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FINANCIAL AID TO WAR SUPPLIERS
16 January 1948

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GENERAL McKINLEY: Gentlemen, this morning our speaker is Brigadier General Eugene M. Foster, Assistant Chief of Finance of the United States Army. He is a graduate of the Industrial College, Class of 1934, and also of the Army War College, Class of 1939.

His entire military service has been spent in performing finance and fiscal work. Prior to and during World War II General Foster served in a number of positions on the War Department General Staff and in the office of the Fiscal Director of the Army Service Forces which required him to effect many policy decisions of major importance in fiscal and financial matters. I know of no other person in the service who is in a better position, from both training and experience, to address us on the important subject of financial aid to war suppliers. It is indeed a pleasure to present to you the Assistant Chief of Finance of the United States Army, my old classmate at the War College, Brigadier General Eugene M. Foster.

GENERAL FOSTER: Gentlemen, the subject I am going to talk about is one in which the Fiscal Director (now Chief of Finance) had a very vital part during the war. The idea of financing war contractors was one of the vital features of the production program. We feel that it was a most successful one, as was demonstrated during the war.

The title "Financial Aid to War Suppliers" is imposing, and when we consider that for the period 1 July 1940 to 31 August 1945 total War Department expenditures for procurement of materiel, including subsistence, totaled 118 billion dollars, it was big business. It involved the whole economy of the country and placed a special burden on our Nation's financial facilities. Yet in retrospect we view the solution to the problem with calm satisfaction.

The War Department had no difficulty in getting appropriations from Congress to meet our war program. The committees of Congress were more than generous as is evident by the fact that unexpended balances in each year of the war totaled billions of dollars. We highlight the fact that ample appropriation funds were available because it was this potential that made possible the development of procedures to finance war contractors without specific appropriations or authority from the Congress. It may therefore be stated that once our financial program was developed, the lack of dollars in no way impeded war production. We had sufficient funds and any contractor who could convince War Department representatives that he could contribute to the production requirements of the Department could obtain funds for the purpose.

It may be well to briefly review the means by which a war contractor could secure funds. These consisted of the following:

1. A loan from a bank, secured by an assignment of claims under a government contract, or otherwise.

2. A loan from the Reconstruction Finance Corporation.

3. A loan from the Smaller War Plants Corporation.

4. A loan from a Federal Reserve Bank under the provisions of Section 13 (b) of the Federal Reserve Act.

5. Advances from the War Department, Navy Department, or Maritime Commission if the business enterprise held a prime contract.

6. A Regulation V-, VT-, or T-loan from a bank or other financing institution guaranteed pursuant to the provisions of an executive order and the regulations issued thereunder.

7. A direct loan from the War Department, Navy Department, or Maritime Commission.

8. A combination of two or more of the foregoing.

So you can see there were many agencies involved in financing war contractors.

In view of the fact that we are convinced that the War Department facilities for financing war contractors were the simplest and most satisfactory method, we will touch but briefly on the other means previously listed.

The first of these other means was a loan from a commercial bank based entirely on the contractor's normal borrowing potentials, which after 1940 when the Assignment of Claims Act was passed by Congress included the assignment of his government contracts as security. Before that Act was passed there was a general prohibition against assignment of a claim arising under a contract made by the United States. The amendment to the Act in 1940 changed the situation so that the contractor could assign a government contract to a bank in support of a loan. Of course, even in that case the bank ran the risk of a cancellation of the contract by the Government thus impairing the bank's security.

It should be stated at this time that it was the view of the department then and still is that private facilities for financing of war suppliers should be utilized to the fullest extent possible for two main reasons. These were (1) private financing eliminates to a large extent the need for disbursement of appropriated funds and (2) it eliminates the need for the establishment by the government of an extensive organization and the use of a large number of personnel in connection with the administration of such financing. The credit resources of commercial banks, related as they are to the economy of the country, are an appropriate instrument by which financing in time of war can be successfully effected. During the late war roughly about two-thirds of the working capital needs of war contractors were supplied by means of private credit. In the beginning, bank loans to war contractors were made in the regular course of business but as the war production picture became more demanding and loans had to be made to contractors in amounts greatly in excess of their normal working capital requirements, or had to be made to contractors, who though able to produce, were not financially strong enough to get a bank loan, it was necessary to find other means to implement normal commercial banking loan procedures. We will discuss them in order.

As my subject is limited to financial aid for procurement of supplies as distinguished from development of facilities to produce those supplies, we can easily eliminate the Reconstruction Finance Corporation from our discussion. That corporation granted loans for the development of facilities and, except in a very few cases, was not involved in loans of the type we are discussing today.

The Smaller War Plants Corporation had limited funds for its purpose. It had an authorized capital of 350 million dollars. In view of that limit it was restricted in operation. It undoubtedly was of assistance to small contractors within the limitation referred to, but even the needs of most small contractors for funds to meet war contracts were met by the War Department financing program.

The authority for loans by the Federal Reserve Bank under the provisions of Section 13 (b) of the Federal Reserve Act was not a war measure and was circumscribed by normal peacetime rules to such an extent that it was not used extensively during the emergency.

The first major government aid to war supply contractors was the advance payment program of the War Department, Navy Department, or Maritime Commission where the contractor held a prime contract. This method of financing war contractors was a very effective means of meeting prime contractors' fund requirements. Authority to make advance payments on contracts for war supplies not exceeding 30 percent of the contract price was given the departments in the Act of 2 July 1940. This authority was superseded by Title 2 of the First War Powers Act of 18 December 1941 under which Executive Order 9001, dated 27 December 1941 was issued. This order authorized the departments to make advances, progress, and other payments under its contracts in any percentage of the contract price wherein, in their judgment, the prosecution of the war would be facilitated thereby. In the War Department, under this authority, chiefs of the technical services were authorized to approve the making of advance payments when the amount of the contract was less than five million dollars. Advance payments on contracts amounting to five million dollars or more and advance payments in excess of 50 percent of the amount of a contract required the approval of the Under Secretary of War. The Chief of Finance was the agent of the Under Secretary of War in approving for him these advances. Under the Contract Settlement Act of 1944 authority was granted to increase the former limitations, if necessary, to carry a contract to completion or for interim financing. Increases of this nature could be made up to 90 percent of the total amount estimated to be payable under a contract, including termination charges, less any unliquidated balances of advance payments previously made.

Where advance payments were authorized, the amount of the authorization was based upon the use of the contractor's own working capital as much as possible. The advance payment agreement provided that all payments on cost-plus-a-fixed-fee contracts and at least 85 percent on fixed-price contracts be deposited into a special bank account with suitable negative covenants to protect the government's interest. These authorizations were limited to thirty-day requirements and withdrawals from special bank accounts were closely supervised.

The procedure for making advance payments was as follows. Requests for authorization to make advance payments in excess of the authority delegated to the technical services were in each case submitted through the head of the technical service concerned to the Fiscal Director (Chief of Finance) for approval or disapproval under the delegated authority of the Under Secretary of War. I will not attempt to give you the various items of information required to be furnished with such requests. They were 12 in number. Briefly, they included a showing of the need for the advance, a statement of the contractor's financial position, and such additional information as would permit of a proper evaluation of the need and the risk to the government involved in the advance. Advances were authorized only upon the furnishing of adequate security by the contractor. The security was in the form of a lien in favor of the government paramount to all other liens, upon the supplies contracted for, upon the credit balances in any special accounts in which such payments may be deposited, and upon such of the material and other property acquired for performance of the contract as the head of the technical service and the contractor should agree.

It may surprise you gentlemen to know that Uncle Sam in this case and in the guaranteed loan procedures which I will discuss later was not the benevolent gentleman that he might appear to be in making these advances. He had a direct interest in getting production and proper financing made this possible, but he also injected into the procedures some business acumen. He charged interest on the money so advanced by the government. It was computed at the rate of $2\frac{1}{2}$ percent per annum on the unliquidated balance of advance payments outstanding from time to time. There were, however, exceptions to this interest charge which were (1) in connection with contracts which provided that the work thereunder should be performed at cost without profit or fee to the contractor; (2) in connection with cost-plus-a-fixed-fee contracts on which the fee was disproportionately small compared to the amount of interest that would accrue on the advance payment; and (3) under certain conditions when specifically authorized the Under Secretary of War and a few other cases where circumstances warranted, but in the majority of cases the interest charge was made. That this banking business of the War Department was a profitable undertaking is evident when we realize that not only were contractors' fund requirements in excess of seven billion dollars met, but interest accruing to the government on such advances totaled over 30 million dollars leaving a net balance of almost 29 million dollars to be deposited to the general fund of the Treasury.

From July 1940 when the first advance payment was authorized to 31 July 1946 when the program of advance payments began to be materially curtailed, 4,278 advances had been made to over 1,500 contractors. As of 31 July 1946 advance payments had actually been made to contractors in the aggregate amount of $7,149,000,000 and the amounts which have not been recouped as of this date total only 18 million dollars and involve only 92 contracts. It is estimated that of the total advances made, not to exceed $1,500,000 is regarded as uncollectable.

There were certain limitations under the advance payment procedure which limited its use in financing all war contractors. For instance, advance payments could not be made to subcontractors except through prime contractors. Advance payments were not authorized in connection with any contract entered into after formal advertising. Contractors who submitted a competitive bid were expected to depend upon their own resources and ability to borrow through commercial channels for financing their work.

Before leaving the item of advance payments, it may be well to call attention to another item of payments which were of material value to the contractor but which are in common use in normal Army operations. That is the partial or progress payments. These involve payments to the contractor upon property acquired or produced by him for the performance of his contract. They were limited to 75 percent of the cost to the contractor of the property upon which payment was made, and in no event would the total exceed 80 percent of the total contract price of the supplies still to be delivered. Partial payments could be made up to 90 percent of the direct labor and material costs to the contractor of the property on which payment was made. These are provided for in the contract provisions and present no problem. Furthermore, they differ from the advance payment inasmuch as there is no interest charge for advances so made.

Our next subject is the one in which the Department considers its best answer to the problem of financing war contracts. It was a Regulation V-, VT-, or T-loan from a bank or other financing institution guaranteed pursuant to the provisions of the Executive Order and the regulation issued thereunder. In discussing the advance-payment arrangements I mentioned the fact that the War Department was going into the banking business, but it was not until we consider the guaranteed or V-loan and later VT-and then T-loan plan that we really did become bankers. The Department takes pride in the development of the guaranteed programs and feels it is an ideal means of financing war contractors. These programs were flexible. They met the requirements of subcontractors as well as prime contractors. They made use of commercial banking facilities and were operated at a minimum cost to the Government.

The authority for the guaranteed loan program was based on Executive Order 9112, dated 26 March 1942.

This order was issued at the solicitation of the War and Navy Departments and the Maritime Commission by virtue of the authority vested in the President by the various provisions of the First War Powers Act, approved 18 December 1941, on the basis that such action would facilitate the prosecution of the war. The first whereas of the order reads as follows:

"Whereas in order that contracts of the War Department, the Navy Department, and the United States Maritime Commission (hereinafter referred to as Maritime Commission) which are now outstanding or may hereafter be entered into for war production, including the obtaining or conversion of facilities, may be promptly and effectively performed, it is essential that additional facilities be provided through governmental agencies to supply necessary funds to contractors, subcontractors and others engaged in such war production pursuant to such contracts;..."

The order further authorized the use of funds appropriated by Congress for the purpose of guaranteeing loans, and authorized the use of the facilities of the Federal Reserve Banks and the Board of Governors of the Federal Reserve System. It recognized the need of small business for assistance by the following whereas:

"Whereas the guaranteeing or making of such loans, discounts, advances and commitments will greatly facilitate the participation of small business enterprises in war production;..."

The Office of the Fiscal Director of the War Department (Chief of Finance) was given the authority by the Secretary of War to administer the program in his name and the success of the program is a tribute to our national military policy wherein a small Regular Army is expanded to an army of millions of men through the inclusion therein of men of every walk of life trained in every technique of business. Bankers who volunteered for service with the Army brought with them the latest commercial banking methods and procedures, and the small group of Regular officers blended with these business techincians to guide their commercial training and abilities into military accomplishments.

The organization consisted of a special division in the Office of the Fiscal Director (now Chief of Finance) handling advance payments and guaranteed loans and with military representatives located in the various Federal Reserve districts as liaison officers to assist contractors in securing the necessary war loans. These liaison officers were located in the Federal Reserve Banks. They were people who were familiar with banking procedures and with making loans. They were the operating people in the field. They did a fine job. There weren't so many of them, but they were in each district; maybe one or two in each district.

The Federal Reserve Banks made available to these liaison officers office space and facilities and any expense involved was reimbursed to the Federal Reserve Banks from earnings accumulated from the loans. The operations were along this line. A contractor would be contacted by a representative of the technical service as to his ability to produce munitions. After it was determined that he had a potential for production either in facilities or "know-how" his financial problems were reviewed. He had the opportunity to go to his own bank and borrow up to the limit that the bank would allow. If this was not sufficient, the representative of the technical service and the contractor would contact the Army fiscal liaison officer asking aid in financing the contractor's need. After an investigation of the contractor's finanical condition to determine that he was a reasonable risk, giving consideration to the emergency requirements for war production, the bank would be advised that guarantees would be granted under the provisions of Executive Order 9112, and a guarantee agreement would be drawn up to cover the transaction. After approval of the agreement the contractor would be granted his loan by the bank and the loan would be administered by the bank and supervised by the Federal Reserve Bank acting as fiscal agent for the United States. The extent of our guaranteed loan program covered borrowings in excess of 9 billion dollars.

You will remember in the beginning of this talk I mentioned the fact that the ample appropriations available to the War Department made it possible for us to finance war contractors without specific appropriations from Congress for that purpose. Initially when the program was begun, the

Federal Reserve Banks and some contractors were afraid that if appropriated funds were to be used, there was a danger if the war ceased suddenly, that the appropriations might all be used up in procurement and there would not be sufficient balances to meet guarantees. The delay incident to obtaining new appropriations would be fatal to reconversion. To satisfy this demand there was set up on the books of the Finance Department a reserve under each appropriation covering procurement. It was decided that initially this reserve would be approximately 20 percent of our total guaranteed loans. However, as the program progressed and was accepted with confidence by the banking fraternity, the Department felt it unnecessary to maintain full 20 percent reserves. It was felt that in view of the possible cancellation of contracts that would come with the close of war, sufficient funds would be changed to an unobligated status to meet any requirements under the guarantees and thereafter the reserves were not adjusted as the program advanced. The program, however, was so successful that any losses could have been paid from guarantee fees and the use of appropriated money rendered unnecessary.

A description of the various types of loans may be of interest.

1. V-loan.--A production loan based on a certain percentage of amounts due on uncanceled contracts. Originally, going concerns not needing working capital were not eligible for a V-loan, since originally such loans were confined to present needs or immediate anticipated needs for war production.

2. VT-loan.--A production loan based on borrower's investment in uncanceled and canceled contracts. Protection against termination exists in allowing borrower to include in the loan formula his investment in receivables and inventory and also payments made or to be made to subcontractors under canceled contracts.

3. T-loan.--A termination loan based on borrower's estimate of termination claims. Of 560 such T-loans guaranteed by the War Department, only one offers possibility of loss due to the company's overstatement of its claims. However, it should be borne in mind that when this basis of borrowing was incorporated in the Contract Settlement Act of 1944, the prime objective was to provide interim financing with a minimum of delay and red-tape. The T-loan program successfully served its purpose.

4. Direct loans.--While authority to make direct loans was included in Executive Order 9112, this method of financing was kept to a minimum. Only four direct loans for production purposes in the amount of $11,850,000 were made by the Army. Four more direct loans in the amount of 56 million dollars were made under Joint Termination Regulations to provide funds to prime contractors to settle subcontractor's termination claims. Those were cases where the banks for some special reason did not

want to participate. The contractor asked for direct loan, and the Department granted it.

I might say that in this loan program the Army, Navy, and Maritime Commission worked very closely together. If a contractor wanted money to finance his Army war production contract and he had another contract with the Maritime Commission or Navy, the service having the largest contract would handle the financing for the other interested services, and the losses, if any, would be shared proportionately by the services. One service would carry the guarantee and arrange to take care of the contractor's needs.

Under the guaranteed-loan agreements the bank could at any time request the War Department to purchase the guaranteed portion of the loan. This was a sound protection to the banks. However, the War Department was called upon to purchase approximately only 20 million dollars of the guaranteed portion of loans. Of that amount we have recouped 16 million dollars. These were different and in addition to the direct loans previously mentioned.

The thing we must realize about this loan business is that the amount loaned was in line with the amount of business which the Government gave a contractor. So we did have good security. When we made a guarantee, we knew that the man had enough government contract business to cover any amount which he would get under the loan. It was only in case the war ended suddenly that we would be in danger. It is evident from the success of the program that our guarantees were not excessive.

To emphasize the point that the guaranteed-loan program was a broad, all inclusive one to meet war suppliers' financial needs, it may be well to cite a few specific cases of loans to show you we played no favorites regarding size. I mention a case of a loan of four thousand dollars on a revolving credit guaranteed 90 percent. (This revolving credit is where we have a loan of four thousand and the contractor could draw out three thousand and later pay back some and continue to borrow, just so the amount did not exceed at any time the total of four thousand in his revolving credit. Our guarantee would be on 90 percent of the loan. The bank, having a 10 percent share, would take an interest in doing a good job in handling it. Of course I am not saying that the banks wouldn't have done that anyhow. It was a patriotic job they were doing as well as good business.) This item was a termination loan supported by a claim of the contractor for approximately four thousand dollars. He had a number of other unterminated purchase orders aggregating about 14 thousand dollars. The application for the loan was made 14 September 1945 and the guarantee agreement was consummated on 24 September 1945. The loan was paid off when the termination claim was settled.

We now skip to one of the largest credits ever extended to the knowledge of the banking fraternity. It was a V-loan with a maximum credit on a revolving basis of one billion dollars. It was to one of the Nation's largest industrial organizations. About 200 banks participated in the credit. Our guarantee percentage ranged between 50 and 90 percent depending on the outstanding balance. The highest amount drawn down at any one time was one hundred million dollars. The application for the guarantee was made 10 October 1942 and was approved 31 October 1942. Of course this is the official record. I assure you, however, extensive negotiations were carried on before formal documents were drawn up. This loan was paid in full.

Undoubtedly you gentlemen would like to hear more about how we made a profit out of this banking enterprise. Banks in making loans to contractors under this program charged not to exceed 5 percent interest on loans made. The War Department required of the banks a fee for guaranteeing the loan. That is, a percent of the interest earned by the banks. This percent was based on the percentage of the guarantee and varied from about 10 to 50 percent of the interest rate. This little operation netted, after deduction for all losses and expenses incurred by the Federal Reserve Banks in administering the loans, about 18 million dollars which will be eventually deposited to the general fund of the Treasury.

That the guaranteed-loan program was a success in evidenced by the fact that there was introduced in the first session of the present Congress a bill, H.R. 3268, to amend the Federal Reserve Act so as to permit any Federal Reserve Bank to carry on a similar program as a normal procedure. This bill has the indorsement of Mr. Eccles, Chairman, Board of Governors, Federal Reserve System. In my opinion, however, it would be to the advantage of the National Defense Establishment to carry on its own guarantee program for war production. It can set its own rules to meet its own requirements and in administration be more liberal in its application of the rules governing the guarantee.

In war ample appropriations are made available to meet our requirements. We talk about budget problems and all that, but the real fund problems in war are not getting the money from Congress. We turned back in the Fiscal Year 1944 and had reappropriated for our next year's needs over 33 billion dollars. Appropriations for 1944 exceeded 74 billion dollars.

During the war as Chief of Fiscal Control of the Office of the Fiscal Director I would have requests from officers of operating branches for funds to finance projects totaling millions of dollars. The only question asked was whether or not the project was approved as necessary for the war effort. We could not measure dollars against men's lives. Therefore, the terms millions and billions were glibly used and our thinking became much inflated. Those days are over now and we are going to get back to talking in hundreds as was the case prior to the beginning of the war.

A personal experience may highlight this point and be of interest. In the First World War I was at Camp Meade, Maryland. The only old timer assigned to me was a Sergeant, Quartermaster Corps. He asked me to recommend him to Washington for promotion to a senior grade Sergeant which I did, and almost before the recommendation reached there I received a wire promoting the Sergeant and ordering him to proceed without delay to Newport News, Virginia. I was not terribly sorry to lose the old boy because we had had several difficulties. He wanted to stick exactly to the book, whereas I had just come from civil life and didn't know any too much about the book. He had warned me that with my liberal ideas I would never get along in the Army; that I would sure get into trouble. In the latter part of 1918 I was sent to Newport News on an inspection and met my old friend the Sergeant, who had been promoted to a 2nd Lieutenant. I had been promoted to a Major. I asked him how things were going. He said pretty well but that he didn't feel that he had gotten very far in view of his Army experience, but he had reached this conclusion. "You know, I often think about you and me and our talks at Meade. I have come to realize why it is that I am only a 2nd Lieutenant and you, fresh from civil life, a Major. My conclusion is that before the war I used to deal in hundreds and thought a hundred dollars was a lot of money. When the war came on I said, 'this is big business and I am going to talk in thousands.' You came from civil life without the inhibitions of the old Army and immediately started to talk in millions. It put you over, whereas my thousands held me back." That is just where we are today. We have been talking in millions and billions and we have quite an inflated idea on dollars, but I can assure you we are going to change our language from now on. We are going to get back to the old Sergeant day and talk in hundreds again. Then when war comes--if it does--we may again inflate our ideas and talk in millions and billions.

Now, in the invitation for me to talk to you there were two items mentioned which I have not discussed here. One of them was the question of shortening the time between the negotiation period for a contract and the actual drawing up of the contract so the contractor can go to the bank and negotiate a loan promptly. That being mainly a procurement matter, I made inquiries around the top brass of the War Department. I shouldn't say "top brass." I mean, the medium working class there. I found that serious consideration was being given the subject.

The question was asked as to whether a formal contract was needed by a contractor to borrow from a bank. I found that the banks do require something that they can use as collateral, and that a letter of intent is not accepted for that purpose. However, a letter contract is accepted for that purpose, and it was used extensively during the war. This being a procurement matter, I am not going to discuss it further this morning. I haven't enough information or ideas on the subject to really be of value to you here.

I did ask General Cook, who is on a board coordinating procurement between the Army, Navy, and Air Force, whether that subject would come up; and he said he was pretty sure that it would. So we may have a solution of that from that board.

There was one other question that was listed for me, and that is the performance bond. I find that the same thing happened there during the war. Performance bonds were not used very much, because we picked our contractor. It was not a question of contractors coming in and bidding on something and you not knowing anything about them. You picked your contractor and so you weren't worried about such things as performance bonds. In most cases you weren't worried about them anyway because it was a cost-plus-a-fixed-fee contract. You paid for it yourself anyhow.

So a performance bond is just a question of judgment. In peacetime it was useful, especially when you didn't know with whom you were dealing. But that too is an item which is subject to further study and I am not going to dwell upon it. Therefore I think that I have given you all I can in a prepared talk. Before I lay myself open to your tender mercy, I will summarize my thinking.

1. In war ample funds will be provided by Congress to meet our every need.

2. The guaranteed-loan program and the advance-payment program developed during the late war is a sound method of providing funds for war contractors.

3. The use of commercial banking facilities and funds for financing war contractors is the most efficient and economical way to accomplish the purpose.

4. Through the use of the guaranteed-loan program financial aid was furnished war contractors in a sum in excess of 16 billion dollars without any final charge to the public Treasury. In fact the operations during the late war of the advance-payment program and the guaranteed-loan program will permit of a deposit to the general fund of the Treasury of a net profit in excess of 40 million dollars.

5. It is to the interest of the National Defense Establishment to administer the guaranteed-loan program rather than to have it administered by another agency of the Government. If we maintain the program, we can

keep it flexible and base our approval of the loan on the paramount need for the facility to be financed rather than the financial position of the contractor; whereas if the loan program is controlled and administered by another government agency such as the Federal Reserve System, there is danger that requests for loans will be approved on the basis of the contractor's financial position instead of our requirement for his facility.

GENERAL McKINLEY: Before we get into the question period I will take a few minutes to state that the story that General Foster told has a very great moral as far as I am concerned. My war experience in my assignment here in Washington was of such a nature that I was in contact with the General Staff, with what we might call the top brass, probably the Pentagon "D-ring" level rather than the "E-ring" level, during the war. One thing that I saw there was that important military men, very highly respected and with high rank, lost their heads because they could not absorb big figures rapidly enough. That one thing that he was talking about in his story about the sergeant who was frozen in thinking in hundreds, cost many important people their heads. So I caution you, in all your thinking, in all your planning, and in all your future in the Army, keep flexible and be able to accept new things and rapid advancements. It is important when you get up there and the chips are down.

Now we will have questions for the General.

QUESTION: The President's Air Policy Committee in its report intimated that 1 January 1953, might be A-day, after which we might expect a sudden attack. What plans are being made for financing war supplies in the event that war takes place overnight or if we are struck suddenly?

GENERAL FOSTER: We haven't any improvement that I can think of on the guaranteed-loan program as it was developed during the war. It is so simple and so flexible that I do not see any problem in financing war contractors in the future.

It is a very simple system, because all they do is go to the bank. I mean, after our people go to them and talk about a contract and say, "We are anxious about production. We want you to do this," the man says, "I haven't the money to reconvert to do the job." We say, "Come with us." So the technical service man takes the contractor to the finance liaison man. They sit down with the banker and our finance man assures the banker, "You take what you want of this loan and we will guarantee the difference." Then the banker is assured that at any time he can dump it back in our lap. The money is as free as can be for procurement contracts. I do not see any problem at all.

QUESTION: You mentioned the risk of financing contracts. Did any of your contractors go bankrupt?

GENERAL FOSTER: I do not know about that. Here is the thing: If they went bankrupt, it was not because of their difficulties in getting money. I think there were few, if any, war contractors who went bankrupt during the war. After the war some contractors tried to reconvert on a shoe string and all they had was know-how. We had put them in business. A lot of them tried to keep in that business after the war. They did not get civilian business fast so failed. I doubt that there were very many failures during the war, our flexible means of taking care of financing contracts prevented it.

QUESTION: Have there been any cases of contractors trying to get payment for supplies or services on contracts made by unauthorized persons or on oral contracts and not confirmed in writing?

GENERAL FOSTER: We had some cases like that. Where they were made by unauthorized persons, the question was whether the Government got the goods. If the Government got the goods, the contractor would get his money. The technical problems that we have in peacetime were not there during the war. We had very close cooperation with the Comptroller General.

GENERAL McKINLEY: I can't say too much, General Foster, about the surprising cooperation we got from the Comptroller during the war. On his record during peacetime I thought that his office was going to be our big stumbling block. But they really were wonderful.

COLONEL McCULLOCH: Have you any recommendations in mind for possible inclusion in the Industrial Mobilization Plan that is now under study that might help this situation in the event of another war?

GENERAL FOSTER: I would definitely recommend that you include a guaranteed-loan program, supplemented by an advance-payment program. Some people like the advance-payment program better than the guaranteed-loan, but the guaranteed-loan program was very broad. Any advance-payment program would be limited. If we wanted to advance money to a subcontractor, the only way to do it was to advance it to the prime contractor, whereas a guaranteed-loan could be made to the subcontractor or sub-subcontractor. We guaranteed many loans to subcontractors.

GENERAL McKINLEY: Would it require the preparation of any legislation to include a plan that would require immediate action of Congress in the event of an emergency?

GENERAL FOSTER: We got by with Executive orders in the late war and we can get by again. However, what you are going to be up against is this: Mr. Eccles is up with a bill to authorize the Federal Reserve system to operate such a program. He would probably object to any legislation allowing the military Departments to do it. He wants the Federal

Reserve Bank to do the complete job and would probably object to our request for legislation.

I remember we were told when I was in the Industrial College in 1934 that it was a question as to whether we should present the Industrial Mobilization Plan to Congress at that time or whether we should wait, because if we presented it at that time, it would be torn apart and maybe we wouldn't get anything, whereas our chances would be better when we are threatened. That is what we are up against in regard to this very thing of the guaranteed-loan program. If we put it up to Congress right now, I am afraid Mr. Eccles will object to it and probably it will help him to get his bill through.

COLONEL CRANE: Under the V-loan program that you talked about would it be possible for a critical program to be held up by a bank's refusal to send money by virtue of the excessive risk involved in the ten percent unguaranteed portion of the loan?

GENERAL FOSTER: If the Army, Navy, or Air Forces thought the contract was necessary, they would make a direct loan. They were authorized under Executive order, if the bank thought the risk was too great, to take all the risk.

COLONEL CRANE: In other words, it would be an advance payment?

GENERAL FOSTER: No. It would be a loan, but a direct loan instead of a guaranteed-loan. We would loan the money from appropriated funds or earnings accumulated from interest on the program.

GENERAL McKINLEY: Do I understand that the only difference between those two is that in the direct loan you have to administer it, that is, do the banker's administration, which you would like to be free from?

GENERAL FOSTER: That is right.

GENERAL McKINLEY: You want to do as little of that as possible?

GENERAL FOSTER: Yes. We want to keep that in commercial channels as much as possible. That is the point. We can make a direct loan, as we did in these cases cited. We could do that if necessary, but then we would have to put up our own money. Whereas when you guarantee a loan, you do not use your own money. The banks use their money. The Services do not use their own money unless they pick up the loan.

QUESTION: If I remember your figures correctly, you said that the Army financed something in the neighborhood of 170 billion dollars during the war, and that about two-thirds was financed by normal commercial means, and you gave various means. I remember that you said you had about 16 billion under this guaranteed-loan program. Would you mind reviewing the other amounts, the Federal Reserve and so forth, and stating the approximate magnitude of the others?

GENERAL FOSTER: Commercial banks would give a loan without any guarantee in many cases. Here is the thing about guaranteed loans: The bank, if it thought there was no risk involved, would not bother to get a guarantee on the loan, because it would earn all the interest due on the loan. It was only in cases where banks were leery that they would ask for a guarantee.

QUESTION: I understand that, but I mean public financing. I gather that two-thirds was by private financing.

GENERAL FOSTER: Yes.

QUESTION: And one-third was public financing. There were various programs--the Federal Reserve, for instance. Would you mind indicating the amounts of the different programs, how much they were?

GENERAL FOSTER: I haven't any figures on that. I looked up the RFC report, and its loans were facility loans. I was told I was not to discuss facility loans. The RFC did a big business in facility loans in the last war. It not only made loans but actually built plants through its Defense Plant Corporation. I am getting off my subject on that part of it. I have no figures on how much Smaller War Plants spent for war production, because under its authority it could help finance plants for civilian production. So I do not know how much of its work went for war production. I have no figures with me.

QUESTION: General, in connection with the guarantee of loans you made a statement a moment ago which indicated to me that the Government took part of the interest on guaranteed loans. Can you give us some idea what that amounted to?

GENERAL FOSTER: Yes. That would depend on the basis of how much of the guarantee we took. It would be from 10 to 50 percent of the interest earned by the bank.

COLONEL McKENZIE: General, in many cases the record of payments by the Army was not too good. If we are making a point here of charging these people interest on the money they borrowed from the Government, what would be your thought about giving the vender interest on the accounts due him?

GENERAL FOSTER: I am glad you brought that up, because, you see, I am a representative of the Finance Department. I didn't want to crow too much about the Finance Department, but I will tell you this: The prompt payment of bills is our job, and I think we did a swell job, and I have records to prove it. I might say that one of the big aids to finance war contractors is to always get him his money promptly.

Now, there were some cases where payments were not made promptly, but those were where there were arguments with the contracting officer or contractor about how much was due. There would be cases where a Receiving Report was delayed due to questions on delivery.

We had our disbursing officers widely distributed, and required reports to be made of any delay in payments. Any bill on hand over 30 days had to be reported. I tell you, our people were right up to date in payments. As soon as we saw any office get behind, we assigned additional personnel to help them.

Regarding the payment of interest on delayed payments, you would not get to first base with Congress or anyone else on that. If we were to say that payments were delayed through our failure, Congress would soon tell us to correct the situation.

COLONEL McCULLOCH: I would like to supplement what you said. It seems to me that the penalty might be automatic. If we don't pay an account within the discount period, we lose the discount.

GENERAL FOSTER: Yes, if there is a discount offered.

GENERAL McKINLEY: I want to make a remark about this thing of paying bills, because I had some grief on that myself, being in the business of processing invoices for payment. A great deal of the delay was in our own hands in processing instruments to the Finance Department.

It may be interesting to you to know that just at the Q.M. Depot at Philadelphia, where they handled a lot of interim payments on account of repeated shipments on a contract, after making a study and revising all the procedure in processing invoices, we were able to reduce the number of invoices that had to be in process at all times from 17 thousand to 13 thousand. That was what was on hand in the pipe line in trying to get the invoices to the finance officer for payment.

We kept track also of the time it took to get the checks out. It wasn't so bad there. It was worse on us. But you fellows in the fresh vegetable business want the money before you will even provide the stuff.

COLONEL McKENZIE: I don't believe I made the statement that the Finance Department had been neglectful in paying the accounts. I used the expression "the Army."

GENERAL FOSTER: I did not mention that to be critical; but, as I say, the prompt payment of accounts in something I have lived with for thirty years, ever since I joined the Army. Right after the late war I was on duty in the Office, Chief of Finance and worked on that very thing, of speeding up payments. You touched on a subject that I could talk on for hours, but I will not.

COLONEL McKENZIE: The point was made of discounts that would be lost. I don't believe most of our war contracts had any discounts provided in them. I was aware of many cases where small contractors were really up against the fence. A lot of deliveries had been made and the papers were in process, but the delivery point would be at some distance. The paying officer would be quite some distance removed even from the man who had accepted delivery on these items. There was an awful lot of money tied up on the part of many contractors even after delivery had been made.

I realize that there is no provision by law whereby they would be entitled to any interest. But you have made quite a point this morning, General, that the Government has taken interest on these loans. I just wanted to throw that other idea into the hopper.

GENERAL FOSTER: Of course, in regard to payments where the supplies are shipped to a distance, under our contract arrangements there is no provision requiring that accounts be paid at just one place. That is up to the contracting officer.

Before the war there were contracts made in Chicago for beef to be shipped out to different places and payment would be made at destination. It would go through the local agent of the beef company, and we would pay their bills locally, or we would pay in Chicago whichever way was provided for in the contract.

We can do that. Our system is so flexible that all we have to do is to put in the contract where bills are to be paid. We have twenty-seven Finance Offices, U. S. Army located throughout the country.

QUESTION: Does the Finance Office have a responsibility for seeing that papers get together? In other words, does the Finance Officer have the full responsibility from the time, we will say, a shipment is made? Is the time figured from then as to whether the bill is paid promptly, or only after these papers get back into the Finance Office?

GENERAL FOSTER: Normally it is the responsibility of the Finance Officer to see that the bills of the Army are paid promptly. To accomplish this, a system was established in 1920 which provides that the purchase order or contract will contain a provision that the invoices be mailed direct to a particular Finance Officer. It further provides that at the time of issuance a copy of the contract or purchase order be mailed direct to the Finance Officer and further that a copy of the receiving report be mailed to such officer immediately upon receipt of supplies provided for in the contract. Under this system whenever a Finance Officer receives a copy of a contract, an invoice, or a receiving report, he is required to start tracer for any of the missing documents so that he may expedite payment. Such a procedure accomplishes two purposes. It charges one agency with the prompt payment of accounts and it tends to reduce the possibility of fraud which is inherent in a system whereby a procurement officer through collusion with some agent of the contractor might be able to complete fraudulent vouchers and submit the completed vouchers to the Finance Officer for payment. Under such circumstances it would be difficult for the Finance Officer to detect fraud. If papers are sent to the Finance Officer from three different sources, (1) the bill from the contractor, (2) the contract or purchase order from the contracting officer, and (3) the receiving report from the receiving officer, probability of collusion is materially reduced.

During the war exceptions were made of this general provision and in some cases contractors were directed to mail their invoices direct to the procuring officer. Likewise the receiving reports were to be sent to him. In those cases he prepared a complete voucher, certified same, and sent it to the Finance Officer for payment. Where this was done, the responsibility for any delay in payment was taken from the Finance Officer and placed on the procurement officer. This has a defect other than that of making fraud more easy, that is, the procurement officer's job is to procure and the payment of the account in secondary. Therefore, delays may occur due to lack on his part of a primary interest to expedite payments. The thought has been advanced in favor of this procedure that if the invoice was mailed to the procurement officer he could check to see that the amount billed for is in agreement with the amount purchased. The answer to that is if all papers are sent direct to the Finance Officer, he is able to verify the fact that the amount purchased, the amount delivered, and the amount billed for are in agreement and that any discrepancies are independently investigated. I definitely feel that the system of having the Finance Officer receive invoices direct is the soundest and will assure accurate and prompt payment.

GENERAL McKINLEY: We are almost fifteen minutes overtime, so we are not going to have any arguments about that. Let me take this opportunity to thank you very much indeed for coming down here and giving us this most entertaining morning. Thank you very much, General.

(11 February 1948--450)S.