. (1948), 263, "An Act To amend the Reconstruction Finance Corporation Act, as amended, and for other purposes," sec. 4(a).

² U.S., Congress, Report on Audit of Reconstruction Finance Corporation for the Fiscal Years Ended June 30, 1948 and 1949 (House Report No. 638; 81st Cong., 2d sess.), p. 26.

Section 2

Non-lending Activities in the Post-War Period

Commencing in 1940 and continuing during World War II the RFC carried on, under authority of law, certain national defense and war activities (other than lending) through subsidiary corporations, as we have seen in Section 2 of Chapter IV. Net expenditures for these activities to June 30, 1947, aggregated \$9,313,736,531. At that date a large part of the activities had been completed; however, certain programs, particularly those relating to the production of synthetic rubber, tin and fibre were being continued. The Government Corporations Appropriation Act, 1949¹ (June 30, 1948), authorized cancellation of RFC's notes payable to the Treasury in the amount of \$9,313,736,531, representing the unrecovered costs at June 30, 1947, relating to the national defense and war activities. The act also provided that any amounts recovered by the RFC from the activities after deduction of related expenses were to be deposited in the Treasury as miscellaneous receipts. By this action the RFC was in effect assigned the functions of operator, custodian, and liquidator of the remaining assets. In addition, the RFC was designated to liquidate the net assets of the Smaller War Plants Corporation and Defense Homes Corporation.

¹62 U.S. Stat. at L. (1949), 1187, "The Government Corporations Appropriation Act, 1949."

1. Synthetic Rubber Program:

The wartime development and growth of the synthetic rubber industry, occurring in a period of spectacular scientific and industrial achievement, is today considered out of the outstanding accomplishments of American technology. In 1941, with its industry girding itself for the biggest war effort in history, the United States was faced with the imminent loss of its major sources of natural rubber, a commodity then as indispensable to our society as steel and petroleum. The domestic production of synthetic rubber that year was less than 10,000 long tons, about one per cent of the total rubber consumption.¹

A program was authorized in May 1941, with the approval of the President, for the construction of plants with an annual capacity of 40,000 long tons of GR-S (butadiene-styrene) rubber. Immediately following Pearl Harbor, the program was increased by Rubber Reserve Company to 400,000 long tons, and after the fall of Singapore, the program was increased in successive stages during the first half of 1942 to a total of 805,000 long tons consisting of 705,000 long tons of GR-S; 60,000 long tons of GR-I (butyl); and 40,000 long tons of GR-M (neoprene). By 1944, less than three years after its inception, the program was essentially in full operation and production that year reached 737,000 long tons, exceeding the total domestic consumption of all types of new rubber. The new industry reached its production peak early in 1945, and

¹U.S., R.F.C., Annual Report and Financial Statements (June 30, 1949), p. 32.

the performance of individual plants indicated the potential aggregate capacity to be 1,000,000 long tons per year.¹ The success of the program was attested by the fact that the war effort was at no time hampered by a shortage of rubber.

After the cessation of hostilities, natural rubber became available in increasing quantities and an era of price competition between synthetic and natural rubber began. This era was marked by numerous fluctuations but in general the demand for synthetic rubber fell until it reached its lowest level in the latter part of 1949. However, from beginning of 1951 the demand for synthetic rubber, riding on the strength of a booming national economy, particularly in the automobile and related industries, with an attendant natural rubber increase, rose to the point that facilities in production were unable to satisfy all the demand.²

Table 13 presents the trend of this change in synthetic rubber production in recent years.

Synthetic rubber production in January 1950 had slumped to a rate of 215,000 long tons a year, compared with the RFC's goal of maintaining a minimum productive capacity of 600,000 long tons. The plant capacity itself had been cut to a maximum of 400,000 long tons. Thus when the Korean

¹Ibid. (June 30, 1950), p. 46.

²Ibid. (June 30, 1952), p. 15.

Table 13

PRODUCTION OF SYNTHETIC RUBBER UNDER THE RFC¹

(Unit in long tons)

| Type | Up to fiscal 1947 | 1948 | 1949 | 1950 | 1951 | 1952 |
|-------------------|----------------------|---------|---------|---------|---------|---------|
| GR-S ² | 2,470,000 | 360,753 | 362,231 | 274,343 | 528,841 | 715,732 |
| GR-I ³ | 181,000 | 74,731 | 56,413 | 48,013 | 65,625 | 83,534 |
| Total | 2,651,000 | 435,484 | 418,644 | 322,356 | 594,466 | 799,466 |

¹Source: U.S., R.F.C., Annual Report and Financial Statements (from 1947 to 1952 inclusive).

²GR-S--general purpose of synthetic rubber

³GR-I--special purpose rubber principally for pneumatic inner tubes.

War began in June 1950 an immediate shortage developed. However, by November 1950 the maximum annual production had been stepped up to approximately 500,000 long tons.¹ By July 1951, the production rate of general purpose (GR-S) synthetic rubber had reached the goal of 760,000 long tons per year as set forth in the series of four directives from the Executive Office of the President.²

The act of March 29, 1947,³ continued the powers, functions, duties and authority of the government to manufacture and sell synthetic rubber until Congress adopted permanent legislation or until March 31, 1948, whichever was the earlier. The RFC was given authority to continue handling the synthetic rubber program.

The Rubber Act of 1948,⁴ approved March 31, 1948, authorized the government to continue the manufacture and sale of synthetic rubber until June 30, 1950. It provided that "there shall be maintained at all times within the United States, rubber producing facilities having a rated production capacity of not less than six hundred thousand long tons per annum of general-purpose synthetic rubber and not less than sixty-five thousand long tons per annum of special-purpose synthetic rubber."⁵ In

¹U.S., R.F.C., Annual Report and Financial Statements (June 30, 1950),

²Ibid. (June 30, 1952), p. 16.

³61 U.S. Stat. at L. (1947) 24 "Joint Resolution To strengthen common defense by maintaining an adequate domestic rubber-producing industry."

⁴62 U.S. Stat. at L. (1948) 101 "Rubber Act of 1948."

⁵Ibid.

addition, facilities in operation by the government or private persons were to produce annually not less than one-third of the rated production capacities specified above. The act also authorized the President to issue such rules and regulations as he deemed necessary and appropriate to carry out the provisions of the act.¹

Executive Order 9942, dated April 1, 1948, delegated certain functions under the Rubber Act of 1948 to the RFC and to the Secretary of Commerce. Those functions granted to the RFC were as follows:

1. Produce and sell synthetic rubber.

2. Maintain in operation or in standby condition facilities with an annual rated capacity of 600,000 long tons of general purpose rubber and 65,000 long tons of special purpose rubber until a disposal program is adopted.

3. Formulate for transmission to the President and the Congress by April 1, 1949, a program for disposal of the synthetic rubber facilities to private industry.

4. Undertake research and development in rubber and allied fields.²

An act of June 24, 1950 extended the earlier legislation and the authority for operation of the synthetic rubber program to June 30, 1952.³

On June 23, 1952, the Rubber Act of 1948, as amended, was extended from June 30, 1952 to March 31, 1954. The RFC continued to operate all the Government-owned synthetic-rubber-producing plants and certain other

¹Ibid.

²"Executive Order 9942: Providing for the Performance of Certain Functions Under the Rubber Act of 1948," C.F.R., supp., 1948, p. 106.

³64 U.S. Stat. at L. (1950-1951), "An Act To extend the Rubber Act of 1948, and for other purposes."

facilities. Production in 1952 amounted to approximately 800,000 long tons of synthetic rubber (excluding carbon black and oil content), an increase of 200,000 tons over the preceding year.¹

A significant accomplishment resulting from the RFC's research program during the period of 1948 and 1949 was the development of processes and the conversion of facilities for the manufacture of "cold rubber", a general purpose synthetic rubber produced at 40° F rather than at 122° F. Laboratory and road tests indicate that the wearing qualities of tire treads made from this "cold rubber" surpass those made from natural rubber. Production on a continuous plant scale basis was begun in February 1948, and by August 1949 seven plants with an aggregate annual capacity of 183,000 long tons were engaged in production of this new type rubber.²

2. Tin Program:

The RFC's tin activities fall into two major categories: the operation of a tin smelter at Texas City, Texas, and the import of, and trading in, refined tin and tin ores.

Three-fourths of the world's tin ore production is found in Southern Asia. The remaining one-fourth is produced in Bolivia, Nigeria, and the Belgian Congo. Because of the difficulties and hazards inherent in war-time ocean shipping, and in order to insure a domestic supply of tin, the

¹U.S., Congress, Report on the Audit of Reconstruction Finance Corporation for the Fiscal Year Ended June 30, 1952 (House Doc. No. 104; 83d Cong., 1st sess.), p. 2.

²Ibid., for the Fiscal Years Ended June 30, 1948 and 1949 (House Doc. No. 638; 81st Cong., 2d sess.), p. 83.

RFC early in 1941 entered into the construction of a tin smelter in Texas City. The plant was completed in April 1942 at a cost of \$6,638,000.¹

At the time of establishment of the tin smelter in Texas City in 1941, no other tin smelting operations were being carried on in the United States. This tin smelter is now the only such facility of importance in the Western Hemisphere. The relationship between Texas City tin smelter production, United States imports and United States consumption of primary tin is shown in Table 14.

Since the end of the War in August 1945, the RFC has continued to control the import of tin and the smelter operation in order to insure an orderly transfer of tin metal to commercial channels and as a necessary part of the post-War defense program. The act of July 25, 1946, which extended the effective period of the Emergency Price Control Act of 1942, approved continued buying and selling at a loss until June 30, 1947, "with respect to purchases by the Reconstruction Finance Corporation, of such tin ores and concentrates as it deems necessary to insure continued operation of the Texas City tin smelter."² The act of June 28, 1947, authorized the Corporation to continue through June 30, 1949, both the operation of the tin smelter and the general trading program. This act was amended on June 29, 1948, to further extend RFC's tin program func-

¹Ibid.

²60 U.S. Stat. at L. (1946), 664, "Joint Resolution Extending the effective period of the Emergency Price Control Act of 1942, as amended, and the Stabilization Act of 1942, as amended."

Table 14

RELATIONSHIP BETWEEN TEXAS CITY SMELTER PRODUCTION, UNITED STATES
IMPORTS and UNITED STATES CONSUMPTION OF PRIMARY TIN¹

(Unit in long tons)

| Calendar Year | U.S. Imports | U.S. Consumption | Texas Smelter Production | % of U.S. Consumption |
|---------------|-----------------|---------------------|-----------------------------|--------------------------|
| 1942 | 26,753 | 56,288 | 15,695 | 27.88 |
| 1943 | 11,919 | 46,253 | 20,727 | 44.81 |
| 1944 | 13,338 | 59,156 | 30,619 | 51.76 |
| 1945 | 9,375 | 55,642 | 40,591 | 72.95 |
| 1946 | 15,520 | 54,627 | 43,468 | 79.57 |
| 1947 | 24,899 | 59,166 | 33,292 | 56.27 |
| 1948 | 49,196 | 59,863 | 36,064 | 61.27 |
| 1949 | 60,222 | 47,164 | 36,677 | 76.47 |
| 1950 | 82,916 | 71,774 | 32,817 | 45.72 |
| 1951 | 27,784 | 56,542 | 31,669 | 56.01 |
| Total | 321,922 | 566,474 | 321,619 | 56.78 |

¹Source: U.S., R.F.C., Annual Report and Financial Statements (June 30, 1952), p. 25.

tions until June 30, 1951.

Significant during the Far Eastern crisis was legislation (S. 3666) enacted into law on August 14, 1950, which extended the government's legal authority to own and operate a tin-smelting plant at Texas City, Texas. The legislation was approved by President Truman on August 21, 1950.¹

S. 3666 was reported in the Senate on June 23, 1950, from the Armed Services Committee. As reported it extended for five years the government's authority to maintain a domestic tin-smelting industry "in the interest of national security."²

The existing law (due to expire June 30, 1951), authorized the RFC: (1) to buy, sell and transport tin, tin ore and tin concentrates; (2) to maintain and operate, by lease or otherwise, the government-owned tin smelter at Texas City; (3) to finance research in tin smelting and processing; and (4) to do whatever might be necessary to accomplish these purposes.³

The Senate Armed Services Committee's report, written before the Korean war broke out, said Communist-inspired activities in Southeast Asia "constitute a self-evident threat to the free world's supply of tin . . . The international situation which originally made construction

¹64 U.S., Stat. at L. (1950), 468, "An Act To extend for five years the authority to provide for the maintenance of a domestic tin-smelting industry."

²"Statement by Senator Johnson of Texas," Congressional Record, vol. 96, pt. 9, p. 12424.

³61 U.S. Stat. at L. (1947), 190, "Joint Resolution To strengthen the common defense and to meet industrial needs for tin by providing for the maintenance of a domestic tin-smelting industry," sec. 2.

of the Texas City tin smelter essential is virtually duplicated again today."¹

The measure was brought up and passed in the Senate on June 30, 1950, by voice vote.²

Before any action on S. 3666 had been taken in the Senate, the House Banking and Currency Committee on June 16, 1950, reported H. R. 8569 which was virtually identical to the Senate measure with one exception. Where the Senate's proposal was simply an extension bill, the House measure had a clause directing the government to take notice of "the public interest in the maintenance of domestic smelting of Western Hemisphere tin ores and concentrates by American private enterprise."³

The House Committee on Banking and Currency held a hearing on the bill on June 12, 1950. The spokesman for the RFC urged adoption of the five-year extension bill, saying the previous method of year-to-year extension was detrimental to defense.⁴

Before the passage of H. R. 8569, however, objection was raised by Representative John P. Saylor of Pennsylvania. He pointed out that the smelter was operated by a Dutch-owned firm.⁵ He said it should be turned

¹"Tin Smelting," Congressional Quarterly Almanac, VI (81st Cong., 2d sess.--1950), 657.

²Ibid.

³"Texas City Tin Smelter Operation," Congressional Record, vol. 96, pt. 8, p. 11007.

⁴"Tin Smelting," ibid.

⁵The tin smelter is operated for the RFC by its agent, the Tin Processing Corporation, an affiliate of N. V. Billiton Maatschappij, the

over to American private enterprise, or, if that were impossible, it should be operated by the United States Bureau of Mines. He offered an amendment to that effect, but it was defeated. Representative Wesley A. D'Ewart of Montana then proposed an amendment to require the Dutch firm to make available to American processors all patents and knowledge it gained through use of the plant. This amendment also was defeated.¹

The Senate refused to accede to the House changes in S. 3666, and so the measure was sent to a joint House-Senate conference for harmonization. The conference reached agreement on August 11, 1950, throwing out the House Committee's amendment. Both the House and Senate adopted the conference report on August 14, 1950.²

Purchases of refined tin have been made under a program of international allocation. In December 1945 a Combined Tin Committee was formed to assume the function of allocating the available world supply of refined tin to the various member countries. The United States participated in the international distribution in order to obtain its share of the available supply. The tin and tin ores acquired were purchased in part by the U. S. Commercial Company, and sold to the Metals Reserve Company of the RFC at less than cost.

leading Dutch producer of tin. The operator has the use of the trained personnel, the processes, and the formula of the Dutch company. All costs, including a management fee, are borne by the RFC.

¹ "Tin Smelting," ibid.

² Congressional Record, vol. 96, pt. 9, p. 12424.

On March 5, 1951, Defense Production Administrator¹ delegated to the RFC the authority to purchase tin metal, tin ores, and concentrates for Government use or resale under Executive Order 10161 (September 9, 1950)² and Executive Order 10200 (January 3, 1951).³ The RFC, since March 12, 1951, was designed as sole importer of tin metal including private importations of tin.⁴

Following the Korean war, some difficulties arose for the RFC as the sole importer of tin metal. The fact was that a group of Bolivian, British, Dutch, Indonesian, and Belgian companies had long been controlling the world tin price and the Singapore price had long been the world standard, no matter how loudly the United States politicians screamed about cartels. With the start of the Korean war, the price of tin at Singapore jumped from 73.4¢ to \$1.93. To stop this runaway, the United States put consumption under Defense Production regulations and named the RFC as sole buyer.⁵ This resulted in suspension of purchases of tin by the RFC until January 1952, when the Governments of the United

¹By Executive Order 10281 (August 28, 1951), the Administrator of Defense Materials Procurement Agency succeeded to the authority, with respect to tin, previously vested in the Administrator of General Services Administration. "Executive Order 10281: Defense Materials Procurement and Supply," C.F.R., supp., 1951, p. 464.

²"Executive Order 10161: Delegating Certain Functions of the President Under the Defense Production Act of 1950," C.F.R., supp., 1950, p. 123.

³Executive Order 10200: Establishing the Defense Production Administration," C.F.R., supp., 1951, p. 61.

⁴U.S., Congress, Report on the Audit of Reconstruction Finance Corporation for the Fiscal Year Ended June 30, 1952. (House Doc. No. 104; 83d Cong., 1st sess.), p. 26.

⁵U.S., R.F.C., Annual Report and Financial Statements (June 30, 1952), p. 23.

States and the United Kingdom entered into an agreement on price and delivery of tin metal. In March 1952, a further agreement was reached with Indonesian representatives on the importation of tin metal by the United States.¹ In the same month, an agreement was also reached with African Metals Corporation for purchasing and delivering tin metal to the United States.² Negotiations with the Bolivian government were not equally successful because of the change of regime in Bolivia in April 1952, and the unstable economic policy of the new regime, although the U. S. State Department tried to bring about the end of the RFC boycott on tin purchasing.

3. Abaca Program:

Since January 3, 1942, the RFC had been engaged in the production of abaca fiber in Central America as a part of the war-defense program of the Government. Under the conditions existing during a national emergency involving military operations, there are certain strategic or critical materials which must be obtained, if possible, with but little consideration as to their cost. Abaca fiber, a raw material used in the manufacture of articles for military operations, is an outstanding example of a strategic natural commodity.

Most of the abaca fiber used in the United States is made into rope and cables for ships--for which use it is particularly adapted, having

¹Ibid.

²Ibid., p. 24.

the necessary high tensile strength, durability, lightness, and resistance to sea water. Abaca rope absorbs water slowly and dries quickly, thus preventing, to a large extent, the rotting which ordinarily is so destructive to other types of ropes in marine use. The most important uses of abaca rope are for hawsers, mooring lines, and heavy towing lines. Tarred abaca rope of smaller sizes is used on ships, in rope for rigging, belt rope for sail edges, lanyards from deck to mast, and boat-falls for life-boats.¹

At the time of the entry of the United States into World War II, the entire supply of abaca fiber was cut off by the Japanese occupation of the Philippine Islands, which up to that time produced 95 per cent of the world's supply of abaca--the remainder being produced in the Dutch East Indies.²

Complete records of the attempts that have been made to grow abaca in countries other than the Philippines are not available, but many such attempts have been made. With but few exceptions these experiments were unsuccessful. However, the United Fruit Company which, in conjunction with the Department of Agriculture, had been conducting experiments in Central America for approximately 20 years had, by 1941, approximately 2,000 acres of abaca under cultivation in Panama, proving that abaca could successfully be grown outside of the Philippines. But the United

¹U.S., R.F.C., Annual Report and Financial Statements (June 30, 1950), p. 54.

²Ibid. (June 30, 1952), p. 27.

Fruit Company had had no success in the development of efficient machinery for the large scale processing of abaca on a profitable basis, and it was occupied in solving this problem when the War broke out. The War changed the outlook and approach to abaca production in the Western Hemisphere from a commercial to a defense basis and on December 12, 1941, the RFC, acting through its subsidiary Defense Supplies Corporation, opened negotiations with the United Fruit Company for the installation of U.S. Government-owned abaca plantations in the Western Hemisphere. These negotiations culminated in operating contracts dated January 3, 1942.¹

From the date of the surrender of Japan, operations under the contracts of January 3, 1942, were continued under authority of the War Mobilization and Reconversion Act of 1944. Because of the strategic importance of abaca to the nation's military and industrial requirements, the Abaca Production Act of 1950, providing for the continuance and expansion of the government-owned abaca plantations in this hemisphere, was enacted on August 10, 1950.²

Under this legislation Congress not only provided for the continuation of the original plantations but also for their expansion from 25,000 acres to a maximum of 50,000 acres when, in the discretion of the

¹For a more detailed history behind the abaca program of the RFC, see U.S., R.F.C., Annual Report and Financial Statements (from 1947 through 1950).

²64 U.S. Stat. at 4. (1950-1951), 435 "An Act To strengthen the common defense by providing for continuation and expansion of Western Hemisphere production of abaca by the United States."

President, such expansion should be deemed necessary. In addition, the Act permits surveys and research in abaca development, because the existing plantations were installed under war pressures without opportunity for adequate surveys and studies. The mass-production of fiber on the Government plantations is in its infancy.

On August 21, 1950, the President directed the RFC to expand operations to as near 50,000 acres as practicable. In order to carry out this directive, the RFC entered into an agreement with the Department of Agriculture to make soil surveys for the purpose of locating new plantations. In addition, the RFC held a series of negotiations with commercial companies for the purpose of entering into contracts for the operation of the proposed additional plantations in Central America. It tried to reach the authorized acreage as soon as possible after the issuance of the Presidential directive.¹

While the production from the government-owned plantations is, at present, but 10 per cent of the world production, it does nevertheless provide the nucleus of the fiber needs of the country during an emergency. It is therefore looked upon as a "stock-pile-in-the-ground," which has the effect of reducing the physical stockpile and lessening rotation problems.²

¹U.S., Congress, Report on the Audit of Reconstruction Finance Corporation for the Fiscal Year Ended June 30, 1951 (House Doc. No. 367; 82d Cong., 2d sess.), p. 25.

²U.S., R.F.C., Annual Report and Financial Statements (June 30, 1950), p. 54.

4. Liquidation of the Smaller War Plants Corporation:

The Smaller War Plants Corporation was organized in 1942 to assist in the mobilization of the production facilities of small business for war purposes. It was empowered to make loans and to purchase and lease facilities to small business firms for use in the production and manufacture of items for war or essential civilian purposes. It was further authorized to enter into contracts with the government, to furnish material and equipment, and to arrange for the performance of such contracts by letting sub-contracts to small business concerns.¹ The SWPC also undertook to assist small business in the direct procurement of contracts and to furnish engineering and other technical advice. Additional powers and duties were assigned the SWPC at the end of the war in connection with reconversion and surplus property disposal.²

The SWPC was authorized by the Surplus Property Act of 1944 to purchase and resell surplus property to small business and to make and guarantee loans to small business in connection with the acquisition of surplus property.³ "Small business" was defined as any privately owned business operated for profit, not dominant in its field, and having less than 500 employees. The program was undertaken to assist small businesses

¹Ibid., for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 127.

²Ibid.

³Ibid., p. 28.

⁴Ibid.

and qualified veterans in the procurement of surplus property and to assist the Surplus Property Board in preventing discrimination against small business. It constituted the principal postwar activity of the SWPC.¹

In compliance with Executive Order 9665, dated December 27, 1945, all SWPC personnel, functions, assets and liabilities were transferred in part to RFC and in part to the Department of Commerce, effective at the opening of business on January 28, 1946.² The functions, assets, and liabilities transferred to RFC were mainly those relating to the loan, lease, prime-contracting, and management activities. By the act of June 30, 1947, the corporate entity of SWPC was abolished and the RFC was directed to continue the liquidation of its affairs.³ As of June 30, 1952, of the assets of the SWPC transferred to the RFC for liquidation, only 37 loans with unpaid balances of \$2,000,000 remained.⁴

¹Ibid.

²U.S., Congress, Report on the Audit of Reconstruction Finance Corporation for the Fiscal Year Ended June 30, 1952 (House Doc. No. 104; 83d Cong., 1st sess., p. 36.

³61 U.S. Stat. at L. (1947), 209, "Joint Resolution To extend the succession, lending powers, and the functions of the Reconstruction Finance Corporation," sec. 207.

⁴U.S., R.F.C., Annual Report and Financial Statements (June 30, 1952), p. 14.

5. Liquidation of the Defense Homes Corporation:

Prior to June 30, 1948, the Defense Homes Corporation¹ was administered by the Housing and Home Finance Administrator. Pursuant to The Government Corporations Appropriation Act of 1949,² all assets, liabilities, capital stock, and records of the DHC were transferred to the RFC for the purpose of liquidation effective June 30, 1948.

The principal assets transferred to the RFC were the following four mortgage notes and accrued interest totaling \$46,200,451:

| <u>Borrower</u> | <u>Maturity</u> | <u>Balance on June 30, 1948</u> |
|--|-----------------|-------------------------------------|
| Fairmac Corporation | April 15, 1975 | \$38,466,746 |
| Bremco, Inc. | April 15, 1975 | 666,451 |
| Veterans Cooperative Housing Association | January 1, 1968 | 4,490,295 |
| Meridian Hill Corporation | March 25, 1968 | 2,526,922 |
| Total Mortgage loans | | <u>46,150,414</u> |
| Accrued interest on above | | <u>50,037</u> |
| Total | | 46,200,451 ³ |

Of this amount of \$46,200,451, the RFC still held over \$43,800,000 of net assets on June 30, 1952.⁴

¹For the activities of the Defense Homes Corporation, see pp. 88-90.

²62 U.S. Stat. at L. (1949), 1187, "The Government Corporations Appropriation Act of 1949."

³U.S., Congress, Report on Audit of Defense Homes Corporation for Fiscal Year Ended June 30, 1948 (House Doc. No. 41; 81st Cong., 1st sess.), p. 14.

⁴U.S., R.F.C., Annual Report and Financial Statements (June 30, 1952), p. 14.

Section 3

Congressional Investigations of the RFC

In the years immediately following the War and continuing on through very recent times many of the RFC loans came in for violent criticism both from the Congress and from outside. This section intends (1) to examine some of the controversial RFC loans which were the targets of Congressional investigation¹ and public criticism, (2) to look into the so-called "outside influence," "political and personal favoritism" and "mismanagement" in connection with the operation of the RFC, and (3) to analyze some of the most significant results of these Congressional investigations and public criticism.

Before going into the above-mentioned studies, one should survey briefly RFC loan procedure practiced during the post-War period in order better to comprehend not only the nature and meaning of these phrases "loan controversies," "outside influence," "political and personal favoritism," and "mismanagement" but also some of the issues involved in Congressional investigation and the consequent outcome of

¹There had been a series of Congressional investigations and hearings during the post-War period. Among them, most noteworthy for this study were those conducted by two special subcommittees of the Senate Committee on Banking and Currency. One was the "Special Subcommittee to Investigate the Reconstruction Finance Corporation" headed by Senator C. Douglass Buck of Delaware as its Chairman, under Senate Resolution 132 (80th Cong., 1st sess., passed June 20, 1947) for an "inquiry into the operation of the Reconstruction Finance Corporation and its Subsidiaries." This Subcommittee held open hearings during December 1947 and January 1948. The other one was "Subcommittee on Reconstruction Finance Corporation", commonly known as either "RFC Subcommittee" or "Fulbright Committee," headed by Senator J. William Fulbright of Arkansas as its Chairman. This subcommittee held many hearings between April 1950 and May 1951.

the reorganization of the RFC.

Prior to the effective date of Reorganization Plan No. 1 of 1951 (it became effective May 4, 1951), lending activities were conducted through the principal RFC office in Washington, D.C., and the 31 loan agency offices located throughout the country. Applications for business loans were processed originally by one of these local loan agencies which had authority to approve any direct loan up to \$100,000 and any participation loan up to \$350,000 provided the participating banks took at least a 25 per cent share. All other business loan applications and all applications which were declined by the local agency were forwarded to Washington for final consideration.¹

When there was an application filed with a local agency for a loan, the loan application was referred to a loan examiner who was expected to examine the applicant's request for assistance from the standpoint of need, sufficiency of collateral, purpose of the loan, management, earning history, ability to obtain credit elsewhere, and any other credit factors applicable in the circumstances. The loan examiner then prepared a report setting forth his findings and recommendations. The same application was next referred to a review committee in the agency. This committee was expected to review the findings and recommendations of the loan examiner and to prepare an independent report setting forth the views of a majority of its members.²

¹U.S., Congress, Senate, "Inquiry Into the Operation of the Reconstruction Finance Corporation and Its Subsidiaries Under Senate Resolution 132," Hearings: Before a Special Subcommittee of the Committee on Banking and Currency (80th Cong., 1st sess.), on S. Res. 132 (December 3, 11 and 12, 1947), pt. 1, p. 32.

²Ibid. (January 14, 15, 16, and 22, 1948), pt. 2, p. 590.

All of the foregoing reviews and recommendations were purely advisory as the final power to approve or disapprove the loan was vested in the local agency manager, provided the loan did not exceed \$100,000 in a direct loan or \$350,000 in a participation loan.¹

Loans in excess of \$100,000 or participating loans in excess of \$350,000 were referred to the Washington office. In that office there were also a loan examiner and a review committee, each of them assigned to review the prior recommendations and to prepare an independent report to the Board of Directors. As in the case of the local loan agency, the loan examiner and review committee in the Washington office were purely advisory and no power was delegated to them to approve or disapprove a loan. The purpose intended to be served by these numerous reviews was to furnish the Board of Directors of the RFC with a searching examination of each application and the soundest possible advice in order that they would be in a position to pass upon the loan application on its merits.²

Effective May 4, 1951, under Reorganization Plan No. 1 of 1951, a Loan Policy Board was created.³ The Board first consisted of the

¹"Testimony of Harley Hise, Chairman, Board of Directors, Reconstruction Finance Corporation," in U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee of the Committee on Banking and Currency, 81st Cong., Texmass Loan (April 13, 22 and 27, 1950), p. 58.

²It is extremely helpful to keep in mind the RFC loan procedure for studying the operations of RFC business loans. Particularly in section 3 of this chapter it will be insufficient to examine the controversial loans without this background of the RFC loan procedure practiced in this period.

³"Reorganization Plan No. 1 of 1951," House Report (Report No. 188; 82d Cong., 1st sess.), pp. 1-2. Also see "Reorganization Plan No. 1 of 1951, Providing for the Reorganization of the Reconstruction Finance Corporation," Senate Report (Report No. 213; 82d Cong., 1st sess.), p. 9.

Administrator of the RFC, Deputy Administrator of the RFC, Secretary of the Treasury, and Secretary of Commerce,¹ and effective May 15, 1952, the Administrator of the Defense Materials Procurement Agency was added to it as a fifth member.²

On August 7, 1951, the Loan Policy Board issued "Loan Policy Statement No. 1," declaring, among other things, that "In addition to meeting the general objectives and requirements of the RFC Act, all loans shall be made in accord with the following principles:

- (1) The primary consideration in determining whether to grant a loan shall be the interest of the general public rather than the interest of the individual borrower.
- (2) Loans shall not be granted which in effect would promote monopoly.
- (3) In carrying out the objectives of the RFC Act, particular consideration shall be given to the credit needs of small business enterprises."³

In accord with another provision of Reorganization Plan No. 1, a board of review, composed of five employees of the RFC, analyzed all applications for loans in excess of \$100,000 and recommended either approval or disapproval.⁴ Whenever the Administrator or Deputy Admin-

¹
Ibid.

²The Plan provided for "one other member which shall be designated from time to time by the President from among the officers of the United States," Ibid., sec. 4.

³U.S., Congress, Report on the Audit of Reconstruction Finance Corporation for the Fiscal Year Ended June 30, 1951 (House Doc. No. 367; 82d Cong., 2d sess.), p. 74, Appendix B, "Policy Statement No. 1."

⁴Ibid., p. 4.

istrator acted contrary to the board of review's recommendation his reasons for so acting were set forth in a memorandum which was placed in the files of the RFC.¹ In addition, memorandums were placed in the files whenever differences of opinion occurred on loans of \$100,000 or less, and whenever the Administrator and the board differed as to whether a loan was to be authorized under the RFC Act or section 302 of the Defense Production Act.²

To assure uniformity of action under more restricted lending policies the Administrator on June 27, 1951 directed that all loan authorizations except those for catastrophe loans be made in Washington.³ This directive was amended, effective May 1, 1952, giving the loan agency managers authority to approve direct loans and immediate participation loans in amounts not exceeding \$50,000 and deferred participation loans in amounts not exceeding \$100,000 to any one borrower, provided approval was in substantial concurrence with the recommendation of the loan examiner who prepared the report on the application. Before approving a loan, however, the agency managers must obtain an acknowledgment from the RFC's Office of Small Business that the loan conformed to the policies

¹ During the year 1952, for instance, the Administrator or the Deputy Administrator approved two loans aggregating \$525,000 on which the board of review had recommended decline; and they declined one loan of \$150,000 on which the board of review had recommended approval. Ibid.

² Ibid., p. 5.

³ U.S., Congress, Report on the Audit of Reconstruction Finance Corporation for the Fiscal Year Ended June 30, 1952 (House Doc. No. 104; 83d Cong., 1st sess.), p. 3.

established by the Loan Policy Board.¹ The RFC continued its practice of requiring that all applications recommended for decline by the agency managers be forwarded to Washington for final disposition.

1. The Baltimore & Ohio Railroad Company Loan:

During the period 1932 to 1938, the RFC made loans totaling approximately \$86,000,000 to the Baltimore & Ohio Railroad Company (hereinafter referred to as the B. & O.). In 1939, the B. & O. filed its petition for debt readjustment under chapter XV of the Bankruptcy Act.² This readjusted in a judicially approved plan that in effect created a moratorium on a substantial portion of its fixed charges for a period of 6 years. Included in this plan of readjustment was a debt of approximately \$85,000,000 due to the RFC. The proceedings were before the District Court of the United States for the District of Maryland.³

On July 2, 1944, the B. & O. filed in the same district court a second petition under a reenacted chapter XV of the Bankruptcy Act, alleging its inability to meet its debts, matured or about to mature,

¹Ibid.

²For a study of bankruptcy laws of the United States, see U. S., Congress, Document Room of the House of Representatives, Bankruptcy Laws of the United States (Compiled by Elmer A. Lewis; Washington, D.C.: Government Printing Office, 1946).

³For the decree of the court, see U.S., Congress, "Court Order No. 16: In the District Court of the United States for the District of Maryland in the Matter of the Baltimore and Ohio Railroad Company, Petitioner," in Hearings: Before the Committee on Banking and Currency, on \$80,000,000 loan to the B. & O. Railroad (80th Cong., 1st sess.), pt. 2, pp. 1559-77.

and seeking approval of a plan of readjustment, dated September 20, 1944.¹ The Company stated that it was unable to meet, except through a temporary extension, the \$13,490,000 principal amount of notes which would mature August 1, 1944, and it would be similarly unable to meet another obligation of \$71,083,381 maturing on November 8, 1944. Both of these debts were owing the RFC.²

The 1944 plan of readjustment approved by the U.S. district court extended the maturity dates of the first mortgage bonds, and converted the RFC loan from a note basis to a bond basis, extending the maturity to 1965.³

However in July 1945, Senator Burton K. Wheeler, then Chairman of the Senate Committee on Interstate Commerce, in a letter to the Federal Loan Administrator, called for an investigation of the RFC loans to the B. & O.⁴ Senator Wheeler brought out the point that the net income of the B. & O. from the end of 1939 to the middle of 1945, after all taxes and interest charges, had been more than \$100,000,000, and he stated that an additional net profit of \$35,000,000 had been made by the B. & O. in re-purchasing its obligations on the open market at a price below par.⁵

¹For the petition, see "Exhibit Q--Petition No. 9905 Bankruptcy Docket, in the matter of the B. & O. Railroad Co., filed July 2, 1945," in ibid., pt. 1, pp. 316-46.

²Ibid., pp. 324-35.

³For this action, the Senate Banking and Currency Committee later, in May 1947, stated that the 1944 readjustment plan was a "serious violation of the RFC Act" as the legal limit on the maturity of an extension of a RFC loan was then set at January 31, 1955. See "Statement of the Chairman, Senate Banking and Currency Committee: Reconstruction Finance Corporation--B. & O. Co. Case," ibid., p.550.

⁴Letter from Hon. B. K. Wheeler to Hon. John W. Snyder, July 28, 1945," ibid., p. 206.

⁵Ibid.

He also named a list of former RFC officials who then were on the top management of the B. & O., and added: "It seems to me rather shocking that Government officials charged with lending huge sums of money such as those lent to the B. & O. should shortly thereafter become officers and directors of the company to which the money was lent,"¹ and that the Government loans "are being used as a means of obtaining employment in or control of large privately owned corporations for the benefit of former RFC officials."²

The fact was that between 1941 to 1943 four RFC officials joined the management of the B. & O. at a time when the railroad was in debt for over \$80,000,000 to the RFC. Stewart McDonald went with the B. & O. as director of chairman, Russell L. Snodgrass went as vice-president, Cassius M. Clay went as solicitor, and F. K. Baukhages went as executive assistant in charge of finance.³ Not long after they joined the B. & O. the expiration date of the RFC loans approached which would mature in August and November 1944. The railroad's management with these four top officials in it decided upon a strategy that would permit the company to escape paying the loan at that time. It was the situation under which the B. & O. filed a petition on July 2, 1944, in the District Court of the United States for the District of Maryland. In order to accomplish their objective for the readjustment of the debts, the officials of the B. & O.

¹Ibid.

²Ibid.

³"Testimony of Stewart McDonald, director and chairman of the Baltimore and Ohio R.R., Baltimore, Md.," ibid., p. 85; "Testimony of Russell H. Snodgrass, vice-president, Baltimore and Ohio R.R., Baltimore, Md.," ibid., p. 242; "Testimony of Cassius M. Clay, of Paris, Ky.," ibid., p. 13. and "Testimony of Frederick E. Baukhages, general solicitor, Baltimore and Ohio R.R., Baltimore, Md.," ibid., p. 8.

needed a letter from the RFC demanding that the B. & O. pay up. Later Mr. Snodgrass admitted in Congressional hearings¹ that he had composed two drafts of such a letter, and sent them to his colleagues back at the RFC; then the RFC, using these drafts as a basis, in turn prepared a letter on RFC stationery and sent it back to him.² He also admitted that the letter was used in court as a basis for winning a readjustment plan.³ As a result of such maneuvers at this, Mr. Clay resigned his position as general solicitor of the B. & O. in September 1945, giving as his ground for doing so his disapproval of the plan for readjustment, which he characterized as "fraud upon the court," and a "frame-up in a gigantic scheme promoted by one time RFC boss Jesse H. Jones to keep RFC men in top B. & O. jobs."⁴

In a reply to the letter from Senator Wheeler, Mr. Charles H. Henderson, Chairman of the Board of Directors of the RFC, on August 23, 1945 made public a letter to Senator Wheeler in which he formally absolved the officials under discussion from any responsibility for the loans.⁵

¹Hearings were held during April and May 1947 before the Senate Committee on Banking and Currency, 80th Cong., 1st sess.

²Testimony of Russell L. Snodgrass, vice-president, Baltimore & Ohio R.R., Baltimore, Md., ibid., p. 250.

³Ibid., p. 269.

⁴"Testimony of Cassius M. Clay, of Paris, Ky.," ibid., pp. 22-23, and 96.

⁵For the text of the letter, see "Baltimore and Ohio R.R.," in The Commercial and Financial Chronicle, 162 (September 3, 1945), 979. The letter from Senator Wheeler to John W. Snyder, the Federal Loan Administrator, was referred to Charles B. Henderson, Chairman of the RFC, for answer, Ibid.

He pointed out that the B. & O. officials while with the RFC had no connection with the loans and no responsibility for determining whether or not the loans should be made. He contended that their position was no different from that of any other ex-RFC officials now employed in industry.¹ Mr. Henderson also explained reasons for the readjustment in the letter. Excerpts from his letter on this phase of the controversy follow:

The 1948 plan, despite unprecedented earnings, has failed. The operation must now be done over. The reason it failed is the fact that it did not sufficiently postpone maturities. This plan greatly improves on it in that respect. It is intended to provide a 20-year breathing spell instead of 6 or 8. Probably that will suffice.²

The circumstances surrounding these transactions and accusations were inquired into extensively in connection with hearings on the proposed extension of the RFC before the Senate Committee on Banking and Currency headed by Senator Charles W. Tobey of New Hampshire as its Chairman, in April and May 1947 and again before a Special Subcommittee of the Senate Committee on Banking and Currency headed by Senator C. Douglas Buck of Delaware as its Chairman, during December 1947 and January 1948.

On May 5, 1947, Mr. Robert R. Young, then chairman of the Chesapeake & Ohio Railroad Co., was invited as an expert on the question of B. & O. to the hearings before the Senate Committee on Banking and Currency. He testified that "I think RFC has been grossly mismanaged,"³ declaring that

¹Ibid.

²Ibid.

³"Testimony of Robert R. Young, Chairman of the Board, Chesapeake & Ohio Lines, Cleveland, Ohio," ibid., p. 285.

"Now we have in essence an \$80,000,000 loan to the B. & O. It is a frozen loan, and it is there for a 20-year maturity. It is the people's money, and no efforts have been made to liquidate it."¹ After having given the financial status of the B. & O. around 1944, Mr. Young unequivocally stated that B. & O. could have paid all or any part of its debt to the RFC had it or the RFC so desired.² As to the management of the B. & O. in relation to the RFC, he went on to say that by appointing former RFC employees as trustees of the bankrupt roads the RFC had in effect created an evil "voting trust" and as a result "those railroads have been grossly, almost criminally managed."³

On the other hand, the information presented by the RFC itself showed that its other railroad debtors had paid all or substantially all of their loans at the beginning of 1947 while the B. & O. loan, the largest railroad loan ever on the RFC books, had been reduced by roughly only 7 per cent--from \$85,000,000 to \$80,000,000. Thus, while the hearings were being held before the Senate Committee on Banking and Currency in May 1947, Senator Charles M. Tobey, the Committee Chairman, on May 21, 1947 issued a statement in which he concluded that "The arrangements on which the RFC management had relied for the ~~payment~~ or liquidation of the more than \$80,000,000 still owed by the B. & O. now promise not to be satisfactory."⁴ Even as of June 30, 1952, the B. & O. still owed the RFC in

¹Ibid., p. 274.

²Ibid., p. 279.

³Ibid.

⁴"Statement of the Chairman, Senate Banking and Currency Committee," ibid., p. 550.

the amount of approximately \$70,000,000.¹ At this point it seems fair to ask whether the RFC was ever intended to make so large a loan for so long a time with so little effort to have it repaid. It seems hard to justify such a small reduction in the principal amount of the loan over so long a period (1932-1952) which included at least 10 years of relative prosperity for the B. & O. and railroads in general.

2. The Kaiser Loans:

During the period from March 4, 1942, to December 22, 1944, the RFC at the request of the War Production Board and its predecessors, authorized various loans to the Kaiser Company, Inc., Oakland, California, in amounts aggregating \$111,805,000. The loans were made for the purpose of building and operating a steel plant at Fontana, California.² The RFC recognized that the ultimate retirement of the loans would depend largely upon the profits of the iron and steel division of the company, since the earnings of the shipbuilding division would decline after the War. Consequently, the RFC engaged an engineering firm to make a survey of the possibilities of the steel plant. The depreciated value, less excess war cost, of the steel plant at June 30, 1945 was estimated by the engineering firm to be \$58,000,000. The engineers also estimated that, with new facilities and good management, the plant could expect peacetime operations at 70 per cent of capacity and on that basis earnings before interest, amortization and depreciation would exceed \$6,000,000 a year.³

¹Ibid.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.) p. 171.

³Ibid.

On the basis of these findings, the RFC in August 1945 authorized an additional loan of \$11,500,000 to the Kaiser Company, Inc. (succeeded by the Kaiser Steel Corporation, effective August 1, 1949). Thus the Kaiser Steel Corporation received a total of over \$123,000,000 in loans from the RFC, of which \$96,000,000 was still outstanding at June 30, 1949.¹

The Balance Sheet of the RFC at June 30, 1949, showed that out of a total of \$384,000,000 outstanding in RFC loans to business, the Kaiser Steel Corporation owed \$96,000,000, over a quarter of the total.²

On top of the outstanding loans of \$96,000,000 to the Kaiser Steel Corporation, the RFC further extended to the Kaiser-Frazer Corporation³ a first loan of \$34,400,000 on October 6, 1949, a second loan of \$10,000,000 on October 21, 1949, and a third loan of \$25,000,000 on December 4, 1950.⁴

As more loans were made to the various enterprises of the Kaiser interests, criticism mounted. Critics assailed the loans as examples of

¹Ibid., p. 172.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Its Wholly Owned Subsidiary Federal National Mortgage Association For the Fiscal Years Ended June 30, 1948 and 1949 (House Doc. No. 638; 81st Cong., 2d sess.), p. 124, "Exhibit 1, Consolidated Balance Sheet-- June 30, 1949).

³The Kaiser-Frazer Corporation was established on August 9, 1945, as a corporation of the State of Nevada, manufacturing automobiles which have been distributed through a wholly owned subsidiary, the Kaiser-Frazer Sales Corporation.

⁴U.S., Congress, Report on the Audit of Reconstruction Finance Corporation For the Fiscal Year Ended June 30, 1941 (House Doc. No. 367; 82d Cong., 2d sess.) Appendix A, p. 69.

political pressure and favoritism. Representative John M. Mason of Illinois, for instance, on the House floor charged the RFC with lending "taxpayers' money to some big manufacturers on favorable, liberal, easy terms, while their competitors have to take their chances of borrowing from the banks on regular banking terms, covering interest charges and adequate collateral."¹ Representative Mason further continued:

Has Uncle Sam decided to favor certain business friends but handicap, hinder, and punish certain other business concerns because they are not friendly toward the so-called Fair Deal? If the administration takes taxpayers' money and uses it to reward certain business friends and to punish certain business enemies, then we are headed down the road to national socialism.²

Again, Representative Hugh D. Scott, Jr., of Pennsylvania, criticized the Kaiser loans on the House floor as an example of government favoritism to a certain business group. He pointed out that:

The most impressive fact is the amount of the outstanding debt of the Kaiser interests to the RFC. As of November 1949, the total Kaiser indebtedness to the RFC was approximately \$140,265,000. This was 32.4 per cent of the total amount of such RFC loans.³

Then he continued, "at no time in history has another single group been so favored by Government largesse."⁴ He further speculated on the soundness of the financial status of the Kaiser-Frazer Corporation and its subsidiaries and disclosed the loan procedure of the RFC on the Kaiser-Frazer loans in comparison to the normal procedure applied to other applicants.⁵

¹U.S., Congress, "Government Favoritism with RFC Loans," Congressional Record, vol. 96, pt. 13, p. A654.

²Ibid.

³U.S., Congress, "How Henry Kaiser Got His Hands on One-Third of All RFC Money," Congressional Record, vol. 97, pt. 13, P. A-2925. Harvey J. Gunderson, then Chairman of the RFC, testified to outstanding \$140,265,000 loans to the Kaiser interests on November 17, 1949, before the Subcommittee on Monetary Credit and Fiscal Problems, Joint Committee on the Economic Report. Ibid.

⁴Ibid., p. A2926.

⁵Ibid.

In defense of the loans, an article appeared in the December 15, 1949 issue of The Machinist, official weekly newspaper of the International Association of Machinists, which is published in Washington, D.C. It praised the "industrial genius" of Henry Kaiser, stating that he was "going to undersell Ford and Chevrolet by \$200 or \$300 . . . one that will give approximately twice the gas mileage you get out of your Ford or Chevrolet. . . ." ¹ The article further endorsed the RFC loans to the Kaiser-Frazer Corporation, supporting the viewpoint that "this is a step in the right direction . . . everybody ought to be encouraging Kaiser . . . like 51,000 other businessmen before him, Kaiser got a loan from Uncle's Reconstruction Finance Corporation." ²

Representative Harry R. Sheppard of California also appraised the achievements of Henry Kaiser, remarking on the House floor that

Mr. Kaiser's genius has brought us of the West to new vistas of industry and new concepts of industry-employee cooperation and we of the State of California and the West in general are very proud of Mr. Kaiser and his achievements. ³

As a starting point in explaining the reasons why the Kaiser-Frazer Corporation loans were granted, a letter by Harley Hise, then Chairman of the RFC, dated October 25, 1949, addressed to Senator J. W. Fulbright of Arkansas, gives fairly good background behind the loans. Among other

¹Gordon H. Cole, "Kaiser---Auto Makers Wish He'd Go Back to Boat-building," The Machinist, December 15, 1949 in Congressional Record, vol. 96, pt. 13, p. A204.

²Ibid.

³U.S., Congress, "Arrival of Henry Kaiser," Congressional Record, vol. 97 pt. 14, p. 4840.

points, the letter indicated:

Kaiser-Frazer employs directly approximately 10,000 persons and reasonably estimates that an additional 44,000 are employed by more than 1,000 small manufacturers which supply parts and materials and by dealers and distributors of Kaiser-Frazer automobiles and automobile accessories throughout the Nation. The widespread public interest in the success of Kaiser-Frazer springs not only from the number of employees and number of small businesses which are, to a large extent, dependent upon it, but also by reason of the broad distribution of its stock, which is held by approximately 40,000 stockholders. Mr. Henry Kaiser, the members of his family, and the various companies in which they are interested own less than 10 per cent of the stock of Kaiser-Frazer Corp.¹

The letter went on to say:

The Directors of RFC are convinced that these loans will enable Kaiser-Frazer Corp. to maintain a production level that will insure profitable operation, will provide employment for thousands of workers, will assist and encourage many small businesses, will increase production in a number of manufacturing fields,² and generally will promote the economic stability of the country.

Under these circumstances, it is suggested in the interim report of the RFC Subcommittee that the refusal by the RFC of the Kaiser-Frazer loans, according to the applicant, would have caused liquidation of the enterprise, an event which would have had a serious effect on a great many

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"Letter by Harley Hise, Chairman of the RFC, to Senator J. W. Fulbright, Chairman of the RFC Subcommittee, October 25, 1949," in U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Interim Report of the Committee on Banking and Currency: Loans to Kaiser-Frazer Sales Corp. (Senate Report No. 552; 82d Cong., 1st sess.), p. 11. The same view was expressed by Edgar F. Kaiser, President of the Kaiser-Frazer Corp. before the RFC subcommittee hearings on February 21, 1951. U.S. Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: before a Subcommittee of the Committee on Banking and Currency (82d Cong., 1st sess.), pt. 2, pp. 675-76.

²U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Interim Report of the Committee on Banking and Currency: Loans to Kaiser-Frazer Corp. and Kaiser-Frazer Sales Corp., op. cit., p. 2.

people.¹ Dealers and distributors had an estimated investment of \$175,000,000 in sales, service, and parts facilities and it was estimated that the annual payrolls of Kaiser-Frazer and of dealers, distributors and suppliers supported by Kaiser-Frazer approached \$100,000,000.² Thus the interim report finds that the maintenance of employment stability in this structure was one of the principal objectives sought by approval of the loan application.³ The effects which liquidation of the automobile company would have had on the Kaiser interests would undoubtedly have been felt in important American industries other than the automobile industry and they might have had important repercussions in those other industries.⁴

Notwithstanding these things, the RFC Subcommittee expressed its belief that the RFC should not have made the Kaiser-Frazer loans. Among its detailed reports from its findings out of the hearings by the Subcommittee, a review of the correspondence and document files in the Washington office of the RFC and of certain public records available for the Subcommittee, the RFC Subcommittee discloses the following important facts in connection with the RFC loans to Kaiser-Frazer.

First of all, judging from the records of the lending agency, the original RFC loan, \$34,400,000, was negotiated in September 1949 by the borrower directly with the RFC Board of Directors, one examiner,

¹According to The Kaiser-Frazer Story published at Willow Run, Mich., December 5, 1949, the Kaiser-Frazer Corporation then employed about 11,000 persons directly. An estimated 30,000 persons were employed as and by dealers and distributors, and in addition approximately 47,000 were employed by direct and indirect suppliers. The publication reported also that there were 40,000 stockholders and 400,000 owners of Kaiser-Frazer cars. Ibid., p. 5.

²Ibid., p. 12.

³Ibid.,

⁴Ibid., p. 2.

J. F. Williams, in the Washington office providing the only review at a lower level. The examiner, realizing Kaiser-Frazer financial requirements, recommended that the RFC lend \$24,400,000 and that the "Kaiser interests" supply \$10,000,000.¹ The RFC Subcommittee finds that the loan application was considered by the Washington office review committee but that, contrary to the usual custom, the committee members were called before the Board of Directors individually and polled as to their views, without reporting in writing nor as a committee. That was an abnormal arrangement. Again the Subcommittee finds that each member of the review committee expressed doubt that the loan could be repaid from earnings.² However, the loan of \$34,400,000 was approved on October 9, 1949.

Again, the RFC Subcommittee finds that the application for the second loan, originally \$15,000,000 was considered by both an examiner and the review committee in the Washington office of the RFC. Although the examiner gave a favorable recommendation for the loan application, the review committee recommended that the loan not be made because of uncertainty regarding the borrower's ability to produce automobiles successfully under its then financial structure.³ However, the loan was again approved for \$10,000,000, over this objection.

The third RFC loan of \$25,000,000 was examined in the Detroit RFC loan agency as well as in Washington. The Detroit agency turned the

¹Ibid., p. 8.

²Ibid., p. 3.

³Ibid.

application down, when it was filed with the agency on November 16, 1950, because the collateral was deemed marginal and the borrower's future prospects seemed unfavorable.¹ The Washington review committee also recommended that the application be declined, giving as reasons the extended financial condition of the borrowers.² In the course of time, the Washington examiners gave a favorable recommendation, while the Detroit agency manager changed his previous recommendation on the third loan application and came to support the Washington examiners' view.³ The loan was approved by the Directors on December 4, 1950. According to the Chairman of the RFC, W. E. Harbor, the RFC wanted to see the Kaiser-Frazer Corporation continue in production because the loans already made would be somewhat less secure if it were forced to shut down.⁴

Investigation into the collateral for the Kaiser-Frazer loans from the RFC shows that the principal item of collateral for the first loan to the Kaiser-Frazer Corporation (\$34,400,000) was the Willow Run plant which made up most of the property appraised in 1949 at a value of \$67,000,000 from the standpoint of a going concern.⁵ The Willow Run plant had been constructed by the Government at a cost of \$42,300,000. It was sold to the Kaiser-Frazer Corporation for \$15,100,000.⁶ When

¹Ibid., p. 16.

²Ibid., p. 4.

³Ibid., p. 4 and p. 16.

⁴Ibid., p. 4 and p. 15.

⁵Ibid., p. 3.

⁶Ibid., p. 9.

the RFC loan of \$34,400,000 was made in October 1949, the Kaiser-Frazer Corporation owed the Federal Government \$13,500,000 out of the total of \$15,100,000 for which it had purchased the plant. Thus the pledge of the plant as collateral for the RFC loan added little if anything to the overall security of the Government's interest in or advances to the Kaiser-Frazer Corporation because the Government already held a first-mortgage lien under the mortgage securing the purchase obligation..

In April 1951, the Kaiser-Frazer Corporation asked the RFC to waive principal repayments on the first loan \$34,400,000 until May 30, 1954; to extend maturities on the second and third loans (\$35,000,000) also until May 30, 1954; and to agree that the RFC would not seek to effect collection of the loans by legal action so long as the private banks granting the V-loan revolving credit would refrain from taking legal action to enforce their obligations.¹ The RFC on April 20, 1951 agreed to cooperate with the borrower under this plan, with the exception of fixed payments of \$3,440,000 per annum required under the first loan agreement.² At May 31, 1951, a total of \$31,695,931 was owed under the first loan agreement, \$10,000,000 was owed under the second loan agreement, and \$20,205,213 was owed under the third loan agreement. The three

¹Ibid., p. 4 and p. 20.

²The first loan of \$34,400,000 had a 10-year maturity, payable \$3,440,000 each year beginning in 1951; the second loan of \$10,000,000 and the third loan of \$25,000,000, approved October 21, 1949 and December 4, 1950, were 4, 1950, were direct 18-month loans, without any fixed installment payments. See U.S., Congress, Report on the Audit of Reconstruction Finance Corporation for the Fiscal Year Ended June 30, 1951 (House Doc. No. 367; 82d Cong., 2d sess.), p. 70.

balances totaled \$61,901,144.¹ By this time the RFC loans to the Kaiser Steel Corporation (aggregating over \$123,000,000) and other various RFC loans to the Kaiser interests other than the above three loans had been paid off in full.²

Whatever its motives, and the reasons for the loans to the Kaiser interests, the RFC could have avoided much criticism by not extending such an unusual amount of financial aid to the enterprises of a single entrepreneur. The RFC Subcommittee of the Senate Committee on Banking and Currency also expressed the belief that the RFC should not have made the original loan, because:

It does not believe that the interest of the general public was such as to justify the use of public funds to continue operation of Kaiser-Frazer as an automobile company.³

¹U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Interim Report of the Committee on Banking and Currency: Loans to Kaiser-Frazer Sales Corp. (Senate Report No. 552; 82d Cong., 1st sess.), p. 20.

²U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee of the Committee on Banking and Currency (82d Cong., 1st sess.), Lending policy, pt. 2, p. 677. In addition to \$123,000,000 of loans to the Kaiser Company, Inc., (succeeded by the Kaiser Steel Corporation, effective August 1, 1949), the RFC made loans of some \$37,000,000 to the Kaiser Aluminum Co., \$28,000,000 to the Permanent Metals Corporation, and \$1,000,000 to the Kaiser Fleetwings, Inc. All of these loans had been paid off by February 21, 1951.

³U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Interim Report of the Committee on Banking and Currency: Loans to Kaiser-Frazer Corp. and Kaiser-Frazer Sales Corp. (Senate Report No. 552; 82d Cong., 1st sess.), p. 2.

3. Lustron Loans:

Before examining the RFC loans to the Lustron Corporation, it seems helpful to review the statutory background for making the RFC loans, and to look into the organization and financial status of the borrower, the Lustron Corporation.

The RFC's statutory authority to make loans to business enterprises was contained in (1) the amendments to the RFC Act, approved June 19, 1934, and amended in April 1938, which became section 5d of the RFC Act;¹ and (2) the amendment to the RFC Act, approved June 25, 1940, which was added to section 5d of the RFC Act as section 5d(2).² Loans made under section 5d were restricted to those which in the opinion of the Board of Directors offered reasonable assurance of repayment. Section 5d(2) was enacted in 1940 as part of the broad powers conferred upon the RFC at that time to aid the Government in its national defense program. Loans made under authority of section 5d(2) were required to be "advantageous to the national defense" but were not required to meet the "assurance of repayment" test.³ In considering applications for loans to aid the veterans' emergency housing program the RFC concluded, in effect, that the loans were advantageous to national defense and were eligible under the provisions of section 5d(2) of the RFC Act. However, the RFC was generally reluctant to make the loans, as they were considered unsound, and it made them only

¹ See

² See

³ See

after being specifically requested to do so by the Housing Expediter.¹ The request was considered by the RFC as tantamount to a directive from the Housing Expediter, whose authority to issue directives, as interpreted by RFC, was obtained from section 2(b) of the Veterans' Emergency Housing Act of 1946, which provides:

The Housing Expediter, in addition to such other functions and powers as may be delegated to him by the President, is authorized to . . . issue such orders, regulations, or directives to other executive agencies . . . Each executive agency shall carry out without delay the orders, regulations, or directives of the Housing Expediter, and shall, to the extent necessary, modify its operations and procedures from time to time to conform to the directives of the Housing Expediter.²

In addition, the following excerpt from an opinion of the general counsel of the RFC in a memorandum to the Board of Directors, set forth RFC's interpretation of this law:

In view of the foregoing it is difficult to escape the conclusion that the Housing Expediter, under the Act, (1) is limited in the issuance of directives to executive agencies to the substantive powers vested in those agencies which relate to housing, (2) may establish policy and direct action with respect to such policy, which insofar as such action relates to RFC, includes a determination of terms and conditions of housing loans, and, (3) must assume complete responsibility not only for the directive, but also for any action taken by the Board thereunder.³

Furthermore, the Housing Expediter's interpretation of his authority

¹U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 50.

²60 U.S. Stat. at L. (1946), 207, "Veterans' Emergency Housing Act of 1946," sec. 2(b).

³U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 50.

was indicated in a letter dated November 1, 1946, to the Chairman of the Board of Directors of the RFC:

I would be remiss in my duty if I did not exercise the powers conferred upon me by Congress to direct the RFC to grant loans which are necessary to bring about production of vitally needed houses and materials.¹

The original negotiations for the Lustron loan involved two different entities, both of which were named the Lustron Corporation. The first Lustron Corporation was an affiliate of the Chicago Vitreous Enamel Products Company. That is, around October 1946, three partners in Chicago Vitreous, in order to develop housing for the mass market, using porcelain enamel and steel, and yet not to mix up this venture with the operations of Chicago Vitreous, set up a new corporation named the "Lustron Corporation," for which Carl G. Strandlund became the president.² The second Lustron Corporation was organized in October 1947 by Mr. Strandlund, while the first Lustron Corporation changed its name to the Porcelain Products Company.³ It was the second Lustron Corporation which borrowed originally \$15,500,000 from the RFC and which had subsequent additional loans of \$22,000,000--a total of \$37,500,000 in loans from the RFC--and which finally became bankrupt.

¹ Ibid.

² "Testimony of Carl G. Strandlund, President, Lustron Corp., Columbus, Ohio," in U.S., Congress, Senate, "Inquiry into the Operation of the Reconstruction Finance Corporation and its Subsidiaries under Senate Resolution 132," Hearings: Before a Special Subcommittee of the Committee on Banking and Currency, 80th Cong., 2d sess., on S. Res. 132, pt. 2, p. 350.

³ Ibid. Mr. Strandlund put \$1,000 into the new company for 100 shares of Class A stock. For that he received 86,000 shares of common B stock giving him voting control of the new company. Ibid., p. 353.

The sequence of the significant events related to making the original loan follows: In 1946, 1947, and 1948, there was a critical shortage of housing. Under the existing conditions, in October 1946 the Housing Expediter requested the RFC to lend the (first) Lustron Corporation (which was then still at the stage of forming) \$52,000,000.¹ Following the creation of a new organization in later October 1946, the (first) Lustron Corporation, on January 17, 1947, made a formal application to the RFC for a loan of \$12,500,000 to provide funds for the manufacture of pre-fabricated steel houses.² The RFC agreed to grant the loan under certain conditions, one of them being a guarantee by the Chicago Vitreous Enamel Products Company. Further negotiations culminated in the authorization of a loan of \$15,500,000 on June 30, 1947.³ However, on October 6, 1947, the (first) Lustron Corporation formally notified the RFC that it declined the loan which the RFC had authorized on June 30, 1947. The (first) Lustron Corporation objected to the guarantee requirement involving the Chicago Vitreous Enamel Products Company, which firm the owners wished to exclude from the venture.⁴

Meanwhile, the (second) Lustron Corporation was about to be organized, selling 84,000 shares of stock to the public at \$10 a share.⁵ The (second)

¹Ibid., p. 350.

²Ibid.

³Ibid., p. 351.

⁴Ibid., p. 352. The controlling interests of the Chicago Vitreous Enamel Company were possessed by the Hogeson brothers. Ibid., p. 370.

⁵Ibid., p. 356.

Lustron Corporation was organized in October 1947 with a paid-in capital of \$840,000, out of which \$340,000 was paid to the Chicago Vitreous for the physical assets which had been used for the development of factory-built housing.¹ Consequently, negotiations to amend the loan authorization which had been made on June 30, 1947, were continued between the RFC and the new Lustron Corporation. On October 31, 1947, the RFC entered into an agreement with the new Lustron Corporation for a loan of \$15,500,000 without guarantee by Chicago Vitreous.² The first disbursement of \$3,000,000 was made the same day. On the same day the lease agreement for the Curtiss-Wright plant, in Columbus, Ohio, for the use of the Lustron Corporation was entered into between the War Assets Corporation and the Lustron Corporation.³

In making this loan, the RFC relied on the authority of the original authorization of June 30, 1947, which had been made under section 5d(2) which expired on June 30, 1947.⁴ The ultimate borrower, the new Lustron Corporation, which was organized in October 1947, as has just been pointed out, did not come into existence until about four months after June 30, 1947.

The circumstances concerning the Lustron loan were inquired into extensively from December 1947 through January 1948 by a Special Sub-

¹ Ibid.

² Ibid., p. 357.

³ For the lease agreement for the plant, see ibid., pp. 535-40, Exhibit 44.

⁴ See pp. 91-94 and 173.

committee of the Senate Committee on Banking and Currency, headed by C. Douglass Buck as Chairman of the Subcommittee,¹ while the Comptroller General of the United States, Lindsay C. Warren, stated in his audit report of the RFC for the fiscal years ended June 30, 1946 and 1947, that "in making this loan, RFC relied on the authority of the original authorization of June 30, 1947, made under section 5d(2) of the RFC Act which expired on June 30, 1947,"² and "in the meantime the commitment had been amended to an extent tantamount to a reexercise of the expired authority."³

The report on Special Subcommittee hearings did not state whether or not the RFC acted within its authority in making the loans. Since that time there have been other congressional investigations and many conflicting statements concerning other loans.⁴ However, the hearings did bring out the fact that RFC refused to make the loan of \$15,500,000 to the new Lustron Corporation until John R. Steelman, one of President Truman's top advisers, recommended it strongly. Mr. Steelman's letter to Mr. John D. Goodloe, Chairman of the RFC, said in part:

I am greatly impressed by the fact that, according to expert advice, production by Lustron would make a real contribution toward meeting the housing deficit during the coming two years and would have important long-term implications in that the

¹For the Subcommittee hearings, see U.S., Congress, Senate, "Inquiry into the Operation of the Reconstruction Finance Corporation and its Subsidiaries Under Senate Resolution 132," Hearings: Before a Special Subcommittee of the Committee on Banking and Currency, 80th Cong., 1st sess., on S. Res. 132, pt. 1 (December 3, 11, and 12, 1947), and *ibid.*, 80th Cong., 2d sess., pt. 2 (January 14, 15, 16, and 22, 1948).

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 51.

³Ibid., p. 13.

⁴See U.S., Congress, Senate, "Operations of the Reconstruction Finance Corporation," Senate Report (Report No. 974; 80th Cong., 2d sess.).

Lustron method represents the fullest application of mass-production techniques to the housing problem.

I have discussed this matter with the President and he has authorized me to state that the views expressed herein meet with his approval. I believe therefore under all the circumstances that this loan should be made.¹

That day--June 30, 1947--the RFC granted Lustron a \$15,500,000 loan. Thereafter the RFC granted an additional \$22,000,000 in loans to Lustron for a total of \$37,500,000, as follows:

LOANS TO LUSTRON

| <u>Date</u> | <u>Amount</u> | <u>Period</u> | <u>Due Date</u> |
|-------------------|---------------|---------------|-------------------------------|
| October 31, 1947 | \$15,500,000 | 7 year term | October 30, 1954 |
| October 11, 1948 | 10,000,000 | 1 year term | October 11, 1949 |
| February 21, 1949 | 7,000,000 | 6 month term | August 21, 1949 |
| July 7, 1949 | 1,000,000 | 60 day term | September 7, 1949 |
| July 15, 1949 | 1,000,000 | 60 day term | September 15, 1949 |
| August 10, 1949 | 1,000,000 | 60 day term | October 10, 1949 |
| August 30, 1949 | 2,000,000 | 60 day term | October 30, 1949 ² |

The best that can be said about these loans is that they were made with questionable authority under dubious circumstances for a laudable purpose. Unfortunately, Lustron had missed the peak of the housing market: the back of the housing shortage had been broken and "there were no longer

¹"Letter of John R. Steelman, Assistant to the President, to John D. Goodloe, Chairman of the Reconstruction Finance Corporation," in U.S., Congress, Senate, Hearings: Before a Special Subcommittee of the Committee on Banking and Currency, 80th Cong., 1st sess., on S. Res. 153, pt. 1, p. 238, Exhibit 27.

²Source: "Facts About Lustron," prepared by the Lustron Corporation, December 28, 1949, in U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee on Banking and Currency, 82d Cong., 1st sess., pt. 3, pp. 945-46.

six customers for every house-for-sale sign."¹ What urgent market pressure remained was in the low cost bracket, and Lustron's price to the dealer, counting freight, was around \$6,000. For the price to the customer, the cost of site labor, land, and utilities had to be added. Early in 1949 in Wisconsin, for instance, Lustron houses on lots were selling for \$10,000; in Illinois for \$11,000; in New York for \$10,500; in Connecticut for \$11,000. These prices were not low cost houses. Consequently, without some additional financing steam from Lustron, they were not priced low enough to persuade dealers to take the risk of building the houses without a down payment from a waiting buyer. In other words, even the limited mass distribution formula devised by the merchant housebuilder--who puts up a number of houses at once and takes the risk that he can find customers--was not yet working for Lustron.²

Lustron's financial matters were handled satisfactorily into the late summer of 1949. On August 21, 1949, however, Lustron defaulted on a loan of \$7,000,000, and shortly thereafter other notes matured and were not paid--to a total, including the first one, of \$15,500,000. Around that time it also came to light that the Lustron Corporation was running in the red \$1,100,000 a month after about two years of experiment, a large part of the RFC loans of \$37,500,000 having gone into payrolls, machinery, and capital equipment; meanwhile there were over \$3,000,000 worth of Lustron houses standing idle in the warehouses of Lustron, waiting for somebody to purchase them.³

¹"Factory Built House is Here," Architectural Forum, 90 (May 1949), 108.

²Ibid.

³"Lustron Prefabricated Houses," Congressional Record, vol. 95, pt. 11 (October 13, 1949), p. 14457.

Here again a series of criticisms arose in Congress as well as in public, while the RFC officials expressed dim views of the future repayment of the Lustron loans. For instance, Harvey J. Gunderson, Director of the RFC, on being questioned by the House Committee on Banking and Currency about the Lustron affairs said; "I think the Lustron experiment even now has no better than a 50-50 chance of ever succeeding."¹ Representative Charles W. Vursell of Illinois struck out at the original idea of Lustron housing projects, stating:

The fundamental objection which should have been recognized and raised in the beginning which makes this project impossible of success hinges on the fact that the American people will not accept a steel prefabricated house. These houses should go over big and be a luxury in Russia where the Government tells you where to live and in what type of a house you shall live in.²

The general public was even more critical about the Lustron loans. For instance, Fortune in October 1949 issue wrote up the "stories behind the \$37,500,000 RFC loans of taxpayers' money," and concluded by saying:

What is scandalous about the whole affair is the government's assumption (which it finds easier and easier to make) that the taxpayer is a bottomless well of money. What is still more scandalous is the government's presumption in putting that money into a customer product that it isn't even sure the consumer wants. This is the crux of the matter. A private enterpriser may and sometimes does put his money into a product that he believes people want. His judgment, however, is tempered and sharpened by the consideration that if he is wrong he loses money, reputation, and sometimes even his shirt. A government's judgment is subject to no such direct and punitive check and balance; and inevitably it finds itself putting money into what it guesses the people want, or what it believes is good for them.³

¹Ibid.

²"Lustron Prefabricated Houses," statement made by Representative Vursell of Illinois, Congressional Record, vol. 95, pt. 16 (October 11, 1949), p. A6181.

³"That Lustron Affair; It's what happens when government starts handing out 'risk' capital," Fortune, 40 (November 1949), p. 94.

In 1950 the Lustron Corporation went into bankruptcy after defaulting on all but \$1,000,000 of the \$37,500,000 that it had borrowed from the RFC. As of June 30, 1950, the RFC had written off \$35,500,000 of the Lustron Loan as uncollectable.¹

Mr. Strandlund subsequently requested the RFC to call off its foreclosure suit and lend him \$3,500,000 to reorganize the plant for a fresh start, this time in the defense housing field. On March 49, 1951, however, RFC Chairman Elmer Harber announced that he had signed papers transferring the Lustron plant at Columbus, Ohio, to the Navy. The RFC action followed the January order of 1951 of the Defense Production Administration that the plant be turned over to the Navy for Aircraft assembly.²

The Lustron affair did not end the loss of the taxpayers' money of \$35,500,000. There were at least two more significant events which aroused public criticism. One was a scandalous business transaction between the Lustron Corporation and the Commercial Home Equipment Corporation, a corporation of the State of Delaware, together with the role the RFC played in this transaction. The other one was the "success story" of one E. Merl Young, who began his career of government service in 1940, at an annual salary of \$1,080, and who estimated his income for 1950 at \$60,000.

In April 1950, a charge that Commercial Home Equipment Corporation had fraudulently overbilled Lustron Corporation for transportation

¹U.S., R.F.C., Annual Report and Financial Statements (June 30, 1950), p. 16.

²U.S., Congress, Senate, "Study of Reconstruction Finance Corporation and Proposed Amendment of RFC Act," Senate Report (Report No. 469; 82d Cong., 1st sess.), p. 80.

services in an amount in excess of \$500,000, and that the Lustron Corporation had paid such overcharges, was brought to the Subcommittee on the Reconstruction Finance Corporation of the Senate Committee on Banking and Currency, headed by Senator J. W. Fulbright as chairman (the RFC Subcommittee). During June 26-30, 1950, the RFC Subcommittee conducted open hearings and received testimony and documentary evidence for the purpose of developing all of the pertinent facts.¹

The RFC Subcommittee did not pass upon the legal consequences of the alleged charges against the Commercial Home Equipment Corporation, a corporation of the State of Delaware, leaving the matter to the Department of Justice.² However, the RFC Subcommittee commented that the officials of the RFC were ineffectual for the servicing and supervision of the Lustron loans made to promote the manufacture of prefabricated housing.³ The RFC Subcommittee also brought out some facts in doubtful dealings between the officials of the Lustron and the Commercial Home Equipment Corporation. That is, a director of Lustron was also a stockholder and director of the Commercial Home Equipment Corporation and this director actively conducted negotiations on behalf of the Commercial Home Equipment Corporation with his associates and subordinates in the Lustron Corporation with respect to the transportation dealings between the two corporations.⁴ The RFC Subcommittee concluded that the RFC officials

¹For the hearings, see U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee of the Committee on Banking and Currency, 81st Cong., 2d sess., on S. Res. 219 (June 26, 27, 28, 29 and 30, 1950).

²U.S., Congress, Senate, "Study of Reconstruction Finance Corporation: Lustron Corp.--Transportation Contract," Senate Report (Report No. 1689, pt. 2; 81st Cong., 2d sess.).

³Ibid., p. 21.

⁴Ibid.

were remiss in their duties through their tacit approval of such practices and through their failure to subject transactions and arrangements arising from such negotiations to the most rigorous scrutiny.¹

The story of E. Merl Young will be purposely detailed in order that a fair picture may later be drawn of the so-called "outside influence" on the operations of the RFC.

Mr. Young, when his wife went to work for Senator Truman in 1940, entered the government service as a messenger at an annual salary of \$1,080. In 1942, he enlisted in the U. S. Marine Corps. After his discharge from the Marine Corps in October 1945, he started to work for the RFC at an annual salary of \$4,500. During the next 3 years, he moved from audit control work to the position of examiner, the last position he held with the Government, which paid him \$7,193 a year.²

On July 15, 1948, when he left the RFC and joined the management of the Lustron Corporation, Mr. Young was made assistant secretary of Lustron, in charge of the Washington office, at an annual salary of \$12,000. Mr. Young's duties, as he testified in the RFC Subcommittee hearings, included all relations with Government agencies and taking care of local construction of Lustron Houses.³ It is significant that the position Mr. Young assumed was a newly created one, and that Mr. Young had no prior experience in the housing field.

¹Ibid.

²"Testimony of Merl Young, Washington, D.C., " in U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee of the Committee on Banking and Currency, 82d Cong., 1st sess. (February 21, 22, 23, 26, 27 and March 1, 1951), pp. 610-11.

³Ibid., p. 611. Also see "Study of Reconstruction Finance Corporation and Proposed Amendment of RFC Act," U.S., Congress, Senate, Senate Report (Report No. 469; 82d Cong., 1st sess.), p. 45.

The story behind the hiring of Mr. Young by the Lustron Corporation, as was disclosed by the Congressional hearings, was that Mr. Harvey Gunderson, a Director of the RFC, in spring 1948 requested that Lustron put Mr. Young on the payroll. This request was acceded to by Mr. Strandlund. Mr. Young rose rapidly in the Lustron organization, becoming vice-president of the corporation in December 1948, at an annual salary of \$18,000. It was also disclosed during the RFC Subcommittee hearings that the president of the Lustron Corporation was persuaded to promote Mr. Young and to increase his salary, by Mr. Harley Hise the Chairman of the RFC.¹

At about the same time that the Lustron Corporation rewarded Mr. Young with a vice presidency, Mr. Rex C. Jacobs, president of the F. L. Jacobs Co. of Detroit, Mich., also a borrower of \$3,000,000 from the RFC, hired Mr. Young at a salary of \$10,000 per year.²

There is a substantial difference of opinion as to whether Mr. Strandlund knew that Mr. Young was serving two masters. Both Mr. Jacobs and Mr. Young swore Mr. Strandlund knew of the arrangement; Mr. Strandlund swore he did not.³ There was some relationship between the two companies,

¹"Testimony of Carl A. Strandlund, President, Lustron Corp.," in U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee of the Committee on Banking and Currency, 82d Congress., 1st sess. (February 21, 22, 23, 26, 27, and March 1, 1951), pp. 942-43.

²"Testimony of Merl Young, Washington, D.C., " ibid., p. 612.

³U.S., Congress, Senate, "Study of Reconstruction Finance Corporation and Proposed Amendment of RFC Act," Report (Report No. 649; 82d Cong., 1st sess.), p. 46.

and so Mr. Young's dual capacity may not have been as demanding as might be supposed. For example, Mr. Jacobs wanted to install his washing machines in the Lustron houses, for which Mr. Young is alleged to have been promised a commission of \$15 per machine, an allegation stoutly denied both by Mr. Young and Mr. Jacobs.¹

Mr. Young's duties with the F. L. Jacobs Company during the time he was also employed by Lustron were solely, according to his own admission, to encourage Coca-Cola outlets in the Washington area to use the dispenser manufactured by the Jacobs firm. Mr. Young's job, according to Mr. Jacobs, was to create a demand; sales were made by the local bottler.²

In addition to his salaries, Mr. Young was recompensed for expenses by both Lustron and Jacobs. For Lustron, Mr. Young testified, the expenses involved travel, hotel bills, "taking people to lunch," and the like. The nature of expenses for the Jacobs Company was explained as "taking people out to dinner and everything."³

¹"Testimony of Merl Young, Washington, D.C.," in U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee of the Committee on Banking and Currency, 82d Cong., 1st sess. (February 21, 22, 26, 27, and March 1, 1951), p. 613.

²"Testimony of Rex C. Jacobs, President, F. L. Jacobs Co.," ibid., p. 975.

³Ibid., p. 613 and pp. 623-26. During the period July 24, 1948, to December 2, 1949, the Lustron Corporation spent a total of \$12,000 for Mr. Young's expenses. At the same time, the Jacobs Company was footing the bill for its share of Mr. Young's business upkeep. His account with the Jacobs Co. over the period December 4, 1948 to January 3, 1950, amounted to almost \$9,000, of which over \$6,500 was disbursed on entertainment. For the expense account spent by Mr. Young for the period June 24, 1948 to December 2, 1949, see ibid., p. 622, and "Testimony of Carl A. Strandlund President, Lustron Corp.," ibid., pp. 943-44, and for the expense account of Mr. Young by the Jacobs Company, see "Testimony of Rex C. Jacobs, President, F. L. Jacobs, Co.," ibid., pp. 1038-39.

There arose a suspicion whether or not at least a part of the expenses claimed by Mr. Young and allowed by the Lustron Corporation were spent in furthering the cause of Democratic candidates in the general election of November 1948.¹ Mr. Young denied that any such funds were direct political contributions, but admitted he had spent "quite a bit of time" at the Democratic National Committee headquarters working with Mr. William Boyle who had not at that time succeeded to the chairmanship of the committee.² Mr. Young further admitted that his political trips to Texas, Illinois, Ohio, Massachusetts, New York and Missouri had been charged to and paid by Lustron. During the last week of the campaign Mr. Young traveled with President Truman, helping to bolster his own reputation as a man with "pretty close contact in high circles."³

Mr. Young decided to sever his connections with the Lustron and Jacobs firms at about the same time, in late 1949. There was evidence that the Lustron Corporation had begun to doubt his value. Certain operating economies had been urged on the management of the corporation by the RFC. Mr. Strandlund told RFC Director Dunham that if these economies were effected Mr. Young would be fired. Mr. Dunham called Mr. Dawson, who checked with President Truman, then told Mr. Dunham to

¹Ibid., p. 47.

²"Testimony of Merl Young, Washington, D.C.,--Resumed," U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee on Banking and Currency, 82d Cong., 1st sess. (Lending Policy--pt. 2), pp. 1046 and 1049-51.

³U.S., Congress, Senate, "Study of Reconstruction Finance Corporation and Proposed Amendment of RFC Act," Report (Report No. 649; 82d Cong., 1st sess.), p. 47.

tell Mr. Strandlund to "go ahead and do what was best without regard to what happened to Mr. Young."¹

The rumors as to whether Mr. Young was in fact a so-called White House intimate, or whether he was related to President Truman, are questionable. The fact is that Mrs. Young was still secretary to the President while Mr. Young was serving both Lustron and Jacobs. The fact also is that Mrs. Young is a native of Missouri, and in fact, comes from the same county as does Donald Dawson. What Mr. Dawson thought of Mr. Young's influence at the White House is not directly known, but it is certainly relevant that Mr. Dawson took the precaution of notifying President Truman and of relaying the President's very proper response to Director Dunham.

It is not known if Mr. Young was aware of this apparently callous disregard for his fortunes, but matters came to a head in October 1949, when Mr. Strandlund wrote Mr. Young that Lustron would close its Washington office, and requested Mr. Young to report for duty one week hence in Columbus.² Mr. Young resigned three days later.³ Mr. Strandlund and the Lustron board, perhaps fearful of official Washington

¹"Testimony of Walter Dunham, Director, Reconstruction Finance Corporation," in U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee of the Committee on Banking and Currency, 82d Cong., 1st sess., Lending Policy--pt. 3, p. 1331.

²"Letter of Carl A. Strandlund, President, Lustron Corp., to Mr. Young regarding transfer to Columbus plant, October 10, 1949," ibid., p. 1011.

³"Letter of resignation from Lustron Corporation by Merl Young, October 13, 1949," ibid., p. 1011.

reaction to Mr. Young's severance from the company, wrote him to stay and offered to re-open the Washington office.¹ Mr. Young declined, having made other plans.²

4. Texmass Petroleum Company loan:

In 1944, Mr. Homer V. Snowden, a Dallas oil operator, and Mr. A. W. Smith, of Boston, Mass., persuaded some 350 wealthy Bostonians to invest more than \$8,000,000 in oil ventures managed by Snowden and his associates under a partnership agreement.³ For the most part, these investors acquired fractional participations in working interests in oil-and-gas-producing properties. This type of investment was attractive to taxpayers in high federal income-tax brackets because of tax-savings possibilities.⁴ Later in October 1946, the Texmass Petroleum Company was organized as successor to the Snowden partnerships. At the outset it was heavily burdened with the partnership debts which it assumed. In the spring of 1947 Texmass borrowed \$4,000,000 from Massachusetts Mutual Life Insurance Company, \$3,500,000 from John Hancock Mutual Life Insurance Company, and \$500,000 from the Mercantile National Bank of Dallas.⁵ Later, the 350 Bostonians put up another \$1,000,000 to protect

¹"Letter of Carl A. Strandlund, President Lustron Corp., to Mr. Young regarding the Washington office, November 9, 1949," ibid., p. 1012.

²"Letter of Merl Young to Mr. Strandlund, November 21, 1949," ibid., p. 1012.

³U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Senate Report (Report No. 1689, pt. 1; 81st Cong., 2d sess.), p.3.

⁴Ibid.

⁵Ibid., Appendix C, pp. 26-27.

their original investments. Though a little oil dribbled in from scattered leases, the company's cash gushed out much faster. By August 31, 1949, Texmass had on hand properties valued at only \$3,890,000, according to the RFC Subcommittee records.¹ This value of \$3,890,000 was made up primarily of the cost of properties owned by Texmass, a large portion of which consisted of overriding royalty interests in leaseholds in which the working interests were owned by others.²

The sequence of events related to making a loan of \$14,100,000 by the RFC to Texmass Petroleum Company in September 1949 follows: March 30, 1949, Texmass Petroleum Company applied to the RFC agency at Dallas, Texas, for a loan of \$22,500,000 from the RFC--\$18,500,000 to acquire properties and to pay debts, and \$4,000,000 for working capital.³ Before any action was taken on the application, the loan application was amended by a letter dated June 7, 1949, reducing the request to \$18,950,000, of which \$14,950,000 was to be used for the acquisition of oil interests and the payment of debts, and the remainder to be used as

¹Ibid., p. 3. The RFC disagreed; it appraised the properties from \$12,900,000 to \$16,000,000 estimated by various expert engineers. See U.S., Congress, Senate, "Testimony of Harley Hise, Chairman, Board of Directors, Reconstruction Finance Corporation," in Hearings: Before a Subcommittee of the Committee on Banking and Currency, 81st Cong., 2d sess., Texmass Loan (April 22, 1950), p. 61.

²U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Senate Report (Report No. 1689, pt. 1; 81st Cong., 2d sess.), p. 3.

³U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee of the Committee on Banking and Currency, 81st Cong., 2d sess., pursuant to S. Res. 219, Texmass Loan (April 13, 22, and 27, 1950), pp. 212-43, "Dallas loan agency examiner's report of June 8, 1949."

working capital.¹ The Dallas loan agency examiner, C. E. Herrington, in his report of June 8, 1949, recommended decline of the loan and the agency review committee concurred in his report.² On the other hand, on June 22, 1949, the Dallas advisory committee and the Dallas agency manager recommended a loan for \$15,925,000 and the application was forwarded to the Washington office of the RFC in accord with what was understood to be standard practice.³

Before taking formal action on the application the Board of Directors deemed it advisable to employ the services of a competent disinterested geologist and petroleum engineer to make a report concerning the value of the property offered as collateral for the requested loan. M. M. Garrett of Dallas, Texas, was employed by the RFC to make a study and report on the property.⁴ In early September 1949, Mr. Garrett's report was referred to the Dallas loan agency for further study and action. The Dallas loan agency examiner, Mr. Herrington, again reviewed the application in the light of the Garrett report and recommended that the loan be declined. However, the review committee of the Dallas loan agency recommended that the loan be approved, and under date of September 21, 1949, the manager of the Dallas loan agency and the advisory committee recommended a loan for an amount of \$15,638,513.⁵ The application was forwarded to Washington

¹Ibid., pp. 244-48, "Dallas loan agency examiner's supplemental report of June 24, 1949."

²"Testimony of Harley Hise, Chairman, Board of Directors, Reconstruction Finance Corporation," ibid., p. 59.

³Ibid.

⁴Ibid.

⁵Ibid.

where it was examined by Washington Loan Examiner W. J. Rochelle who recommended denial from a credit standpoint, and the five-man Washington Review Committee unanimously recommended a resolution approving denial because:

1. The loan has little, if any, public interest.
2. Proposed rehabilitation is in reality a salvage operation for which there should be a further injection of risk capital. A loan of an amount that would properly rehabilitate and develop the properties is not warranted.
3. Loan is largely a bail-out of investors and certain creditors who presently appear to be faced with a loss.
4. Report of consultant, Mr. M. M. Garrett, was not encouraging as to repayment of loan from earnings and did not find sufficient tangible collateral.¹

On September 29, 1949, despite the adverse recommendations of the Dallas examiner, the consulting geologist, the Washington loan examiner, and the Washington review committee, the Board of Directors of the RFC authorized a 10-year loan of \$15,100,000 to Texmass Petroleum Company-- the RFC to participate to the extent of \$10,000,000 and insurance companies and others to participate to the extent of \$5,000,000. Of the proceeds of the loan, less than \$1,500,000 was for working capital; \$12,438,513 was to pay off existing indebtedness and \$1,200,000 was to be used to acquire additional oil and gas properties.²

¹ "Comments of Review Committee," *ibid.*, p. 262.

² U.S., Congress, Report on Audit of Reconstruction Finance Corporation and its Wholly Owned Subsidiary--Federal National Mortgage Association for the Fiscal Year Ended June 30, 1950 (House Document, No. 125; 82d Cong., 1st sess.), p. 118.

Minutes of the meeting of the Board of Directors indicate that the resolution passed by a 2-to-1 vote, one director being absent and one present but not voting.¹

This loan was the subject of hearings before the RFC subcommittee of the Senate Committee on Banking and Currency, headed by Senator J. W. Fulbright as its Chairman, on April 13, 22, and 27, 1950. Among the first witnesses was Comptroller General of the United States, Lindsay C. Warren. He was asked by the RFC Subcommittee to review the facts, to express his opinion as to the legality of the Texmass Company loan and to advise ~~the~~ RFC Subcommittee what comment he would make with respect to it, pursuant to his duties under the Government Corporation Control Act. This act requires the Comptroller General in his audit report:

. . . to show specifically any program, expenditure, or other financial transaction or undertaking observed in the course of the audit which, in the opinion of the Comptroller General, has been carried on or made without authority of law.²

The Comptroller General replied that unless additional refuting evidence came before him he would report the Texmass loan to be "a transaction without authority of law."³

¹ Directors Gunderson and Dunham voted for the resolution. Director Willet opposed it. Chairman Hise was present but disqualified himself because a distant cousin of his was married to a Texmass official, while Director Mulligan was absent because of illness. See U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Senate Report (Report No. 1689; pt. 1; 81st Cong., 2d sess.), p. 4 and p. 14.

² 59 U.S. Stat. at L. (1945), 597, "Government Corporation Control Act," sec. 106.

³ U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee of the Committee on Banking and Currency, 81st Cong., 2d sess., Texmass loan, p. 9.

After the hearings, the RFC Subcommittee in its interim report made the following findings and conclusions:

1. . . . it is evident that the Board of Directors of Reconstruction Finance Corporation gave only casual and superficial consideration and study to the Texmass Petroleum Company loan. Those Directors who approved the loan . . . overruled the findings and recommendations of their own review committee without persuasive evidence justifying such action.

2. On the record before the subcommittee it appears that the primary consideration of the Texmass Petroleum Co. loan is not the interest of the general public. On the contrary, it is primarily a "bail-out" of existing creditors of the borrower. Eighty-one per cent of the loan funds will go to insurance companies, banks, other creditors, and individual investors, minimizing their risk of loss in highly speculative venture.

3. The Reconstruction Finance Corporation in its records, its statements to the subcommittee, and the testimony of its officials has not made an affirmative showing that this loan will (as prescribed in the RFC Act of 1948) "encourage small business," "help in maintaining economic stability of the country," and "assist in promoting maximum employment and production," to the extent necessary to justify disbursement of public funds "to aid in financing agriculture, commerce, and industry."

4. The Reconstruction Finance Corporation has not established that financial assistance to the Texmass Petroleum Co. "is not otherwise available on reasonable terms" (as required by the RFC Act of 1948, as amended).

5. The Reconstruction Finance Corporation has not shown that the loan is of such "sound value or so secured as reasonably to assure retirement or repayment" (as required by the RFC Act of 1948, as amended). On the estimates of reserves and earnings most favorable to the borrower, relied upon by the Reconstruction Finance Corporation, the loan cannot be repaid within 10 years, the maximum period for which Reconstruction Finance Corporation is authorized to make business loans. On the basis of estimates relied upon by the Reconstruction Finance Corporation of the value of the oil and gas reserves and equipment offered as collateral by the Texmass Petroleum Co. and the formula employed by the Reconstruction Finance Corporation to determine the sound loan value of such collateral, a loan in the amount of \$15,100,000 is not justified.¹

¹U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Senate Report (Report No. 1689, pt. 1; 81st Cong., 2d sess.), p. 2.

Criticism over RFC loans to the Texmass Oil Petroleum Company did not end here. On September 28, 1950, Allen Freeze resigned his \$10,750-a-year job as assistant RFC controller to go with Texmass at \$22,500 a year. In the meantime Texmass (having changed its name to Texas Consolidated Oil Co.) was involved in a receivership case before the federal court in Texas. The court held that Mr. Freeze was ill-suited for his job and that payment of a \$22,500 salary to him constituted a waste of assets of the Texmass firm, announcing that:

He (Mr. Freeze) is not a professional oil man; he was employed at a salary of \$22,500 merely because he was at one time the assistant controller of the RFC, and this was to get along with RFC; and he allowed the loan to become delinquent by failing to file a quarterly report with RFC. This employment constitutes a waste of assets of Texas Consolidated.¹

It also developed that Mr. Freeze apparently drew a salary from Texmass while still with the RFC. On June 18, 1951, W. Stuart Symington, then newly appointed Administrator of the RFC under the reorganization, announced concerning Mr. Freeze:

. . . information has been developed by our investigation office that a former RFC official accepted a salary from a borrower while he was employed by RFC, and carried on business with and for the borrower from his office at RFC.²

5. Waltham Watch Company Loans:

On September 30, 1948, the Waltham Watch Company, employing about 2,300 persons, applied to the RFC for a direct, 10-year loan of \$4,500,000. This company, an old and well-known manufacturer of jeweled watches, clocks and precision devices, had suffered sizable operating

¹U.S., Congress, Senate, "Study of Reconstruction Finance Corporation and Proposed Amendment of RFC Act," Senate Report (Report No. 649; 82d Cong., 1st sess.), p. 69.

²Ibid.

losses during 1946, 1947, and 1948.¹

Decline of the loan application was recommended at all levels in the RFC. The Boston agency examiner's reasons were insufficiency of collateral, continued operating losses of the company, the contemplated "bail out" of banks to the extent of \$4,500,000, Waltham's unfavorable performance as compared with other companies in the industry, and the absence of definite workable plans for recovery. The last of these was the primary reason for decline by the Washington examiner, concurred in by the review committee.² In December 1948 Waltham filed a petition for reorganization and the court appointed trustees.³

Meanwhile, considerable sentiment appeared to be building up in New England for the continuation of the Waltham Watch Company.⁴ In view of this interest, the Boston loan agency manager, John J. Hagerty, urged that interim loans be made to the reorganization trustees.⁵ Shortly

¹U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Special Subcommittee of the Committee on Banking and Currency, 81st Cong., 2d sess., Loan to Waltham Watch Co. (July 20 and 21, 1950), p. 3.

²Ibid.

³U.S., Congress, Report on Audit of Reconstruction Finance Corporation for the Fiscal Year Ended June 30, 1950 (House Doc. No. 125; 82d Cong., 1st sess.), p. 119.

⁴Senators Lodge and Saltonstall, as well as various Massachusetts Congressmen, expressed interest in the loan and took more or less active parts in negotiations with the RFC. See "Memorandum re: Waltham Watch Co.," in Hearings: Before a Subcommittee of the Committee on Banking and Currency, 81st Cong., 2d sess., Waltham Watch Co. Loan, p. 191.

⁵Agency manager Hagerty submitted a comprehensive appraisal of the situation to the Board of Directors, giving in some detail (in 25 pages) the conflicting interests in, and the feasibility of, a reorganization. See "Resume of significant facts regarding Reconstruction Finance Corporation loan to Waltham Watch Co., prepared by subcommittee staff," ibid., p.3.

thereafter the RFC approved loans totaling \$2,850,000 on trustees' certificates of which a total of about \$1,800,000 was eventually disbursed.¹ On February 18, 1949, the Board of Directors of the RFC authorized a loan of \$6,000,000 to Waltham to mature in 10 years and to be collateralized principally by a mortgage on property, plant, and equipment. Seven months later, in September 1949, Waltham emerged from reorganization as a corporation under the control of voting trustees. At that time the first disbursement of \$2,900,000 was made by the RFC.² Of this amount \$1,800,000 was to be used to refund RFC loans on trustees' certificates and to pay real estate taxes; \$600,000 was to be used for payments under the reorganization plan including trustees' fees and expenses; the remainder (about \$500,000) was available to Waltham for working capital. Further disbursements totaling about \$1,100,000 were made during October-November 1949 for working capital.³

Despite RFC aid, the company's condition continued to be strained and additional loans were requested. The RFC declined the additional request, and the plant shut down in February 1950, the Boston RFC agency becoming mortgagee.⁴

On July 20 and 21, 1950, the RFC Subcommittee headed by Senator J. W. Fulbright held hearings on various aspects of the Waltham loans. The significant points in connection with the Waltham loan for this

¹Ibid., p. 4.

²Ibid., p. 5.

³Ibid.

⁴U.S. Congress, Report on Audit of Reconstruction Finance Corporation for the Fiscal Year Ended June 30, 1950 (House Doc. No. 125; 82d Cong., 1st sess.), p. 119.

study were primarily two. One was the employment of John J. Hagerty as president and general manager of Waltham. The other was the nature of this loan which "bailed out" certain New England banks to which the company was indebted for \$4,500,000.

While negotiation for \$6,000,000 was going on, in February 1949 Mr. Hagerty, then Boston Agency Manager of the RFC with a yearly salary of \$10,000, became president and general manager of the Waltham Watch Co. at a starting salary of \$30,000, with promise of substantial raises.¹ However, following Waltham's fold-up in February 1950, the RFC rehired Mr. Hagerty at his former salary to be special assistant to the Board of Directors.² The RFC had an explanation: Hagerty was rehired because he would be useful; his job was to study operations connected with loans and investments.

One can reasonably say that the Waltham loan is an example of the pitfalls involved when Government goes into direct lending. Unlike private lending agencies, which must make sound loans or perish, the RFC has shown no such compelling concern since it is underwritten by the taxpayers. As the Hoover Commission declared in its Report on Federal Business Enterprises:

Direct lending by the Government to persons or enterprises opens up dangerous possibilities of waste and favoritism to individuals or enterprises. It invites political and private pressure, or even corruption.³

¹U.S., Congress, Senate, "Study of Reconstruction Finance Corporation and Proposed Amendment of RFC Act," Senate Report (Report No. 649; 82d Cong., 1st sess.), p. 69.

²Ibid., p. 70.

³U.S., Congress, House, "Report of Commission on Organization of Executive Branch of the Government," House Document (Doc. No. 55; 81st Cong., 1st sess.), p. 36.

In addition, in the Waltham loan these pressures were not confined solely to the parties interested, but were regional in character. Outsiders took up the cudgel in the press and otherwise on behalf of the borrower, making difficult a dispassionate decision by the RFC on the merits of the case. Although such an atmosphere undoubtedly makes RFC's position more difficult, the public in no way excuses the RFC from observing the statutory requirements and limitations imposed on its powers by the Congress.

6. Aireon Manufacturing Corporation Loan:

On January 23, 1947, the RFC authorized a loan of \$2,000,000 to the Aireon Manufacturing Company, Kansas City, Kansas, a manufacturer of juke boxes. The loan was made under an immediate participation agreement with a group of 8 banks and one private lender, who agreed to participate to the extent of 20 per cent and 5 per cent respectively. The RFC portion of 75 per cent amounted to \$1,500,000.¹

The loan was made for the purpose of providing Aireon with working capital and repayment of delinquent loans of \$925,000 due the 8 participating banks. The loan was approved by the Board of Directors of the RFC. The Washington examiner and the Washington review committee had recommended that the applicant's request be declined. Their recommendations were based on the fact that the operating record of Aireon since the end of the War had been definitely unfavorable, and also the collateral offered was inadequate.² Approximately 8 months after the disbursement of the loan,

¹U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Senate Report (Report No. 76; 82d Cong., 1st sess.), p. 23.

²Ibid.

Aireon became bankrupt. Eventually the RFC became the owner of the assets which had been pledged for payment.

The Comptroller General of the United States commented on this loan as follows:

It appears that this loan arrangement had the effect of bailing-out the banks in that the banks' position was immediately bettered to the extent of \$525,000 in cash.¹

. . .

In view of the apparent collateral deficiency and Aireon's poor operating record, it can be questioned whether the loan was of such sound value or so secured as reasonably to assure repayment (a statutory requirement) as to warrant RFC's risking \$1,500,000 of public funds.²

7. Ribbonwriter Corporation of Florida Loan:

In May 1949, the Board of Directors of the RFC approved a \$400,000 loan to provide working capital for an expanded production schedule for Ribbonwriter Corporation of Florida. The firm was organized to produce a typewriter attachment to permit making one to five copies without the use of carbon paper.³

The RFC Board of Directors (three members present--no negative votes) granted the loan in spite of the fact that Florida RFC personnel recommended that the loan be declined and that two Florida banks had previously turned down Ribbonwriter's request for funds. The only affirmative recommendation came from the Washington examiner and his

¹ U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 169, Appendix B.

² Ibid.

³ "Testimony of Harley Hise, Chairman, Board of Directors, Reconstruction Finance Corporation," in U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee of the Committee on Banking and Currency, 81st Cong., 2d sess. (Lending Policy), p. 31.

opinion was not shared by the Washington review committee.¹

The first disbursement on the loan was made on May 16, 1949. Two months later, on July 29, 1949, Ribbonwriter was placed in involuntary bankruptcy and a receiver was appointed by the Federal court. On March 31, 1950, Ribbonwriter was indebted to the RFC in the amount of \$313,880 including interest.²

Judging from the evidence pointed out in the foregoing, it is fair to criticize the RFC Board members for failing to establish any firm reasons for granting the loan in the face of advice from all but one of the RFC's staff advisers.

8. Mapes Hotel Corporation, Reno, Nevada, Loan:

The San Francisco agency manager and the Washington examiner recommending approval, the RFC Board of Directors on October 6, 1949 approved an 8-year loan of \$1,300,000 to Mapes Hotel Corporation with a Reno bank participating in the loan. The agency review committee, agency advisory committee, and Washington review committee had recommended that the application be declined.³

The Mapes Hotel was a swank new building, with the added attraction of a casino on its premises. The hotel drew 30 per cent to 40 per cent of its income from a thriving twelfth-floor gambling casino called "The

¹Ibid., pp. 33-38.

²Ibid., p. 33.

³"Further Testimony of Harley Hise, Chairman, Board of Directors, Reconstruction Finance Corporation," ibid., pp. 248-49.

Sky Room," which was leased to big-time gambling operators.¹ Notwithstanding these facts, the loan was granted. In fact, during the RFC Subcommittee hearings when these facts were disclosed, the RFC Chairman Harley Hise defended the loan on the excuse that the RFC had nothing to do with the management of the hotel, as the borrower of the loan had leased out the gambling rights, in a state where gambling is legal.² Nobody could prove anything shady or illegal about the Mapes Hotel loan, but neither could anybody prove that the RFC's action looked very smart.

There were other loans which were criticized, but the foregoing loans were representative. As the RFC Subcommittee stated: "There have been a large number of instances in which the Board of Directors has approved the making of loans over the adverse advice of the Corporation's most experienced examiners and reviewing officials, notwithstanding the absence of compelling reasons for doing so and the presence of convincing reasons for not doing it."³

The record of RFC Subcommittee hearings and report did not end with the controversial loans and mismanagement of the RFC by its directors. In the course of a series of investigations and inquiries by the RFC Sub-

¹"Testimony of Hilton W. Robertson, Examiner, Washington Office, Reconstruction Finance Corporation," *ibid.*, pp. 253-55. For instance, it was disclosed during his testimony before the Fulbright Subcommittee, out of \$327,000 of net income of the hotel for the period of December 1, 1947, to November 30, 1948, \$103,000 was made from the gambling features. *Ibid.*, p. 255.

²"Further Testimony of Harley Hise, Chairman, Board of Directors, Reconstruction Finance Corporation," *ibid.*, p. 249.

³U.S., Congress, Senate, "Study of Reconstruction Finance Corporation-- Favoritism and Influence," Senate Report (Report No. 76; 82d Cong., 1st sess.), p. 2.

committee, some evidences of "outside influence" and "political and personal favoritism" became known to the public. According to the Subcommittee report, the RFC, with its vast resources, was operating as a veritable political treasury, and there was a substantial traffic in influence.¹

The RFC Subcommittee reported that it had found the RFC's operations ridden by "favoritism" and dominated by outsiders wielding undue influence over RFC officials.² Particularly, Mr. Donald Dawson, an administrative assistant to President Truman, was, according to the report, exercising "considerable influence" over certain RFC directors and had "tried to dominate" the agency from his White House connection.³ Mr. Dawson's duties at the White House were largely concerned with the President's appointing powers, or what might be termed his personal patronage. He screened potential appointees and submitted nominees, together with such recommendations as the President desired, to the President for decision. Mr. Dawson was mentioned in a RFC Subcommittee report as one to whose influence the RFC Board had been unusually receptive.⁴ He denied that he had any influence and, more emphatically, that he had ever tried

¹U.S., Congress, Senate, "Study of the Reconstruction Finance Corporation--Favoritism and Influence," Senate Report (Report No. 76; 82d Cong., 1st sess.), p. 1.

²U.S., Congress, Senate, "Study of Reconstruction Finance Corporation--Favoritism and Influence," Senate Report (Report No. 76; 82d Cong., 1st sess.), p. 14.

³Ibid.

⁴U.S., Congress, Senate, "Study of Reconstruction Finance Corporation--Favoritism and Influence," Senate Report (Report No. 76; 82d Cong., 1st sess.), p. 14.

to influence the RFC Board.¹

However, a Director of the RFC, Walter L. Dunham, testified before the RFC Subcommittee that, when he joined the Board of Directors of the RFC in 1949, Mr. Dawson told him that "top personnel matters of the RFC should be cleared through the White House."² Mr. Dunham further added: "Because he was the only White House official I knew, I assumed that meant such matters should be cleared through him."³ He also revealed in his testimony: "I subsequently contacted him on other matters."⁴ Mr. Dunham further stated that he had found, soon after taking office as a RFC Director, that Mr. Dawson, RFC Director William E. Willett, Mr. Merl Young, Mr. Rex Jacobs were all close friends that he "was obviously regarded as a new member of their social group."⁵

The full extent of Mr. Dawson's influence and attempted influence on the RFC Board were not known. Furthermore, the question was not at all one of legality or illegality. What was then involved was the question

¹"Testimony of Donald S. Dawson, Administrative Assistant to the President of the United States," in U.S., Congress, Senate, "Study of Reconstruction Finance Corporation," Hearings: Before a Subcommittee of the Committee on Banking and Currency, 82d Cong., 1st sess. (Lending Policy--pt. 3), p. 1712.

²"Testimony of Walter Dunham, Director, Reconstruction Finance Corporation," ibid., p. 1316.

³Ibid.

⁴Ibid.

⁵Ibid., p. 1324.

of moral and ethical standards of public servants, in this case one in close association with the President of the United States. In addition, Mr. Dawson was formerly personnel director of the RFC, prior to entering the office of the President; and his wife, Mrs. Alva Dawson, was the chief custodian of the RFC files. Under these circumstances, the public could judge that Mr. Dawson "apparently exercised considerable influence over certain of the directors."¹

In the course of the Fulbright Subcommittee investigation, there were numerous other affairs disclosed to the public, either directly related to the operation of the RFC or sometimes indirect personal connections. For instance, Mr. Merl Young (who has been discussed in detail previously), after his resignation from the Lustron Corporation, was soon found in an insurance enterprise with Mr. Joseph Rosenbaum, of the Washington law firm of Goodwin, Rosenbaum, Meacham, and Bailen. Public criticism toward "the RFC Affairs" mounted even higher when it was disclosed that Mrs. Young was the only White House secretary who had a \$9,540 mink coat, that Mr. Rosenbaum had purchased the mink coat for Mrs. Young, and that Mr. Rosenbaum was a legal representative in obtaining a \$175,000 RFC loan for a furrier-seller as well as a few other loan transactions with the RFC, such as a total of \$6,300,000 in loans to the Central Iron & Steel Co.²

Another example which also gave rise to violent criticisms within

¹U.S., Congress, Senate, "Study of Reconstruction Finance Corporation--Favoritism and Influence," Senate Report (Report No. 76; 82d Cong., 1st sess.), p. 15.

²U.S., Congress, Senate, "Study of Reconstruction Finance Corporation and Proposed Amendment of RFC Act," Senate Report (Report No. 649; 82d Cong., 1st sess.), pp. 72-73.

and out of the Congress was an alleged personal influence by Mr. William J. Boyle, Jr., Democratic National Chairman. Among the charges against Mr. Boyle was his alleged influence in securing a \$565,000 RFC loan for the American Lithofold Corporation in May 1951. Mr. Boyle vigorously denied that he had used any political influence in this loan. The fact was that the American Lithofold application had been denied three times by the manager of the RFC St. Louis office, but soon after Mr. Boyle became a counsel for American Lithofold the loan application file was forwarded to Washington and by a three to two vote approved by the RFC Board of Directors, and that Mr. Boyle received legal fees from the company after the loan was granted.¹ The whole point was that influence might have been used effectively, considering Mr. Boyle's relations with the White House, Mr. Young, and the RFC.

The direct results of the investigations by the RFC Subcommittee were at least two-fold--first, immediate reorganization of the RFC; and second, eventual abolition of the RFC. The RFC Subcommittee in its report on "Favoritism and Influence" endorsed a bill (S 514) providing for a single RFC Administrator in place of the then five-man Board of Directors of the RFC.² President Truman first resisted that recommendation when it was reported on February 5, 1951. However, all of a sudden on February 19, 1951, the President transmitted Reorganization Plan No. 1, accepting the proposal in the Senate report.³ The plan was accepted by both the houses

¹Ibid., pp. 65-67.

²U.S., Congress, Senate, "Study of Reconstruction Finance Corporation--Favoritism and Influence," Senate Report (Report No. 76; 82d Cong., 1st sess.), p. 2.

³U.S., Congress, House, "Reorganization Plan No.1 of 1951," Hearings: Before the Committee on Expenditure in the Executive Departments, 82d Cong., 1st sess. (March 2 and 5, 1951), pp. 2-3.

and became effective May 4, 1951, when Mr. W. Stuart Symington took office as Administrator under the new plan.¹

The reason behind Reorganization Plan No. 1 of 1951 was that it would remove the political element from the RFC's loans if the five-man Board of Directors were replaced by a single Administrator. There were obvious advantages to this. For one thing, if a really important, capable, and honest executive were appointed for the job, he might be able to restore confidence in the RFC and lessen the possibilities of political influence.

The plan provided for certain additional safeguards with respect to loan policy and to specific loan applications by the creation of a Loan Policy Board of five members to promulgate general policies to govern the granting and denial of applications. The members of the Board were to be the Administrator of the RFC as Chairman; the Deputy Administrator of the RFC, the Secretary of the Treasury, the Secretary of Commerce, and a member designated by the President from among Federal officials who had been approved by the Senate.² This Board actually established general policies in the granting and denial of applications for financial assistance by the RFC.

The final and biggest question resulting from the Congressional investigations is the question of whether the RFC should or should not be

¹The Reorganization Plan No. 1 of 1951 was due to become effective unless a majority of the House or the Senate disapproved.

²On May 15, 1952, the President designated the Administrator of the Defense Materials Procurement Agency as the fifth member of the Board. U.S., Congress, Report on the Audit of Reconstruction Finance Corporation for the Fiscal Year Ended June 30, 1952 (House Doc. No. 104; 83d Cong., 1st sess.), p. 3.

continued as an agency of the Government of the United States. This was largely a question of social and governmental philosophy as well as an economic one.

Senator Harry F. Byrd¹ of Virginia, Chairman of the Joint Committee on the Reduction of Federal Expenditures, argued that the RFC was originated as a depression measure and it was useless in a period of high inflation.² He attacked the RFC as "an agency which is being used as a work-shop by get-rich-quick political predators."

When the President's Reorganization Plan No. 1 of 1951 was being discussed in the Senate in March 1951, Senator Byrd advocated abolition, not reorganization.³ "Such loans do not promote the public welfare. They provide easy credit which is not needed in inflationary periods."⁴ "Most of the vandalism brought out by the Fulbright committee to date has been the by-product of activities engaged in by a useless non-essential agency with no real purpose to serve."⁵ Senator Byrd further went on to expose some of the weakest points of those defending the RFC in the nature of "political favoritism" and "personal influence." He said:

¹Back in 1937, Senator Byrd was the only man in the United States Senate to vote against extension of the RFC.

²"Proposed Abolition of the Reconstruction Finance Corporation," Congressional Record, vol. 97, pt. 2, p. 2384.

³Ibid.

⁴Ibid., p. 2385.

⁵Ibid.

The RFC is now so permeated with political favoritism that it should be completely cleaned out. There is an old Blue Ridge saying 'You cannot measure a snake until it is dead.' I think this applies to the RFC. In my judgement, a nonpolitical liquidation of this agency will disclose many evidences of favoritism, collusion, improper influence, and perhaps criminal practices. It has contributed in a large way to political moral delinquency and has done, and is doing, much to cause the people to lose faith in their Government, and the agency should be abolished.¹

On February 13, 1953, Senator Byrd, together with four other senators introduced a bill, S 892,² to abolish the RFC before the termination date (June 30, 1954, under the existing law at that time), and to transfer certain of its functions relating to national defense to other agencies of the Government.

Upon the introduction of the bill, S 892, Senator Byrd made a statement, part of which reads:

Senators Bricker and Robertson of the Senate Banking and Currency Committee, and Senators Ferguson and Williams, have joined me as sponsors of a bill which I have introduced in the Senate today for the abolition of the Reconstruction Finance Corporation.

. . .

The agency this year is costing more than \$14.5 million in administrative overhead, and it is employing more than 2,000 people--about half of them in Washington and the other half in five branches and 32 loan offices scattered throughout the country and in Puerto Rico and Alaska.³

¹Ibid.

²"Dissolution of Reconstruction Finance Corporation," Congressional Record, vol. 99, No. 25 (February 13, 1953), p. 1089.

³Ibid.

If passed, this bill would terminate the RFC and its lending powers on December 31, 1953. Thereafter the Secretary of the Treasury would take over liquidation of the RFC's assets under section 10 of the RFC Act.¹ Net profits of the liquidation would be used to reduce the public debt. While prohibiting the Secretary of the Treasury from extending maturities or renewing loans, he would let RFC debtors make interim payments. The rubber, tin, and abaca programs of the RFC would be transferred to the Secretary of Commerce, effective January 1, 1954, for continued operation. The defense loan program, by January 1, 1954, would be transferred by the President to the Secretary of the Treasury, Federal Reserve banks, or any other department or agency of the Government.² The RFC functions under the Federal Civil Defense Act of 1950 would be transferred on January 1, 1954, to the Secretary of the Treasury for continued operation.³

Joining with Senator Byrd in his condemnation of the RFC was Senator Homer Ferguson from Michigan. On April 23, 1952, Senator Ferguson made in the Senate the following remarks on the question of corruption in the RFC:

The Government continues to make individual loans. I had one example called to my attention only a few weeks ago. I did not think it was possible that the United States Government would lend small amounts of money for the establishment of beauty parlors in the District of Columbia. Yet that has happened. I was called off the floor by a person who said she was a former resident of the State of Michigan. She had obtained a loan of \$2,000 from the RFC to buy a beauty parlor. She found that she could not repay it and she wanted to know whether I would intervene in her behalf in order that she might have more time in which to repay the loan.

¹61 U.S. Stat. at L. (1947), 202, "Joint Resolution To extend the succession, lending powers, and the functions of the Reconstruction Finance Corporation," sec. 10.

²The RFC currently conducted the defense loan program under the Defense production Act of 1950. See pp. 187-189.

³For the provisions of the bill, S. 892, see "S. 892, 83d Cong., 1st

She said the reason she came to me was because she was a Democrat when she came from Michigan . . . and she felt that since the RFC now had a Republican director she had to come to the Republican Senator from Michigan in order to get an extension.¹

Then Senator Ferguson attacked the RFC further stating that "It is not only the employees in the RFC but also the whole set-up of the RFC that is wrong." He insisted that "regardless of the issue of corruption I believe the time has come to abolish the RFC. Corruption has taken place because of the nature of the agency as well as because of the nature of people. Both contributed equally to the evil situation which developed."²

The Hoover Commission on Organization of the Executive Branch of the Government in its report to Congress in March 1949 strongly recommended the liquidation of the RFC and the substitution of guaranties by the Government, operating through the Federal Reserve Banks, of loans to be made by commercial banks.

The Commission believed that "direct lending should be absolutely avoided except for emergencies." Direct lending by government, they maintained, "opens up dangerous possibilities of waste and favoritism to individuals or enterprises. It invites political and private pressure, or even corruption."³

sess.; A Bill To dissolve the Reconstruction Finance Corporation and transfer certain of its functions relating to national defense to other agencies of the Government," U.S., Congress, Senate, Hearings: Before the Committee on Banking and Currency, 83d Cong., 1st sess., pp. 2-4.

¹"Amendment of Reconstruction Finance Corporation Act," Congressional Record, vol. 98, pt. 4, p. 4264.

²Ibid.

³U.S., Congress, House, "Report of Commission on Organization of Executive Branch of the Government," House Document (Doc. No. 55; 81st Cong., 1st sess.), p. 36.

Quoting some passages from the report of the Commission on Organization of the Executive Branch of the Government, of which he was Chairman, Mr. Herbert Hoover on April 30, 1951 stated to the Senate Banking and Currency Committee: "I think you will agree that that statement (above quoted) made a few years ago was rather prophetic."¹ Mr. Hoover elaborated "a good many reasons" which led him to conclude in favoring the abolition of the RFC. Among the "good many reasons," he felt that the RFC was a creation of a great economic crisis of 1932 therefore the agency was no longer needed in other times² and the loans in excess of \$100,000 had led to favoritism and corruption demonstrated by the exposures of the Fulbright Committee.³ He added the "Corruption in business affects only the pockets of the employer or the owner. Corruption in Government affects the pockets of all taxpayers, but far worse, it affects the morals of a people and lowers their respect for government."⁴

Mr. Hoover elaborated further on the nature of the RFC loans in recent years, mentioning: "It would appear that the test of public interest has been very little applied in recent years. The public interest in several of the large loans has already been questioned by the Fulbright Committee. As further examples, I append some lists of a few

¹"The Reconstruction Finance Corporation--Statement by Hon Herbert Hoover," Congressional Record, vol. 97, pt. 4, p. 4499.

²Ibid., p. 4498. It will be remembered that the RFC was a creation under the Hoover Administration.

³Ibid., p. 4499.

⁴Ibid.

samples. The first list is 39 lesser-sized loans made for hotels, ranging from \$9,000 to \$1,500,000 in 23 states. . . . The second list is 14 loans made to hard- and soft-drink manufacturers and distributors. . . . The third is 18 loans to theaters and bowling alleys ranging from \$17,000 to \$1,200,000. . . . I could have made up a list of beauty parlors and pool rooms and snake farms."¹ Then he argued: "What public interest there can be in the operation of these types of business at the taxpayers' risk is very difficult at least for me, to see."²

The Jesse H. Jones, who ran the RFC for 13 years as a Board Director, as Chairman of the RFC, as Federal Loan Administrator, and as Secretary of Commerce, writing to the Fulbright investigating committee on April 10, 1950, expressed his view: "As for the future of the RFC, I think it should be given a decent burial, lock, stock, and barrel."³ His reasons were: "first, none of the conditions which prompted the creation of the RFC exist today; second, Government lending in competition with private business is not a proper function under our free-enterprise system; third, the RFC is being prostituted when making such loans as the Kaiser-Frazer, the Lustron, the Texmass, and the Waltham Watch Company; and fourth, there is ample credit for all legitimate and justifiable loans."⁴

¹Ibid. For the "Selected loans to distillers, brewers, and bottlers, June 30, 1950," see ibid., pp. 4499-4450.

²Ibid., p. 4499.

³"Letter of Jesse H. Jones, Houston, Tex. to Senator J. W. Fulbright, April 10, 1950," in U.S., Congress, Senate, Hearings: Before a Subcommittee of the Committee on Banking and Currency, 81st Cong., 2d sess., p. 444.

⁴Ibid.

He ended his letter with the following warning:

I have made these observations, comments, and suggestions from my long experience with the Corporation, and wish to remind you that where the sugar is you will always find the flies.¹

As has been said in Chapter IV,² Mr. Jones was entrusted with confidence by both Congress and the country at large, in his ability to handle the RFC. The fact was that when Mr. Jones became Secretary of Commerce in 1940, Congress let him take the RFC along; and when he resigned the post of Secretary of Commerce, the Congress took the RFC out of the Department of Commerce. But now Mr. Jones also became one of those who were insisting that the RFC should be abolished.

As energetic as Senators Byrd and Ferguson in making vital attack on the "corruption of the RFC," is Senator John W. Bricker from Ohio. For instance he, joining with Senators Byrd and Ferguson in a debate on the question of liquidation of the RFC, on April 23, 1952, in the Senate urged an early abolition of the RFC, mainly because of "the loans made by the RFC over the past several years."³ He recounted some of the "selected loans to distillers, brewers, and bottlers" from hearings before the Fulbright Subcommittee "for the enlightenment of the Senate."⁴

However, Senator Fulbright countered the mass attack on the problem of corruption of the RFC by those who criticized it, with the following

¹Ibid., p. 445

²See pp. 167-168.

³Liquidation of Reconstruction Finance Corporation," Congressional Record, vol. 98, pt. 4 (April 23, 1952), p. 4261.

⁴Ibid., The list lasts for about a page and a quarter.

statement:

. . . to be logical and at all reasonable about this matter (abolition of the RFC), I think the issue is whether the functions authorized and which are being performed by the RFC are valid functions. The issue of corruption, to me, is completely irrelevant to the question of whether the RFC should be continued or not, because if one follows that line, he could apply it to any one of a number of agencies of the Government. For example, let us refer to the Maritime Commission. It has had much said about it in the past; and, presently, the Internal Revenue Bureau has had much said about it.¹

Then Senator Bricker answered:

I agree with the Senator that the corruption in the agency, flagrant as it is, is not the sole reason for its abolition. It may not be the main reason; it may not be a reason at all. But my opposition to its continuance is based entirely upon the function it performs, and upon my feeling that there is no place for direct Government lending.²

However, Senator Bricker could not resist adding to his remarks that "the corruption is, I believe, almost a necessary corollary to the Government's entering this kind of business (lending)."³

Senator Bricker gave some other reasons why the RFC should be abolished at the earliest practicable date. He felt that, in the first place, the operation of the RFC was an expensive one. To him the contention that the RFC had made a profit was doubtful, because the cost of Government money was not properly taken into account, and factors other than lending had contributed to show a favorable balance for the RFC.⁴

¹Ibid., p. 4266.

²Ibid.

³Ibid.

⁴Ibid., p. 4261.

Secondly, the RFC had often bypassed Congressional appropriations, which he remarked that he with many other Congressmen regretted.¹

Mr. Marriner S. Eccles, long-time Chairman of the Federal Reserve Board, gave economic reasons for abolishing the RFC when he gave testimony before the Senate Committee on Banking and Currency on April 30, 1951.² He argued that throughout the post-War period and particularly since the Korean invasion, the country had experienced a most serious inflationary development and that the RFC, instead of liquidating its outstanding credits during this period, added to inflationary pressures by extending its lending activities and those of its affiliate, the Federal National Mortgage Association.³ He explained that inflation had greatly depreciated the purchasing power of the dollar, and as a result the cost of living had increased approximately 45 per cent since the end of the war. He went on to say that this was a most serious and unjustified development, and should not have been permitted. He further stated that this inflation had worked a grave injustice upon large numbers of our people and it had injured most the aged, the pensioners, the widows, the disabled--the most helpless members of our society.⁴

¹Ibid.

²For Mr. Eccles's statement, see "Reconstruction Finance Corporation--Statement of Hon. Marriner S. Eccles, Congressional Record, vol. 94, pt. 4, pp. 4500-4502.

³For the amount of loans during the post-War period by the RFC and activities of the Federal National Mortgage Association, see pp. 184-187.

⁴Congressional Record, vol. 94, pt. 4, p. 4501.

Yet it is a debatable question as to whether or not the RFC operations during the post-War period were inflationary. For instance, in reply to a question raised by Senator Fulbright as to whether or not the effect of RFC operations in increasing the volume of credit available to business enterprises was inflationary, John B. Goodloe, Chairman of the Board of Directors of the RFC, made the following answer:

The loans, Senator, that are made by the RFC are loans made for the production of commodities and materials and we do not regard these loans as inflationary in the ordinary sense of the word. . . . As a matter of fact, I do not propose to be an economist or financial wizard, but my understanding is that loans we are making are really fighting inflation. In other words, inflation is largely one of price inflation, and the best way to meet that is to get production of the materials and commodities that are scarce.¹

The above-stated theory, adhered to by Mr. Goodloe, is a re-emergency of the "real bills doctrine" in a somewhat special form.²

If, on the other hand, there is an increase in the money supply as a result of loans granted by the RFC, this will tend to stimulate spending. Borrowers will have funds they did not previously have and presumably will spend them; otherwise, they would not have borrowed the money. As a result of spending these newly created funds upon investment goods, cash balances will be higher than desired by the community, assuming that an equilibrium existed previously, and this will lead to increased expenditures until prices are adjusted upward.

¹U.S., Congress, Senate, "Inquiry into the Operations of the RFC and Its Subdivisions under Senate Resolution 132," Hearings: Before a Special Subcommittee of the Committee on Banking and Currency, 81st Cong., 2d Sess., pt. 1, p. 39.

²Lloyd W. Mintz, A History of Banking Theory (Chicago: University of Chicago Press, 1945), pp. 30-38.

Judging from the amount of outstanding loans presented in Table 12 (page 192), and the fact that throughout most of the post-War period unemployment was near the minimum, it appears to be valid to conclude that the result of RFC lending activities in the post-War period was to make prices rise further than they would have risen in the absence of RFC loans. Furthermore, it is reasonably fair to conclude that the continuation of the activities of the RFC into the post-War years, after the conditions for which the Corporation was originally created were eliminated, resulted in making the control of inflation more difficult. There is no logical justification for continuing lending activities of Government agencies such as the RFC and at the same time acting to balance the Federal budget and restrain credit expansion to prevent inflation. Of course the question of whether the RFC should or should not be abolished as a Government lending agency is largely a question of social and governmental philosophy and not purely an economic one.

Leading the fight for retention of the RFC has been Senator William J. Fulbright of Arkansas, the same legislator who had been in charge of the corruption-finding committee--commonly called the RFC Subcommittee or the Fulbright Committee. For advocating the continuance of the RFC, Senator Fulbright cites a genuine need, such as he finds within his own State, for a lending agency of RFC caliber--especially for small business. In such places, he insists, local banks often do not have the capital for business loans, and far-off Wall Street is not interested in expanding small-sized industries and businesses. Examining the record of the RFC, it is found that 90 per cent of the number of RFC loans were \$100,000 or

under, and 65 per cent of such loans did not exceed \$25,000.¹ Table 15 presents the cumulative number and amount of RFC loans of \$100,000 or less up to October 31, 1947. First of all, answering Senator Harry F. Byrd and those who attacked the continuance of the RFC, Senator Fulbright on April 23, 1952, during debate in the Senate on proposed RFC abolition, stated:

I want to say one or two more words about corruption in Government. I think that aspect has been greatly overdone, so far as RFC is concerned. In opposing the abolition of RFC I am in no sense condoning what occurred. In fact, I think the very fact that we actually exposed and, I believe, eradicated the culprits-- I am sure we did eradicate the major culprits when we abolished the Board of Directors--was really the remaking of the RFC, because that was where the real trouble arose. When that was done, I think the RFC found itself well on the road to a proper administration and a useful life.²

The problem facing small businesses has often been examined from a social and political instead of an economic point of view. On grounds of equity and of social policy, action by the government has been urged to equalize the competitive positions of small and large businesses, to provide the small man with a fair opportunity, and to develop, through multiplication of small entrepreneurs, the desirable social qualities of self-reliance, initiative, and leadership as widely as possible.³

It is even declared that "the health of small-scale enterprise-- the opportunity for every American to establish his own business, and the maintenance of economic conditions which will permit such businesses

¹See Table 15.

²"Amendment of Reconstruction Finance Corporation Act," Congressional Record, vol. 48, pt. 4, p. 4265.

³Theodore N. Beckman, "Large Versus Small Business After the War," The American Economic Review, XXXIV (March 1944), 104-06.

Table 15

NUMBER AND AMOUNT OF LOANS OF \$100,000 OR LESS¹
(Cumulative from 1932 to date indicated)

| To-- | Number of loans | Percentage | Amount | Percentage |
|-----------------------|-----------------|------------|---------------|------------|
| \$5,000 and under | 7,578 | 31.0 | \$ 19,383,167 | 0.6 |
| \$5,001 to \$10,000 | 3,760 | 15.4 | 29,424,398 | 0.9 |
| \$10,001 to \$50,000 | 5,094 | 20.8 | 88,390,904 | 2.8 |
| \$25,001 to \$50,000 | 3,127 | 12.8 | 117,769,347 | 3.8 |
| \$50,001 to \$100,000 | 2,384 | 9.8 | 181,415,980 | 5.8 |
| December 31, 1945 | 21,943 | 89.8 | 436,383,796 | 13.9 |
| \$5,000 and under | 10,385 | 28.2 | 27,360,208 | 0.8 |
| \$5,001 to \$10,000 | 5,659 | 15.4 | 45,243,210 | 1.3 |
| \$10,001 to \$25,000 | 7,968, | 21.7 | 142,388,779 | 4.1 |
| \$25,001 to \$50,000 | 5,177 | 14.1 | 198,897,648 | 5.8 |
| \$50,001 to \$100,000 | 3,801 | 10.3 | 295,992,722 | 8.6 |
| December 31, 1946 | 32,990 | 89.8 | 709,882,567 | 20.6 |
| \$5,000 and under | 11,603 | 26.7 | 30,901,389 | 0.8 |
| \$5,001 to \$10,000 | 6,661 | 15.3 | 53,246,427 | 1.4 |
| \$10,001 to \$25,000 | 9,757 | 22.5 | 174,701,881 | 4.6 |
| \$25,001 to \$50,000 | 6,412 | 14.8 | 246,190,548 | 6.4 |
| \$50,001 to \$100,000 | 4,838 | 11.2 | 380,264,419 | 10.0 |
| October 31, 1947 | 39,271 | 90.5 | 885,304,664 | 23.2 |

¹Source: U.S., Congress, Senate, "Inquiry into the Operation of the Reconstruction Finance Corporation and Its Subsidiaries Under Senate Resolution 132," Hearings: Before a Special Subcommittee of the Committee on Banking and Currency (81st Cong., 2d sess.; on S. Res. 132), pt. 2, p. 588, Exhibit 65-A.

to grow and prosper--is essential to the preservation of our free society."¹ Support for various types of subsidization of small business on grounds of its contribution to social and political well-being has become an increasingly strong factor in legislation, and the subsidization of financing is no exception. Thus, in discussion of the purely economic aspects of such financial assistance, the importance of its other aspects should not be forgotten.

In his annual message to Congress on January 14, 1946, President Truman summarized and endorsed this point of view when he declared: "Many gaps exist in the private financial mechanism, especially in the provision of long-term funds for small- and medium-sized enterprises."²

The private financial mechanism, if it is to be considered adequate, must provide private business enterprise with three general types of financing: equity capital, loan capital, and short-term credit. The lines between these general types cannot always be drawn sharply, but recognition of their basic differences is essential if we are to avoid confusion in appraising the gaps which may exist.

Equity capital is, of course, ownership investment, whether it be simply proprietorship or partnership net worth or in the form of capital stock and surplus.³ In addition to financing a part of the assets of the business on a permanent basis, equity capital serves the important

¹Investment Bankers Association of America, Capital for Small Business (Chicago: Investment Bankers Association of America, 1945), p. 7.

²"Annual Message from the President of the United States," Congressional Record, vol. 92, pt. 1, p. 136.

³Douglas R. Fuller, Government Financing of Private Enterprise (Stanford: Stanford University Press, 1948), p. 14.

function of a cushion to absorb possible losses and thereby limit the risk assumed by creditors, who are asked to supply the balance of the financing required.

Loan capital, or medium term and long-term debt, consists of borrowed funds employed for capital purposes to supplement the permanent capital supplied by the owners of the equity.¹ Normally, loan capital is expected to be replaced gradually by profits accumulating from the operations of the business. Much debt of this type, particularly that running for periods of less than ten years, carries a fixed schedule of installment repayments.

Short-term or commercial credit includes a wide variety of loans and bank credit extended for periods of less than one year. Generally such credit is used to supplement capital funds in order to meet seasonal or temporary requirements and to permit a greater volume of business by limiting the period of time the borrower's capital funds need be tied up in inventory and receivables.

Banks and other commercial financial institutions play a most important part in supplying the credit needs of small business, but advances from these institutions are usually limited to short-term needs. Numerous examples can be found in the experience of the RFC where small businessmen applied for long-term loans upon the advice and recommendation of the banks who were willing to supply all the short-term credit needed.²

¹Ibid., p. 15.

²U.S., R.F.C., Annual Report and Financial Statements (June 30, 1951), p. 9.

For instance, the Senate Committee on Banking and Currency, in 1947, conducted a survey of the Nation's 14,545 banks to determine the relationship of the RFC under existing laws with the over-all banking picture. It was found from replies received from 8,217 banks that some of these occasionally declined business loans.¹ Commercial banks are reluctant to make business loans with long maturities, for example over 5 years, because their deposits are subject to withdrawal at any time. The survey showed that banks also decline business loan applications for other reasons which are not directly concerned with the credit risks involved.²

The experience of the RFC during 1949-50 indicated that small businesses were still encountering difficulty in securing adequate and reasonable long-term financing from private sources.³

Over the years, the short-term credit requirements of small businesses have been well met by the nation's private lenders and investors. However, the RFC's experience indicates that the source of many small business financial difficulties is the inability of smaller enterprises to secure adequate amounts of equity capital and long-term credit. Subsequently similar conclusions have been reached by committees of the Congress, the Federal Reserve Board, and other bodies--both in

¹"Senate Committee on Banking and Currency--RFC Inquiry, Senate Post Office Box 100," U.S., Congress, Senate, "Inquiry Into the Operations of the Reconstruction Finance Corporation and Its Subsidiaries Under Senate Resolution 132," Hearings: Before a Special Subcommittee of the Committee on Banking and Currency, 80th Cong., 2d sess., pp. 519-22, Exhibit 38-B.

²Ibid.,

³U.S., R.F.C., Annual Report and Financial Statements (June 30, 1950), p. 10.

and outside of government--which have made studies in this field.¹ Most needs for equity capital and long term credit arise when new projects are undertaken or when existing concerns endeavor to hold or strengthen their position through expansion and modernization of their facilities and by widening their market. Large business firms frequently raise funds for these purposes through public sale of stocks and debentures, but this method is seldom employed by smaller concerns because of the prohibitive costs incurred in marketing small issues. The independence so much prized by small businessmen is also a deterring factor, for the owners of small concerns are often reluctant to secure capital from the sale of additional stock. Furthermore, new issue and secondary markets for the securities of smaller, more or less unknown concerns are practically non-existent.

Caution, however, must be taken to differentiate Government aids to small business from Government subsidization. Although many factors of cost and risk limit the supply of funds available for small loans and thus make for high rates, it seems apparent that the fact that a small borrower must pay a relatively high rate of interest does not necessarily demonstrate that a financial gap exists. If the Government, for reasons of social benefit, were to make small loans available at rates which would be unprofitable to private lenders, it would then be a question of subsidization of small borrowers, not one of plugging a gap in the private financial mechanism.

¹Amendment of Reconstruction Finance Corporation Act," Congressional Record vol. 94, pt. 3 (80th Cong., 2d sess.), p. 4106.

To summarize prevailing opinions, there is general agreement that gaps exist in the present-day private financial system with respect to the provision of equity capital and long-term loan capital to small business.

Representative Wright Patman of Texas, on February 26, 1953, addressed the House: "Small business--small, private, competitive, independent business--is the backbone of a democratic and capitalistic economy. In other words, it is essential to our way of living." He continued: "It may come as a great surprise to some people, but all of our great industrial giants were small business once, and incidentally most of them got Government assistance, too, through tariffs, tax advantages, land grants, and so forth. However, today we are talking about sound, business-like assistance; for each small-business man who merits it is also required to repay it with interest."¹ He then defended the accomplishments of the RFC in aiding small business, saying: "Although the RFC has made a few large loans to both small- and medium-size businesses, it is a fact that over a period of time approximately 90 per cent of all of the RFC business loans are for amounts less than \$100,000 each."²

After having given some of the RFC's business loan policies, Representative Patman argued that he "will never come to the point of favoring an action which would push the small-business man into the clutches of the loan shark."³

¹"Does the RFC Compete with Private Banker," Congressional Record, vol. 99, No. 33 (February 8, 1953), p. 1497.

²Ibid., p. 1498. See also Table 15.

³Ibid.

Mr. James G. Patton, President of the National Farmers Union, on May 23, 1951, before the Senate Banking and Currency Committee, made a statement on behalf of the Farmers Union in which he first appraised the accomplishments of the RFC during times of depression, war and prosperity and then endorsed the continuation of the RFC as it was constituted in May 1951.¹ Among the reasons he gave for his endorsement for the continuation of the RFC, he emphasized the need of the RFC in aiding small business. He explained that, because of concentration of economic power during World War II, many industries at the end of this War period were dominated by relatively few companies, therefore small business experienced great difficulty in securing capital necessary to shift from wartime to peacetime production, and that the RFC supplied the necessary long-term capital loans which the small business would otherwise have been unable to secure.² He also called attention to the fact that the overwhelming majority of all RFC loans were made to small-business institutions.³ Then he concluded his statement with the warning that the abolition of the RFC would . . . "inflict a crushing blow on small business from which it would never recover."⁴

The statement made by Mr. Wendell Berge, Chairman of the Small Manufacturers' Emergency Committee, before the Senate Banking and

¹U.S., Congress, Senate, "Statement of Angus MacDonald, on Behalf of James G. Patton, President of the National Farmers Union," Hearings: Before the Committee on Banking and Currency, 82d Cong., 1st sess. (May 23, 1951), p. 428.

²Ibid., p. 429.

³See Table 15, on p. 283.

⁴"Statement of Angus MacDonald, on Behalf of James G. Patton, President of the National Farmers Union," op. cit., p. 429.

Currency Committee on May 22, 1951, was convincing. He first stated that during the War and preparation the small-and-independent-business men had been liquidated.¹ Assailing those who advocated the abolishment of the RFC, he argued that the drive to abolish the RFC was inspired by long-time opponents of the RFC who wanted to see it eliminated for selfish reasons and "there is at least an informal alliance between the big private banks and investment houses and large monopoly enterprises who are the customers of these banks and investment houses, to monopolize the credit of the United States and channel it into big-business operations at the expense of small business."²

In connection with the financial need of small business, Mr. Berge elaborated the "financial gap" existing today. That is, as Mr. Berge stated, local commercial banks are ordinarily not permitted by the regulations under which they operate, to make long-term or intermediate loans. They are generally strictly limited to short-term loans, and are usually not prepared to handle loans for 5 to 10 years. He insisted that, because of this gap, the continuance of the RFC was urgently necessary "if thousands of small business enterprises throughout the country are to survive."³

Senator Paul Douglas of Illinois, defending basic theories of the RFC when he spoke in the Senate on April 23, 1952, pointed out a genuine

¹U.S., Congress, Senate, "Statement by Wendell Berge, Chairman, Small Manufacturers Emergency Committee," Hearings: Before the Committee on Banking and Currency, 82d Cong., 1st sess., May 22, 1951, p. 345.

²Ibid., p. 346.

³Ibid., p. 350.

need for the RFC together with the functions it had been performing in connection with loans to small business, disaster loans and public agency loans. He stated: "There are some localities in this country which find it difficult to get capital from local banks because the local banks do not have enough deposits to make the loan. That is largely true of the South, the Southwest, the great plains, and, to some degree, the Mountain States."¹ He added that the RFC could step in and meet some of these sectional deficiencies in capital.²

The same view was consistently expressed by Senator Fulbright. For instance, he once stated in a debate in the Senate that the largest single institution among the banks in his state, Arkansas, had total assets of about \$60,000,000 and that was the only one of that size, and that there was another one close to it, but aside from two or three like that, there were other banks with total assets of only around \$10,000,000 or \$15,000,000. He added that these banks in his state were quite unable to finance a reasonably expanding business, as their lending limits were somewhere in the neighborhood of \$50,000 or \$60,000.³

He again recently stated in the Senate: "There is plenty of capital in the East, plenty in Michigan, Ohio, California, Pennsylvania, But how about the fellow with a furniture business in Arkansas, who needs

¹"Amendment of Reconstruction Finance Corporation Act," Congressional Record, vol. 98, pt. 4, p. 4263.

²Ibid.

³"Amendment of Reconstruction Finance Corporation Act," Congressional Record, vol. 98, pt. 4 (April 23, 1952), p. 4285.

a \$75,000 loan? He is not going to find a bank back home to take care of him. And he cannot come East with his problem; the New York bankers won't be interested in a loan of that size. What can he do? If it weren't for the RFC, hundreds of businesses in the South and West could never expand."¹

The regional aspect of the abolition of RFC is a remarkably ticklish business. The chief beneficiaries of the RFC's ordinary business loans (considering the number of loans rather than their dollar value) were Texas, Tennessee, Washington, Arkansas, and Georgia, in that order. A vigorous push for abolition of RFC, even one led by Byrd of Virginia, could very easily be made to look like an assault by northern big business against the struggling young enterprises of the South and West.

What this confused state of affairs boils down to is that several of the functions of the RFC will have to be retained for some time to come, even if the agency itself is abolished. And if the functions are to be retained, why not retain the agency that has been performing the functions, and has got the experienced administrators? This simple-sounding question has carried some weight with Congress in the past; and the answer to it--that the RFC has become an administrative monstrosity which would be easier to abolish than to reorganize--is hard to state effectively in a public forum.

¹"Resolution on Reconstruction Finance Corporation," Congressional Record, vol. 99, No. 25 (February 13, 1953), p. 1090.

The three-year-old battle on the question of whether or not the RFC should be abolished ended when a committee of conference reached an agreement on a bill to dissolve the Reconstruction Finance Corporation and to establish the Small Business Administration, and both houses passed the bill. The bill was signed by the President on July 30, 1953, to become Public Law 163 (83d Cong., 1st sess.)--commonly to be called "Small Business Act of 1953--Reconstruction Finance Corporation Liquidation Act."¹

¹Public Law 163, (83d Cong., 1st sess.), "An Act To dissolve the Reconstruction Finance Corporation, to establish the Small Business Administration, and for other purposes."

Section 4

General Appraisal of RFC Activities in the Post-War Period and the Present Status of the RFC

As World War II drew to a close, the Congress started curtailing the vast wartime activities of the RFC and its subsidiaries. It must be remembered that during the War the RFC was engaged in financing the American industrial expansion at the direction of the production and military high command, and that the bulk of this vast undertaking was accomplished through its subsidiary corporations. Some of these corporations became so swollen with the demands of war activity, that they grew larger than the peacetime RFC itself.

By an act approved June 30, 1947, Congress abolished the Federal Loan Administration and rewrote the RFC Act, repealing prior legislation and providing a new charter for the Corporation. This Act terminated most of the World War II activities of the RFC.

In the spring of 1948, the RFC Act was again amended, and extended the Corporation from June 30, 1948, through June 30, 1956, and the lending powers from June 30, 1948 to June 30, 1954.

Under these two amendments of 1947 and 1948, the RFC was authorized to make loans to business enterprises (including railroads and air carriers); to financial institutions; to States, municipalities and other public agencies; and to make loans because of floods or other catastrophes.

Other functions relating to the production of synthetic rubber, tin, and abaca have been continued under the RFC by special enactments of the

Congress and Presidential directives. The RFC also has continued liquidating certain defense plants and facilities.

Meanwhile, the outbreak of the Korean war placed the RFC in the defense picture once again. Under the Defense Production Act of 1950, the RFC gave consideration to loans to business enterprises which contributed to the national defense. Under section 302 of that Act, the RFC made loans to business enterprises for the expansion of capacity, the development of technological processes and the production of essential defense materials upon the issuance of a certificate of essentiality by the Defense Production Administration, the Defense Materials Procurement Agency, or the Department of Agriculture. Under section 714 of the Defense Production Act, the RFC made loans to small business concerns which had been recommended for the loans by the Small Defense Plants Administration. The RFC was also authorized to aid in financing projects for civil defense purposes, as provided by the Federal Civil Defense Act of 1950.

During the period 1945-1951, the Senate Banking and Currency Committee held a series of hearings, inquiring into and investigating the operations of the RFC. Among those hearings, most noteworthy for this study were (1) those conducted under the chairmanship of Senator Charles W. Tobey of New Hampshire, which lasted from June 1945 until May 1947, in connection with the \$80,000,000 loan to the Baltimore and Ohio Railroad Company; (2) those conducted under the chairmanship of Senator C. Douglas Buck of Delaware during the period December 1947-January 1948,

in connection with the extension of the RFC; and (3) those conducted under the chairmanship of Senator William J. Fulbright of Arkansas, in connection with the operation of the RFC.

Above all, the hearings conducted under the so-called Fulbright Subcommittee gave particular attention to top-level policy. Subsequently the hearings turned to the subject of "political influence," "personal favoritism," and "mismanagement."

The immediate results of these hearings were at least two-fold. One was the reorganization of the RFC, the other was a political battle on the question of whether or not the RFC should be abolished. As of May 4, 1951, the single Administrator replaced the five-man Board of Directors and, at the same time, a Loan Policy Board of five members was created in order to promulgate general policies to govern the granting and denial of loan applications.

The results of the three-year-old political battles on the abolition of the RFC were the liquidation of the RFC as a Government agency and the creation of a new Government agency called the Small Business Administration.

Under the "Reconstruction Finance Corporation Liquidation Act" approved July 30, 1953, the RFC's lending authority was terminated as of September 30, 1953 (60th day following the enactment of the act),¹ and the agency itself is to be dissolved as of June 30, 1954 (instead of June

¹Public Law 163 (83d Cong., 1st sess.), Title I, "Reconstruction Finance Corporation Liquidation Act," sec. 102(b).

30, 1956, under the previous law).¹ The RFC Liquidation Act authorizes the Secretary of the Treasury to carry out the liquidation of the RFC's activities.²

The RFC functions under the Federal Civil Defense Act of 1950 have been transferred to the Secretary of the Treasury effective October 1, 1953, for continued operation.³

The disaster loan program and the municipal loan program of the RFC were vested in the newly created Small Business Administration⁴ and a revolving fund of \$25,000,000 is provided for the operation of each of these programs.⁵

The rubber, tin and abaca programs of the RFC are to be transferred to the President not later than June 30, 1954.⁶ The defense loan programs under the Defense Production Act of 1950 have already been transferred to the President effective October 1, 1953.⁷

¹Ibid., sec. 102(a).

²Ibid., sec. 102(d).

³Ibid., sec. 104.

⁴Ibid., sec. 108, and title II, "Small Business Act of 1953," sec. 207.

⁵Ibid.

⁶Ibid., Title I, sec. 107(a).

⁷Ibid., sec. 107(b).

The "Small Business Act of 1953,"¹ created the "Small Business Administration" under the general supervision of the President, as an independent Federal agency not affiliating itself with or within any other agency or department of the Federal Government.²

In establishing the SBA, the Congress specifically put the policy of the Congress into the law. Section 202 of the Small Business Act of 1953 reads:

The essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation. Such security and well-being cannot be realized unless the actual and potential capacity of small business is encouraged and developed. It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts for supplies and services for the Government be placed with small-business enterprises, and to maintain and strengthen the overall economy of the Nation.

Further, it is the declared policy of the Congress that the Government should aid and assist victims of floods or other catastrophes.³

The Small Business Act of 1953 vests the management of the Administration in an Administrator to be appointed by the President by and with the advice and consent of the Senate, and authorizes the Administrator to appoint three Assistant Administrators and other necessary personnel.⁴

¹Public Law 163 (83d Cong., 1st sess.), Title II, "Small Business Act of 1953."

²Ibid., sec. 204.

³Ibid., sec. 202.

⁴Ibid., sec. 204(c).

The Administration is authorized to obtain money from the Treasury of the United States not to exceed a total of \$275,000,000 outstanding at any time. For this purpose appropriations not to exceed \$275,000,000 are authorized to be made to a revolving fund in the Treasury.¹ Of such total there may be outstanding at any one time \$150,000,000 for business loans, \$100,000,000 for contract and subcontract authority, and \$25,000,000 for disaster loans.²

The Act further set up a limitation on the amount of loan or loans to a borrower, not more than \$150,000 to a borrower outstanding at any one time.³

As was the case of the RFC under the Reorganization Plan No. 1 of 1951, the Act established a Loan Policy Board made up of the Administrator as Chairman and secretaries of the Treasury and Commerce (or their designated representatives).⁴

The Act sets the termination date of the Administration at June 30, 1955.⁵

A review of the studies in this chapter and a comparison of the provisions in the RFC Liquidation Act and the Small Business Act of 1953 lead to the conclusion that the RFC was liquidated not because of the functions it was performing but mainly because of the manner in which it

¹Ibid., sec. 204(b)

²Ibid.

³Ibid., sec. 207.

⁴Ibid., sec. 204(d).

⁵Ibid., sec. 221.

was operated. Most of the primary functions which the RFC had been performing were not repudiated. Some were taken over by a newly created agency with more rigid restrictions on lending policies and more narrowly limited fields of operation than the RFC; and some were transferred to other Government agencies, as has been pointed out.

CHAPTER VI

SOURCES OF THE RFC'S OPERATING FUNDS

Since its inception, the RFC's funds have been derived principally from three sources: (1) subscriptions to capital stock by, and borrowings from, the United States Treasury; (2) sale of its obligations to the general public; and (3) earnings derived from lending activities and other miscellaneous income such as dividends from its investments in securities, income from properties and securities acquired in liquidation of loan indebtedness, fees on loan participation agreements, and commitments fees, and the like.

Section 2 of the RFC Act provided the Corporation with capital stock of \$500,000,000 subscribed by the United States of America, and it authorized the appropriation of this amount for the purpose of making payments on the subscription when called.¹ Pursuant to this authorization, Public Resolution No. 7, approved January 27, 1932,² appropriated \$500,000,000, and the subscription was made and paid for by the Secretary of the Treasury on behalf of the United States. Of the \$500,000,000 of the original capital stock, the RFC in July 1941 retired \$175,000,000 pursuant to authority granted by the Act of June 25, 1940.³ Again, by

¹47 U.S. Stat. at L. (1932), 5, "RFC Act," sec. 2.

²47 U.S. Stat. at L. (1932), 14.

³54 U.S. Stat. at L. (1940, 572, "An Act To Authorize the purchase by the Reconstruction Finance Corporation of stock of Federal home-loan banks. . . ." sec. 2. For a further explanation for this retirement, see pp. 315-316.

an act of Congress approved May 25, 1948, the RFC further reduced its outstanding capital stock from \$325,000,000 to \$100,000,000 by payment of \$225,000,000 to the United States Treasury in July 1948.¹

In addition to the funds provided by the subscription to its capital stock and by the net earnings from its lending activities, the RFC obtained funds from borrowings which constituted the principal means of financing its operations. The borrowings were made in accord with the provisions of section 9 of the RFC Act, under which the Corporation was "authorized and empowered, with the approval of the Secretary of the Treasury, to issue, and to have outstanding at any one time in an amount aggregating not more than three times its subscribed capital, its notes, debentures, bonds, or other such obligations."² Accordingly, the initial borrowing authority of the Corporation was established at \$1,500,000,000; or three times its subscribed capital stock. However, such authority was greatly increased by subsequent legislation until 1947, as indicated below.

| <u>Enactment</u> | <u>Borrowing authority and increase</u> |
|---|---|
| Initial authorization, 47 Stat. 5..... | \$1,500,000,000 |
| July 21, 1932, 47 Stat. 714..... | 1,800,000,000 |
| June 16, 1933, 48 Stat. 210..... | (400,000,000) |
| Jan. 20, 1934, 48 Stat. 319..... | 850,000,000 |
| Feb. 24, 1938 and National Housing Act..... | (1,660,000,000) |
| Sept. 26, 1940, 54 Stat. 962..... | 1,500,000,000 |
| June 10, 1941, 55 Stat. 250..... | 1,500,000,000 |
| Oct. 23, 1941, 55 Stat. 744..... | 1,500,000,000 |
| March 27, 1942, 56 Stat. 176..... | 2,500,000,000 |
| June 5, 1942, 56 Stat. 326..... | 5,000,000,000 |
| | \$14,090,000,000 ³ |

Note: Parentheses denote decrease.

¹62 U.S. Stat. at L. (1948), 261, An Act To amend the Reconstruction Finance Corporation Act, as amended, and for other purposes," sec. 2.

²47 U.S. Stat. at L. (1943), 5, "RFC Act," sec. 9.

³U.S., R.F.C., Reconstruction Finance Corporation Act (as amended) January 1946), p. 239, Appendix A--Reconstruction Finance Corporation, Borrowing Authority.

In addition to the general authorizations reflected in the foregoing tabulation, "the amount of notes, debentures, bonds or other such obligations which the Reconstruction Finance Corporation is authorized and empowered to have outstanding at any one time" was increased from time to time, by various acts of Congress, by amounts sufficient to carry out the provisions of said acts authorizing and directing the Corporation to make specific allocations, loans, advances, and purchases of securities.

Some of these authorizations were in specific amounts and others were not limited. The RFC, under the so-called "specific borrowing powers," could issue further obligations limited by the amounts which it was authorized to expend in certain specific activities, and in other cases it was authorized to borrow for certain specific purposes without limitation on the amounts.¹

After June 30, 1947, the borrowing authority of the RFC from the Secretary of the Treasury was limited to an amount "sufficient to enable the Corporation to carry out its functions under this Act (RFC Act) or any other provision of law."² Consequently the borrowing authority of the RFC was changed in accordance with the limitation of its amount of investments, loans, purchases and commitments. The RFC Act of 1947³

¹ For example, the RFC was "specifically" authorized by section 6(b) of the Federal Home Loan Bank Act, approved July 13, 1933, to make funds available to the Secretary of the Treasury to enable him to make payments on stock of the Federal home loan banks; and by section 2(b) of the Federal Emergency Relief Act of 1933, approved May 12, 1933, to make advances to the Federal Emergency Relief Administrator up to \$500,000,000. On the other hand, for example, the RFC was authorized by section 5 of the Agricultural Adjustment Act of 1933, approved May 12, 1933, to borrow "an amount sufficient to provide for advances" to the Secretary of Agriculture "to purchase cotton" in accord with the provisions of the Agricultural Adjustment Act of 1933.

² 261 U.S. Stat. at L. (1947), 202, "Joint Resolution To extend the succession, lending powers, and the functions of the Reconstruction Finance Corporation," sec. 7.

³Ibid.

provided that the total amount of investments, loans, and commitments made after June 30, 1947, "shall not exceed \$2,000,000,000 outstanding at any one time."¹ This limitation was increased several times by Congress. The following tabulation presents the change of this limitation after June 30, 1947.

| <u>Enactment</u> | <u>Date</u> | <u>Amount</u> |
|------------------------------|-----------------|-----------------|
| Under RFC Act | June 30, 1947 | \$2,000,000,000 |
| | July 19, 1949 | 2,500,000,000 |
| | Oct. 25, 1949 | 3,500,000,000 |
| | June 30, 1950 | 3,750,000,000 |
| | Sept. 1, 1950 | 993,096,711 |
| Under Defense Production Act | Sept. 8, 1950 | 75,000,000 |
| | August 20, 1951 | 275,000,000 |
| | June 30, 1952 | 411,000,000 |
| | Oct. 2, 1952 | 461,000,000 |
| Under Civil Defense Act | Jan. 12, 1952 | 250,000,000 |

The limitations imposed by the various acts of Congress were intended primarily as restrictions on the amounts of its funds which the RFC could invest, loan, or advance for the purposes set forth in these acts, and the increases in the borrowing authority of the RFC which were contained in certain of these acts had the effect of merely increasing the total borrowing authority of the Corporation. Consequently the Corporation did not make a separate accounting of the amounts of funds borrowed for general purposes and another for those borrowed for specific purposes.²

¹Ibid., sec. 4(c).

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945 (House Doc. No. 450; 80th Cong., 2d sess.), p. 33.

In this connection, it is very significant to point out what the Comptroller General of the United States recommended to the Congress in his audit report of the RFC for the fiscal year 1945. His recommendation read:

We did not find any evidence that RFC exceeded its borrowing authority at any time. However, in order that control by the Congress may be simplified, it is considered desirable that the borrowing authority be fixed at a single amount to cover all purposes and that this amount be increased or decreased by the Congress from time to time as may be necessary.¹

The authority of the RFC to incur obligations by borrowing from the Treasury normally would impose upon the Corporation the requirement that it use the borrowed funds in a manner consistent with their ultimate repayment to the Treasury. It is evident that the permanent expenditure of funds advanced by the Treasury is the equivalent of the withdrawal of funds from the Treasury, yet, according to Article I of the Constitution of the United States of America "No money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law."² It is further provided by law that "No Act of Congress passed after June 30, 1906, shall be construed to make an appropriation out of the Treasury of the United States . . . unless such Act shall in specific terms declare

¹ Ibid. It is also significant to note that the Small Business Act of 1953 sets up overall limit of \$275,000,000 which the Administration can borrow as revolving fund from the Treasury, and within this overall limit (not in addition to) a certain amount of money is set aside for a certain purpose such as making catastrophe loans. Public Law 163 (83d Cong., 1st sess.), "Small Business Act of 1953," sec. 204 and sec. 207.

² Constitution, Art. I, sec. 9.

an appropriation to be made. . . ."¹ Enactment of the authority to cancel the indebtedness had the effect of showing Congressional approval of the expenditures, after the funds had been withdrawn from the Treasury and disbursed; but, under the act of June 30, 1906, it did not constitute an appropriation, and hence was contrary to the Constitution. However, through the medium of note cancellations, the borrowing authority of the RFC has been utilized as a means of avoiding the necessity for making appropriations of public monies. This device of avoiding direct Congressional appropriations by use of the RFC borrowing power was first used by Congress itself in siphoning off relief funds from the Treasury in July 1933. Upon order of the Congress, the RFC, by issuing its notes to the Treasury, secured \$500,000,000 which was paid out in relief grants to the States.² In avoiding a direct appropriation, the Congress sidestepped an increase in the Budget deficit.

A minority report of the House Committee on Banking and Currency, issued on April 20, 1933, with respect to relief expenditures then proposed to be made from the RFC funds, contained the following comments:

In dissenting from the proposal to give \$500,000,000 to the States for relief purposes, we find ourselves in fullest sympathy with the end in view, but unable to believe the method proposed is either necessary or wise.

¹U.S. Stat. at L. (1906), 764, "An Act Making appropriations for sundry civil expenses of the Government for the fiscal year ending June 30, 1907, and for other purposes," sec. 9.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945, (House Doc. No. 450; 80th Cong., 2d sess.), p. 35.

. . . While they (expenditures of \$500,000,000) will be made at once and so be in fact current expenditures, they will not show up in the Budget. If this is legitimate finance, then every exceptional expenditure should be segregated and dealt with by independent accounting, but in no case **should** the facts be concealed. The people have a right to know such facts.¹

The minority report further states:

The Reconstruction Finance Corporation was conceived and shaped to be a lending agency, precisely after the fashion of the War Finance Corporation, which repaid to the Treasury all the public funds it had received and more too. It was never thought of as a spending agency or a distributing agency. To engraft on it the giving function is illogical and undesirable. . . .²

At times it is necessary for the Government to undertake extensive programs involving the expenditure of money. Sometimes the dilemma arises because public opinion has not developed to the point where the Congress can reasonably debate and enact adequate measures for meeting the crisis, or, because of other good reasons, the public disclosure of detailed plans is not deemed advisable (as in the case of the national defense measure enacted in 1940). Presumably it has been felt the constitutional restrictions and the administrative rules which have been adopted to give effect to them, if rigidly applied in these circumstances, would impair the Government's ability to meet the crisis. And accordingly, the restrictions and the rules are side-stepped.

¹"Use of RFC to Avoid the Need for Making Appropriations of Public Money: Statement of Mr. Theodore Herz, Assistant Director of the Corporation Audits Division, General Accounting Office," in U.S., Congress, Senate, "Inquiry Into the Operation of the Reconstruction Finance Corporation and Its Subsidiaries Under Senate Resolution 132," Hearings: Before a Special Sub-committee of the Committee on Banking and Currency, 80th Cong., 1st sess. (December 3, 11, and 12, 1947), p. 237.

²Ibid.

The device of avoiding direct Congressional appropriations by use of the RFC's borrowing power had been used even on a larger scale. Prior to June 30, 1945, the Secretary of the Treasury had cancelled obligations of RFC in the total amount of \$2,785,000,000, pursuant to the provisions of an act approved February 24, 1938,¹ and to those of section 602 of the National Housing Act. These were obligations incurred by RFC in obtaining funds, by direction of Congress, for allocations to other Government agencies and for relief. The cancellations were effected without the making of appropriations.²

As it appeared at June 30, 1947, that the Treasury would have to cancel RFC obligations of about \$9,300,000,000 in settlement of the Corporation's participation in the national defense program, the war effort, and the Government's reconversion activities, the question of note cancellations by the Treasury for borrowings by the RFC was again considered by Banking and Currency committees of both the Senate and the House of Representatives in December 1947 during hearings held in connection with the passage of the 1947 RFC Act.³ Mr. Theodore Herz, Assistant Director of the Corporation Audits Division, General Accounting

¹52 U.S. Stat. at L. (1938), 79-80, "An Act to authorize the Secretary of the Treasury to cancel obligations of the Reconstruction Finance Corporation incurred in supplying funds for relief at the authorization or direction of Congress, and for other purposes."

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Affiliated Corporations for the Fiscal Year Ended June 30, 1945 (House Doc. No. 316; 80th Cong., 1st sess.), p. 7.

³61 U.S. Stat. at L. (1947), 202-209, "Joint Resolution To extend the succession, lending powers, and the functions of the Reconstruction Finance Corporation."

Office, made the following statement before the Senate committee hearings:

Reconstruction Finance Corporation has been described from time to time as the back door to the Treasury of the United States. This means that access to public funds could be had through RFC in a way which avoided the ordinary Government processes for controlling the expenditure of cash resources. Substantially the description is accurate.¹

He continued:

One of the most important uses which has been made of RFC has been its use in transactions which avoided the Appropriations Committees of the Congress and the ordinary congressional procedures by which expenditures of public funds are reviewed, debated, modified, and approved, or disapproved, in advance.²

As has just been pointed out, in a minority report of the House Committee on Banking and Currency, issued on April 20, 1933,³ the employment of the RFC and the use of its borrowing authority, in activities whose nature requires the expenditure of moneys for purposes which would preclude their recovery for repayment to the Treasury is basically inconsistent with the corporate character of the enterprise. In conducting such activities, the RFC could not act for itself, but rather it had to act as agent for the Government. And this being so, such activities should be financed by the departments for which they were undertaken and whose officials were responsible for the activities in question.

¹"Use of RFC to Avoid the Need for Making Appropriations of Public Money: Statement of Mr. Theodore Herz, Assistant Director of the Corporation Audits Division, General Accounting Office," U.S., Congress, Senate, "Inquiry Into the Operation of the Reconstruction Finance Corporation and its Subsidiaries Under Senate Resolution 132," Hearings: Before a Special Sub-committee of the Committee on Banking and Currency, 80th Cong., 1st sess. (December 3, 11, and 12, 1947), p. 236.

²Ibid.

³See pp. 306-307.

This principle was affirmed by the Congress in the Government Corporations Appropriations Act, 1947, title II, which reads:

. . . no part of the funds of the Reconstruction Finance Corporation or of any subsidiary thereof shall be used to make any purchase or for personal services or to enter into any contract for the use or benefit of any other agency of the government unless such agency shall have authority in law and appropriations available to make reimbursement for such purchase, personal services or contract. . . .¹

In addition to this provision from the Government Corporations Appropriations Act, section 102 of the Government Corporation Control Act provides, with respect to statements included in the Budget program, presenting estimates of the financial condition and operations for the ensuing year, "such statements shall include estimates of . . . appropriations required to provide for the restoration of capital impairments."²

Examining the nature of the net expenditures of \$9,300,000,000 incurred by the RFC in connection with the national defense program, and with the war effort, the RFC undertook net expenditure activities in response, directly or indirectly, to the enactments of the Congress and to Executive orders issued under the First War Powers Act, as we have discussed in Chapters IV and V. Notably, the directive that the RFC continue to supply funds to the War Damage Corporation to the extent

¹60 U.S. Stat. at L. (1946), 538, "An Act Making appropriations for Government corporations and independent executive agencies for the fiscal year ending June 30, 1947, and for other purposes," Title V, Federal Loan Agency.

²59 U.S. Stat. at L. (1945), 597, "Government Corporations Control Act," sec. 102.

of \$1,000,000,000 which, incidentally did not become necessary, was prescribed for the RFC by the Congress.¹ The Emergency Price Control Act of 1942 provided that certain subsidies could be paid only by the RFC subsidiaries, as we have discussed in Chapter IV.² There were many instances in which the RFC undertook to acquire war assets simply in order that other agencies might not have to request appropriations. For instance, the War Department in December 1940, in order to conserve its existing appropriations, directed the Defense Plant Corporation to acquire certain assets and to supply certain facilities for the War Department with a promise that the amount of investments by the Defense Plant Corporation would be "paid out of future appropriations by Congress" and the Defense Plant Corporation would be "reimbursed in full."³

The Government Corporations Appropriation Act of 1949, approved on June 30, 1948, authorized the Treasury to cancel RFC's notes to the extent of the total net expenditures made by the Corporation for national defense, war, and reconversion purposes.⁴ The canceled notes amounted to \$9,313,736,531.⁵ By this action the RFC was reimbursed in full for its

¹See pp. 126-129.

²See pp. 143-145.

³"Letter of Robert P. Patterson, The Assistant Secretary of War, to Mr. Emil Schram, Chairman, Reconstruction Finance Corporation," in U.S., Congress, Senate, "Inquiry into the Operation of the Reconstruction Finance Corporation and Its Subsidiaries under Senate Resolution 132," Hearings: Before a Special Subcommittee of the Committee on Banking and Currency, Exhibit 28, p. 241.

⁴62 U.S. Stat. at L. (1948), 1183, "The Government Corporations Appropriation Act, 1949," Title II.

⁵Ibid.

total net expenditures for wartime activities.

These three major by-passing operations together resulted in the net expenditure of public monies totalling more than \$12,500,000,000 by use of procedures which gave the appropriations committees no opportunity to pass on the expenditures in advance and which, therefore, withheld from the Congress the opportunity to make appropriations in the ordinary course of business.

Within the limit of the general and specific borrowing powers, the RFC also borrowed from the public with principal and interest guaranteed by the Federal Government. The borrowing authority of the RFC was utilized on one occasion as a means of reducing the borrowing requirements of the Treasury of the United States. In the fiscal year 1941, when the public debt was approaching its legal limit of \$49,000,000,000, the Corporation temporarily discontinued borrowing from the Treasury, and it paid a total of \$300,000,000 into the Treasury, pursuant to authority granted by the act of June 25, 1940.¹ This total was made up of \$125,000,000 to purchase the stock of the Federal home loan banks then held by the Treasury, and \$175,000,000 to retire part of the capital stock of the RFC, as discussed at the beginning of this chapter.² Instead of borrowing from the Treasury, the RFC borrowed \$645,000,000 on April 17, 1941, and \$571,000,000 on July 3, 1941, respectively, from the public. The Treasury's needs for this period were thus reduced by a total of \$1,216,000,000 as evidenced in Table 16. In the interim the statutory

¹54 U.S. Stat. at L. (1940), 572, "An Act to authorize the purchase by the Reconstruction Finance Corporation of stock of Federal home-loan banks; to amend the Reconstruction Finance Corporation Act, as amended, and for other purposes," sec. 2.

²See p. 301. See also Table 16.

limit had been raised (on February 19, 1941) from \$49,000,000,000 to \$65,000,000,000 and the necessity for borrowing from the public ceased. The President, in his 1948 Budget Message, recommended that the authority of Government corporations to issue guaranteed obligations to the public be repealed and that they be limited in the future to borrowing funds solely from the Treasury.¹ Since that time the RFC was solely financed by the Treasury, its borrowings reaching a total of over \$10,000,000,000 as shown in Table 16.

It is believed that centralized financing by the Treasury avoids competition in the investment market between the Treasury and other Government agencies and makes for fiscal efficiency and economy.² This is considered especially important at the present time because of the magnitude and complexity of the problems involved in the management of the public debt.³ In a few wholly owned or mixed-ownership Government corporations where authority still exists for issuance of debentures to the public, the Secretary of the Treasury, under section 303(a) of the Government Corporation Control Act, must approve any issue as to form, timing, maturity, and price.⁴

¹"Address of the President of the United States," Congressional Record, vol. 93, pt. 1 (January 6, 1947), p. 135. And also U.S., Congress, House, "Budget Message of the President and Summary Budget Statements," House Document (Doc. No. 19; 80th Cong., 1st sess.), p. M58.

²Sidney D. Goldberg, and Harold Seidman, The Government Corporation: Elements of a Model Charter (Chicago: Public Administration Service 1953), p. 20.

³Ibid.

⁴59 U.S. Stat. at L. (1945), 579, "Government Corporation Control Act," sec. 303(a).

Table 16

NOTES OUTSTANDING TO THE TREASURY AND TO THE PUBLIC, AND CAPITAL STOCK¹

| Date | Capital Stock | Notes | |
|---------------|---------------|----------------|----------------|
| | | To Treasury | To Public |
| Dec. 31, 1932 | \$500,000,000 | \$ 810,000,000 | 0 |
| Dec. 31, 1933 | " | 2,350,000,000 | \$ 180,025,854 |
| Dec. 31, 1934 | " | 3,585,000,000 | 249,336,666 |
| Dec. 31, 1935 | " | 4,095,000,000 | 252,459,666 |
| Dec. 31, 1936 | " | 3,685,000,000 | 251,724,666 |
| Dec. 31, 1937 | " | 3,605,000,000 | 297,272,666 |
| Dec. 31, 1938 | " | 754,796,054 | 508,979,000 |
| Dec. 31, 1939 | " | 10,898,445 | 1,096,057,000 |
| Dec. 31, 1940 | " | 22,804,250 | 1,096,757,000 |
| June 30, 1941 | " | 0 | 1,741,449,000 |
| Dec. 31, 1941 | 325,000,000 | 804,770,000 | 1,801,613,000 |
| June 30, 1947 | " | 10,009,704,982 | 0 |
| June 30, 1948 | " | 0 ² | 0 |
| June 30, 1949 | 100,000,000 | 855,176,299 | 0 |
| June 30, 1950 | " | 1,460,752,973 | 0 |
| June 30, 1951 | " | 953,015,458 | 0 |
| June 30, 1952 | " | 258,392,673 | 0 |

¹Source: U.S., R.F.C., Annual Report and Financial Statements (from 1947 through 1952), and Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, XXXIII-XXXVIII (January 1947 through December 1952).

²At June 30, 1948, the RFC had liabilities to the U.S. Government arising from national defense, war and reconversion activities, including liquidation of the Small War Plants Corporation. The RFC utilized such funds in the administration of its lending functions. See U.S., R.F.C., Annual Report and Financial Statements (June 30, 1948), p. 26.

The RFC, from its inception in February 1932 through June 30, 1947, realized \$551,901,483 of accumulated income from its lending activities.¹ However, the accuracy of the accounting of this accumulated net income was challenged by the Comptroller General of the United States in his audit report for the fiscal years 1946-1947. He recommended that the RFC should consider the following situations in its accounting:

1. The Corporation has had the interest-free use of from \$325,000,000 to \$500,000,000 dollars of Treasury funds received in payment of the Government's subscription to its capital stock, as well as the interest-free use of retained accumulated income which at June 30, 1947, aggregated approximately \$552,000,000.
2. The interest rate paid to the Treasury for funds borrowed by RFC was substantially less than the average rate at which the Treasury was able to borrow from the public.
3. RFC has borrowed large sums of money from the Treasury which it, in turn, re-loaned to other Government agencies at a higher rate of interest than that paid to the Treasury.
4. Certain additional costs incurred by the Government for the account or benefit of RFC or its employees were not allocated to the Corporation.²

The Comptroller General estimated that the accumulated net income of the RFC by June 30, 1947, would have been approximately \$300,000,000 less had the RFC been required to pay the Treasury's average rate of

¹U.S., R.F.C., Annual Report and Financial Statements (June 30, 1947), p. 15.

²U.S., Congress, Report on Audit of Reconstruction Finance Corporation and Subsidiaries for the Fiscal Years Ended June 30, 1946 and 1947 (House Doc. No. 468; 81st Cong., 2d sess.), p. 34.

interest on funds used in the lending activities.¹

By June 30, 1952, the RFC reported \$606,050,437 of accumulated net income from its lending activities.² In the meantime, by the same act which made the RFC retire \$225,000,000 out of its outstanding capital stock of \$325,000,000 in July 1948, the RFC was directed to reduce to \$250,000,000 its retained accumulated net income.³ Under this provision, the RFC reduced its accumulated net income at June 30, 1948, from \$557,391,555 to \$250,000,000 by payment of \$307,391,555 to the Treasury in December 1948. The foregoing change in capital structure reduced by over \$525,000,000 the interest-free funds used in the lending activity. After that the RFC operated on a capital stock and accumulated net income aggregating only \$350,000,000.

¹Ibid., p. 5.

²U.S., R.F.C., Annual Report and Financial Statements (June 30, 1952), p. 40.

³62 U.S. Stat. at L. (1948), 261, "An Act To amend the Reconstruction Finance Act, as amended, and for other purposes," sec. 1.

CHAPTER VII

CONCLUSION

Crisis conditions in the autumn of 1931 made government aid imperative and justified the creation of a Federal lending agency-- the Reconstruction Finance Corporation, for a temporary period of time. The main objective of the agency was to combat the depression by providing emergency financing facilities for banks, trust companies, and other financial institutions, to aid in financing agriculture, commerce, and industry through banks and other financial and agricultural institutions, and to make loans directly to railroads. In order to achieve these objectives the RFC was conceived as a powerful organization with adequate resources--\$2,000,000,000--backed entirely by the Federal Government.

Very soon after its creation, its functions and resources had steadily grown by congressional enactments, executive direction and its own assumption within the provision of law. Through amendatory and supplemental legislation, the RFC was further authorized to make loans on the assets of closed banks and trust companies, and, with the approval of the Secretary of the Treasury, to purchase preferred stock, or, if the state laws prohibited or restricted the issuance of such stock, capital notes or debentures of banks. Through further amendatory and supplemental legislation, the effect of which was to broaden extensively its original powers, the RFC, for the purpose of maintaining and promoting

the economic stability of the country, encouraging the employment of labor, and for other purposes, was authorized, generally, to make direct loans to any business enterprise, to make loans to states, municipalities, political subdivisions of states, and other public authorities, to make loans to various government corporations and agencies such as the Commodity Credit Corporation, the Export-Import Bank of Washington, and the Rural Electrification Administration, to make catastrophe loans, first directly by the RFC under specific congressional enactments and later through its subsidiary, the Disaster Loan Corporation, and to aid in the maintenance of a normal market for home mortgages insured or guaranteed by the Federal Housing Administration chiefly through its two subsidiaries--the RFC Mortgage Company and the Federal National Mortgage Association. In addition, the RFC was directed to perform certain miscellaneous functions from time to time through congressional enactments or Executive direction, such as regulating high salaries paid to corporate officials who borrowed money from the RFC, and establishing a government market for gold in the United States. The RFC even assumed miscellaneous functions which had not been specifically mentioned in any congressional legislation or Executive orders--for instance, as a result of the default of the Dawes loan, the RFC came into the utility business for a short period of time; and for the purpose of administering and liquidating the collateral acquired from the loan made to a real estate business, the RFC organized the Consolidated Realty Corporation which managed hotels, theaters, office buildings, and other miscellaneous properties for over ten years.

The RFC undoubtedly contributed materially to improvement of the economic stability of the country in the 1930's by lending money to distressed financial institutions and business enterprises, thereby staving off bankruptcy or liquidation and preventing the dissipation of billions of dollars of assets. Further, it aided in reducing unemployment by financing public and private projects. Then followed the national emergency and World War II periods.

During the national defense and war periods Congress further augmented the Corporation's functions to enable it to assist in carrying out various programs essential to the national defense and war effort, such as the financing of plant conversion and construction, providing war production facilities, acquiring critical and strategic materials, and other diversified undertakings.

In order to carry out these ever expanding functions, which had never been contemplated when the RFC was first created in 1932, the RFC created and acquired eight subsidiary corporations through which it carried on its war activities. They were the Metals Reserve Company, the Rubber Reserve Company, the Defense Plant Corporation, the Defense Supplies Corporation, the War Damage Corporation, the U. S. Commercial Company, the Rubber Development Corporation, and the Petroleum Reserves Corporation (later the War Assets Corporation).

Fundamentally the RFC was the principal financial agent for the entire Government during World War II. Not only did it handle the finance for its own account and for the accounts of its numerous subsidiaries, but in addition it performed activities which effectively

supplemented the appropriations of other governmental organizations--in fact, the RFC was the "backdoor of the Treasury." That is, the borrowing authority of the RFC was utilized as a means of avoiding the necessity for making appropriations of public funds, through the medium of ex post facto note cancellations by enactments of Congress. Such by-passing resulted in the advancing of \$12,500,000,000, with no opportunity afforded to appropriations committees to pass on the wisdom of the appropriations.

With the expansion of the functions in lending and non-lending activities, the borrowing power of the RFC was greatly expanded, totaling once over \$14,000,000,000. Thus, under these circumstances, the functions of the RFC evolved to such a point that Mr. Jesse H. Jones is reported to have said, "We can lend anything that we think we should--any amount, any length of time, any rate of interest, and to anybody that we feel is entitled to the loan."

The fact of the Congress delegating such authority with such discretionary powers to a single government agency was partly, yet to a large extent, explained by the personal influence of Mr. Jones, in whom the Congress had unbounded confidence. But a sound government principle cannot be built upon faith in one man, for officials are mortal and fleeting.

As the War drew to a close, the Congress started to curtail the vast wartime activities of the RFC and its subsidiaries. It must be remembered that during the War the RFC was engaged in financing the American industrial expansion at the direction of the production and military high command, and that the bulk of this vast undertaking was

accomplished through its subsidiary corporations. Some of these subsidiary corporations became so swollen with the demands of war activity that they grew larger than the peacetime RFC itself. By an act approved June 30, 1945, most of these subsidiary corporations were dissolved and their assets and records were transferred to the parent, the RFC.

When the War was won by the latter part of 1945 and depression was not in sight around 1947, the continuance of the RFC had to be justified on a basis other than that upon which its original creation was justified. First of all, the RFC performed an extremely useful and vital function during the emergencies of the depression in the 1930's and during the War. It was then reasoned that should such events recur, the existence of such an agency, already established, would permit more prompt and effective action than would be possible if an agency had to be re-created. Second, it was found that a "financial gap" existed in the private credit structure. It was further stressed that the major deficiency of the existing financial mechanism was found to be its lack of facilities for providing small businesses with equity and long-term capital financing. Thus it was reasoned that there were some limited functions which such an agency could usefully perform during periods which could not be characterized as times of economic depression or national emergency.

Thus, the RFC was extended first until 1948 and then until 1956 by the 1947 and 1948 legislation. At the same time, the Congress rewrote a new charter for the RFC which was expected to function in "normal times," repealing prior legislation which was no longer needed, and providing new

criteria under which the RFC was to function. While the new enactments in 1947 and 1948 limited the lending power and in turn the borrowing power of the RFC to \$2,000,000,000, these enactments authorized the RFC to make loans to business enterprises, to financial institutions, to states, municipalities and other public agencies, and to make loans because of floods or other catastrophes. Other functions relating to the production of synthetic rubber, tin, and abaca were to be continued under the RFC by special enactments of the Congress and by Presidential directives.

Loans to industrial and commercial enterprises expanded during this period, while loans to railroads, financial institutions, political subdivisions of states and territories decreased to an insignificant amount. The greatest increase in funds provided by the RFC was in the purchase of mortgages.

When the Fulbright Subcommittee on the RFC started to disclose the "outside influence," "personal favoritism," and "mismanagement" of the RFC operations by some of the officials of the RFC, a clamor for abolition of the RFC arose from the Congress as well as from the public. The Reorganization Plan No. 1 of 1951 by which a single Administrator replaced the five-man Board of Directors, and a Loan Policy Board was created for the purpose of setting up standards for granting or refusing loan applications, was a stop-gap for remedying the evils disclosed by the Fulbright Committee but it could not stop criticisms from those advocating complete abolition. Death was brought to the RFC when President Eisenhower signed a bill to liquidate the RFC and to establish a new Federal lending agency called the Small Business Administration. Thus the

RFC's lending authority was terminated effective September 1, 1953, and the Corporation is to be dissolved by June 30, 1954, two years earlier than the natural death contemplated under the previous law.

All political systems are the natural reflection of their historic environment, and the programs of most government corporations are "in politics" so far as their social acceptability and support are concerned. Pressure group politics are often a factor in weighing social values for creation and liquidation of certain governmental institutions. One group may loudly insist that Government lending in normal times is an open governmental interference with private enterprise, and that a Government lending agency making loans which commercial lending agencies cannot or will not make offers an open invitation to favoritism and influence. They argue that direct government lending is a gambling with tax-payers' money, a protection and perhaps a subsidization of inefficiency, and that a long-run goal of increasing the nation's productivity requires that inefficient firms be weeded out by failure. Another group may cry from a social and political instead of an economic point of view, that the Government must take action for equalizing the competitive positions of small and large businesses and for providing the small businessmen with a fair opportunity, because free-independent business enterprise is the back-bone of a free society.

When voices from the opposing group are as high as those of one's own group, and each group has some valid arguments, the groups often come to compromise in order to get at least some of the arguments of each group into legislation. For those who advocated abolition of the RFC, the Re-

construction Finance Corporation Liquidation Act and the Small Business Act of 1953, approved June 30, 1953, were not exactly what they had been requesting. They had advocated the abolition of the RFC because, among many other reasons, they alleged that direct government lending by the RFC interfered with the private enterprise system; but they now have to be content with the fact that most of the functions carried by the RFC are to be continued by the Small Business Administration or transferred to other Government agencies.

It can fairly be concluded that the RFC has been liquidated not because of the functions it performed but mainly because of the manner in which it was operated, for there appears little difference between the reasons for which the RFC was extended in normal times and those by which the new Small Business Administration was created. The latter will be another Government "direct" lending agency just as the former was, although, for the time being at least, its activities are confined to a much more limited field.

Harold J. Laski points out in his book, The American Democracy, that "most Americans have a sense of deep discomfort when they are asked to support the positive state. . . . They tend to feel that what is done by a governmental institution is bound to be less well done than if it were undertaken by individuals, whether alone or in the form of private corporations."¹ If a service cannot be performed by private enterprise, then obviously the next best thing is something which looks as nearly as possible

¹Harold J. Laski, The American Democracy (New York: Viking Press, 1948), p. 167.

like a private institution and which has a little as possible to do with Government. However, with the RFC, the Americans have experienced fighting the worst kind of depression the nation has ever faced, and have demonstrated productive ability as the "arsenal of democracy" during the last War. The twenty-two-year existence of the RFC was a good experiment for the entire nation. Should the economy of the country take such a turn in the future, or should the national security require an abnormal industrial productive expansion, the experience of the RFC will readily enable the Congress to act promptly in taking such steps as appear necessary for the protection of the nation.

Finally, the lessons learned from the RFC as a Government credit agency to financial institutions as well as directly to industry will be extremely valuable for the underdeveloped countries where private capital is about at the stage of emerging or is not yet big enough to supply adequate funds for industrial expansion which these countries need. Commercial bank facilities do exist in most of the underdeveloped areas. However these commercial banking institutions offer little scope for long-term investment proper because their operations are hampered by excessive prudence and sometimes by legal restrictions. Commercial banks were founded largely by the great mercantile countries and many of them are still controlled both as to stock and management by institutions in the advanced countries. Even when the commercial banks have been taken over by the nationals of underdeveloped areas, or when similar institutions have been established by them, their lending policies have continued on the traditional lines of short-term character or requir-

ing apparent good security, such as real estate. To meet this situation there have developed, for example, the fomento corporations of the Latin American countries. The most famous of these are the Fomento Corporation of Chile and the National Financiera of Mexico, both heavily backed by the governments of their respective countries. The Chilean Fomento has been remarkably successful both in systematic development and in economic diversification in Chile. It has established enterprises for steel, for generating and distributing power, for the manufacture of agricultural machinery, and for the production of cement, transport equipment, copper wire, and tires. The National Financiera of Mexico has been equally successful in encouraging a sort of industrial revolution. It is generally understood that other countries, especially Egypt, India, the Philippines, and Puerto Rico have also established public lending institutions resembling the fomentos. Of special promise is the Industrial Corporation of India, created in 1948 with capital contributed by the Central Government of India, the Reserve Bank of India, and some of the other financial institutions of the country.

The prolonged three-year war in Korea has brought overwhelming misery and catastrophe to the people, and large-scale devastation and destruction to the soils of Korea. The lessons of the RFC as a powerful organization with adequate resources and diversity of functions can be extremely valuable when Korea enters into a stage of reconstruction and rehabilitation. Native private capital is a trickle by comparison with the need for a reconstruction program such as is advocated by the government of Korea, while private foreign financing is no longer fashionable for

either recipient or creditor countries. A public credit organization similar to the RFC of the United States of America or to the fomento corporations of Latin American countries will doubtless be a time-honored device receiving government support and meeting the conditions of capital-furnishing countries on the one hand, while supplying funds for reconstruction and rehabilitation of the war-torn country on the other.

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