

PERSONAL AND CONFIDENTIAL

March 15, 1946.

Dear Bill:

You may have noticed Senator Ellender's statement, quoted in last Monday's press -- I enclose the Washington Post story -- to the effect that our debt is so large that we ought not to make the British loan, the implication being, of course, that the debt would rise above the 278 billion-dollar figure he mentions if the loan is made. That is misleading to the public for the simple reason that "it ain't necessarily so."

The Budget Message estimates that as of June 30, 1947, the debt will be 275 billion dollars and that as of June 30, 1948, it will be 271 billions. While budget estimates are just that and may be upset, of course, the point is that this budget allowed for 2.6 billion dollars of expenditures on international finance for the rest of fiscal '46, and 2.7 billions for fiscal '47. Included in these totals is 500 million dollars on the British loan in the current fiscal year and 1.5 billion in fiscal '47. In other words, 2 billion dollars of the proposed total British credit of 3.75 billions to be extended over the next five years is in the budget with the debt held to a point under the figure Senator Ellender uses.

Beyond that, however, I enclose a memorandum from which you will note that the budget allows also for some 950 million dollars for the International Fund, listed as if all of it would be disbursed during the rest of the current fiscal year when, in fact, this 950 million probably will not have to be provided until 1948 or later.

As you requested, I also enclose an analysis of the RFC and subsidiaries, from which it is evident that if the present law is not extended the RFC would terminate on January 22, 1947. If pressure is brought in Congress to terminate the RFC as of that time, receipts from liquidation of its assets, as well as receipts from surplus property beyond what the budget allows for, should more than take care of all foreign credits during the next year or two without increasing the debt.

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You appreciate, I know, why I feel that if you wish to make use of any of this information, it would not be advisable to indicate its source.

Always with best regards,

Sincerely yours,

The Honorable J. William Fulbright,
United States Senate,
Washington 25, D. C.

Enclosures 3

ET:b
[Handwritten signature]

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date March 7, 1946.

o Chairman Eccles

Subject: Figures given in the President's Budget Message for expenditure on international finance.

From Mr. Knapp

The figures given in the President's Budget Message for expenditure on international finance were 2.6 billion dollars for the rest of fiscal 1946 and 2.8 billion dollars for fiscal 1947. The following table shows how these estimates were reached:

	<u>Rest of fiscal 1946</u> (Millions of dollars)	<u>Fiscal 1947</u>	
British loan	500	1500	
International Bank	64 ^{1/2}	254 ^{18/10}	<i>total</i> 2,150,000 2,150,000
International Fund	950	—	
Export-Import Bank	<u>1100</u>	<u>1000</u>	
Total	2614	2754	

The figure for the International Fund is rather misleading. It represents the United States subscription (2,750 million dollars), less the amount to be provided from assets of the Stabilization Fund (1,800 million dollars), which is regarded as an extra-budgetary item. Actually the Fund will keep only our gold contribution (687 million dollars) and perhaps 200 million dollars of working balances and hand the rest of the contribution back against our demand notes. It will then make calls upon these demand notes to replenish its dollar working balances as foreign countries draw dollars from the Fund. The dollars realized from the use of Stabilization Fund assets are almost certain to last through fiscal 1947, so that the 950 million dollars which is listed as a disbursement in fiscal 1946 probably will not actually have to be provided until fiscal 1948 or later.

Attachment

LIQUIDATION OF RECONSTRUCTION FINANCE CORPORATION

Summary

The principal facts and conclusions concerning the problem of liquidating the Reconstruction Finance Corporation, which are presented in this memorandum, are:

1. The present law provides for termination of the life of the RFC on January 22nd, 1947. Unless extended by act of Congress it would not continue in existence beyond that date and its remaining assets would be turned over to the Treasury for liquidation.

2. As of last September the total assets of the RFC amounted to more than 10 billion dollars.

3. Of this total about 8 1/2 billion represented the assets of war affiliates -- mostly plants and equipment belonging to the Defense Plant Corporation. According to a recent announcement such of these assets as they are declared surplus by the war agencies after March 25th, will be taken over for actual disposal by the War Assets Administration, an independent agency. Both the declaration of war property as surplus and the actual disposal of surplus property, including RFC assets and some \$40 billion of other property, has been proceeding slowly. It is not yet clear how much of the RFC assets will be declared surplus and how rapidly they will be so declared. Nor is it clear what assets may continue to be held by affiliates such as the Metals Reserve Company and the Defense Supplies Corporation and what may be the future of these affiliates. These present special problems.

4. Aside from these war assets and the outstanding loan of about 1/4 billion dollars to Great Britain there remain about 1 1/2 billion dollars of assets. This amount, which represents the magnitude of the liquidation problem for the RFC proper, may be roughly divided as follows:

\$600 million of loans and investments made in connection with the depression emergency.

\$500 million loaned to or invested in other government agencies.

\$400 million of business loans.

5. The loans and investments made in connection with the depression emergency are being gradually reduced. Liquidation or disposal to private creditors might be expedited somewhat, and the remaining amounts might at some early date be turned over to the Treasury for further liquidation.

6. Assets of other government agencies held by the RFC could and probably should be turned over to the Treasury, in accordance with precedent already established with respect to the Commodity Credit Corporation and the Export-Import Bank.

7. The business loans and the guaranteeing of business loans should be turned over to some permanent government agency.

A recent development that may complicate somewhat the question of liquidation of the RFC is the increase in its activities in connection with the new housing program. It has been reported that the RFC would help to finance the program through loans to new business ventures to produce materials and prefabricated dwellings. The RFC has already announced that the blanket participation agreement with banks to guarantee loans will include loans made to contractors and other business enterprises engaged in building residences.

* * * * *

At the present time, when the Government generally is liquidating its emergency war activities, it would be expedient to proceed with the liquidation of the RFC. The current major lending activity of the Corporation - loans to commercial and industrial businesses - will not justify further extension of its existence. In a small way, liquidation of the RFC might help to reduce inflationary pressure. To the extent that loans, investments, and other assets would be purchased by private financing institutions or the public, additional outlets would be provided for the large volume of private funds seeking investment, and the public debt would be reduced.

The magnitude of the liquidation problem

The principal assets of the RFC which would be disposed of in case of liquidation are shown below. (Figures are as of September 30, the latest date for which balance sheet data are available; most items appear to have changed relatively little since that date.)

(In millions of dollars)

(1) Assets of war affiliates: ^{1/}	
Land, structures, and equipment	6,875
Commodities, supplies, and materials held for sale	939
Accounts and notes receivable	100
Advances to contractors and agents	236
Undistributed charges	325
Other	127
(2) Outstanding loans from emergency financing of the early 1930's	662
(3) Outstanding loans to commercial and industrial businesses	364
(4) Loan to the United Kingdom	270
(5) Assets of nonwar affiliates, largely loans	69
(6) Loans to and investments in other Government agencies ^{2/}	499

^{1/} These affiliates, except for the War Damage Corporation with total assets of about 230 million dollars, were merged with the parent company on July 1, 1945. The figures may include small amounts for the parent company which are not segregated in the Treasury statement.

^{2/} This excludes 174 million dollars of preferred stock of the Export-Import Bank which has been taken over by the Treasury Department in October.

About four-fifths of the present assets of the RFC were acquired by war affiliates; of these the more important are 6.9 billion dollars of land, structures, and equipment - largely defense plants - and 0.9 billion of commodities, supplies, and materials held for sale. As will be elaborated later, the problem of disposing of much of this property, after it is declared surplus, has already been transferred out of the RFC. Less than 700 million dollars remain of the loans and investments made to meet financial difficulties of the early 1930's. The RFC also has about 600 million of loans to and investments in nonwar affiliates and other Government agencies. Current lending activity is largely in loans to industrial and commercial borrowers.

Liquidation of emergency agencies a Government policy

From a broad point of view an essential part of the adjustment of Government activities to the Nation's postwar needs is the liquidation of Government corporations and agencies organized for emergency conditions which have now ceased to exist. Termination of the RFC would be in line with policy declared at the time the agency was created by act of Congress, approved January 22, 1932. The RFC Act, as amended, provides (Sec. 4) that the Corporation shall have succession for 15 years, that is, until January 22, 1947, unless dissolved sooner by act of Congress. It also provides (Sec. 5d) that corporations created or organized by the RFC shall not have succession beyond January 22, 1947, except for purposes of liquidation, unless extended by act of Congress. If at the end of the 15-year period the board of directors of the RFC shall not have completely wound up its affairs, it is provided (Sec. 14) that the duty of completing such liquidation shall be transferred to the Secretary of the Treasury.

Considerable progress has already been made in liquidating two of the large emergency agencies arising out of the depression, the Home Owners' Loan Corporation and the Federal Farm Mortgage Corporation.

The legislation creating the HOLC in 1933 provided for the winding up of its affairs by 1952, and provision was made later for termination of its lending activities in 1936. In 1943 a recommendation for liquidation by June 30, 1945, was made by a Congressional Investigating Committee. Officials of the Corporation reporting to Congress opposed these plans on the grounds that losses incurred in liquidating by the earlier date would not be justified. Congress did not press the issue, and the corporation has proceeded according to original plans. Disposal of outstanding mortgage loans and properties has been proceeding ahead of schedule, largely as a result of the favorable housing market of the war period.

In 1945 Congress amended legislation relating to the farm credit system in order to provide for early liquidation of the Federal Farm Mortgage Corporation, possibly by July 1, 1946. These amendments authorized the Federal land banks to buy Land Bank Commissioner loans held by the Federal Farm Mortgage Corporation and also liberalize the authority of the Banks in making new loans by increasing the amount that may be loaned from 50 to 65 per cent of appraised normal value of farms. The latter provision is expected to make further Commissioner loans unnecessary.

Liquidation of war activities of the RFC

The RFC participated in the war largely through subsidiaries organized to carry on specific activities to aid the war program. The extent of the growth of war affiliates is indicated by the fact that on June 30, 1945, just prior to their being merged with the RFC for liquidation, total assets of the subsidiaries amounted to 8.2 billion dollars, ^{1/} compared with total assets (excluding interagency) of the parent company of 1.5 billion. The Defense Plant Corporation, which financed construction and installation of industrial facilities for war production, ^{2/} probably accounted for nearly 4/5 of the assets of all war affiliates.

Under present arrangements the War Assets Administration, an independent agency established by Executive Order signed January 31, 1946, will actually dispose of the industrial facilities owned by the RFC. The declaration of property as surplus will involve some kind of responsibility on the part of the RFC, the owning agency, but this is likely to be a routine responsibility since a war plant is not "declared surplus" until all military production in that plant has ceased. The situation at the present time is that many plants have not been declared surplus because they have a small amount of production in process for the war procurement agencies.

Information is not available on the plans for winding up the activities of other war affiliates. The greater part of their assets are commodities, supplies, and materials held for sale, owned largely by the Metals Reserve Company and the Defense Supplies Corporation. The Metals Reserve Company acquired its assets in the course of providing a reserve of strategic and critical metals and minerals for war purposes. The Defense Supplies Corporation handled war procurement problems not covered by other agencies, and also conducted RFC activities in its cooperation with OPA programs for keeping down prices on certain consumer commodities, such as butter and meats. The Defense Supplies Corporation may continue to acquire assets under OPA price-control programs.

1/ War affiliates of the RFC as of June 30, 1945, included Defense Plant Corporation, Defense Supplies Corporation, Metals Reserve Company, Rubber Reserve Company, and War Damage Corporation. U. S. Commercial Company, Rubber Development Corporation, Petroleum Reserves Corporation, and Defense Homes Corporation set up originally by the RFC, had been transferred to other agencies.

2/ Other manufacturing facilities accounting for the balance of the 17 billion dollar total owned by the Government are owned by the war procurement agencies, largely the War and Navy Departments.

In considering the problem of liquidating the RFC, it should be noted that the recent Executive Order transfers out of the RFC its functions as disposal agent for surplus war property, together with the related personnel. Under the Surplus Disposal Act of 1944 and subsequent administrative developments, the RFC had been designated the disposal agency for all capital goods, producers' goods, and consumers' goods, after declaration as surplus by the owning agency. Property of these types will constitute over 90 per cent of the disposal problem of the Government. Beginning March 25, this will all be handled by the War Assets Administration.

In general, it appears that the disposal of war property will run over a considerable period of time. By the end of 1945, about 12 billion dollars of domestic and foreign property (including nonsalable aircraft) had been declared surplus. Present estimates indicate that some 42 billion dollars more will be declared surplus in the 18 months ending June 30, 1947.

Total disposals to the end of 1945 amounted to less than 1.5 billion dollars, about one-sixth of the salable property turned over as surplus. The magnitude of the job still ahead can be illustrated by comparing the Government investment in war plants to be declared surplus (1,540 plants costing 11 billion dollars) with the progress made to date in disposing of them. Only 2.6 billion of this investment has been declared surplus, and disposal has been made of plants costing 203 million dollars.

Liquidation of remaining emergency financing of the 1930's

Outstanding loans and investments from the emergency financing of the early 1930's now total less than 700 million dollars. The RFC was the first emergency agency created by Congress for dealing with financial problems arising out of the depression. Prior to the bank holiday in early 1933 the Corporation made loans to tide over financial institutions and railroads whose assets were frozen. After the bank holiday funds for such purposes were made available to banks by investment in preferred stock, capital notes, and debentures, while loans were made chiefly to closed banks, largely to receivers and mortgage loan companies, for the purpose of expediting the payment of dividends to depositors of closed banks. RFC loans to financial institutions and railroads reached a peak of about 1.4 billion dollars in 1933; its investments in the capital structure of banks, made largely in 1934, resulted in a peak of outstanding loans and investments of nearly 2.3 billion dollars at the end of 1934.

Since the end of 1934 these early types of loans have been gradually reduced. The total, which excludes some subsequent new lending activities, had been reduced to about 1.4 billion dollars when the national defense program was started and to 660 million dollars by September 30, 1945. Figures for individual types of loans are shown in the table on the next page.

Outstanding Loans and Investments of the Reconstruction Finance Corporation, Excluding Interagency Items
(In millions of dollars)

	Dec. 31, 1934	Dec. 31, 1940	Sept. 30, 1945
Loans to financial institutions	840	172	27
Preferred stock, capital notes and debentures	834	452	248
Loans on preferred stock of banks and trust companies	47	53	45
Loans to railroads	377	474	202
Loans to drainage, levee, and irrigation districts	12	83	32
Loans for self-liquidating projects	123	36	30
Other loans	20	5	5
Securities purchased from the Public Works Admin.	2	116	73
Subtotal	2,255	1,391	<u>1/</u> 662
Loans to industrial and commercial businesses			
For national defense	-	7	324
Other	7	121	40
Loan to Great Britain	-	-	270
Contract settlement loans and guarantees	-	-	<u>2/</u>
Total loans and investments (other than inter-agency)	2,262	1,519	1,297

1/ This total was reduced by 17 million dollars by Dec. 31, 1945.
2/ Less than \$500,000.

About 400 million dollars of the outstanding loans and investments of the RFC from the emergency financing of the early 1930's could perhaps be turned over to private financing institutions under some systematic arrangement for the sale of these assets and for the writing off of losses. Into this group would fall the remaining holdings of securities purchased from the Public Works Administration (about 70 million dollars); outstanding loans to drainage and irrigation districts, and for self-liquidating projects (about 60 million); loans to railroads (about 200 million); and the 70 million of loans to banks and other financial institutions.

One of the problems to consider is the extent to which these loans and investments are likely to be attractive to private financing institutions. The unusual amount of funds available during the war has resulted in extensive repayments of private debts. The outstanding total of the group of loans and investments referred to above was reduced by about 500 million dollars from 1940 to 1945. Loans not retired during this period may represent liabilities of businesses in poor condition, a large proportion of which would be written off as losses.

It might also be possible to return to private hands a part of the remaining investment of 240 million dollars in preferred stock, capital notes, and debentures of banks; funds raised through sales of common stock could be used to take up this special RFC investment. To the extent that this could not be accomplished, the RFC investment in the capital structure of banks should be transferred to a Federal bank supervisory agency for gradual liquidation.

Loan to the United Kingdom

The loan of 1941 to the United Kingdom, secured by investments in this country and serviced by earnings on these investments, could very properly be handled by the Treasury Department. This loan had been reduced from its peak of 385 million dollars in February 1942 to 250 million at the end of 1945.

Loans to commercial and industrial businesses

Recent lending activities of the RFC have consisted of loans to industrial and commercial businesses as authorized by Section 5d of the RFC Act. Lending authority for such loans was granted in 1934, at the time that Congress amended the Federal Reserve Act by adding Section 13b authorizing the Federal Reserve Banks in certain circumstances and under certain restrictions to make direct loans, and to participate with banks in loans, to commercial and industrial businesses.

RFC disbursements for these loans to March 31, 1944 (the latest data available) totaled 300 million dollars (excluding 720 million for national defense and war purposes), compared with aggregate disbursements on loans and investments of 8 billion dollars. The outstanding amount of RFC loans under its authority had grown to about 130 million dollars when the defense program was inaugurated in 1940; as a result of loans for war purposes, the total stood at about 364 million at the end of September, 1945. By the end of 1945, as shown below, the total had declined to 339 million, reflecting a reduction of 130 million in loans for war purposes and an increase of 105 million in those for other purposes.

RFC Loans to Industrial and Commercial Businesses
(In millions of dollars)

	Sept. 30, Dec. 31, 1945		Change
	1945	1945	
Total	364	339	-25
For national defense purposes	324	194	-130
Other	40	145	+105

The RFC announced in the early part of 1945 a program for assuring adequate credit to business in the transition period. Under this program the RFC will guarantee up to 75 per cent any business loan authorized by a bank which has entered into the RFC Blanket Participation Program. By the

end of 1945, 1,100 loans, ranging from \$240 to \$350,000 and aggregating 53 million dollars, had been extended by banks under this participation plan.

Liquidation of the RFC would probably involve some arrangement whereby another Government agency would be given authority to guarantee loans made by private banks and an arrangement to transfer RFC guarantees to that agency. It might also make desirable provisions whereby private banks, possibly under a guarantee arrangement, would take over outstanding loans made directly by the RFC. RFC loans for war purposes should be liquidated and provision made for writing off any losses that prove uncollectible.

If the RFC program for lending and guaranteeing loans to commercial and industrial enterprises should become the occasion for extending the life of the organization beyond January 22, 1947, the termination date now set by law, the country would face a concrete instance of misuse of a government corporation originally created for emergency purposes. It would be preferable for Congress to use existing permanent agencies than to continue for this limited purpose an organization geared for large and varied lending activities.

RFC loans to and investments in nonwar corporations and agencies

The RFC on September 30, 1945, owned stock in two nonwar affiliates, the RFC Mortgage Company and the Federal National Mortgage Association, whose assets totaled 69 million dollars, including 56 million of home mortgage loans. These agencies were organized in the 1930's to assist in establishing a market for insured home mortgage loans. Gradual liquidation has been in process for some time.

Nonwar Government agencies - There would remain the problem of transferring to the Treasury or some other Government agency the RFC holdings of stock in and loans to other Government agencies shown in the table.

Outstanding Loans and Investments of the RFC in Other
Government Agencies ^{1/}
(In millions of dollars)

	1945 <u>Sept. 30</u>
Loans to Tennessee Valley Authority	3
Loans to Rural Electrification Administration	253
Loans to Farm Security Administration	118
Capital Stock of Federal Home Loan banks	125
	2/
Preferred stock of and loans to Export-Import Bank	174
Total loans and investments to Government Agencies	673

^{1/} Excludes affiliates of the RFC.

^{2/} Effective October 1, 1945, RFC investment in the Export-Import Bank was assumed by the Treasury.

In October, 1945, the Treasury took over the RFC investment of 17½ million dollars in preferred stock of the Export-Import Bank, in accordance with the act approved July 31, 1945, which provided that a substantial increase in the capital stock of the Export-Import Bank be subscribed by the Treasury.

The Treasury or some other agency should take over 125 million dollars of capital stock of the Federal Home Loan banks and the loans to the Rural Electrification Administration, the Farm Security Administration, and the Tennessee Valley Authority totaling 423 million and made to finance the lending activities of these agencies.

This will probably raise the question whether there should be a Federal loan agency to provide funds for loans and investments of a semi-subsidy character which are authorized for the programs of Government agencies, such as assistance in establishing Farm ownership for small tenant farmers, or development of the use of electricity in rural areas. If a loan agency is to be planned, a revamped RFC may very well be the outcome.

A precedent appears to have been established, however, for the Treasury Department, which raises the money, to supply such financing directly. Funds for emergency crop and feed loans have been provided by the Treasury and administered by a Government agricultural agency. Programs of the Commodity Credit Corporation, originally financed by the RFC, have been financed by the Treasury in recent years. The Treasury holds the Government-owned stock of the Federal land banks. If loans to and investments in Government corporations and agencies are made directly by the Treasury Department, perhaps a new Bureau or Division of the Treasury could perform the necessary functions of a "Federal loan agency." In that event Congress would perhaps have more direct control over the activities of Government agencies. In Congressional circles in recent years there have been some views that Government corporations and independent agencies may take over an increasing volume of Government activities without adequate check or review by Congress. Indirect financing through another Government corporation may be one of the elements of diffused responsibility.