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WAR FINANCE CORPORATION BILL.

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Mr. Simmons, from the Committee on Finance, submitted the following

REPORT.

[To accompany S. 3714.]

The Committee on Finance, to whom was referred the bill (S. 3714) to provide further for the national security and defense, and for the purpose of assisting in the prosecution of the war, to provide credits for industries and enterprises in the United States necessary or contributory to the prosecution of the war, and for other purposes, having had the same under consideration, report it back to the Senate with sundry amendments, and as amended recommend that the bill do pass.

Before taking up the consideration of the general purposes of the bill, the committee desires to call attention to certain amendments to the bill which have been made by the committee. The more important of these amendments are as follows:

Section 3. As amended this section requires the directors of the corporation to be appointed by the President of the United States, by and with the advice and consent of the Senate, instead of by the Secretary of the Treasury, with the approval of the President of the United States.

Section 5. The amendments to this section strike out the provision requiring directors of the corporation to devote their entire time to the business of the corporation, and fix the salary of the directors at not exceeding $12,000 per annum. They also strike out the provision providing that no director or officer of the corporation shall continue to be an officer, director, or trustee of any other corporation or member of any firm of bankers.

Section 6. Subdivision (*c*) is amended so as to extend the term of advances to savings banks from 90 days to one year, and provides that the rate of interest charged on such advances shall not be less than one-half of 1 per cent per annum instead of 1 per cent per annum (as provided in the original draft of the bill) in excess of the rate of discount for 90-day paper prevailing at the time of such advances at Federal reserve banks in the district where the borrowing institution is located.

Section 6, subdivision (*d*). This subdivision has been stricken out and rewritten. As rewritten the corporation may make advances directly (1) to any corporation owning or controlling (directly or through stock ownership) any railroad or other public utility, and (2) to any firm, corporation, or association conducting an established and going business whose operations are necessary or contributory to the presecution of the war: *Provided*, That such advances shall be made only in such cases as the board of directors in their discretion shall determine to be of exceptional importance in the public interest.

These advances may be made for a period not exceeding five years from the passage of the act.

Section 7. This section has been revised so as to confer the licensing powers upon a capital issues committee to consist of five members appointed by the Federal Reserve Board, with the approval of the Secretary of the Treasury, of whom at least three shall be members of the Federal Reserve Board, and the compensation of the several members of such committee who are not members of the Federal Reserve Board is fixed at $7,500 per annum, the same to be paid by the corporation.

Section 8. The penal provisions of this section are reduced from a maximum of five years' imprisonment to a maximum of one year, and from a maximum fine of $5,000 to a maximum fine of $1,000.

The Secretary of the Treasury, the Hon. W. G. McAdoo, in his appearance before the committee presented a written statement which it is believed fully and clearly sets forth the reasons of and the necessity for this legislation as an emergency measure.

The following is a copy of such statement with certain omissions, covering interrogations by members of the committee and other changes suggested by the Secretary:

Secretary McAdoo. The proposed act to incorporate a War Finance Corporation should be regarded primarily as a measure to enable the banks, both national banks and State banks and trust companies, to continue to furnish essential credits for industries and enterprises which are necessary or contributory to the presecution of the war.

The Government's borrowings, particularly during the period immediately preceding and following each Liberty loan, have tended to preempt the credit facilities of the banks and often to prevent them from giving needed and customary help to quasi public and private enterprises. Many instances have been brought to the attention of the Secretary of the Treasury and of the Federal Reserve Board where industrial plants, public utilities, power plants, railroads, and others have found it difficult, if not impossible, to obtain the necessary advances to enable them to perform vital service in connection with the war because essential credits, ordinarily available to them, are being absorbed by the Government itself.

In Europe central banks are permitted to grant to banks and bankers loans upon stocks and bonds upon certain well-defined terms. The Federal reserve act does not provide for these, and the War Finance Corporation is designed as a war emergency to fill this gap. The provisions of the Federal reserve act which permit Federal reserve banks to rediscount and purchase commercial paper and paper secured by the Government's obligations have had the effect of forcing the banks to discriminate against loans on ineligible paper, even where such loans were vitally necessary for war purposes, in favor of loans on commercial paper even where they represented activities or enterprises not related to the war and which might well be curtailed during the period of the war. It is believed that the proposed bill has been wisely and conservatively conceived as a war measure to give relief from this condition during the war. The banks of the country would, no doubt, scrutinize with the utmost care both the loans themselves and the security therefor and would exercise their individual judgment upon the borrower's credit before assuming a liability for the amount of the loan, and also because they would be under the necessity of advancing, out of their own resources, at least 25 per cent of the amount loaned. The bill would authorize advances to a bank of only 75 per cent of the amount loaned by the bank on the notes or obligations of persons, firms, or corporations whose activities are necessary or contributory to the war.

The bill contemplates that the War Finance Corporation shall lend money to banks, both National and State, which are making loans to enterprises conducted by persons, firms, or corporations producing materials or supplies, or doing anything else which is necessary for or contributory to the war. If a bank, for instance, should loan money, we will say, to a munitions company and take the company's six months' note with the company's bond as collateral security, that note would not be eligible for rediscount in the Federal reserve banks; but the War Finance Corporation in such circumstances could advance to the bank against the note of the munitions company, so secured with that bank's indorsement on it, 75 per cent of the face of that note.

The provision of the bill permitting direct loans by the corporation in exceptional cases is intended to provide for those rare instances where it may be made to appear to the corporation that a meritorious borrower is being unwisely discriminated against by the banks.

As a corollary to the provision for the extension of credits the bill as amended by the Senate Finance Committee provides for approval by a Capital Issues Committee to consist of five members appointed by the Federal Reserve Board, with the approval of the Secretary of the Treasury, through a system of licenses, of issues of securities with a view to preventing the use of capital in unnecessary expenditures during the period of the war. I should have preferred that the original provisions of the bill in this respect should have been retained.

It is important that appropriate provisions be made by law, so that, for the duration of the war, funds available for investment in securities shall be effectively and economically used to supply the financial requirements of the Government and of those industries whose operations are necessary or contributory to the war. The ordinary flow of capital, which in normal times is left free to seek its own investment, should during the war be so directed and conserved that these requirements shall be taken care of before funds shall be invested either in new enterprises or for the expansion of such old enterprises as are not necessary or contributory to the prosecution of the war. In these critical times funds available for investment must not be dissipated on miscellaneous capital expenditures which, however useful or desirable in normal times, will not now aid in the success of the war. It is not so much a question of money as a question of labor and materials. It is essential that the demand for labor and materials for industries which are not contributory to the prosecution of the war should be kept within bounds, so that the war needs shall be first provided for. The test must be whether the proposed expenditure will strengthen the industrial and military structure of the country for the purposes of the war.

The Secretary of the Treasury has already asked the voluntary submission to the Federal Reserve Board of any projected capital issues and has asked the Federal Reserve Board to pass upon such issues. The Federal Reserve Board is already performing this patriotic service through its Capital Issues Committee. The work which the board has undertaken along these lines should be regarded as preliminary and as laying the basis and furnishing in no small part the organization for the work which the corporation or the Capital Issues Committee provided for in this bill as amended will have to do. While patriotic business men and bankers have in many instances voluntarily submitted the question whether the particular security issue then contemplated will be in any way helpful to the prosecution of the war, it is certainly not desirable that matters of such great importance should be left upon a purely voluntary basis. These questions should be dealt with systematically under authority of Congress. The thoughtful and patriotic citizen who voluntarily submits his plans to the Government should not be placed at a disadvantage with his less thoughtful or less scrupulous fellow citizen who goes ahead with his private affairs without reference to the war needs of his country.

The proposed license system for security issues is in line with the act which established the selective draft in lieu of a voluntary system of creating an army. The sacrifices which must be made if the war is to be won should be made by all alike and not merely by those whose patriotism impels them to volunteer and who would have to carry the entire burden unless the slackers are compelled to do their part.

The bill has been drawn with the double purpose of restricting unnecessary capital expenditures and of providing facilities for aiding those industries whose operations are necessary or contributory to the prosecution of the war. Broadly speaking all these are "war industries." The bill is purely a war measure designed to conserve the supply of labor and materials for the purposes of the war, and to help supply the war's financial requirements, and to give them a first claim on capital seeking investment in like manner as the war's material requirements have been given a first claim on production. By the term "war industries" is meant not only those industries turning out the actual munitions of war but also all those supplying any of the other elements of production or distribution in an industrial structure designed to meet the diversified requirements of the war. The bill is not intended to interfere with the continued existence and operation of existing industries, even though not remotely contributory to the prosecution of the war. Such industries should not, however, be permitted to assert a first claim on fresh capital or be considered until the requirements of the Government and of the "war industries" have been fully met.

The proposed bill creates the War Finance Corporation, to make loans of its funds or its credit in aid of "war industries." It also provides as amended by the Finance Committee for a capital issues committee to regulate the sale of new issues of securities. It prohibits any person, firm, corporation, or association from selling or offering for sale any securities issued after the date of the approval of the act unless a license for such sale or offering (if required by such committee) shall have been obtained from such committee. Through the regulation of security issues this committee will be able to keep the field somewhat clear for the borrowing operations of the Government, and at the same time the corporation will stand ready and able to aid "war industries" whose financial requirements may be rendered difficult if not impossible to meet in competition with Government loans. This regulation of security issues will also tend to prevent the further diversion of labor and materials into non-essential industries.

The entry of the United States into the European war immediately necessitated a vast increase in the country's production of material, which in turn necessitated an increase in the machinery of production and corresponding enlargement of land and water transportation facilities. No such enlarged demand could be met without increased demands upon the banks for commercial credits to produce the goods required and upon capital both for enlarging the machinery employed by our industries and for developing railroad facilities, for building ships, and for other purposes. Fortunately the establishment of the Federal Reserve System had already provided the means through which the financing of the greater commercial turnover could be largely taken care of, and this has been supplemented by the Government's policy of making advances through the War Credits Board of the War Department to manufacturers upon work in process for the Government. I do not regard advances of this character with favor, as it tends to force upon the overburdened Treasury the load of financing private enterprises through the indirect medium of the War Department, when such transactions ought to be made through the banks. If the banks are unable to meet such demands, then the War Finance Corporation can do so and relieve the strain now unwisely imposed directly upon the Treasury.

Permit me to say in connection with that statement about the advances now being made through the War Department that I am not criticising the act which authorizes that to be done. The War Department, as you know, and I think also the Navy Department, has the right to make advances on Government contracts of not exceeding 30 per cent, at the discretion of the heads of those departments.

It seems to me wise that the capital issues committee should have the power to regulate securities issued even for refunding purposes, for if issues of this character should be excepted from the regulation of the committee it would open the door for a lot of "camouflaged" refunding operations which on investigation might turn out to be of quite a different character. I believe that this has been the experience of the capital issues committee of the Federal Reserve Board, about which I shall have something more to say later on.

I want to say a few words more on the question of advances upon Government contracts. We find that contracts are made, and that the departments have the power to make these advances to the contractor, without consulting the Treasury at all. They do not have to consult the Treasury under the law. They do not decline to consult the Treasury, but everybody is very busy, and they proceed under authority of law and make these contracts from their own particular standpoints upon the assumption that the Treasury is ready to meet any strain that may be put upon it. We are now trying to work out a plan for consultation with the other departments, and there is a thorough disposition on their part to consult with the Treasury and to cooperate with respect to such advances, so that they will not be made without our knowledge and so that unusual demands will not come upon the Treasury without notice. But I think the practice is bad, because these contractors are only too willing to get advances from the Government at a lower rate of interest than they are really entitled to from the commercial standpoint. In this indirect way these contractors divert to the Treasury financial transactions that ought to be conducted through the banks, and would ordinarily be conducted through the banks.

Now, if the banks are unable to finance those demands, this Finance Corporation could step in the breach and finance the demands upon a character of security that a commercial bank might not like to take. Even though the banks may not now be in position to do this financing, after the War Finance Corporation has been established they could very properly do it because the War Finance Corporation could always come to their relief and take paper which would be unavailable for rediscount in Federal reserve banks.

The money required for increased facilities for ocean transportation has been provided by act of Congress. Provision for at least a part of the money required for enlarging railroad transportation facilities is contemplated in legislation now pending in Congress.

The necessary increase, however, in machinery to produce goods, which requires the investment of capital in industrial enterprises, not only has not been provided, but a considerable restriction has been imposed upon the usual supply of capital for investment, partly by reason of the investment market having been preempted by the Government through the issue of its own bonds and partly because of the natural tendency of investors who, notwithstanding that they have money to invest, hesitate to do so on account of the uncertainties of war.

The situation with which the country is confronted, therefore, seems to require the imposition of reasonable restrictions upon the investment of capital in industries and production not essential for the conduct of the war. It is equally important that there shall be some means of supplying necessary capital to the industries which are essential to the production of war materials and of those things which indirectly contribute to the efficiency of the Nation. The restriction of unnecessary capital expenditures will relieve the market of demands which now interfere not only with the direct financial requirements of the Government, but which make it difficult for those who are furnishing the Government and the people with essential goods to obtain the capital necessary to increase their production.

The license system proposed is peculiarly applicable to a country of the great size of the United States, where banking and credit transactions are conducted by a vast number of independent banks and private banking firms.

The combined operation of the functions to be performed by the Corporation and the Capital Issues Committee—that is, the extension of credit and licensing—will make the exercise of governmental supervision and regulation much more effective in putting the productive activities of the country on a war basis than would be the case were the Government simply to make advances without at the same time exercising supervision and control of security issues.

In so far as the corporation may be called upon to make advances to banks, its first concern would naturally be to aid those for which other instrumentalities of relief have not already been provided; for example, savings banks, and particularly mutual savings banks, which are without capital stock and which are not operated for the profit of stockholders. As a class these institutions are not members of the Federal Reserve System nor are most of them eligible for membership. Their investments consist for the most part of the securities of the United States and of States and municipalities and of the bonds of industrial, transportation, and utility companies, and also mortgages.

Nothing will tend so greatly to prevent the development of any possible uneasiness among savings bank depositors as the assurance provided by this act that any solvent savings bank in case of sudden withdrawals can obtain advances upon the security of its investments and promptly liquidate the claims of its depositors. There is considerable apprehension among savings banks as to means of relief if an emergency arises, but I believe that the assurances of support which this War Finance Corporation will provide will allay all apprehension and probably head off any demand for withdrawals of deposits.

The next concern of the corporation would be the requirements of commercial banks, which are unable to get required accommodation upon the security of their investments through the Federal reserve banks. Many banks which are now called upon to extend large lines of credit to customers which are expanding their businesses to meet the present needs of the Government are obliged to take securities from these customers which are not eligible for rediscount at Federal reserve banks. At the same time these banks are being called upon to extend larger lines of credit to their customers than ever before. Their customers are calling upon them not only for commercial loans to carry their large inventories but for what are in effect temporary capital loans in order to construct new facilities and add machinery to existing plants for the purpose of filling Government contracts. The burdens of these banks is also heavily increased by the financial requirements of the Government, which at the same time is calling upon them to lend large sums through sales of Treasury certificates of indebtedness.

In these circumstances the commercial banks are quite naturally discriminating in their loans between those eligible for rediscount by Federal reserve banks and those which are not. The proposed act, however, would remove the ground for any such discriminations, for it provides a means by which such banks may procure accommodation upon certain securities arising out of war conditions which are not eligible at Federal reserve banks. The proposed act would thus free credit pressingly needed at the present time, both directly and indirectly, for the Government's use.

I shall give one or two illustrations of pressing needs which it is hoped that the War Finance Corporation may be able to meet. It is not necessary to multiply examples, as everyone at all familiar with existing industrial and financial conditions will be able to supply other illustrations from his own knowledge.

There has been called to my attention the case of an important and successful power company whose business is showing substantial increases and whose power is consumed largely in war industries. It has recently made a public offering of its securities. The proceeds of the securities were to be used in part to pay maturing obligations and in part for needed extensions to plant. The capital-issues committee of the Federal Reserve Board had determined this issue to be compatible with the national interest. After a public offering in the usual way, less than 20 per cent of the entire amount was sold, and most of these sales were made to persons whose prior investments in the company's securities made it desirable that the issue should be a success. This is only one illustration of the difficulties with which even the most successful industries having maturing obligations or pressing capital requirements are confronted.

Another instance will show the importance of dealing with this matter promptly. A power company operating in central Pennsylvania is under insistent demands for power for the operation of coal mines, approximately 80 per cent of its power being utilized for that purpose. Under ordinary conditions, it was stated by one of its officers, the company would sell at the present time about $1,500,000 of securities for the purpose of completing necessary extensions and construction work. Being unable to do so, the company is borrowing about $500,000 on short loans from small local banks throughout its territory. A demand on the part of a few of these banks for repayment of loans could not possibly be met, and not only would extension work cease but the company might face a receivership. Relief in this sort of case, in view of the urgent necessity for an enlarged production of coal, is of vital importance.

A similar situation in Michigan has been called to my attention: A public-utility corporation has $5,000,000 of notes maturing, all having been issued for construction purposes. This company is now borrowing over $5,000,000 in short loans from different banks. There is an insistent demand from the industries of that section for more power for manufacturing purposes, which the company is unable to meet because of lack of adequate capital and because of the uncertainty of its position with such a large floating debt.

The necessary restriction of passenger transportation by the steam railroads during the present period of congestion will throw greater burdens upon urban and interurban railroad lines, which will therefore require for their operation a greater amount of electric power and doubtless some extension of their facilities. In some cases, no doubt, enlargement of their facilities is directly required for the Government's service at the various Army encampments. Borrowings for such purposes are not eligible for rediscount with Federal reserve banks, and necessary provision must be made for the development of such lines.

A very large part of the manufactures of the country are conducted by the use of electric energy, for which the demand in some parts of the country necessitates immediate enlargement of production by both steam and hydroelectric power. Indeed, I am informed that in some important industrial districts there exists a distinct shortage of electric power, which is badly needed for war industries. If this deficiency is to be supplied, additional facilities must be procured, and money is urgently needed for the necessary capital expenditures. Existing financial conditions are such that power companies find themselves unable to procure these funds on reasonable terms. That these funds should be obtained to produce the power needed for our war industries is a matter of prime importance, and yet, at the present time it is difficult, if not impossible, to obtain these funds through the ordinary channels.

Since the publication of the terms of the proposed act some criticism has appeared indicating a belief that the operation of the corporation may produce expansion, or as some term it inflation, of a dangerous nature.

In my opinion the existence of this corporation and the intelligent exercise of its functions will do more to prevent unsafe expansion than any other course which could now be pursued, for it must be remembered that the investment markets are practically closed to the country's industries, including public-utility corporations and the railroads. These essential industries and transportation companies in these circumstances, in the absence of some such plan as is presented in this bill, are obliged to look to the banks for the means not only of continuing their normal business but of enlarging it for war purposes. The needs of these corporations, which sound finance would require to be provided for in the form of capital loans, must now increasingly be taken care of in the form of bank loans. The burdens placed upon the banks to meet the demands of this class of borrowers can only be met if these banks use the facilities of the Federal reserve banks by discounting such eligible paper as they may have in their portfolios. The continuance of this process of looking more and more to the banks for short loans of funds which should be provided as capital by investors is the quickest way to bring about an unsound expansion of bank credits. If this burden, through the instrumentality of the War Finance Corporation, can be removed from the banks, and if investors can be induced to furnish necessary capital, that kind of expansion will be checked.

The intervention of a corporation of this character, with its large capital, will provide the class of security which will appeal to the minds of even the most timid investors and will naturally assist in converting what might become a dangerous bank expansion into a legitimate investment of free capital. Even though the corporation were not called upon to make any considerable advances itself, so that the issue of its own securities to a large extent might not be required, it has been the experience in Great Britain, and I believe it will be our experience also, that the restraint imposed upon unnecessary capital borrowings, through Government intervention such as is proposed, not only allays the fears of timid investors but stimulates a demand generally for issues of licensed securities. Such securities sell promptly, and their distribution is general and effective. This again provides a check to unwise expansion of bank credits.

The functions of the corporation are intimately connected wirh Government finance, and are therefore within the peculiar province of the Treasury Department. The War Finance Corporation is an administrative device for exercising governmental regulation of security issues during the war and for utilizing for war purposes the revolving credit created from the proceeds of its capital stock and other securities. As the operations of the corporation must be harmonized with the financial operations and policy of the Government itself, the proposed bill provides that the Secretary of the Treasury shall be a director and chairman of the board of directors and imposes upon him certain other duties in connection with the corporation.

A somewhat fuller statement of the functions and operations of the corporation under the proposed act as amended by the Senate Finance Committee is given below under the appropriate section numbers of the act.

SECTION 1.

For the purposes outlined above, the Secretary of the Treasury and four additional persons, to be appointed by the President, by and with the advice and consent of the Senate, are created a corporation, under the name of the "War Finance Corporation." The bill in this respect has been amended by the Senate Finance Committee.

The Secretary of the Treasury and these same four persons will constitute the original board of directors. The life of the corporation, by the terms of the bill, is limited to 10 years, but its powers are to cease, except such as may be necessary to its successful liquidation, six months after the termination of the war.

SECTION 2.

The capital stock of the corporation is fixed at $500,000,000, all of which is to be subscribed by the United States, and for that purpose an appropriation of a like amount is made. Payments upon this subscription will be called only when three-fifths of the board of directors shall so determine. The capital stock was fixed at this amount to provide the corporation with substantial resources with which to aid "war industries" and to furnish an additional equity for any other securities issued by the corporation.

SECTION 3.

The management of the corporation is vested in a board of directors, constituted as stated above. The directors are to serve for four years; and provision is made in the following section for rotation in office, so that two directors shall retire every two years.

I understand there has been some criticism of the powers conferred upon the Secretary of the Treasury in this bill as originally introduced. As originally introduced the bill conferred the power of appointment of the four directors upon the Secretary of the Treasury, with the approval of the President. It seems to me that this provision was desirable because the policies of this corporation and its operation must be integrated and articulated absolutely with the Treasury if it is to perform the functions which it ought to perform, just as much so as the functions of the Treasury must be articulated through the Secretary and the Assistant Secretaries. As a matter of fact, all we are now proposing to have done could be done through the ordinary Treasury machinery if we could use the Treasury of the United States to issue obligations or bonds of the character proposed by this bill; but, of course, the Government of the United States can not conveniently engage directly through the Treasury in this form of security issues. The bill creates a corporation of a character which may take collateral securities for loans and obligations indorsed by the banks, which the Treasury should not do. Therefore the Secretary of the Treasury should be put as nearly as it is possible to put him in the same relative position with regard to the management of this corporation that he holds with respect to the management of the Treasury through the Assistant Secretaries; naturally, however, he would not have such power over these directors as he would have over the Assistant Secretaries of the Treasury, but we ought to approach that situation as nearly as possible in order to insure an absolutely harmonious cooperation of this corporation, and coordination of its operations and policies, with those of the Treasury Department. That is the reason the bill was originally framed in this way.

SECTION 4.

The corporation is authorized to establish branch offices, though the principal office is required to be located in the District of Columbia.

That is done so that the corporation may be reached at different points throughout the country without requiring everything to be sent to Washington. My idea is that the Federal reserve banks, which are the fiscal agencies of the Government, are a very useful nucleus for that organization—the Federal reserve banks with their branches.

And I may say further in this connection that even if the bill had not been amended by the Senate Finance Committee it had been my purpose to employ the very excellent organization already established by the Federal Reserve Board at my request through their capital issues committee, of which Mr. Warburg, the vice governor of the Federal Reserve Board, is chairman, and which has been establishing agencies of this character throughout the country for the purpose of passing upon these capital-issue applications. The machinery thus provided is being perfected all the time, and would be in shape to come directly under the operations of this corporation and to perform that function for it.

SECTION 5.

Under the bill as amended by the Senate Finance Committee the directors are to receive salaries to be fixed by the Secretary of the Treasury, with the approval of the President, not in excess of $12,000 per annum.

The bill is so drawn that where a man is receiving—as a member of the Federal Reserve Board is now receiving—$12,000 a year, if he were appointed a member of this board of directors he could not receive additional compensation; but if some other Government official were put on this board who was receiving, say, $6,000, then the corporation could grant an additional $6,000 a year in order to bring his salary up to $12,000 a year; that is, if $12,000 should be fixed as the salary for members of the board of directors of this corporation.

SECTION 6.

This section defines the corporate powers of the corporation, including the specific provisions for extending aid to "war industries," while the regulation which the capital issues committee is to exercise over security issues is provided for in section 7.

The corporation is granted (subdivision (a)) the ordinary powers and privileges enjoyed by corporations, including among others the power to sue and be sued, to contract, to adopt a corporate seal, to appoint officers and agents, and, with the approval of the Secretary of the Treasury, to adopt by-laws for the conduct of its business and to define the powers and duties of its officers.

The corporation is empowered (subdivision (b)) to make advances, for periods not exceeding five years, upon such terms as it may prescribe, "(1) to any bank, banker, or trust company"—you see, it is not limited to banks in the Federal Reserve System—"and which has outstanding any loan or loans to any person, firm, corporation, or association whose operations shall be necessary or contributory to the prosecution of the war and evidenced by a note or notes, or (2) to any bank, banker, or trust company which has rendered financial assistance, directly or indirectly, to any such person, firm, corporation, or association by the purchase of its bonds or other obligations." The bill thus provides two different methods for extending aid indirectly to "war industries" through any bank, banker, or trust company (referred to generally as a bank). These two different methods have no sharply defined line of demarcation, but they are based upon two generally distinct devices used in corporate finance. The first method is where financial requirements are provided for through bank loans, and the second method is where such requirements are provided for through the sale of securities.

The first method (see (1) in preceding paragraph) applies when the bank has made a direct loan to a "war industry" evidenced by a note. This is the ordinary bank transaction, and the bill provides that the corporation may make an "advance" to the bank to the extent of 75 per cent of the bank's loan to the particular war industry.

The second method (see (2) above) of extending aid to a "war industry" through a bank applies where a bank has purchased the bonds or other obligations of a "war industry" either directly from a "war industry" or from others. The "war industry" has been benefited by the sale of its securities, whether this sale has been made directly by the "war industry" to the bank or indirectly through others, and the corporation is therefore authorized in either case to make an advance to the bank. These "advances" may be made to the bank up to 75 per cent of the "market value" of the bonds or other obligations of the "war industry" acquired by the bank. It provides a method by which banks may procure funds from the corporation upon this class of securities.

Let us take the case of a power company, for instance, which is furnishing a large amount of power to coal mines. Suppose a bank had bought $100,000 of the bonds of that power company. The power company would be, of course, a war industry, because it is furnishing power for the production of coal which is used, in turn, to run the factories that are turning out war munitions or other supplies needed for the war. In such case the War Finance Corporation may loan to that bank 75 per cent of the market value of the bonds which the bank has bought.

Under either of these provisions (1) or (2) the aid extended by the corporation to the "war industry" is indirect and the advances made to the bank are always secured by the obligation of the bank. This plan enables the corporation to aid "war industries" through the ordinary banking channels. In either case the bank must not only give its own note to the corporation for the amount of the advance received from the corporation but must also secure that note by the notes or bonds or other obligations of the particular "war industry" the purchase or acquisition of which forms the basis for the advance by the corporation.

The terms of the advances, including the interest rate, are to be determined by the corporation, with the limitation that no advance is to be for longer than five years.

As alternative arrangements, instead of 75 per cent advances to the banks, advances may be made by the corporation up to 100 per cent of the particular loans made by the banks to a "war industry," or up to 100 per cent of the market value of the bonds or other obligations of a "war industry," provided that in either case the bank to which the particular advance is made shall itself supply additional collateral to the extent of 25 per cent of the advance.

These provisions as to security require in effect that the corporation shall have an equity of at least 25 per cent in the security for the advances in addition to the obligation of the bank to which the particular advance is made.

You can see the whole theory of this bill will oblige the corporation to take only well-secured loans, just as Federal reserve banks are required to take only well-secured loans.

The corporation may (subdivision (*c*)) make advances directly to savings banks and other banking institutions which receive "savings deposits" on the note of the borrowing institution, secured by collateral to the extent of 125 per cent of the amount advanced. The duration of these advances is limited by the bill as amended to one year. The interest rate is required to be not less than one-half of 1 per cent in excess of the rate of discount on 90-day commercial paper prevailing at the Federal Reserve Bank in the district in which the borrowing institution is located. This provision will tend to restrict the borrowings of these institutions from the War Finance Corporation to cases in which the necessary funds shall not be obtainable through ordinary banking channels.

I may say that the purpose of this bill is not to preclude the borrowing between banks and trust companies, by one bank from another, in the usual way as they are doing now. It is only an additional facility. It is not intended to restrict, but to enlarge, existing facilities.

It may be suggested that a loan to a savings bank is not an aid to any "war industry." It is, however, important for the protection of the whole financial and industrial fabric that these institutions, which hold the savings of the working people, should be able promptly to obtain cash with which to meet any demands that may be made upon them, without sacrificing sound investment securities under possibly abnormal market conditions. If for any reason the necessary funds should not be obtainable through the ordinary banking channels, then the War Finance Corporation would be in position to make the necessary advances. It would unquestionable have a most far-reaching and detrimental effect upon the "war industries," as well as others, if solvent institutions of this character should not be able to obtain funds to meet their obligations without sacrificing needlessly the securities they hold.

Advances to savings banks are to be made not only for the protection of these institutions themselves and the savings of the working classes, many of whom are themselves engaged in war industries, but for the protection of the community from the shock and financial disturbance which would unquestionably result if these institutions because of abnormal conditions should be unable to meet promptly the demands of their depositors. Any such financial disturbance might seriously embarrass the borrowing operations of the Government.

In ordinary times, current deposits in savings banks are in excess of withdrawals, but as every effort is now being made to induce the investment of savings in Government securities, deposits in savings banks will probably be less than they otherwise would be. Savings bank depositors have, I understand, been discouraged from withdrawing deposits for investment in Government bonds, but there will always be withdrawals for one reason or another and in some communities at least, there has been a net loss of deposits. So far no embarrassment has resulted, but, if continued, an enforced sale of securities to meet the demands of depositors might result. Furthermore, as most savings banks do not pay more than 4 per cent, the falling off in deposits would probably be accentuated if the Government should at any time offer bonds at a higher rate than 4 per cent, for that would probably have the effect of inducing withdrawals for investment in Government securities, no matter how much the practice might be discouraged.

The proposed act safeguards the savings banks by providing a method by which they may obtain loans on these securities, instead of having them thrust upon the market. The War Financial Corporation will not, however, make such advances unless they are amply secured, but will stand ready to lend prompt assistance when needed, upon the security required.

The corporation is authorized (subdivision (*d*), as amended by the committee), to make advances directly to any railroad corporation or any public utility corporation, or to any "war industry" "upon such terms and upon such security, and subject to such rules and regulations as may be prescribed by the board of directors of the corporation, with the approval of the Secretary of the Treasury." This provision is intended to give the corporation power to render direct assistance without the intervention or obligation of any bank. The assistance which may be rendered through the banks which has already been described is of course indirect. This subdivision (*d*) provides for direct assistance in cases where and when it is urgently needed, without compliance with the provisions of subdivisions (*b*) and (*c*). These cases must, however, be such as the board of directors shall in their discretion determine to be of exceptional importance in the public interest.

The corporation may call for additional security for any advances which it may make under any of these subdivisions (*a*), (*b*), or (*c*).

The corporation may (subdivision (e)) buy, subscribe for, and deal in bonds and obligations of the United States to such extent as the Secretary of the Treasury may from time to time determine. Much has been said about the market price of liberty bonds and the subject has received careful study. Following is a quotation from the last annual report of the Secretary of the Treasury:

> The man who subscribes for a Government bond, and is advertised as a patriot for doing so, is not a patriot if he immediately sells that bond on the market when he does not imperatively need the money. It is not mere subscription to a bond that helps the Government; it is the actual purchase of the bond and the keeping of the bond that really helps. The people must save and invest in Government bonds. It is by actually lending money to the Government and not by merely promising it and shifting the load to some one else that the citizen really helps in this great time. If loans are made to the Government and bonds are taken therefor, the lender is supposed to deny himself something which releases in turn a demand on the vital supplies or stores of the country and puts the Government in position to buy the supplies thus released and to furnish them to our armies and navies. But if the lender immediately sells his bonds, relieves himself of the obligation to save vital supplies, and goes on wasting them, he does his country a grievous injury and hurts himself as well.
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> I want to make it clear that there is no desire on the part of the Government to prevent or to interfere with freedom of legitimate trading in Government bonds—that is, trading in good faith.

The only sound and sure way to protect the market price of Government bonds is to teach the people to save so that they may become true investors in bonds and not merely subscribers for bonds. Yet there will be on every issue subscribers who find themselves unable to pay for their bonds or through necessity, misfortune, or otherwise are obliged to sell them. And there will always be those, few in number I am glad to believe, whose patriotism is of the surface sort and who take the credit of appearing as subscribers but are unwilling to make the necessary sacrifices to enable them to become permanent investors in the bonds. Last, and least, are those sympathizers with the enemy who deliberately sell their bonds with a view to the injury that they may do to the credit of the United States. I have studied with interest various measures which have been introduced in Congress and plans which have been presented to me for preventing liberty bonds from going below par. Most of these, I am sorry to say, have been, though very well meant, ill considered and calculated to destroy the success of the Government's financial plans. Any prohibition upon the sale of liberty bonds would restrict subscriptions to such an extent as to jeopardize the success of future loans, and would be an act of bad faith toward those who have subscribed to the past loans and may be unable to hold their bonds. Any attempt to peg the price of liberty bonds at par would be unwise and subject to legitimate criticism as turning the Government's long-term 20 or 25 or 30 year bonds into demand obligations.

The only way in which that could be done would be for the Government to stand ready to redeem them at par at any time. The purpose of borrowing on time by the Government is exactly the same purpose which animates the ordinary manufacturer or merchant in borrowing for a definite period in reference to his needs with a view to paying back the obligation at maturity, and the man who lends the money has no right to expect a borrower to pay it back in advance upon his demand at any time. And yet many people have the idea that the Government, because it borrows their money for 10 or 20 years, or whatever period it may be, and agrees to pay it back at maturity at par with interest meanwhile at the stipulated rate, must stand ready to respond to their claim of necessity and redeem the bonds before maturity at par merely because they want it.

The great mass of the purchasers of liberty bonds not only are buying them with a view to holding them primarily because they are a good investment, but also because they patriotically want to help the Government; and I must say I have been immensely gratified with the splendid spirit shown by the people throughout the United States in buying Government bonds, and the purpose which has animated them. But I think I may say out of the last liberty loan, when we sold over five billion eight hundred million dollars of bonds, there probably has not been sold up to date in the market more than one hundred million of those bonds.

If the Government attempted to make only demand loans, it would not be possible to pay them, and we would put ourselves in a position to face some extraordinary calamity. If the Government attempted to pay those loans on demand it would practically be bankrupt. Then, again, I think that wherever you undertook to peg the market at par you encourage many people to turn their bonds back who get a little tired of holding them and probably want to sell them to gratify some pleasure. Those people are not sufficiently informed about the importance of holding on as long as they can, and if they can turn them back at par they would do so quicker whereas if they are going to be penalized for selling before maturity they are not so anxious to sell.

Practically to attempt to maintain Government bonds at par involves the idea of issuing interest-bearing currency. It is impossible to peg the price of $6,000,000,000 or $10,000,000,000 of any security. The price of Government bonds will fluctuate as the price of other securities fluctuates. The man who holds on to his bonds and now watches calmly a downward variation in the price of his bonds, will see the time come when the variation will be the other way and his bonds will sell at a premium. It is highly desirable that violent and unnecessary fluctuations in price should be avoided and that all possible measures should be taken to stabilize the price of Liberty bonds. The War Finance Corporation would be able, I believe, to stabilize to a large extent the price of Liberty bonds. It is well known that a comparatively small buying power will not only discourage those speculatively or viciously disposed persons who might desire deliberately to depress the price of Government bonds but would furnish added impetus to any upward movement in the price. This plan is along the lines of the plans adopted in European countries whereby sinking funds or specific appropriations are made for the purchase of bonds with the same object in view, and is better than any of them, I think, because the Government itself is removed from the transaction.

The purpose I have in view, under this subdivision (e) of the proposed act, is simply to permit this corporation to act in any circumstances that may develop to such an extent as may seem wise in steadying the market for Government bonds. I say, if in the judgment of the board of directors, such an operation were wise. My own judgment is that no effort ought to be made on any large scale to maintain the price of Government bonds. But there may be times when it will be of very great value to have some means through which we could steady the situation.

I want to make it absolutely clear that the power of the corporation to issue its own bonds does not mean any power whatever to issue currency. It is a means of providing funds in addition to the proceeds of the sale of its stock to the United States by the issue and sale of its own securities. The amount of the corporation's bond issues outstanding at any one time is limited to eight times the paid-in capital stock (i. e., a maximum issue, in case all the stock is actually paid in, of $4,000,000,000).

It could never issue and have outstanding over $4,000,000,000 of bonds and then only against security which is 25 per cent greater than the amount of its own bonds plus all of the $500,000,000 capital stock.

These bonds which the war finance corporation may issue are required to run for not less than one year nor more than five years. They may bear such rate or rates of interest and may be made redeemable at the option of the corporation as the board of directors, with the approval of the Secretary of the Treasury, may determine. These bonds are given a first and paramount floating charge upon the assets of the corporation, and are not to be otherwise secured—for the corporation is specifically prohibited from placing any lien or mortgage upon its property.

The purpose of these provisions is to make any bonds it issues a paramount floating lien or mortgage, because the corporation is prohibited from creating any mortgage or other charge which would have priority over the bonds. Whatever bonds the corporation issues are protected by a blanket obligation and a paramount lien upon all the assets of the War Finance Corporation.

I now want to take up another aspect of the bonds which may be issued by the War Finance Corporation. The Federal reserve banks are authorized, subject to the regulations of the Federal Reserve Board, to purchase, rediscount, and use paper secured by the bonds of the War Finance Corporation in the same manner and to the same extent that paper secured by bonds or notes of the United States not bearing the circulation privilege may be similarly used, purchased, and rediscounted. There are, however, two important exceptions to this statement: First, the Federal Reserve Board may require the Federal reserve banks to charge a higher discount rate on paper secured by the securities of the War Finance Corporation than on paper otherwise secured; and, second, the Federal Reserve Board may impose upon the Federal reserve banks a special interest charge in respect to Federal reserve notes issued against paper secured by the securities of the War Finance Corporation, which need not be applicable to Federal reserve notes otherwise secured.

These provisions are made in order to impose a special tax in effect upon Federal reserve notes circulated by the Federal reserve banks against paper secured by the bonds of this corporation, on the theory that it is an emergency measure, and so obtain the retirement as quickly as possible of any Federal reserve note issues that may from time to time be issued against the security of this class of paper. That is a mere matter of machinery that is easily worked out.

It is believed that the right to impose this higher discount rate and this special interest charge will enable the Federal Reserve Board to exercise a beneficial control over the issue of Federal reserve notes based on bank paper secured by the corporation's bonds. All existing provisions of law not inconsistent with the provisions of the bill are expressly made applicable to Federal reserve notes issued against paper secured by the bonds of the corporation. The Federal reserve banks are also authorized to make advances to member banks secured by bonds of the War Finance Corporation.

There has been some criticism of the bill on the idea that in some way or other there will be currency inflation. Any idea of currency inflation must result from a misconception as to the bonds issued by the corporation, for there is no danger that such securities will cause inflation through an undue expansion of the circulating medium of the country.

It must always be remembered that the Federal Reserve Board has absolute control over the issue of Federal reserve notes. That board would undoubtedly be quick to restrict the issue of such notes if at any future time the danger of inflation appeared. The bonds of the War Finance Corporation are not intended to circulate, though they may of course be bought and sold like ordinary corporate bonds or notes. Moreover, they can not directly be made the basis of Federal reserve note issues. In this respect they stand in the same situation as Liberty bonds.

If a member bank makes a loan to a customer for the purpose of enabling the customer to buy either Liberty bonds or bonds of the War Finance Corporation, taking the customer's note, eligible for rediscount in other respects also, the member bank may indorse and rediscount that note at the Federal reserve bank of its district. The Federal reserve bank, having discounted the note indorsed by the member bank may, with the approval of the Federal Reserve Board, in turn take out Federal reserve circulation upon the security of such note. As the note indorsed by the member bank must mature in not more than 90 days, the Federal reserve notes issued against it must then be either retired or other security must be found therefor. Federal reserve note issues will contract or expand responsively to the contraction or expansion of the demands for credit upon the member banks.

The Federal reserve act requires that there shall always be maintained for Federal reserve notes a "gold cover" of at least 40 per cent.

Section 7. This section, as amended by the committee, prohibits the sale or offering for sale or for subscription by any person, firm, corporation, or association, of any issue of securities in excess of

$100,000, or any part of any such issue, issued after the approval of the act, except under rules and regulations prescribed by the Capital Issues Committee, with the approval of the Secretary of the Treasury, and under licenses from the Capital Issues Committee in case such rules and regulations shall so require. The $100,000 limitation was fixed with the idea of establishing a limitation which shall be sufficiently large so that the Capital Issues Committee shall not be burdened to an impracticable extent with the duty of passing upon minor issues of securities, and which shall also be sufficiently small so that the uncontrolled issue of a very large aggregate amount of securities shall not be permitted.

The difficulty has been to get the provisions of the bill sufficiently broad to bring under the regulation of the committee the issue of all securities which it was desirable that the committee should regulate, and at the same time not include a vast number of transactions which do not involve capital expenditures.

It is not intended that the committee shall exercise any regulation over securities already issued, for new issues of securities make the principal demands upon capital seeking investment. The prohibition against selling or the offering for sale of securities therefore applies only to securities issued after the approval of the act. No buying or selling of existing securities in or out of any stock exchange is prohibited. Though the terms of the bill are broad enough to prohibit any sale of securities issued after the date of the approval of the act, whether or not they have once been licensed, it is probable that the committee will in most instances find it desirable in licensing any issue of securities at the same time to license any resale of such securities. This arrangement would mean that once the sale of an issue of securities had been licensed all further trading in such issue should be entirely free. It may be that the regulations issued by the committee will require a notation of the license to be made upon the securities themselves. In that case it would give those securities a greater market availability. The bill is not intended to prohibit, or in any way to interfere with, the ordinary bank borrowings for the purpose of transactions in the ordinary course of business. Any other borrowings in excess of $100,000 evidenced by bonds, notes, or other obligations are subject to the prohibitions of the bill against the sale or offering for sale of securities without a license from the committee, if the regulations established by the committee shall require such a license.

In order that there may be no embarrassment, while the operations of the corporation are being gotten under way, to corporations having pressing capital requirements, such, for example, as maturing obligations, in making arrangements to meet these requirements, the bill provides that this section shall not take effect until the rules and regulations under which the committee will exercise its functions shall have been duly prescribed.

The provisions of section 7 of the bill do not apply to any railroads which may be in the possession and control of the President. These, of course, could not be subject to the provisions of the bill.

Section 8. This section as amended by the committee prescribes a fine of $1,000 or imprisonment for one year, or both, as the penalty for violation of any of the provisions of the act.

Section 9. The surplus earnings of the corporation not required for its operations are to be accumulated in a reserve fund to be invested, under the direction of the Secretary of the Treasury, in bonds, notes, or certificates of indebtedness of the United States. This section also provides for the liquidation of the corporation, beginning six months after the termination of the war. The proceeds of such liquidation are, of course, to be paid over to the United States. This corporation will undoubtedly be profitable, because it can not lose money under the plan devised.

Section 10. The corporation is to be exempt from taxation except that its real estate is to be subject to local taxation in like manner as other real estate. The bonds of the corporation are to be subject only to like taxation as the bonds of the second liberty loan.

Sections 11, 12, and 13. These sections define the term "securities," reserve the right of amendment, and provide that the invalidity of any portion of the act declared invalid by any court of competent jurisdiction shall not invalidate it as a whole.

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