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From Wartime Expedient to Permanent Pork Barrel: WFC to RFC to SBA



When the U.S. government mobilized the economy to support its participation in World War I, it intervened in the market system in many ways. Yet private capital markets continued to operate. They did not always operate, however, as the government wished. Some enterprises that the government considered essential to its mobilization program—especially in lumbering, coal mining, public utilities, and certain types of manufacturing—found themselves unable to sell their bonds or to obtain loans from private financial institutions. The problem, like so many others, was of the government’s own making: massive government borrowing had “crowded out” private borrowers.

To remedy the problem, Treasury Secretary William Gibbs McAdoo recommended the creation of a government lending agency to fill the gaps opened by the Treasury’s absorption of loanable funds. Congress responded in April 1918 by creating the War Finance Corporation (WFC), endowing it with a capital stock of \$500 million and the authority to borrow as much as \$3 billion by issuing bonds.

With Eugene Meyer, Jr., a wealthy and ambitious capitalist, as its managing director, the WFC began business as “a rescue mission for essential war-disrupted industries.” In the six months that it operated during the war, it lent some \$71 million to

commodity-producing firms and to financial institutions making government-approved loans. It also took over from J. P. Morgan and Company the big job of stabilizing the market for government bonds.¹

When the war ended, the WFC refused to die, notwithstanding the evaporation of its original rationale. So pregnant with political utility was this all-purpose financial rescue mission that it was destined to be revived (eventually under new names) again and again.

The first revival occurred almost immediately. With the cessation of U.S. government loans to the Allies after the armistice, European countries could not finance a continuing large-scale importation of American commodities. U.S. exporters viewed the situation with understandable horror. To forestall “confusion and despair on both sides of the Atlantic,” Meyer proposed to use the WFC to finance U.S. exports, and in March 1919 he nursed through Congress a bill to authorize the expenditure of a billion dollars for this purpose. When that law expired in May 1920, he resigned from the WFC.²

He did not stay away long, however. Supported by bankers, businessmen, and journalists concerned about mounting problems in the agricultural economy, in late 1920 Meyer pleaded with Congress to revive the WFC, and it soon did so, overriding the president’s veto and directing the secretary of the treasury to resume the WFC’s funding for export-financing loans. Meyer returned as the revamped agency’s managing director in March 1921. Later that year, the Agricul-

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tural Credits Act officially transformed the WFC into “a rescue mission for the nation’s distressed farmers.” In this phase, which lasted until January 1925, the WFC lent some \$300 million to agricultural cooperatives and rural banks.³

As the Great Depression worsened in the early 1930s, business failures mounted, and many banks and other financial institutions went bankrupt. The clamor for government bailouts grew, and Eugene Meyer played cheerleader for another revival of the WFC, using his many contacts and his skills as a political manipulator to advance the proposal. In the circumstances, it was not hard to sell, and in January 1932 President Herbert Hoover signed into law an act “to provide emergency financing facilities for financial institutions . . . [and] to aid in financing agriculture, commerce, and industry” by means of a Reconstruction Finance Corporation (RFC), an agency plainly patterned after the WFC.⁴ Naturally, Meyer became the chairman of the new agency’s board of directors.

Congress provided the RFC with \$500 million from the Treasury and authorized it to borrow another \$1.5 billion (increased to \$3.3 billion six months later). The RFC extended loans to financial intermediaries, railroads, and state governments, as well as (via the secretary of agriculture) to farmers. As Meyer’s biographer notes, however, in mid-1932 “sentiment was mounting on Capitol Hill to make the RFC a sort of general relief agency,”⁵ and that is precisely what it quickly became.

Fifty Billion Dollars

Jesse H. Jones, the Texas wheeler-dealer who became the RFC’s chairman in May 1933 and remained in charge of it until March 1945, observed that the RFC “grew to be America’s largest corporation and the world’s biggest and most varied banking organization.”⁶ His memoirs, titled *Fifty Bil-*

lion Dollars, recount a plethora of bailouts for banks, farmers, railroads, cities and states, insurance companies, building and loan associations, exporters, and many others. All of that financial skulduggery occurred, however, before the agency achieved truly monstrous dimensions during World War II, when it financed the stockpiling of raw materials, the construction and equipping of defense plants, the building of housing for war-plant workers, and many other projects. Jones was not just huffing and puffing: \$50 billion dollars was a gargantuan amount of money to dole out. Small wonder that he was widely regarded as the second-most-powerful man in the government.⁷

No surprise, either, that all that loot attracted boatloads of political schemers. Allegations of political favoritism swirled about the RFC from the very beginning and became especially unsavory during the Truman administration. “In 1949, the Hoover Commission on government reorganization advocated an end to direct lending by government, because it ‘invites political and private pressure or even corruption,’” and when the Republicans captured the presidency and the Congress in 1952, they moved quickly to abolish the RFC. Not wishing to appear “the party of big business,” however, they cut a deal in 1953 in which elimination of the RFC was linked with creation of the Small Business Administration (SBA).⁸ The SBA has been squandering taxpayer dollars ever since. □

1. William Gibbs McAdoo, *Crowded Years: The Reminiscences of William G. McAdoo* (Boston: Houghton Mifflin, 1931), pp. 440–42; Merlo J. Pusey, *Eugene Meyer* (New York: Knopf, 1974), pp. 157–63 (quotation from p. 163).

2. Pusey, pp. 164–70 (quotation from p. 164).

3. *Ibid.*, pp. 171–84 (quotation from p. 178).

4. 47 U.S. Stat 5–12, at p. 5 (for a clear statutory connection to the WFC, see Section 6, at p. 8).

5. Pusey, p. 225.

6. Jesse H. Jones, *Fifty Billion Dollars: My Thirteen Years with the RFC (1932–1945)* (New York: Macmillan, 1951), p. 3.

7. “The War Goes to Mr. Jesse Jones,” *Fortune*, December 1941, p. 91.

8. Jonathan J. Bean, *Big Government and Affirmative Action: The Scandalous History of the Small Business Administration* (Lexington: University Press of Kentucky, 2001), pp. 8–9 (quotation from p. 8).