

June 19, 1940

Honorable Robert F. Wagner, Chairman,
Banking and Currency Committee,
Room 301, United States Senate,
Washington, D. C.

Dear Senator Wagner:

The Board of Governors wishes to correct certain misinformation given to the Committee by Mr. Jesse Jones, Federal Loan Administrator, in his testimony before the Committee on June 14, 1940, and in his letter to you of that date regarding S. 3839.

Mr. Jones informed your Committee that he favored the amendments in S. 3839 to liberalize the types of industrial loans that may be made by Federal Reserve Banks. He coupled with this recommendation, however, a condition which would deprive the Federal Reserve Banks of the use of funds previously appropriated and specifically allocated by Congress six years ago for their use in making such loans. His proposal, if adopted, would in practical effect nullify the operations of the Federal Reserve Banks in this field.

The sum of \$139,299,556.99 which Congress set aside for this purpose in 1934 is the exact equivalent of the amount which was originally taken from the surplus of the Federal Reserve Banks for part of the capital of the FDIC. The subsequent allocation by Congress of this amount, for the purpose of making industrial loans, would merely be continued by the pending measure, S. 3839. Accordingly this fund in effect represents money already provided out of the earned surplus of the Federal Reserve Banks and its use under S. 3839 would involve no charge against the Federal budget and no appropriation,

Mr. Jones' suggestion contemplates that the Federal Reserve banks be cut off from the use of this fund and be required to fall back upon further drafts upon their capital and surplus in order to continue to make industrial loans. The capital and surplus of the Federal Reserve Banks has already been reduced to a low level (less than 1-1/2 per cent) in relation to their liabilities. The making of loans to businesses that are without sufficient financial standing to obtain credit from the usual banking sources involves a considerable risk. The Federal Reserve Banks would hesitate, and could not be expected, to make any substantial volume of such loans which might further reduce their capital and surplus through losses. The Board of Governors believes that unless the present law is made more, not less, workable, it would be preferable to repeal it altogether.

(on Bank)

Mr. Jones states that it has been "clearly proven that they (the Federal Reserve Banks) will not make" industrial loans. It is difficult to reconcile this statement with his proposal that Federal Reserve Banks make industrial loans out of their own capital and surplus. If it were a fact, as it is not, that they will not make such loans on the existing basis when one-half of the amounts used for the purpose are obtained from the fund set aside on the books of the Treasury, is it reasonable to suppose that they would make such loans wholly out of their capital and surplus? It seems Mr. Jones must have known that this proposal would in effect nullify the purposes of S. 3839.

Ordinarily the Board would not comment on statements made by the head of another Federal agency about its own operations. In this case, however, Mr. Jones quotes figures on RFC operations for the purpose of comparing them with the industrial loans activities of Federal Reserve Banks. It becomes necessary, therefore, to point out some aspects of Mr. Jones' letter that are misleading.

With respect to his statement that it has been "clearly proven that they (the Federal Reserve Banks) will not make" industrial loans, the facts are that from June 19, 1934, when both the RFC and the Federal Reserve Banks were given authority to make these loans, to January 31, 1935, when the RFC's authority was considerably liberalized, the Federal Reserve Banks made loans and participations of about 32 million dollars as compared with approximately 9 million dollars for the RFC. For the period of nearly four years ending April 1938, when practically all restrictions were taken off the RFC's authority, the Federal Reserve Banks had made loans and participations of approximately 111 million dollars as compared with approximately 105 million dollars for the RFC. It is clear from these figures, which I brought specifically to Mr. Jones' attention by letter dated September 29, 1939, not only that Mr. Jones' statement is not supported by the facts, but that during the period when the Federal Reserve Banks and the RFC operated on anything like a comparable basis the performance of the Federal Reserve Banks was better than that of the RFC.

While practically all restrictions on the RFC's authority were removed in April 1938, the Federal Reserve Banks have continued to make industrial loans in spite of the fact that none of the restrictions on their authority has been eliminated.

Mr. Jones states that the RFC was authorized to make business loans at the same time that the Federal Reserve Banks were, but that the RFC must lend "its own money, money which it borrows and repays with interest". If the Board is correctly informed, the

capital of the RFC came directly from the Treasury and all additional funds come either from the Treasury or through borrowing on the basis of the Government's credit.

Far from drawing upon additional public credit to obtain funds, as Mr. Jones contends, and as in fact the RFC does, all this bill proposes is to utilize funds derived in effect from the earned surplus of the Federal Reserve Banks and already earmarked by Congress for this use.

As to the policy of the RFC in making business loans, it is to be noted that, as of June 28, 1939, of the total authorized loans of the Federal Reserve Banks only 8 per cent had been canceled, whereas of the total authorized loans of the RFC at that time approximately 20 per cent had been canceled. Mr. Jones' figures also show that to date more than 24 per cent of the RFC authorizations have been canceled--as he somewhat vaguely puts it--"for one reason or another". "Authorized" loans are canceled, of course, not so much because the borrowers procure funds elsewhere as for the reason that the conditions attached to the loans are such that the borrower cannot or is unwilling to meet them.

Mr. Jones informed the Committee that 83 per cent of the business loans of the RFC have been for \$50,000 or less and that "small business has been the beneficiary of most of the RFC's business lending". He failed to point out, however, that of the 521 million dollars of loans authorized and commitments outstanding as of December 31, 1939, less than 17 per cent in amount consisted of loans to small business, i.e., \$50,000 or less. Mr. Jones stated that the RFC has disbursed to business borrowers about 305 million dollars, but according to page 8 of the RFC's report to Congress dated March 8, 1940, \$82,900,000 of the disbursements made by it under section 5d of the RFC Act to the end of 1939 represented loans to public bodies, not to business enterprises.

In view of the fact that Mr. Jones' statements to the Committee may have raised many questions in the minds of its members, the Board requests that I advise the Committee of my readiness to appear at an early date to testify further on the matter, if the Committee desires me to do so. It will also be appreciated if a copy of this letter be included in the Committee's record of the proceedings on this bill.

I am authorized to say that the views expressed herein are the views of the Board of Governors of the Federal Reserve System.

Very truly yours,

(Signed) M. S. Eccles

Marriner S. Eccles,
Chairman.

FEDERAL LOAN AGENCY
Washington

JESSE H. JONES
Federal Loan Administrator

June 14, 1940

Dear Senator Wagner:

In connection with your consideration of S. 3839, which deals with loans to business by the Federal Reserve Banks and the Federal Treasury, beg to advise that I favor credit to all deserving business and without too specific Congressional restrictions.

While I doubt that any great amount of good will be accomplished through the passage of this law, I would favor its enactment amended as follows:

(1) By striking out all of the first sentence of section (c) after the words "shall not exceed" (page 3, line 9) and substituting the words "the amount of the paid-in capital of said banks, plus the surplus."

(2) By striking out all of section (d).

(3) By adding a new section requiring the Federal Reserve Banks to repay to the Treasury, as collections are made, the money heretofore advanced to them by the Treasury for making industrial loans, and requiring the balance of the fund of \$139,000,000 to be covered into the working balance of the Treasury.

The Treasury needs all of its available resources, and it should not be required to hold in reserve this \$139,000,000 with which to make advances to the Federal Reserve Banks, which are tantamount to grants, to encourage them to make loans which it has been clearly proven they will not make.

With these corrections in the proposed bill, Federal Reserve Banks will be in a position to make loans direct to business and industry, lending their own funds to the extent of their capital and surplus. I believe that, if the responsibility is placed squarely upon the management of the Federal Reserve Banks, cooperating with their own members in meeting credit demands, without too many restrictions, they can and will be helpful, particularly in emergency periods.

By Act of Congress, approved June 19, 1934--six years ago-- Federal Reserve Banks were authorized to make loans direct to business to the extent of approximately \$280,000,000. To enable the Federal Reserve Banks to make these loans the Federal Treasury was authorized to advance to them an aggregate of \$139,299,557. This money was to be returned to the Treasury by the Banks at the rate of 2% a year if earned--at best in 50 years without interest.

In these six years, according to the latest Federal Reserve Bulletin, all Federal Reserve Banks combined have authorized loans aggregating \$195,351,000, but it is my understanding that they have never had outstanding at any one time more than approximately \$32,000,000. The Treasury advanced the Banks \$27,546,311, which the Banks retained in their own surplus accounts, notwithstanding they only have business loans outstanding aggregating \$11,371,000. The net result of the Federal Reserve Banks' business lending has been to build up an unearned surplus for themselves, rather than to be of any substantial help to business.

The RFC was authorized to make business loans at the same time the Federal Reserve Banks were, but it must lend its own money-- money which it borrows and repays with interest--and whatever losses it makes must come out of its own surplus and earnings rather than from the Federal Treasury.

The RFC has authorized more than 9,000 loans to various and sundry business enterprises aggregating \$550,158,688. Of these loans banks throughout the country have agreed to take participations in 2,497 aggregating \$67,793,895.

Of the 550-odd million dollars authorized by RFC and participating banks, 134-odd million dollars was canceled for one reason or another, and \$129,644,772 remains available to borrowers. Including bank participations the RFC has disbursed approximately 305 million dollars to business loans. 37% in number of these loans have been for \$5,000 or less; 53% for \$10,000 or less; and 83% for \$50,000 or less. In other words, small business has been the beneficiary of most of RFC's business lending.

306 loans aggregating \$18,535,801 have been foreclosed, and on these we expect to have approximately a 50% loss. Something over 900 loans aggregating approximately \$25,000,000 are in default. The estimate of RFC directors and executive force is that losses on

business and industrial loans will aggregate not less than 10% of the total amount of such loans.

Sincerely yours,

(Signed) Jesse H. Jones

Administrator

Honorable Robert F. Wagner
Chairman
Banking and Currency Committee
United States Senate
Washington, D. C.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 30, 1940.

To Chairman Eccles
From Mr. Vest

Subject: Letter to Senator Wagner regarding Mr. Jesse Jones' testimony on industrial loans.

Copies of your letter of June 19, 1940 to Senator Wagner, Chairman of the Senate Banking and Currency Committee, commenting upon the testimony of Mr. Jesse Jones, were sent to all members of the Senate Banking and Currency Committee, to Mr. Jesse Jones, to the Secretary and Under Secretary of the Treasury, to the Reconstruction Finance Corporation directors, to the Presidents and directors of all Federal Reserve Banks and branches, the members and secretary of the Federal Advisory Council, and the members of the Industrial Advisory Committees.

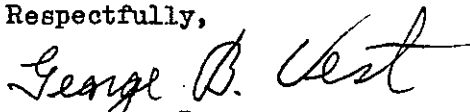
In order to be sure that the letter reached Senator Wagner and the office of the Senate Banking and Currency Committee as promptly as possible, Mr. Brennan (Mr. Bethea's secretary) personally took the signed copy of the letter to Senator Wagner's office on June 19 and left it with the Senator's secretary who said she would take it immediately to him. Mr. Brennan then went to the offices of the Senate Banking and Currency Committee and left a copy of the letter explaining that the original had been delivered to Senator Wagner.

The letter stated: "It will also be appreciated if a copy of this letter be included in the Committee's record of the proceedings on this bill". The printed hearings on this matter, however, do not include a copy of this letter.

On July 29 I telephoned the offices of the Senate Banking and Currency Committee in order to ascertain what I could regarding the omission of the letter from the printed record. The lady who answered the telephone first said she had no record of any such letter and that it was not in the file. I explained how the matter had been handled and stated that she should certainly have the copy if she did not have the original. She later called me back to say that she had located the copy of the letter in the possession of Mr. Wheeler, one of the assistants in the office; but no reason has been given as to why it had not been included in its proper place in the file of the proceedings.

Mr. Williams endeavored to check further into this matter today, but could obtain no additional facts.

Respectfully,


George B. Vest,
Assistant General Counsel.