

# RECONSTRUCTION FINANCE CORPORATION

WASHINGTON

HENRY T. BODMAN  
MEMBER OF THE BOARD

May 14, 1947

Dear Marriner:

In accordance with our conversation of last evening, I am enclosing additional copy of the talk I made before The Economic Club of Detroit.

Yours very truly,



The Honorable Marriner S. Eccles  
Chairman, Board of Governors of the  
Federal Reserve System  
Washington 25, D. C.

Enclosure

May 16, 1947.

Dear Harry:

Thank you for sending me the copy of the talk you made before The Economic Club of Detroit. I was very much interested in seeing it and in noting particularly the conclusions you have drawn, and with which incidentally I would agree, as to the role of Government lending.

I am in accord also with your view that in periods of generally good business conditions Government policies should call for liquidation of loans. Likewise, I think you are right in saying that it was not intended that loans be made for the purpose of protecting private capital investments against the normal competitive risks of business. It seems to me that you correctly look through these operations to their broader underlying purpose, which basically is to help maintain and stabilize production and employment. On that basis, I should not expect you individually to see any objection to the Reserve System's having in place of its direct lending powers, the repeal of which we have recommended, a substitute stand-by authority to guarantee in part loans that would tend to accomplish this broad basic purpose and not merely protect capital against competitive risks.

It has been a long time since you came over to luncheon and I hope that remission may shortly be repaired.

With kindest personal regards,

Sincerely yours,

The Honorable Henry T. Bodman,  
Reconstruction Finance Corporation,  
Washington 25, D. C.

ET:b  


# RECONSTRUCTION FINANCE CORPORATION

WASHINGTON

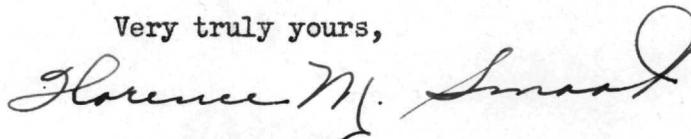
HENRY T. BODMAN  
MEMBER OF THE BOARD

April 21, 1947

Dear Mr. Eccles:

Mr. Bodman suggested I send you the enclosed copy of an address which he made before The Economic Club of Detroit on April 14th.

Very truly yours,



Florence M. Smoot  
Secretary to Mr. Bodman

Honorable Marriner S. Eccles  
Chairman, Board of Governors of the  
Federal Reserve System  
Washington 25, D. C.

Enclosure

FOR RELEASE NOON  
APRIL 14, 1947

86-7-9-10-1-14

THE RELATIONSHIP OF GOVERNMENT LENDING  
TO  
THE FREE ENTERPRISE SYSTEM

An Address

by

HENRY T. BODMAN

Member, Board of Directors

Reconstruction Finance Corporation

Before

THE ECONOMIC CLUB OF DETROIT

April 14, 1947

THE RELATIONSHIP OF GOVERNMENT LENDING  
TO  
THE FREE ENTERPRISE SYSTEM

After an absence of several years, it is a privilege to attend this meeting of the Economic Club which plays such an important part in the life of Detroit.

At a time when the free enterprise system is being weighed in the balance of world opinion, it may be appropriate to consider some of the questions which arise in the operation of that system. Detroit, which has contributed so much to our economic progress and to the American standard of living, and which in a sense so exemplifies the free enterprise system, is particularly concerned with the manner in which these questions are going to be resolved.

What I want to talk about is one of the fundamental questions which arises in the relationship of Government to the enterprise system. It is the question of lending Government money to private business. In order to illustrate some of the problems involved in this question, I intend to draw upon my experience with the RFC.

We all know that the driving force in our enterprise system is the incentive for profit. Through this incentive we develop competition. It is competition among buyers that tends to guarantee the seller that he is getting the best price for his goods or services. It is competition among sellers which protects buyers and consumers and tends to insure that they receive the most for their money. The result of this competition is to reward him the most who consistently offers the greatest value of goods or services at the lowest price. In this way the incentive for profit makes it everyone's business to improve the general standard of living.

It is the essence of this system that there should be no artificial aids or restraints, and that temporary surpluses or temporary scarcities should be recognized as conditions which will be corrected by the system itself.

This means that, for our system to work efficiently, we want as little Government as possible. Under such a system the Government's primary responsibility should be to act as an umpire to insure that unfair advantage is not taken of one group by another, and to insure that fraud and other evils which crop up are eliminated.

The business system and the natural laws of economics work with maximum efficiency when they are free from outside artificial intervention and control. To the extent that monopoly, or Government restraints or activities, are injected into the picture, the system takes on elements of rigidity which tend to prevent the free operation of those natural economic laws which are the basis of the system.

In the same way, if the Government fails as umpire to discharge its responsibility for detecting and penalizing unfair practices, the operation of the system becomes similarly impaired.

These considerations, I think, are fundamental in the concept of the enterprise system as we all want it to be. However, we started a long time ago to permit and, in some cases, to request the Government to extend its activities beyond what one would expect of an umpire. As a result of this our system has not, for a good many years, been entirely free from Government intervention in some form. For example, some of the states went into the canal business 100 years ago; the Federal Government

made land grants to the railroads to get them started; we have had special treatment for silver for at least 50 years, and the Government has been aiding agriculture for quite a while. In recent years the Government has gone into the housing business in a substantial way.

If our objective for the enterprise system is the minimum of Government intervention, assistance and activity, many of these things tend to operate against it, no matter how well justified they may be from other standpoints.

Unfortunately for all of us, the enterprise system has not always worked as smoothly as might be hoped for. It occasionally gets badly out of gear. If we think back a few years we recall that for some reason, or perhaps a variety of reasons, our economic system bogged down in the early 1930s. Whatever the causes of the last great depression were, by 1930 or 1931, the condition of our economic system had become a matter of grave national concern.

In view of the critical nature of this situation, President Hoover decided that the existence of a strong Federal lending agency would provide a bulwark against further deterioration of the economy. To this end in December 1931, he asked for, and Congress granted, authority to organize the RFC with broad powers to make loans to banks and other financial institutions for the purpose of aiding agriculture, commerce and industry.

This was a bold step. It meant that, in spite of possible long-term complications, the Government would engage in the field of private financial transactions. It would enter the lending business and make loans to private institutions.

It is essential to recognize, however, that the loans were not made for the purpose of saving the banks for their stockholders. The true basis was the public interest involved in preventing economic collapse by coming to the rescue of the large number of individuals and business concerns who were the depositors of the banks. To save the economic system of the country it was necessary to save the depositors; to save the depositors it was necessary to save the banks.

In considering the consequences of the decision to put the Government into the lending business, it may be interesting to have a look at the results of the operation of the RFC as a lending institution since its inception in 1932.

The chart before you shows the amount of loans and investments which RFC has held at various times from 1932 to date. It shows, as of each calendar quarter, the major types of loans and investments in RFC's portfolio (excluding loans to the United States and foreign governments). By the end of 1934 the total RFC credit outstanding amounted to almost \$3 billion. Of this amount, \$1.7 billion represented loans to or investments in banks and other financial institutions. These were equivalent to 77% of the total loans and investments held on that date, excluding loan commitments.

It will be observed that in the years beginning in 1935, the banks which had obtained RFC assistance began to repay their loans and to retire the preferred stock which RFC had bought. These repayments have continued at a fairly rapid rate with the result that, in comparison with the maximum investment of \$1.7 billion in 1934, the total amount owing RFC on these loans and investments in banks is today only about \$200 million.

The segment on the chart marked "Public Purpose Loans" consists of investments made in such projects as drainage districts, irrigation districts, special municipal authorities and the like. In this category are included two projects that were very large and which may be worthy of special mention. The first of these was a \$179 million loan made in the early 1930s to the Metropolitan Water District of Southern California to finance the construction of an aqueduct from the Colorado River to Los Angeles. This loan was later sold by the RFC to private investors at a profit. A second large loan included in this group was one for about \$70 million for the construction of the San Francisco Oakland Bay Bridge. This loan likewise was sold to private investors at a profit in 1939. Such "Public Purpose Loans", which reached a peak of \$417 million in 1938, have since been liquidated to the present balance of \$114 million.

The next type of RFC asset shown consists of loans to railroads. In comparison with a figure of \$494 million of such loans held in 1936, total loans and investments in railroads now amount to only \$153 million.

Under the caption "Mortgage Loans" are included loans, made or purchased, on real estate properties by RFC and its subsidiary companies. These include loans on both residential and business properties. Loans of this type reached a peak of \$309 million and have been sold or liquidated almost completely, the total of such assets now held amounting to only \$19 million.

At the bottom of the chart is a segment marked "Business Loans" which represents loans made to ordinary business concerns such as those

engaged in manufacturing, trade and other industries. Loans of this type were first authorized by an amendment to the RFC Act passed in 1934 as the result of a belief that many worthy industrial borrowers were unable to get necessary bank credit due to the condition of the banking system immediately following the 1933 crisis. This situation, it was believed, was retarding the improvement in business and employment conditions which was the Nation's number one problem. In an effort to solve this problem, Congress, in 1934, authorized the RFC to make loans to any business enterprise for the purpose of stimulating business and promoting employment.

The law provides that such loans can be made if they are so secured as reasonably to assure repayment, but only if credit cannot be obtained from private sources on reasonable terms. RFC is not authorized to compete with private lending institutions.

The purpose of authorizing the RFC to make loans to ordinary business concerns was to alleviate the general unemployment situation of the '30s. This very broad authority, which is still in effect, is, I think, too general under present economic conditions. It was not intended that loans be made for the purpose of protecting private capital investments against the normal competitive risks of business.

At the beginning of the war emergency, RFC was given very broad authority to make loans for national defense purposes. These are also included as "Business Loans" on the chart, in the upper part of that portion of the bar.

You will note that the peak of "Business Loans" outstanding was reached in the latter part of 1944 at just over \$500 million and that since the war there has been a marked liquidation to the present figure of \$267 million. Of this latter amount, only about 20%, or \$54 million, represents loans of the non-war type.

Taking an over-all view of the chart, it can be seen that a peak in total loans and investments was reached in 1935 at about \$2.3 billion, and that a later peak of \$1.9 billion came during the war period. Since then these loans and investments have been reduced to three quarters of a billion dollars---a reduction of nearly 60%. The volume of loans now held is at the lowest point since the RFC first got under way in 1932. This liquidation in loans since the war period is consistent with my thoughts on what the RFC's policy should be during periods of good general business conditions.

There is one portion of these bars which we have not talked about. That is the segment marked "Automatic Participations with Banks". This was an arrangement inaugurated just before V-E Day to assist in the financing of small business concerns during the reconversion period. Under it the RFC, in effect, automatically guaranteed up to 75% of certain small loans made by approved banks. The chart shows that as of December 31, 1946, RFC was, in effect, guaranteeing over \$250 million of such loans. It will be noted that this is the only lending activity which expanded in 1946. The RFC discontinued the practice of automatically guaranteeing loans last January.

In the aggregate, RFC has loaned about \$8.3 billion, of which \$7.5 billion, or about 90%, has been repaid. It has taken losses of about \$22 million on these loans and has set up reserves out of earnings of over \$100 million to cover losses which may be realized on the \$750 million of loans still held. After deducting these losses and reserves and the expense of handling the loans, including interest on money borrowed, the earnings made to date by RFC on its lending activities are in excess of \$500 million.

In its war activities, the Corporation was assigned many responsibilities totally unrelated to the purpose for which it was originally organized. It handled for the Government the construction of over \$8 billion of plants and facilities for the manufacture of war products; it arranged for and supervised the construction and operation of some 50 plants for the manufacture of synthetic rubber; it purchased \$12 billion of war material covering every conceivable item from 13 billion gallons of aviation gasoline to metals and minerals bought in 51 foreign countries; it trained pilots for South American airlines and borrowed \$370 million worth of silver from the U. S. Treasury for use in war plants in place of copper.

In all, a total of \$23 billion was spent or invested for these and other war purposes by RFC. Its war activities were staggering in scope and size and completely overshadow the Corporation's normal peacetime operations. The net unrecoverable cost to the Corporation of these war operations to June 30th last is estimated at \$5.5 billion. All of these war activities are being wound up as rapidly as possible.

Returning now to the non-war phases of RFC, it may be interesting to inquire what we can learn from our experience with the Government as a lender of money. One thing is that it got into the lending business in the first place as the result of a widespread public demand for the Government to intervene because of the economic consequences which were contemplated in the event of its failure to do so.

But we can also learn that if the Government is not to intervene, or take an active part in business affairs (which it will do if sufficient pressure is brought to bear upon it), we must all exercise a greater degree of patience in adversity and the greatest degree of restraint at all times in asking the Government for help.

I strongly believe that all elements of the enterprise system must practice a high degree of restraint as a matter of principle if our system is to remain free from Government intervention and controls. We must resolve to deny ourselves the apparent short-term benefits of Government assistance if we are to preserve and maintain the long-term advantages of the enterprise system.

It is, therefore, disturbing to me to note that in the past year there have been numerous instances of particular industries which have requested the Government to interfere with the laws of supply and demand for their special benefit. While various groups, besides industry groups, including labor, have been guilty of special pleading, it is my opinion that if the enterprise system is to survive, business must set the example by not asking for help, even when the going gets rough.

I say this particularly because in recent months certain members of the banking profession, and other fields of endeavor, have yielded to the temptation to lean on the Government. At a time when the banking system should be able to look after itself, there have been too many instances in which banks, opposed in principle to Government lending, have asked the RFC to go into partnership with them by sharing the risk on loans they would not otherwise make. Continued requests for Government help will surely lead to further Government intervention.

Nevertheless, no matter how good a job we may do of resisting the temptation to lean on the Government, experience has shown that from time to time we get into periods of economic crisis, such as 1932, when the Government will be called upon to step into the picture. One of the things it is certain to be called upon to do is to make loans. If that is the case, and I am afraid that it is, it appears to me that this would be the proper time to adopt some principles pertaining to Government loans. It would seem safer to formulate these principles at a time like the present when there is no economic crisis, than to take a chance on making a good last-minute decision when we are up against the gun.

To this end, and because I suppose it is my business to do so, I would like to try to answer what I think is the \$64 question about the Government being in the lending business. I have given that question a lot of thought in the past year that I have been with the RFC and will venture the following conclusions.

First: I believe that, with proper safeguards, the Government would be justified in lending its credit to stimulate economic recovery in a period of financial crisis such as we had in 1932 and 1933. Although such lending constitutes "Government-in-business", it is the kind of action which may become necessary in the national interest and was regarded as such when the RFC was conceived in 1931.

Second: Even in prosperous times, there may be certain projects which, from a national defense standpoint, need to be undertaken but which private capital may be unwilling to undertake. Some projects are too large. Some are not attractive from a profit standpoint. There is rarely much of a profit incentive in peacetime in the enterprise system to undertake projects which are beneficial from the standpoint of national defense. Often there is no financial incentive to develop or preserve natural resources unless a special inducement is provided by the Government. Sometimes this inducement may best be provided by loans from the Government which cannot be obtained from private sources. This may become necessary in view of the importance of natural resources to our national defense position.

Third: Occasionally, there may be loans which, in the public interest, should be made, in good times or bad, to protect our domestic or foreign position. This category of loans is difficult to define, and I have been unable to write a general formula describing it. But there are a few specific examples. One is our air transport system which may need financial assistance in the next few years. There may be certain railroad situations in need of temporary financial assistance to preserve vital transportation

in the years to come. I think there is a basis on which such help may properly be provided by the Government in the absence of private capital. In a world which is moving as rapidly as ours, there will undoubtedly be other purposes of the same general character and importance for which Government credit may have to be extended.

Beyond these three types of loans,- those to overcome a national financial crisis; those in the interest of national defense or for which resources must be preserved or developed; and those of a special nature which I have yet successfully to define (except by analogy and example), I feel that loans for other purposes, if justified at all, must be regarded in the nature of social objectives. If we attempt to achieve too many objectives by means of Government lending, we may find that the long-term disadvantages of such programs will more than offset the immediate gains in other directions.

Having ventured to draw these conclusions, I feel that I should add a word of caution. Although I believe that the Government may be justified in lending its credit to stimulate economic recovery in a period of severe financial crisis, I also believe that no bureau should be put in the position of having to decide whether, at any particular time, the financial crisis is severe enough to warrant such action. The decision to use the taxpayers' money for this purpose is of such tremendous social, economic and political significance that it should not be left to any one bureau of the Government.

My experience also convinces me that, except in times of crisis, a broad authorization to a bureau to make loans for general purposes is extremely dangerous. The bureau, or the responsible individuals in any bureau

which is so empowered, will be subject to tremendous pressure from those who believe that Government intervention and activity are desirable or essential as a general proposition.

We must remember that Congress has the responsibility for the basic decisions regarding the extent to which the Government is to be in business. If Congress is going to adopt a policy of Government lending, it must be specific, so as to relieve the bureau from responsibility for policy decisions which are the province of Congress itself, and from pressures which mere administrative officials may find it impossible to ignore.

We have all noted with dissatisfaction, and even with alarm, the recent tendency of Congress to announce a broad general principle, and to leave it to an administrative body to work out nearly all the important policy determinations. In many cases Congress has gone too far in subcontracting the job of writing the rules.

I fully recognize the magnitude of the job which Congress has, and the limitations which sometimes prevent the careful investigation and analysis of all the questions which come before it. A certain degree of delegation will, of course, be necessary. However, I am hopeful that the extent of it can be curtailed. It will be interesting to observe whether the Congressional Reorganization Act will permit of more time and study of such problems and a better appreciation of just what is involved in some of the policy decisions which heretofore have been left to the administrative agencies.

If our system of free enterprise is not to be hampered by an increasing degree of Government control and intervention, we must practice the self-restraint I have advocated. We cannot expect to have a free enterprise system if, individually, we are to turn to the Government for help whenever it is convenient to do so. Neither can the Government underwrite the normal business losses which are an essential part of the profit system.

When all the world is looking to us as the last bulwark of freedom and opportunity, we must demonstrate that the enterprise system, based on free competition and the incentive for profit, will continue to afford the highest standard of living the world has ever known.

\* \* \* \* \*

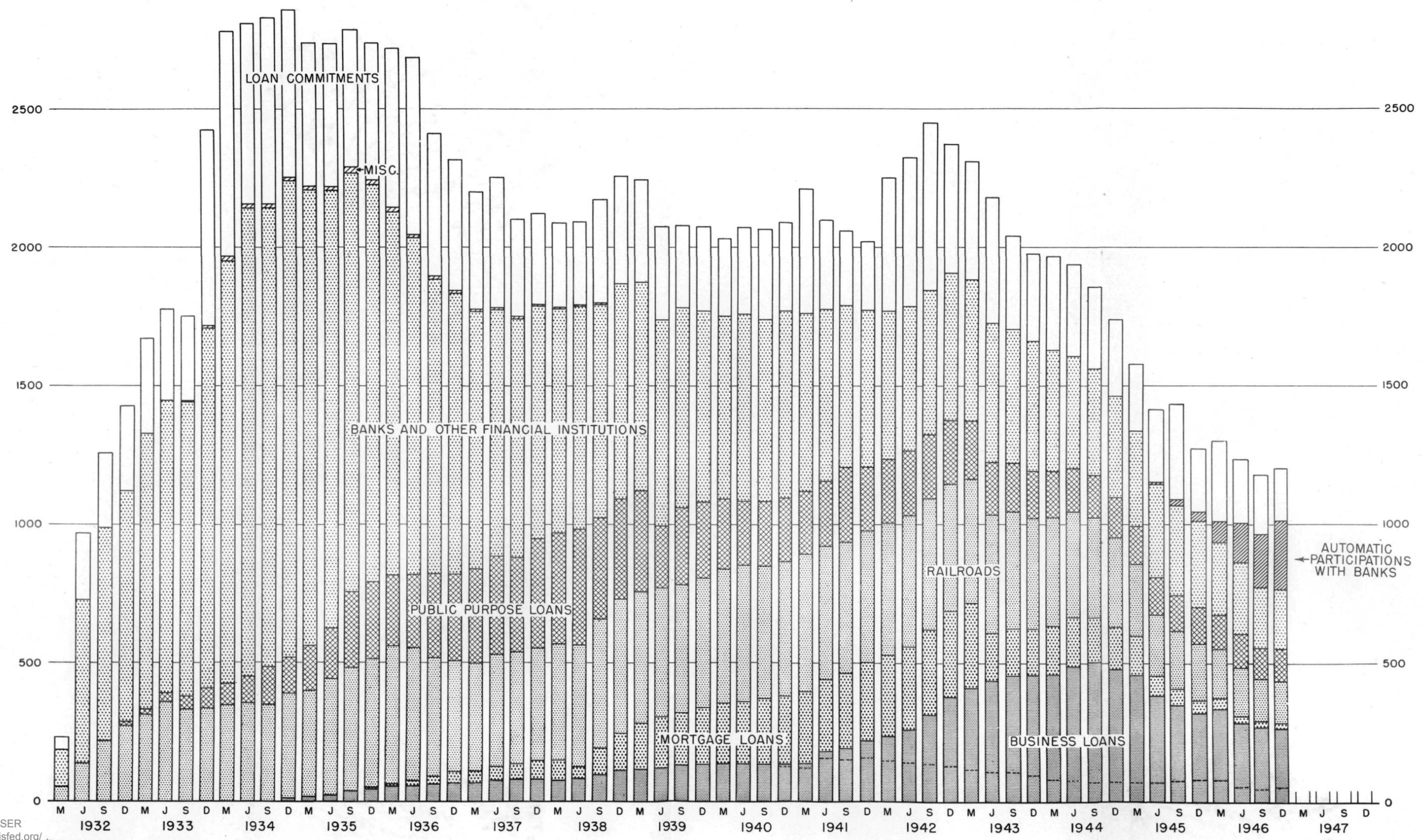
# R.F.C. LENDING ACTIVITIES\*

## TREND OF LOANS AND INVESTMENTS OUTSTANDING

1932 - 1946

MILLIONS OF DOLLARS  
3000

MILLIONS OF DOLLARS  
3000



Digitized for FRASER  
<http://fraser.stlouisfed.org/>  
 Federal Reserve Bank of St. Louis  
 \*Excludes loans to, and investments in, U. S. and Foreign Governments.