

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date April 19, 1951

To Governor Eccles

Subject: Material with respect to

From Mr. Hackley

testimony on RFC

In accordance with your telephone conversation with Mr. Vest on April 17, we have prepared several brief documents with respect to certain points as to which we understand that you wished some information. These documents which are attached include (1) a digest of the pending RFC bills, (2) summaries of the views of Senator Fulbright and certain other Senators regarding the RFC, (3) a summary of the statement made by Mr. Cosgriff before the Senate Committee on Expenditures, (4) a statement as to the substance and history of some previous legislative proposals with respect to business loans, and (5) a general statement of the reasons why the direct lending authority of the RFC should be discontinued.

I understand that the Research Division is now working on a draft of a statement for you and I am sending Miss Burr copies of the above documents for her information and for such use as she may think desirable in connection with the statement.

I am also attaching a brief memorandum calling attention to one important respect in which the present V-loan program is not meeting certain financing needs of defense contractors.

I shall be very glad to talk with you about these documents at any time and to furnish any other assistance which you may need.

*Howard H. Hackley*  
/

**Attachments**

## PENDING RFC LEGISLATION

Several bills have been introduced in the 82nd Congress which directly affect the RFC. Included among these are the following:

S. 515 introduced by Senator Fulbright. This bill would substitute a governor for the board of directors (this has already been accomplished by the President's Reorganization Plan No. 1). The basic lending authority of the Corporation would not be changed. It would continue to have authority to make loans directly or in participation with banks to (1) business enterprises, (2) financial institutions, (3) public agencies, and (4) as may be required by catastrophes. The governor would be required to pass personally on loans of \$100,000 and over. The authority of the Corporation to borrow its funds from the Treasury would be terminated and funds would be supplied by direct appropriation which would be used as a revolving fund and on which annual payments would be required covering costs incurred by the Government in supplying the funds. The Corporation would be required to pay out of this appropriation all its existing indebtedness to the Treasury, retire its capital stock and pay into the Treasury the funds representing accumulated profits which are now being used interest free. Other provisions are generally directed toward insuring that the Corporation operate on a self-sustaining basis.

S. 514 introduced by Senator Fulbright would merely substitute a governor for the present board (already accomplished by the President's Reorganization Plan No. 1).

S. J. Res. 44 introduced by Senator Kem which provides for the termination of the powers and succession of the RFC.

S. 1116 introduced by Senator Byrd for himself, Senators Ferguson and Williams provides for the dissolution of the RFC and the transfer of the rubber, tin, and abaca programs to the Office of Defense Mobilization.

S. 1123 introduced by Senator Bricker would amend section 302 of the Defense Production Act of 1950 to authorize the President to provide for participations in and guarantees of loans made to private business enterprises for national defense purposes. The bill would transfer the rubber, tin, and abaca programs from the RFC to the Secretary of Commerce and the powers of the RFC would be terminated as of June 30, 1951.

4/18/51

## VIEWS OF CERTAIN SENATORS REGARDING RFC

The following brief summaries of the views of certain Senators with respect to RFC are based on statements made by them during the hearings on the President's RFC Reorganization Plan held before the Senate Committee on Expenditures in the Executive Departments on March 21 and 22 and April 3, 1951.

### Senator Fulbright

Senator Fulbright agreed with the President's proposal for the substitution of a single Administrator for the RFC board of directors. A like proposal had been included in the Senator's bill (S. 515) to amend the RFC Act. He also agreed with the President's proposal for establishing a Policy Loan Board, but felt that it would be desirable for the Chairman of the Board of Governors of the Federal Reserve System to be a member of that Board.

With respect to the functions of the RFC, Senator Fulbright stated that, if the RFC is to be continued at all, "the central thing in controversy, as I see it, is whether or not the agency will continue the function of direct lending to business". He stated that after due study he was somewhat inclined to favor the development of a system of guarantees similar to FHA guarantees, and that he had doubts about whether the RFC should continue to have authority to make direct business loans in peacetime. He referred, however, to the fact that RFC now has certain functions in making defense loans under the Defense Production Act.

With respect to whether there is any need for direct Government loans in normal times, Senator Fulbright indicated that there are two areas in which commercial banks do not ordinarily meet the credit needs of business: (1) Long-term loans; and (2) loans to new businesses. Regarding the latter, he expressed the thought that RFC might play a real part in making capital available for the starting of small enterprises.

### Senator Maybank

Senator Maybank stated that he did not desire to commit himself prior to the hearings which the Banking and Currency Committee would shortly begin as to whether or not the RFC should be abolished or as to whether or not some substitute plan should be put into effect under a new law which would limit its authority. He is of the opinion that legislation is necessary even under the President's Reorganization Plan in order to strengthen its administration and restrict to a large degree its lending authority. Referring specifically to the

Reorganization Plan, he indicated his belief that the Plan was not an answer to the RFC problem but is in effect the lesser of two evils. Some of his remarks pointed in the direction of some other agency taking over RFC's present activities on a standby basis.

#### Senator Kem

Senator Kem opposes the President's Reorganization Plan and favors the abolition of the RFC for the following three reasons: (1) RFC was intended to be a temporary agency; (2) the dangerous possibilities of favoritism and waste which might be even increased under a single administrator; and (3) the operations of the RFC are inflationary.

#### Senator Bricker

Senator Bricker opposed the President's RFC Reorganization Plan because he felt that it would be a barrier to consideration of pending legislation either to abolish the RFC or to change its functions and procedures.

Senator Bricker favors the abolition of RFC. If it is continued, however, he is "fundamentally opposed" to direct lending by the Government except in unusual times, and feels that the Defense Production Act adequately takes care of any present need for direct lending for defense purposes. He would favor limiting the lending authority of RFC to participations with private banks.

#### Senator Capehart

Senator Capehart opposed the President's RFC Reorganization Plan because he was opposed to a one-man Administrator and because he felt that adoption of the Plan would preclude consideration of pending RFC legislation.

He stated that he did not think that the RFC should be "100 per cent abolished". However, he indicated that it might be desirable to limit the lending authority of RFC to participation with banks and eliminate authority for direct loans. He feels that favoritism and influence in the RFC have resulted from the Corporation's authority to make direct loans and that that authority, therefore, should be taken away.

4-19-51

**STATEMENT BY MR. WALTER E. COSGRIFF, DIRECTOR OF RFC,**

**Before Senate Committee on Expenditures on March 21, 1951**

Briefly, the principal points made by Mr. Cosgriff in his statement were the following.

He favored the President's RFC Reorganization Plan because he felt that it would insure a "period of tranquillity" during which the RFC might be able to go forward with its operations with restored public confidence.

In support of the continuation of RFC, he emphasized the fact that since its inception the Corporation has made about 600,000 loans to business of which at least nine out of ten in number have been to small businesses.

With respect to the need for continuance of RFC, he expressed the opinion that many banks are refusing to make sound loans and are referring them to the RFC. He gave as his explanation of this situation the fact that the Government, through FHA and other guarantees, has taken the risk out of banking; the fact that the banks have come to depend largely for their profits on holdings of Government bonds; and the fact that bank examiners tend to criticize banks for making what seem to be risky loans.

In further defense of RFC, Mr. Cosgriff enumerated actions which have been taken by the Corporation since he became a director in October 1950, including, among other things, a requirement that borrowers agree not to employ RFC personnel for a period of two years after such personnel terminate their employment with RFC, savings in administrative expenses through reorganization, increase in interest rates on RFC loans, etc.

With respect to the use of direct loans as distinguished from guarantees, he stated that he felt that guarantees of loans are preferable and that generally banks prefer guarantees because they like to keep their customers' accounts.

4-19-51

PREVIOUS LEGISLATIVE PROPOSALS  
FOR THE FINANCING OF BUSINESS ENTERPRISES

Guarantees by Federal Reserve Banks (S. 408)

In 1947, the Board recommended a bill (S. 408) to amend section 13b of the Federal Reserve Act. Under that bill, the direct lending authority of the Reserve Banks would be eliminated. However, the Reserve Banks would be authorized to guarantee chartered banking institutions against loss on loans to business enterprises with maturities of not more than 10 years, provided the Reserve Bank in each case should be satisfied that the required financial assistance could not be obtained on a reasonable basis from the usual sources. Guarantees by the Reserve Banks could not exceed 90 per cent; and the aggregate amount of guarantees outstanding at any one time could not exceed the combined surplus of the Reserve Banks. In addition, the bill would have repealed the present appropriation provisions of section 13b, thus releasing about \$139,000,000 to the Treasury for other uses.

This bill was favorably reported by the Senate Banking and Currency Committee on April 28, 1947. In its report, the Committee pointed out that the Reserve Banks would use their own funds in making guarantees so that no drain on the Federal budget would be involved and that, because of the repeal of the authority to make direct loans, the Federal Reserve Banks would not be placed in competition with the private banking system.

National investment companies and insurance of business loans

In 1950, several bills for the creation of national investment companies and insurance of business loans were given consideration. The principal bill, the so-called Lucas-Spence Bill (S. 3625), would have provided for the insurance of business loans (Bimson Plan) by the Secretary of Commerce and for the establishment of national investment companies, to be organized and initially capitalized by the Federal Reserve Banks, with authority to provide both credit and equity capital to business enterprises. That bill would also have somewhat liberalized the lending authority of the RFC.

A similar bill, introduced by Senator O'Mahoney (S. 2975), would have provided for the establishment of investment companies by the Federal Reserve Banks but would have given such companies authority to insure business loans as well as authority to provide credit and equity capital to business enterprises.

At hearings on these bills before the Senate Banking and Currency Committee, Chairman McCabe presented a statement on June 27, 1950, in which he generally endorsed the Lucas-Spence Bill, except that he expressed preference for placing the program of insuring business loans in the proposed investment companies rather than under the Department of Commerce.

In the present Congress, Senator O'Mahoney on April 12, 1951, introduced a bill (S. 1329) which is substantially the same as that proposed by him in 1950, under which investment companies would be set up by the Federal Reserve Banks with authority to insure business loans, make direct loans or guarantees, and provide equity capital through the purchase of stocks of business enterprises.

#### Defense Plants Corporation Bill

The pending bill, S. 533, introduced by Senator Sparkman, would create a "Small Defense Plants Corporation" which would be authorized, among other things, to make loans to small business concerns to finance the construction and expansion of plants and facilities and the acquisition of equipment and supplies for defense or essential civilian purposes. Such loans could be made either directly or by participation with private lending institutions.

The Board, on April 12, 1951, submitted to the Budget Bureau a draft of a report on this bill in which it is stated that the Board believes that the Government should avoid the creation of additional Government instrumentalities for the purpose of providing credit, but should utilize to the greatest extent possible the private credit facilities of the country. In the proposed report, the Board also points out that it is important that extensions of Government credit be in harmony with present measures to combat inflation and that the number of Government instrumentalities authorized to extend credit should be kept to a minimum.

#### Small Business Coordinator

A bill introduced by Senator Maybank (S. 833) in the present Congress is substantially similar to the Defense Plants Corporation bill introduced by Senator Sparkman, except that it would vest in a Small Business Coordinator in the Office of Defense Mobilization the powers which would be vested in the Defense Plants Corporation by the Sparkman bill. The Board has made a report to the Budget Bureau on Senator Maybank's bill substantially similar to the Board's proposed report on the Sparkman bill.

4-19-51

## ELIMINATION OF DIRECT LENDING AUTHORITY OF RFC

The RFC was created in 1932 as an emergency agency for the specific purpose of assisting in the rehabilitation of the commercial banks during that period of depression and bank failures. Somewhat later, it was given authority to provide business enterprises with financial assistance which they were then unable to obtain from the usual credit sources. The purposes for which the Corporation was established have long since ceased to exist. The banks of the country now have ample resources with which to meet the credit needs of business enterprises; and, indeed, there is need now for the direction of all governmental efforts toward curtailment of credit, particularly further extension of Government credit. Accordingly, there seems no sound reason why RFC should not be liquidated.

At present, the RFC has only three functions of any significance and none of these completely justifies its continued existence. Its functions in administering the rubber, tin, and abaca programs might properly and logically be transferred to other existing Government agencies. Its role under the Defense Production Act, in connection with the making of defense loans, is largely that of an agent and could be carried out in other and perhaps more effective ways. Finally, in the field of business financing, its direct lending authority is directly opposed to current governmental measures to restrain inflation and its guaranteeing functions are now unnecessary because, to the extent that there exists a need for Government guarantees to assist in the financing of businesses engaged in essential defense work, that need can be met by the current V-loan program.

In any event, if RFC is to be continued, its authority should be limited to guarantees of loans by private financing institutions in those cases in which the necessary financing cannot be obtained from any of the usual sources of credit, including the Federal Reserve Banks, without such a guarantee. It should not have any authority to make direct loans except possibly in the most exceptional cases where such loans can be clearly justified as necessary for the national defense.

Direct loans by the RFC or any other Government agency not only increase the drain on the Federal budget, but obviously aggravate and give further impetus to the inflationary tendencies in our economy. The proceeds of such loans, when deposited in commercial banks, form the basis for additional reserves which, in turn, provide a basis for multiple-credit expansion.

At the present time, the Federal Reserve System, through regulation of consumer and real estate credit, the sponsoring of



voluntary credit restraints by financing institutions, and other measures, is actively seeking to combat inflationary pressures. The effectiveness of these measures is seriously impaired by any program of direct Government lending and it seems clear that the direct lending activities of the Government should be kept to a minimum to the greatest extent possible consistent with the requirements of the national defense.

Aside from the inflationary effect of direct loans, there are of course certain other respects in which Government guarantees of private bank loans are preferable to direct Government lending.

Any Government agency engaged in making direct loans out of Government funds is always subject to influence, political pressure, and charges of abuse. At the same time, it is necessarily placed in competition with private lending institutions and, to that extent, its activities are inconsistent with our system of private enterprise. On the other hand, guarantees by a Government agency of loans made by private lending institutions encourage a greater flow of funds from the private banking and credit system into those marginal credit risks which private institutions ordinarily would not assume, and such guarantees therefore can be utilized as a means of preserving and strengthening the private enterprise system.

As a purely practical matter, there is much less danger of "loose lending" where loans are made in the first instance by local financing institutions to local people with whose character and capacity they are familiar than where loans are made directly by a Government agency. To the extent that any governmental assistance in financing business enterprises may be necessary, that assistance should take the form of guarantees of loans made by commercial banks in those cases in which the requisite financing cannot be obtained from the usual credit sources, either because the borrower may be a small business enterprise which presents a questionable credit risk, or because the borrower requires long-term financing of a type which banks ordinarily would not provide without such a guarantee.

Government guarantees of loans made by commercial banks are now well tested as a mechanism for providing financial assistance to business enterprises. The value of this mechanism was most successfully demonstrated by the V-loan program of World War II under which authorizations for guarantees of war production loans aggregating nearly \$10-1/2 billion were processed through the Federal Reserve Banks; and the same mechanism was revived by Congress in the Defense Production Act of 1950 as a means of financing contractors under the present defense program.

The proposal that the direct lending authority of the RFC be eliminated is not new. Early in 1949, the Hoover Commission, while not agreeing with its Task Force recommendation for the outright abolition of RFC, expressed the view that direct Government lending should be avoided and recommended that Congress place restrictions on direct loans by the Corporation in order that the normal channels of credit "might be utilized to the maximum extent possible, or, alternatively, provide for the guarantee of loans made by private or other established agencies."