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FINANCING OF TERMINATED WAR CONTRACTS,
THE SALE OF GOVERNMENT OWNED WAR PLANTS AND EQUIPMENT,
AND RESUMPTION OF PEACETIME PRODUCTION.

Current discussions have brought to the forefront the financial problems relating to the termination of war contracts and to the adjustment of business to peacetime conditions. It is imperative that definite plans be made now for handling these problems so that our return to peacetime production will not be held up because of a lack of adequate financing.

Many proposals have been advanced on the assumption that there will be a need for widespread financial support by the Government in order to insure a prompt resumption of peacetime production. This assumption overlooks in part the fact that business generally has been rapidly increasing its supply of cash and its equivalent. Available statistical information indicates that after the settlement of war contracts American business will have a greater volume of liquid assets than ever before. It is true, however, that many business enterprises, including those which have invested heavily in plant facilities and equipment, will not be able to resume peacetime operations without financial assistance, in many cases beyond that available through normal financing channels. In such cases some degree of Government participation in financing will be necessary. Some enterprises that have had no war contracts but whose business has been drastically curtailed during the war may also find themselves in need of Government assistance in financing their post war operations.

PRESENT AND PROPOSED FINANCING FACILITIES

In this memorandum there will be set forth first the present facilities provided by the Government for financing various types of businesses (other than agricultural), followed by suggestions as to the additional facilities that should be provided. It will be noted that some of these present facilities were established to make loans to business during a depression emergency but have nevertheless been of considerable use in financing the war effort. Other facilities were set up for the express purpose of financing war production. One of them (the V and VT loan program) also provides some protection against the financial hazards of termination to those businesses that make arrangements therefor before the cancellation of their contracts.

1. PRESENT FACILITIES

V Loans - Shortly after the beginning of the war it became apparent that without Government assistance adequate financing was not available to many business enterprises, particularly subcontractors and many of the prime contractors whose operations had been or were about to be expanded several times over their peacetime volume. To supply this need the President issued Executive Order #9112 on March 26, 1942, under which the War Department, Navy Department, and the Maritime Commission guarantee financing institutions against loss on loans or commitments made for the purpose of financing war production contracts. As authorized by the Executive Order, the Armed Services and the Maritime Commission have used the Federal Reserve Banks as

their agents in carrying out the provisions of the Executive Order. All operations of any Federal Reserve Bank under the Order are subject to the supervision of the Board of Governors and to such directions and conditions as the Board may prescribe after consultation with the Armed Services and the Maritime Commission. Under this program, applications through the Federal Reserve Banks for 5,023 guarantees on loans aggregating more than 6.2 billion dollars had been approved up to November 30, 1943. As of the same date about 4.6 billion dollars of such credit was available to borrowers, including loans outstanding of about 1.8 billion dollars. Of the existing facilities for financing war production it is evident that the V loan program has been the most important, except as regards plants and machinery, the bulk of which have been provided by the Defense Plant Corporation and the Armed Services and the Maritime Commission through the expenditure of Government funds.

VT Loans - During the summer of 1943 it became increasingly evident that many businesses engaged in war production were reluctant to take on additional contracts because of the fear that their working capital would be tied up in war production contracts at the termination of the war. They felt that this would delay their return to peacetime operations and thus put them in an unfavorable competitive position. In order, therefore, that war production might be continued at a maximum, it was necessary to provide some means whereby contractors could obtain funds for the purpose of freeing their own working capital after cancellation of their war contracts by the Government, as well as funds for war production purposes. This broadened V loan program was announced on September 1, 1943. The plan enables contractors who make arrangements in advance to obtain the use of most of their own working capital promptly upon termination of their contracts and should greatly minimize the financial problems of such contractors at termination. The maximum amount of the credit which the contractor may draw down under such an arrangement is based upon his receivables, inventories, work in process, and amounts paid or to be paid by him to subcontractors or suppliers because of contract cancellations. Sixty-seven VT loans approved to the end of November aggregating \$711,000,000 are included in the figure of V loans given above.

This program, however, will by no means take care of all the cases where post termination financing will be needed, for there are many businesses which either are not acquainted with the program or do not now foresee the financial needs which will confront them upon termination of their contracts. In addition, the attorneys for a few of the larger banks have expressed some doubts about the legal authority for the program. For these reasons, it is probable that large numbers of business concerns engaged in war production will not have availed themselves of the V loan program prior to the time their contracts are cancelled. At that time, however, many of them will urgently need to arrange in some way for the prompt freeing of their working capital, and this they will not be able to do under the V or VT loan programs, because after termination of contracts guarantees are not available under the Executive Order authorizing such loans. Hence it is highly important that provision be made now, through the legislation discussed hereafter, for financing such concerns pending payment of their claims under cancelled contracts. Otherwise

many of them will not be in a position to readjust their operations quickly to peacetime production.

Industrial Loans by Federal Reserve Banks - In 1934, when many business enterprises were finding it impossible to obtain adequate financing to carry on their normal business operations, Congress, upon the recommendation of the Board, added to the Federal Reserve Act Section 13b authorizing the Federal Reserve Banks to make credit available to business enterprises under certain conditions and subject to such regulations as the Board might prescribe. Because of restrictive provisions of the statute, however, the Reserve Banks have been unable to make credit available to many worthy business enterprises. In order to enable the Federal Reserve Banks to more fully assist in the financing of the resumption of peacetime activities after the war, Section 13b of the Federal Reserve Act should be amended to remove unnecessary hampering restrictions. A proposal to this effect is set forth later on in this memorandum.

Reconstruction Finance Corporation - The Reconstruction Finance Corporation, established pursuant to the Act of January 22, 1932, has broad authority to purchase obligations of and to make loans to business enterprises, as well as various types of financing institutions. It also has authority to purchase stock in such enterprises. Section 5d of the Act, as originally passed in June 1934, authorized the Corporation to make loans similar to those authorized by Section 13b of the Federal Reserve Act. Section 5d, however, has been amended on several occasions so as to broaden the Corporation's authority and remove many of the restrictive provisions contained in the original Act.

Smaller War Plants Corporation - The Smaller War Plants Corporation was created by the Act of June 11, 1942, to meet claims on the part of small business enterprises that they were unable to obtain war production contracts, or in some cases to carry on essential civilian operations, because of a lack of adequate financing. The Corporation is empowered to make loans for war or essential civilian purposes, and recently announced a program under which bank loans up to \$25,000 would be made in the field, with an agreement by the Corporation to purchase on demand the entire amount of each such loan. This, in effect, amounts to a 100 per cent guarantee. The capital of the Corporation is \$150,000,000. It is understood that to November 30 the Corporation had approved 1,030 loans amounting to \$48,307,000.

2. FINANCING TERMINATED CONTRACTS

The War Department has asked Congress for legislation which, briefly described, would authorize the Armed Services and certain other procurement agencies to make advance or partial payments or direct loans to prime contractors and subcontractors whose war production contracts have been terminated; or to guarantee such loans when made by financing institutions. The proposal also provides for an allowance of interest by the Government at the rate of 2-1/2 per cent on amounts payable upon terminated contracts. There was introduced in Congress late in October a Bill, H.R. 3518, which, in general, is

similar to that proposed by the War Department but by its terms is applicable only to the Navy Department and not to the procurement agencies.

It is important both from the standpoint of war production and the prompt resumption of peacetime operations that the proposed legislation have the early consideration of the Congress. Its adoption will assure business enterprises of an opportunity promptly after the cancellation of their contracts to liquefy their working capital tied up in such contracts and thus put them in a position to employ their facilities in peacetime production. If legislation in this respect is postponed until the end of the war, many thousands of applications for credit will be received at approximately the same time, the functioning of which would take weeks, if not months.

In making this proposal the War Department has urged that terminated war production contracts be settled as promptly as possible through negotiations conducted by procurement agencies and that such settlements be not subject to reopening by any agency of the Government except for fraud. This position of the War Department has been endorsed by the Navy Department, the Maritime Commission, and other Governmental agencies and officials. More recently it has been endorsed by the Federal Advisory Council and the Board of Governors of the Federal Reserve System.

There is also pending in Congress a proposal (the Murray-Patman Bill) which would require the Smaller War Plants Corporation to make a loan, interest free, to any concern employing less than 500 people in an amount, if requested by the applicant, up to 75 per cent of its claim on a terminated war production contract. It is understood that this proposal is not concurred in by the procurement agencies.

3. FINANCING DISPOSAL OF GOVERNMENT-OWNED WAR PLANTS, MACHINERY, ETC.

At the end of the war the Reconstruction Finance Corporation's subsidiaries, the Armed Services, and the Maritime Commission will have large investments in plants, machinery, finished goods, work in process, and raw materials, much of which will not be needed by the Government after the cessation of hostilities. Consequently, adequate authority should be available for their prompt sale or lease for use in peacetime production. The sale or lease of such property whether to the concerns now using it or to other private interests and whether by means of negotiated contracts or public sale, should be made in such a manner as will best assist, not retard, resumption of civilian production. In order to accomplish this as rapidly and efficiently as possible the sales and leases should be supervised and coordinated by a single Government agency. Such agency should also be responsible for the prompt removal from private plants of all Government-owned machinery which is not to be sold or leased for use in the plants in which located. Subject to the overall policy of such agency as may be given this authority, it would seem that the best possible arrangements for the sale or lease of Government-owned property could be made by the Government procurement agencies that have control of the property.

The R. F. C. apparently has adequate authority to arrange for the sale or lease of property owned by it or its subsidiaries under such terms and conditions as will be most advantageous to the national economy. The aggregate amount of its plants and machinery adaptable to peacetime use is greater than that of any other Government agency. Therefore the disposition of this property in the right manner will be an important aid, both in the reconversion of war industries and in the resumption of civilian production. The Armed Services and the Maritime Commission should likewise have adequate authority. It is suggested, therefore, that legislation be enacted now granting the War and Navy Departments and the Maritime Commission such authority as is necessary to enable them to sell or lease their surplus property on such terms as they may deem appropriate in the public interest and to guarantee loans made by a financing institution to finance the purchaser of such property. Such legislation should include authority for the Armed Services and the Maritime Commission to use the Federal Reserve Banks as fiscal agents of the Government in arranging for the guarantee of loans in a manner similar to that now followed in making V loans. It would not seem desirable for the war agencies to retain title to or control over any property sold or leased for any extended period after the termination of the war. Accordingly, the legislation should specify the time on or before which a designated civilian agency of the Government should take over the sales contracts, leases and guarantees executed by the Armed Services and the Maritime Commission and assume all rights and obligations in connection therewith.

4. FINANCING RESUMPTION OF PEACETIME BUSINESS.

It should be kept constantly in mind that after the war is over and funds tied up in war production contracts have been freed, not only will business enterprises as a whole have a large volume of cash and other liquid assets, but individual and institutional investors will also be in possession of large supplies of funds seeking investment. This large supply of private funds will go a long way toward supplying the capital and credit needed to finance the prompt resumption of peacetime business. Government policy should encourage in every feasible way the flow of these private funds into the financing of post war business. However, many business concerns, as pointed out in the first part of this memorandum, will need financing beyond that which can be obtained from banks and other private investors without Governmental assistance. This will include concerns engaged in a new business or a different type of business than before the war. Such financing should, insofar as practicable, be supplied by private financing institutions with a minimum of assistance from the Government. In no case should such private financing institutions receive a 100 per cent Government guarantee against loss on loans made to business enterprises. Such guarantees may be justified in war time owing to the exigencies of war needs but cannot be justified in peace times when there exists an abundance of private credit and investment funds.

Smaller War Plants Corporation - Authority of the Smaller War Plants Corporation to make loans will expire under existing legislation on July 1, 1945. Since this is a war agency, it is assumed that its life will not be extended if the war is over by that time.

Reconstruction Finance Corporation - In addition to financing the sale of war plants and machinery, stock piles, etc., it is assumed that the

Reconstruction Finance Corporation and certain of its subsidiaries will continue in operation for some period after the termination of the war. However, the question may well be asked whether it should be the policy of the Government to continue in active operation during periods of prosperity and relatively full employment Government corporations established for the sole purpose of making loans to private business enterprises during the emergency of war or depression. If such emergency agencies are ever to be discontinued, it should be during a period when an abundance of private funds is available for both lending and investment.

Loans with Guarantees by Federal Reserve Banks - It is important that some permanent Governmental agency have authority to facilitate the extension of credit to worthy business enterprises whose products are of the kind needed by the country and which are unable to obtain funds from private sources.

Such an agency should have permanent functions other than the loaning of money and be in constant touch with and interested in maintaining healthy banking and credit conditions throughout the country.

The twelve Federal Reserve Banks and their twenty-four branches, operating under the general supervision of the Board of Governors of the Federal Reserve System in Washington, are in a position to extend this service economically and efficiently. The officers and employees of the Federal Reserve Banks have gained wide experience in administering the V loan program, in addition to that gained since 1934 in making loans to business enterprises in need of credit not available from the usual banking sources. Financing institutions and borrowers alike are familiar with the services of the Federal Reserve Banks in this field.

By an appropriate amendment to Section 13b of the Federal Reserve Act the Federal Reserve Banks, under such regulations as the Board of Governors may prescribe, could guarantee loans made by commercial banks to the extent that such guarantees are necessary in the interests of speedy resumption of peacetime production. Such guarantees by the Federal Reserve Banks could take the form now used in guaranteeing V loans for war production purposes.

Guarantees issued by the Federal Reserve Banks would be limited to loans which deserving borrowers could not obtain from their banks unless the losses of the banks were limited through some form of guarantee. Such guarantee should be available for both working capital and fixed capital purposes.

The Federal Reserve Banks should not be expected to use their own funds to guarantee any large volume of such loans, which would of necessity involve considerable risk, unless they are protected against the substantial losses which might result. To protect them in this respect, the \$139,299,557 which the Federal Reserve Banks subscribed to the capital stock of the Federal Deposit Insurance Corporation, pursuant to Section 12B of the Federal Reserve Act, should be made available to the Board of Governors to be used in absorbing losses on such loans. This sum has already been appropriated out of the increment resulting from the reduction in the weight of the gold dollar for the purpose of enabling the Federal Reserve Banks to make the so-called

"Industrial loans" authorized in 1934 by the addition of Section 13b to the Federal Reserve Act. To make this plan effective, the funds should be under the control of the Board of Governors so that they could be drawn upon if and when necessary to absorb losses incurred by any Federal Reserve Bank on guaranteed loans. The provisions of the Federal Reserve Act authorizing the making of these loans now provide that they must be for working capital purposes only, that they must be made to established business enterprises for periods not in excess of five years, and that they must be made on a reasonable and sound basis. These restrictions should be removed and the Act amended in certain other respects.

It is recognized that against the background of the post war picture, this program appears to be very modest. However, the 139 million odd of available funds could be used to guarantee commitments aggregating four times that amount and still keep such guarantees on a sound basis. This would provide for something over \$500,000,000 of commitments. Furthermore, as heretofore stated, this program can be authorized by Congress without any new appropriation. If it should later appear that there is need of a greater amount of financing, Congress could then be asked for additional authorization.

This plan for the use of the Federal Reserve Banks under regulation of the Board of Governors is proposed not as a primary source of post war financing but as a supplementary one. The most important means should be private funds, principally those of banks and institutional and individual investors, without any Governmental participation. Another important source should be the sale or lease by Government agencies of their plants and machinery and the disposal of their stock piles of finished goods and raw materials, on terms where this is necessary. Guarantees by the Federal Reserve Banks of loans by private financing institutions would not compete with private funds, but would be a stimulant to their flow in the post war period.

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